
**KANSAS DEPARTMENT OF REVENUE
POLICY AND RESEARCH**

Revised Sales Tax Guidelines: Taxing Charges for Computer Products and Services and Internet Related Sales and Services

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Department of Revenue guidelines are intended to help you become familiar with Kansas tax laws and your rights and responsibilities under them. While every attempt is made to provide you with information that is consistent with Kansas law, nothing in this publication supersedes, alters, or otherwise changes Kansas case law or any Kansas statute or regulation. Department guidelines are not legal rulings and any information that is inconsistent with Kansas law is not binding on either the department or the taxpayer. Not every potential tax situation is covered in these guidelines. If you have any questions about how Kansas sales and use tax laws apply to your business, please visit the department's Policy Library on our web site at www.ksrevenue.org or call our Taxpayer Assistance Center at 1-785-368-8222.

Application of this publication. This publication discusses how the Kansas sales tax statutes currently in effect apply to sales of computer software, software maintenance agreements, computer hardware, and labor services performed to software and hardware. It revokes and supersedes all earlier department publications and rulings that discuss the sales and use taxation of computer products and services. This publication also explains the rules for taxing optional software maintenance agreements that took effect on January 1, 2009.

The Kansas statutes that tax sales of computer software have been amended many times over the past twenty-eight years. A chronology of these changes can be found in a Question and Answer that is published in the department's policy library at www.ksrevenue.org. Taxpayers and others who need to research the sales tax laws for computer software that were in place during past years may find this chronology useful.

Tax and software terms. Many of the terms used in this publication have a specific meaning for purposes of the sales and use tax laws. Many of them are defined in K.S.A. 2009 Supp. 79-3602. For example, the amount that is taxed is the "sales or selling price" of the goods or services being sold at retail. *K.S.A. 2009 Supp. 79-3602(II)*. The "sales or selling price," which includes any shipping or postage charges that the retailer bills to the customer, is the amount that is multiplied by the combined state and local tax-rate percentage to determine the amount of tax to charge the customer, collect, and pay to the state. *K.S.A. 2009 Supp. 79-3602(II)*. This amount is also called the "tax base," "measure

of tax," or "purchase price." *See K.S.A. 2009 Supp. 79-3602(ee)*. The term "gross receipts" generally refers to the sum of all retail sales receipts in a reporting period.

For simplicity, this publication will use the terms "selling price" or "tax base" unless the context requires otherwise. *Compare K.S.A. 2009 Supp. 79-3602(o) with K.S.A. 2009 Supp. 79-3602(ee) and K.S.A. 2009 Supp. 79-3602(ll)*. "Sales tax" or "tax" will refer to the combined state and local sales or use tax that is lawfully owed. "Sale" will refer to outright sales, as well as leases, rentals, software license agreements, and similar conveyances unless the context requires otherwise.

The terms "prewritten computer software," "prewritten software," and "canned software" are synonymous. While the term "prewritten computer software" is used in the Kansas statutes, the term "prewritten software" will be used in these guidelines unless otherwise required. "Enhancements or modifications to prewritten computer software," when such enhancements or modifications are designed and developed to the specifications of a specific purchaser of the prewritten software, shall be referred to in these guidelines as "customization of prewritten computer software." *See K.S.A. 2009 Supp. 79-3602(cc)*. "Software" means computer software.

I. DEFINITIONS. (a) "*Custom software*" is software that is designed and developed for the exclusive use and needs of a specific person or business. Custom software becomes prewritten software if it is offered for sale to someone other than the customer for whom it was originally designed and developed. The providing of custom software is considered a non-taxable service.

(b) "*Prewritten software*" is defined at K.S.A. 2009 Supp. 79-3602(cc) as:

computer software, including prewritten upgrades, which is not designed and developed by the author or other creator to the specifications of a specific purchaser. The combining of two or more prewritten computer software programs or prewritten portions thereof does not cause the combination to be other than prewritten computer software. Prewritten computer software includes software designed and developed by the author or other creator to the specifications of a specific purchaser when it is sold to a person other than the purchaser. Where a person modifies or enhances computer software of which the person is not the author or creator, the person shall be deemed to be the author or creator only of such person's modifications or enhancements. Prewritten computer software or a prewritten portion thereof that is modified or enhanced to any degree, where such modification or enhancement is designed and developed to the specifications of a specific purchaser, remains prewritten computer software, except that where there is a reasonable, separately stated charge or an invoice or other statement of the price given to the purchaser for such modification or enhancement, such modification or enhancement shall not constitute prewritten computer software.

(c) "*Customization of prewritten software*" refers to a service that modifies or enhances prewritten computer software, when such modification or enhancement has been developed and designed to the specifications of a specific customer. Customization

of prewritten software requires changing, editing, or adding to the source code of the original prewritten software to meet the customer's specifications. Customization does not transform the underlying prewritten software into custom software. Customized prewritten software is still considered prewritten software.

(d) "*Software source code*" means the code written by a programmer using a programming language which is comprehensible to appropriately trained persons and is not capable of directly being used to give instructions to a computer. A source code includes related programmers' notes, design documents, and manuals. Source code is a set of programming-language instructions that must be translated to machine instructions before the program can run. It is translated by compilation or interpretation into software executable code in binary form.

(e) "*Software executable code*" means any object code, machine code, or other code in binary form readable by a computer when loaded into its memory and used directly by such computer to execute instructions.

II. OVERVIEW: (a) The most common questions that taxpayers ask about software taxation are:

- How are sales of software taxed?
- What software services are taxed? What ones are not?
- How are sales of software maintenance agreements taxed?

This Section provides abridged answers to these three questions. Section IV contains more in-depth answers to these and other questions about how the Kansas sales tax laws apply to sales of computer software, hardware, and services.

(b) **How are software sales taxed in Kansas?** (1) Software sales can be distinguished in a number of ways, including whether or not the software is:

- Operating software, application software, or system software;
- licensed to the customer under a limited-duration right-to-use agreement rather than being sold outright;
- sold with a shrink-wrapped box-top or with a tear-open license agreement;
- delivered to the customer on a tangible storage medium, such as a CD, DVD, or magnetic tape;
- delivered to the customer electronically via the Internet, telephone modem, or some other electronic method; or
- delivered to the customer by "load and leave."

(2) In Kansas, taxability is determined solely by whether the software being sold is custom software or prewritten software.

(3) Sales of prewritten software are taxed both under the specific imposition on sales of prewritten software and under the general imposition on sales of tangible personal property. Such sales are taxable regardless of the method of delivery, which may be made via a tangible storage media, electronically, or by "load and leave." *See K.S.A. 2009 Supp. 79-3602(pp); K.S.A. 2009 Supp. 79-3603(a); and K.S.A. 2009 Supp. 79-3603(s).*

(4) Charges for custom software are not subject to Kansas sales or use tax and are treated as charges for non-taxable services.

(5) Charges for customized prewritten software are taxable, the same as charges for prewritten software. However, a service charge to change or modify the software source code to meet a specific customer's special technical or business needs is not taxable, provided the charge for the customization service is reasonable and separately stated on the customer's invoice. If the charges for the prewritten software and the software-customization service are not separately stated, the entire charge is taxable.

(6) *Summary:*

- Sales of prewritten software are taxable.
- Sales of custom software are not taxable.
- If a software vender bills one charge for prewritten software and another charge for customization of such software, the charge for the prewritten software is taxable while a reasonable and separately-stated charge for the customization service is not. If the two charges are lumped together, sales tax applies to the entire amount being billed.

(c) **What software services are taxed in Kansas? What ones are not?** (1) When prewritten software is sold, the selling price that is subject to sales tax includes separately-stated charges for delivering and installing the software, as well as "any other services that are necessary to complete the sale." *K.S.A. 79-3602(11)(1). See Section IV(b), The tax base for the sale and installation of prewritten software.*

(2) Kansas taxes charges for "the services of modifying, altering, updating or maintaining prewritten computer software." *K.S.A. 2009 Supp. 79-3603(s)*. These services always involve the installation of software or software upgrades or enhancements. *See Section III(b)(4)*.

(3) Kansas does not tax software customization services when the charges for such services are reasonable and separately stated from any charges for prewritten software. Customization services always involve changing the software source code.

(d) **How are sales of software maintenance agreements taxed in Kansas?** Revenue Ruling 19-2009-01 sets forth the sales tax treatment of computer software maintenance agreements, as of January 1, 2009. A maintenance agreement that is required to be purchased with prewritten software is fully taxable. Taxation of optional maintenance agreements is discussed below in Section III(d), *Software maintenance agreements*. Section III(d) also discusses how services performed by a third-party serviceman for a maintenance-agreement provider are taxed.

III. COMPUTER SOFTWARE SALES AND SERVICES. (a) **Prewritten software, custom software, and the customization of prewritten software.** (1) *Prewritten software.* Prewritten software includes:

- Any combination or parts of two or more prewritten software programs;
- customized prewritten software;
- software upgrades and enhancements for prewritten software; and

- software that was initially designed as "custom" software for a specific customer that is later sold to someone else. *K.S.A. 2009 Supp. 79-3602(cc)*.

The sale of prewritten software is taxable whether it is delivered to the customer electronically, on a physical medium, or by "load and leave." *K.S.A. 2009 Supp. 79-3603(s)*. Load-and-leave delivery occurs when the software vendor or its agent visits the customer's site, installs the software using a physical medium, and carries away the physical medium when finished. The sale of a license to use prewritten software for a limited period is taxed the same as the outright sale of prewritten software. *See K.S.A. 2009 Supp. 79-3602(pp)*.

The use in Kansas of prewritten software that is purchased outside the state without payment of sales or use tax, or at a combined state and local rate that is lower than the applicable combined Kansas state and local rate, is subject to consumers' use tax. *K.S.A. 2009 Supp. 79-3702 et seq.* The use tax rate to use to accrue the consumers' use tax is the difference between the combined Kansas tax rates and the combined tax rates of the other state. When a retailer fails to collect sales tax on a taxable software sale made in Kansas, the department may pursue either the customer or the retailer for the uncollected tax. *K.S.A. 79-3604*.

(2) *Custom software*. In today's market, a software designer seldom creates software solely for one customer. Instead, most software is prewritten and can be sold "as is" or customized to adapt it to the customer's special technical or business needs. *See Section I, Definitions*. When a contract requires entirely new software to be designed, written, and sold to a specific customer for the customer's exclusive use, the sale is not subject to tax. *See K.S.A. 2009 Supp. 79-3603(s); K.S.A. 2009 Supp. 79-3602(cc)*. Any subsequent sale to another user is a taxable sale of prewritten software.

(3) *Software-customization services and customized-prewritten software*. Businesses often buy prewritten software: (i) from vendors who agree to customize the software to fit a customer's special technical or business needs; or (ii) with the intention of hiring a third party to customize the software. The sale of prewritten software is taxable regardless of whether it is: (i) sold in its original form; (ii) combined with other prewritten programs; or (iii) customized to meet the purchaser's special needs. However, the vendor of customized software has the option to charge a separate fee for the software-customization services (i.e. programming) that it or its agent performs to satisfy the special order of the customer.

The vendor must maintain records that adequately document the extent of the software customization services being performed to prewritten software. As discussed below in (a)(4) and (a)(5), software customization requires changing the software source code to meet the specific requirements of the customer. A commercially reasonable, separately stated charge for customizing prewritten software is not subject to sales tax. *K.S.A. 2009 Supp. 79-3602(cc)*. If a vendor elects to charge a lump sum rather than separately invoicing one fee for the software customization service and another fee for the prewritten software being customized, the entire amount that is invoiced is subject to sales tax. When a computer programmer does not sell prewritten software and only performs software customization services, the programmer's charge for the software customization services is not taxable.

If a software vendor hires a third-party programmer to customize prewritten software that the vendor is selling to a specific customer, the vendor may issue a resale exemption certificate to the programmer. If, after the initial sale, the vendor resells the customized prewritten software to someone else, the vendor must collect sales tax on the total amount that it bills for the software. If software customization services are performed to meet the needs of a specific customer and the vendor does not intend to sell the customized prewritten software to anyone else, the vendor is not required to charge sales tax on the reasonable and separately stated charge for the software customization services that it bills to the one customer.

(4) *What are software customization services?* (A) To be considered software customization services (i.e. custom programming), the services being performed must satisfy the following two requirements:

- The vendor or programmer must conduct a requirements analysis to determine a specific customer's unique needs for the new software or for the customized prewritten software ; and
- The source code for the prewritten software or prewritten program modules must be changed or added to in order to meet the unique requirements of the customer buying the software.

(5) *Examples and documentation of software customization services.* Software customization services require changing the source code. The following are examples of software customization services, where those require source code changes to be made:

- Creating new interfacing logic to meet the customer's specific needs, such as formatting of the interface between the purchased software and other related software or computer systems, including formatting of graphical user interfaces;
- turning functionalities of a program on or off in accordance with the specific requirements of the purchaser;
- altering the source code so that the software is compatible with the other software and computer hardware of the software purchaser;
- data conversion or migration from a legacy system;
- adding or deleting data fields; and
- report modification or generating new reports.

The performance of such services is documented by the service provider's records. The department will review the following records to establish whether or not a source code has been changed: the contract of sale, logbooks, timesheets, dated documents, source codes, specifications of work to be done, design of the system, performance requirements, diagrams of programs, flow diagrams, flow diagrams, coding sheets, error printouts , translation printouts, correction notes, and invoices or billing notices to the customer.

(6) *What expenses are considered to be incurred as part of software customization service?* Customers who pay for prewritten software along with software customization

services are sometimes billed for services a vendor or software programmer provides and for the expense the vendor or programmer incurs for:

- Requirements analysis and feasibility studies, including economic and technical analysis of existing or potential computer hardware or software needs, identifying information and information access needs, and analyzing business-process analysis done to help a customer improve its information security, operations, quality control, budgeting, financial statements, etc.;
- changing source code so that the purchased software will operate;
- providing consulting services;
- providing technical instruction;
- travel, lodging, and meal expenses; and

When charges on the invoice for these items are commercially reasonable and are broken out separately between those specifically related to the software customization services and those related to the prewritten software, the separately stated charges related to the software customization services are presumed to be non-taxable. This presumption can be overcome if the listed charges related to the software customization services are not reasonable.

Whenever software customization services are performed and the customer is billed a lump sum for the prewritten software and customization services, the tax base is the total amount billed to the customer. This includes any separately stated charges for the items listed above, including requirements, studies, feasibility studies, consulting services, travel expenses, and so forth. *See K.S.A. 2009 Supp. 79-3602(II)*. These expenses are also part of the tax base whenever hardware or prewritten software is sold and no software customization services are performed.

(7) *Software purchased with a computer.* A charge for prewritten software that is installed in a computer or otherwise sold with a computer is subject to sales tax. If a computer is sold with custom software or with customized prewritten software and the charge for the custom software or software customization service is separately stated, the separately stated customization charge is not subject to tax. If the customization charge is not separately stated, the entire amount billed to the customer is taxable.

(b) **The tax base for the sale and installation of prewritten software.** (1) When prewritten software is sold without any customization services, the selling price includes any separately-stated charges for delivery, installation of the software, and "any other services that are necessary to complete the sale." *K.S.A. 79-3602(II)(1)*. Delivery charges are taxable whether the software is delivered to the buyer electronically, by tangible storage media, or by load and leave.

(2) The following are examples of services rendered in connection with the sale of prewritten software that are taxed as installation services or as other services necessary to complete the sale:

- Requirements analysis and feasibility studies, including economic and technical analysis of existing or potential computer hardware or software needs, identifying information and information access needs,

and analyzing business-process analysis done to help a customer improve its information security, operations, quality control, budgeting, financial statements, etc.;

- system design and development;
- establishing the compatibility of the software with the hardware and other software products;
- loading prewritten software into a computer;
- configuring or setting up the software, provided these services do not involve changing the software's source code to meet the specific requirements of the purchaser (which would be software customization services); and
- installing upgrades or enhancements.

These charges are taxable whether they are separately stated or lumped together with other charges.

(c) **Services to modify, alter, update, or maintain prewritten software.** (1) Kansas taxes charges for "the services of modifying, altering, updating or maintaining prewritten computer software." *K.S.A. 2009 Supp. 79-3603(s)*.

(2) Taxable services to modify, alter, update, or maintain computer software always involve the installation of prewritten computer upgrades and enhancements. The charges related to the software installation that are listed above in (b) are also taxed as part of the charges to modify, alter, update, or maintain prewritten software.

(3) Taxable services do not include actions that are taken to assure the efficient operation of prewritten software or hardware, such as deleting or recovering information from a hard drive, virus or spyware removal, or increasing the speed of the computer system unless the service involves the sale and installation of prewritten software or hardware.

(d) **Software maintenance agreements.** (1) *Mandatory software maintenance agreements sold with prewritten software.* A software maintenance agreement is "mandatory" when prewritten software cannot be purchased without buying the maintenance agreement. Mandatory software maintenance agreements are treated as part of the software sale and are subject to Kansas sales or use tax. The charge for the maintenance agreement is fully taxable even when charges for technical support and upgrades are separately-stated on the customer's invoice.

(2) *Optional software maintenance agreements sold with prewritten software.* A software maintenance agreement is "optional" when a customer can buy prewritten software without buying a maintenance agreement for it. When a customer agrees to buy an optional maintenance agreement during negotiations for prewritten software, charges for the agreement are sourced as part of the software sale and are taxed as follows after January 1, 2009:

(A) If the charges for Technical Support and Upgrades are not separately stated, Kansas sales tax applies to 50% of the sales price of the maintenance contract.

(B) If the charges for Technical Support and Upgrades are separately stated, sales tax applies to charge for the Upgrades but not to the charge

for Technical Support. The estimated costs used to apportion the two charges must be reasonable and made in good faith. If the estimated charges do not appear to be reasonable, the department may assess sales tax on 50% of the total cost of the maintenance agreement, along with interest and penalty.

(C) If only Upgrades are contracted to be provided under the optional maintenance agreement and the customer is not entitled to Technical Support, charges for the agreement are taxable.

(D) If only Technical Support is contracted to be provided under the optional maintenance agreement and the customer is not entitled to Upgrades, charges for the agreement are not taxable.

(3) Charges for upgrades and enhancements for prewritten software are taxable because upgrades and enhancements are, by definition, prewritten software. *See K.S.A. 2009 Supp. 79-3602(cc)*. Charges for additional copies of operating manuals and for operating-manual updates for prewritten software are taxable.

(4) *Optional software maintenance agreements sold separately from or after the software sale*. A maintenance agreement may be sold by the software vendor after the software sale is completed or by a different vendor. Charges for these agreements are taxed as set forth in (2)(A) through (D) but are sourced according to K.S.A. 2009 Supp. 79-3670. *See K.S.A. 2009 Supp. 79-3602(cc)*.

(5) *Custom software*. Whether mandatory or optional, maintenance agreements for custom software are not taxable, provided the software has not been offered for sale to someone other than the person for whom it was originally designed and developed. The custom-software provider should pay sales or use tax on the printing cost of any operating-manual or operating-manual updates that are produced for the custom software and given to the custom software purchaser.

(e) **Sourcing software sales and services**. K.S.A. 2007 Supp. 79-3670 *et seq.* applies the destination-based sourcing rules to sales of prewritten software, software maintenance agreements, and computer hardware. These rules provide:

(1) The sale is sourced to the retailer's business location if the customer takes delivery of the product there.

(2) If the retailer delivers or ships the product to the customer, the sale is sourced to the customer's location. This provision is not changed by FOB terms.

(3) If neither (1) nor (2) apply, then the sale is sourced to the location indicated by an address for the purchaser that is contained in the vendor's business records.

(4) If neither (1), (2), nor (3) apply, then the sale is sourced to the address of the purchaser obtained during consummation of the sale. This may include the address on the purchaser's payment instrument, such as a check, credit card account, or money order.

(5) If the four listed rules cannot be applied, then the sale is sourced to the address from which the product is shipped. This includes prewritten software that is delivered electronically.

IV. TAXATION OF CHARGES FOR INTERNET ACCESS, DIGITAL PRODUCTS, WEB PAGE DESIGN, ACCESS TO INFORMATION DATABASES, AND OTHER COMPUTER-RELATED PRODUCTS AND SERVICES. (a)

Overview. Kansas does not tax customer charges for accessing the Internet. The State is prohibited from doing so by the Federal Internet Tax Freedom Act (F-ITFA). Internet access services and the taxability of transactions arranged over the Internet are discussed in more detail in the next subsections.

(b) **Internet access services.** (1) "Internet access service" means the service of providing customers with the ability to access the Internet or World Wide Web. Internet access charges are usually billed on a monthly basis and may include a one-time setup charge. These services include any technical-support that is furnished with the access services, such as telephone user support or telephone consulting whether or not such services are separately stated on the customer's bill or invoice. Internet access services do not include charges for accessing restricted web sites, downloading information, or similar on-line services that are utilized after the network has been accessed. These services, while not classified as internet access services, are not subject to Kansas tax unless they involve the delivery of prewritten software.

(2) The F-ITFA prohibits state and local governments from imposing new taxes on Internet access charges. Congress allows ten states that previously taxed Internet access charges to continue to do so. Kansas is not one of the ten states and has never taxed Internet access charges.

(3) The F-ITFA defines "electronic commerce" as any transaction conducted over the Internet or through Internet access, comprising the sale, lease, license, offer, or delivery of property, goods, services, or information. F-ITFA does not prohibit Kansas and other states from imposing sales or use tax on purchases arranged over the Internet.

(4) Under F-ITFA, otherwise exempt Internet access charges may be taxed if the access charges are bundled with charges for telecommunications services or other taxable services, provided that: (A) the Internet access charges are not separately stated on the customer's bill or invoice; and (B) the access provider's business records cannot identify and reasonably establish its costs that are associated with providing Internet access services.

(5) The F-ITFA does not prohibit Kansas and other states from taxing Voice Over Internet Protocol (VOIP) services. Kansas taxes charges for VOIP services and other telecommunications services.

(c) **Purchases of tangible personal property and digital products arranged on-line.** (1) *Sales of tangible personal property.* Sales of goods arranged over the Internet are taxable. Whenever an in-state or out-of-state retailer that is required to collect Kansas retailers' sales or use tax accepts an order for goods via the Internet and then ships or delivers the goods to a Kansas address, the retailer must charge and collect the appropriate Kansas tax on the sale. The tax base includes any shipping and handling charges that the retailer bills to the customer. Whenever a Kansas customer buys goods that were not taxed by the retailer, the customer must self-assess the tax and remit it on a sales or use tax return or on his or her individual income tax return. *See Kansas Individual Income Tax Return, Form K-40.*

(2) *On-line delivery of digital products.* Digital products, services, and information can be sold and delivered over the Internet. Kansas generally does not tax electronic downloads of digital products. Nontaxable sales include electronic downloads of movies, music, photographs, newspapers, and other similar products. These downloads are not taxed because they are not tangible personal property.

When the same digital product is sold and delivered on a tangible medium such as a CD, DVD, or paper, the transaction is taxable.

The following are examples of digital products and services whose sales are not taxable when delivered to the customer by Internet download or by other electronic means:

- Entertainment such as music or videos;
- photographs;
- pictures;
- newspapers;
- subscriptions to information or research products, such as financial information and legal research databases; and
- other electronic products such as greeting cards.

The following products and services that are delivered electronically are subject to Kansas sales and use tax:

- Prewritten software;
- licenses for prewritten software located in a computer or server in Kansas owned by or leased to the software license purchaser; and
- television and radio subscriber services delivered over the Internet.

Digitized pay-per-view movies and digitized television shows delivered as a service to subscribers are subject to sales tax as charges for subscriber television and radio service. *K.S.A. 2009 Supp. 79-3603(k)*. Charges by satellite-television providers for these services and other satellite services are subject to Kansas state sales tax, but not to local sales tax.

(d) **Accessing information located on a remote database.** (1) An "information service" or "database access service" is a nontaxable service that consists of a collection of records or data that is stored in a remote computer system and contains software that allows the purchaser of the service to access the system electronically to answer queries or extract desired information. These electronic services can provide:

- The furnishing of general or specialized current information, such as tax information (e.g. CCH Tax Research Network, RIA Checkpoint) or legal information (e.g. Westlaw, LexisNexis);
- data retrieval or research, such as newsletters, real estate listings, or financial, investment, circulation, credit, stock market, or bond rating reports;
- mailing lists;
- abstracts of title;
- news clipping services;

- scouting reports;
- surveys;
- bad check lists;
- broadcast rating services; and
- music, videos, pictures, and greeting cards that are delivered electronically.

(2) Kansas does not tax a database provider's charges that allow a customer to electronically access information on the provider's remote database, whether by the Internet, telephone, or some other electronic means. Separately stated charges by a provider for transmitting electronic information that the customer can print or retain are not taxable. These rules apply even though much of the same information and products are taxable when delivered on a tangible medium.

Database providers sometimes sell prewritten software or a package of prewritten software and computer hardware for customers to use to retrieve information from their database. These sales are taxable even when the software and hardware can only be used to access an exempt database.

(e) **Charges for using software on a remote computer.** A lease does not include obtaining remote access to someone else's computer software and equipment via the Internet or other electronic means when the customer does not have control over or have possessory rights to the software or equipment. This includes charges billed by an application service provider (ASP).

The time sharing of a computer or charges to access a computer are taxable rentals when the lessee is given physical possession of a computer in Kansas or has the right to personally control a computer at a location in Kansas. These same rules apply to the charges for access to other computer equipment.

(f) **Data Processing Service.** Data processing service generally refers to the electronic processing of data furnished by customers. For purposes here, data processing service includes: (1) digitizing documents or other information and then indexing, sequencing, combining, manipulating, and storing the data in a format that allows a later computer search and retrieval of the documents or information; (2) developing original information from raw data that is furnished by the customer; and (3) processing of another's data, which may include services to extract, verify, sort, scan or perform similar services on a customer's data or other information.

A business that provides data processing service performs services such as entering and retrieving information, compiling and producing records of transactions, and maintaining information. The data processing service may also furnish reports, forms, invoices, or statements to the customer, the customer's clients, or the customer's cardholders as part of the data processing service.

A data processing service generally provides the customer with additional, different, or restructured information. A charge for the service of processing a customer's data is not subject to Kansas sales tax regardless of: (1) the method by which the processed information is delivered to the customer; (2) the fact that the customer charge is based on the minutes or hours of computer use; or (3) the fact that the customer furnished computer programs to the data processor to use to process the customer's data.

"Data processing services" may include the following services:

- Digitizing records for later retrieval;
- processing information for compiling and producing records of transactions;
- computing data, extracting data, sorting files, sequencing data, and updating continuous files;
- entering, maintaining, and retrieving information;
- payroll and business accounting;
- computerized data and information storage and manipulation;
- filing payroll tax returns;
- preparing W-2 forms; and
- computing and preparing payroll checks.

While data processing services are not subject to Kansas sales tax, tax does apply to charges for converting the same information from one medium to another tangible medium, when the true object of the transaction is the tangible medium. For example, customer charges for services to digitize photographs or films and place them on a memory card or DVD are taxable. Likewise, charges to digitize phonograph records or audio tapes and place them on a CD are taxable. In both of these cases, the customer primarily is seeking the memory card, CD or DVD that contain digitized copies of the tangible photographs, film, or audio tapes. However, charges for digitizing business records and for indexing, sequencing, combining, or rearranging those records so that they can be stored digitally and later accessed by a computer search are not taxable. Here, the customer's wants its business records digitized and placed in a format that allows the digitized information to be accessed, searched, and retrieved quickly by computer.

If the data processing service provider produces tangible personal property that is incidental to the data processing service, the data processing service provider is considered the consumer of such tangible personal property and owes sales or use tax on its purchase of such property.

(g) **Web page design.** Charges for website development services, including consulting, designing, and creating a website and for transferring a website to a remote server accessible by the public, are not subject to Kansas sales and use tax provided software is not downloaded onto the customer's computer. The Kansas retailers' sales tax does not list these services as being taxable. *See K.S.A. 2009 Supp. 79-3603*. Only services enumerated in the act are subject to tax. The exclusion for web page design applies to programming, scanning, and computerized graphic design, whenever these services are furnished by a web page designer in connection with a customer's website. Because a web page designer does not charge or collect sales tax on charges for its services, the designer's purchases are taxable. Taxable purchases include: purchases of prewritten software and hardware for its own use, purchases of prewritten programs that become part of web page software, payments made to a server owner for server rental if the server is located in Kansas, utility purchases, and so forth.

(h) **Web page hosting.** Charges by a web page provider for remote administrative and monitoring services are not taxable so long as the customer is not required to buy or lease computer hardware or to download prewritten software under the contract. As a general rule, for an electronic transaction to be taxable as the sale of prewritten software,

the software must at least temporarily reside in the customer's computer. As with a web page designer, a web page host must pay sales tax on charges for use of a server located in Kansas.

(i) **Remote servers located in Kansas.** When an in-state or out-of-state business leases or leases space on a remote server located in Kansas and buys prewritten software that is installed in the server, the software purchase is subject to Kansas sales or use tax. The charge to the in-state or out-of-state business for leasing or leasing space on the Kansas server is also subject to Kansas tax. Charges by an ASP for its services are not subject to sales tax.

An out-of-state owner or lessor of a server that is located in Kansas is doing business here and is required to register as Kansas retailer and collect and remit the appropriate Kansas tax. *K.S.A. 2009 Supp. 79-3702(h)*.

(j) **Manufacturing exemption for certain software.** The Kansas integrated production exemption is a statutory exemption found at *K.S.A. 2009 Supp. 79-3606(kk)*. As a general rule, (kk) exempts the sale of software if the software directs the operation of production-line machinery or is used to perform some other exempt function as specified in the exemption. In addition, the sale of software for use in product design or in research and development in an integrated production setting is exempt. Manufacturers and processors should carefully review *K.S.A. 2009 Supp. 79-3606(kk)* to determine whether or not particular computer software or equipment is taxed or exempted. If there is any doubt as to exemption, the manufacturer or processor should request a ruling from the department pursuant to *K.S.A. 79-3618* and *K.A.R. 92-19-59*.

Operating-system software that is commercially produced for general use, such as Windows, Linux, BeOS, DOS, OS/2, UNIX, or Mac OS X Leopard, is taxable for nearly all businesses. Also taxable are sales of word processing software, accounting software, database software, and other software that provides similar non-exempt functions.

Computer programming is not an industry that engages in manufacturing and may not claim exemption under *K.S.A. 2009 Supp. 79-3606(kk)*. Computer programmers and others who perform software customization services must pay sales tax on their purchases of prewritten software, hardware, consumables, and other property.

V. TAXATION OF COMPUTER HARDWARE SALES AND SERVICES. (a)

Computer hardware includes equipment such as mainframe computers, personal computers, keyboards, monitors, printers, hard drives, servers, and cables. Computer hardware is tangible personal property. *K.S.A. 2009 Supp. 79-3602(pp)*. The sale or use of computer hardware is taxable as the sale or use of tangible personal property. *K.S.A. 2009 Supp. 79-3603(a)*.

(b) Kansas taxes the services of installing, applying, altering, repairing, servicing, or maintaining tangible personal property. *K.S.A. 2009 Supp. 79-3603(p) and (q)*. Whenever one of these services is performed to computer hardware, the charge for the service is subject to Kansas state and local sales tax. When computer hardware is sold, the tax base includes any charges for delivering and setting up the hardware, as well as any charge for installing prewritten software. *K.S.A. 2009 Supp. 79-3602(ll)*. Repairing or servicing computer hardware includes troubleshooting hardware problems whenever a service provider agrees to or is expected to perform taxable labor services to rectify the shortcomings detected by the troubleshooting. In such cases, the charges for

troubleshooting are taxable even when a separate invoice is issued for the taxable repair services. Services to troubleshoot or diagnose problems with computer hardware, without repairing or fixing the problems identified, are not be taxable.

(c)(1) Charges for a maintenance contract or service agreement (hereinafter "maintenance agreement" or "agreement") for computer hardware are taxable. *K.S.A. 2009 Supp. 79-3603(r)*. When the purchase of a maintenance agreement for hardware is agreed to during negotiations for the hardware, the maintenance agreement is taxed as part of the hardware sale regardless of whether the agreement is mandatory or optional or whether the hardware and agreement are billed on one invoice or on separate invoices. When a customer buys a hardware maintenance agreement, whether purchased separately or as part of the purchase of the hardware, the sale is taxable and is sourced according to *K.S.A. 2009 Supp. 79-3670*.

(2) A hardware maintenance-agreement provider is required to keep records that show whether or not sales tax was charged or an exemption was claimed when the maintenance agreement was originally sold. A provider that can show that an agreement was taxed when originally sold may claim a resale exemption when it hires a third-party repairmen to perform the repair and maintenance work required under the agreement. When the repairman bills the provider for parts and services, no tax is owed because the tax is considered to have been prepaid when the customer bought the maintenance agreement and paid sales tax on it. A provider may issue a resale certificate to the repairman even if the maintenance agreement was originally sold and taxed in another state. Providers may not issue a resale certificate if they cannot establish that tax was charged when the agreement was sold. If a repairman bills the hardware owner or lessee for a deductible, parts, labor, or other expenses, the repairman must charge and collect sales tax on the total amount billed to the owner or lessee regardless of whether or not the maintenance provider issued a resale certificate and was responsible for paying part of the bill.

To claim exemption, the hardware maintenance-agreement provider must give the repairman a completed Kansas or a multi-jurisdiction resale exemption certificate. *Form ST-28A; Form ST-28M; Form PR 78-SSTA (downloadable from Publication KS-1520, www.ksrevenue.org)*. If a repairman does not receive such a resale certificate, the repairman must charge sales tax when it bills the provider for parts and services. *See EDU-28, Sales Tax Guidelines for Businesses that Sell and Service Appliances and Electronic Products*. As discussed in the preceding paragraph, the repairman must always charge sales tax whenever it bills the customer who bought the hardware maintenance agreement.

(3) The same resale-exemption requirements that are discussed in (c)(2) apply whenever a third-party repairman bills a seller or manufacturer for repair services that it performs to satisfy a seller's or manufacturer's warranty obligations. The tax-collection requirements that are discussed in subsection (c)(2) apply whenever a repairman bills the owner of a warranted product for a deductible, parts, or services.

Other publications.

The following publications are available free from the Kansas Department of Revenue. Obtain your copy by visiting our web site at www.ksrevenue.org, or by calling our voice mail Forms Request Line at 785-296-4937. While the Department of Revenue has discontinued printing some of these publications, all of them are available on our web site.

- EDU-26, Sales Tax Guidelines for Contractor and Contractor-Retailers
- EDU-27, Sales Tax Guidelines for Fabricators
- EDU-28, Sales Tax Guidelines Businesses that Sell and Service Appliances and Electronic Products
- EDU-29, Sales Tax Guidelines for Contractor-Fabricators and Contractor-Manufacturers
- EDU-31, Sales Tax Guidelines: How Kansas Motor Vehicle Dealers Should Charge Sales Tax on Vehicle Sales
- EDU-32, Sales Tax Guidelines: How Kansas Motor Vehicle Dealers and Leasing Companies Should Charge Sales Tax on Vehicle Leases
- Pub. KS-1216, Kansas Business Tax Application
- Pub. KS-1500, North American Industry Classification System
- Pub. KS-1510, Kansas Sales and Compensating Use Tax
- Pub. KS-1520, Kansas Exemption Certificates
- Pub. KS-1526, Kansas Sales and Use Tax for Motor Vehicle Transactions
- Pub. KS-1527, Kansas Sales and Use Tax for Political Subdivisions
- Pub. KS-1540, Kansas Business Taxes for Hotels, Motels & Restaurants
- Pub. KS-1550, Kansas Sales and Use Tax for the Agricultural Industry
- Pub. KS-1560, Kansas Tax Guide for Schools and Educational Institutions
- Pub. KS-1700, Sales Tax Jurisdiction Code Booklet
- KW-100, Kansas Withholding Tax Guide

Taxpayer Assistance. If you have questions about this publication, please contact the Taxpayer Assistance Center at 1-785-368-8222. Our fax number is 1-785-291-3614. Additional copies of department publications are available by calling the department's forms request line at 1-785-296-4937 or by download from our website: www.ksrevenue.org. The number for the department's hearing impaired TTY is 1-785-296-6461.

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