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# Denver Sales and Use Tax for Software Sellers and Purchasers

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## *Practical application of Denver's sales and use tax code for data processing*

Although Denver sales and use tax law pertaining to "data processing" has not changed since it was written into the tax code decades ago, tax audits by the city and county of Denver (Denver) are drawing heated media and industry attention. In addition, Denver recently updated its tax guide on data processing programs providing needed clarification on how the tax is applied in the software industry.

The tax guide demonstrates the wide net cast over software sales deemed taxable under Denver's sales and use tax code. It also provides some principles upon which software companies can begin to base decisions on the collection and remittance of sales and use tax. But widespread misunderstanding exists due to the complex and vague language of the rules that fail to address current and evolving technologies, delivery systems and applications.

Partners from TaxOps recently met with the Boulder & Denver Software Clubs at the home office of Convercent in Denver to discuss the practical application of the tax code and concerns over Denver's aggressive stance on sales and use tax. Here is a recap of the spirited discussion.

## Taxable software sales

The Denver tax net includes all retail sales of software programs to customers located in Denver as well as the use, storage, distribution, or consumption of software products and services in Denver. The taxable amount is the purchase price of the retail sale or the license and user fees for taking possession of a software program. Taxable software programs include the following:

- Prewritten retail software;
- Certain custom software, applications, patches, and updates;
- Service contracts, where the purchaser is required to buy the services in order to acquire the software, regardless of the service charges being separately stated on an invoice; and
- Software licenses for Denver-based users accessing that software from both within Denver and from out-of-state servers.

The method of delivery is irrelevant to whether the software is taxed. Both “off-the-shelf” retail products and electronically delivered products may be subject to Denver sales and use tax. As a result, all types of companies – retailers, software designers and platform servers – located across the United States may be affected by the Denver tax.

## Nexus

Liability for Denver sales and use tax exists when an entity has nexus or a "direct connection" with the jurisdiction. Retailers with nexus in Denver are responsible for collecting and remitting sales tax on taxable products. Sales tax is imposed on the purchaser but collected and remitted to the city by the retailer. When no seller nexus in Denver exists in a software transaction, the seller has no obligation to collect sales tax.
Buyer nexus can trigger a Denver use tax. Denver use tax is applicable when 1) Denver sales tax is not collected at the point of sale, and 2) the product or service is used, stored, distributed, or consumed in Denver.

***Example.*** Denver Company A sells pre-written software to Denver Company B. Denver. Company A charges, collects, and remits sales tax from Denver Company B.

***Example.*** Non-Denver Company C sells pre-written software to Denver Company B. Because Company C has no Denver nexus, it is not responsible for charging Company B sales tax. As a result, Company B needs to self-assess use tax on the pre-written software.

Use tax may also be due when the wrong jurisdiction’s tax is charged. For example, a product purchased in Jurisdiction A is subject to Jurisdiction A sales tax. If that product will be used in Denver, the buyer may still be subject to paying Denver use tax.

***Example.*** A company located in Tennessee will pay the state of Tennessee sales tax on a software program it purchases in Tennessee and retains. A use tax obligation could also exist for the same purchased software that was used by the company employees in Denver.

## Custom software

Custom software, at its face, is taxable in Denver. Where custom software becomes non-taxable is when work performed in creating the software is viewed as a “work for hire” service. The distinction between a product and a service boils down to who maintains the title and is best described through examples.

**Custom developer with no title**. Software services where the service provider has no rights in the developed software at any point in time are not taxable in Denver.

***Example.*** A tax firm contracts with a developer to design tax preparation software. It is explicit in the contract that at no time does the developer own the product at any stage in its development. In addition, the developer cannot sell the finished product. Because the tax firm owns the rights to software, this is a “work for hire” service and not subject to Denver tax.

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## How can we help?

To have a deeper discussion about your organization's sales and use tax obligations, please contact one of the authors.

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## About TaxOps

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