

11/23/99

Regulatory Analysis Form

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(1) Agency
Revenue

2000 FEB -1 PM 2:04

INDEPENDENT REGULATORY
REVIEW COMMISSION

McGinley

(2) I.D. Number (Governor's Office Use)
15-392

IRRC Number: 2092

(3) Short Title
Computer Software, Hardware and Related Transactions

(4) PA Code Cite
61 Pa. Code § 31.33

(5) Agency Contacts & Telephone Numbers
Primary Contact: Anita M. Doucette (717) 787-1382
Secondary Contact: Douglas A. Berguson (717) 787-1382

(6) Type of Rulemaking (check one)
 Proposed Rulemaking
 Final Order Adopting Regulation
 Final Order, Proposed Rulemaking Omitted

(7) Is a 120-Day Emergency Certification Attached?
 No
 Yes: By the Attorney General
 Yes: By the Governor

(8) Briefly explain the regulation in clear and nontechnical language.

Pursuant to Act 1997-7, various types of computer services are no longer subject to sales and use tax on or after July 1, 1997. However, certain computer software and hardware transactions remain subject to tax. The purpose of this regulation is to provide guidance concerning these transactions.

Subsection (a) sets forth definitions of various terms utilized in the section. The application of tax as it relates to computer hardware is addressed in paragraph (1) of subsection (b). The application of tax as it relates to computer software, including canned and custom software, is addressed in paragraph (2) of subsection (b). Exemptions from taxation are addressed in subsection (c).

(9) State the statutory authority for the regulation and any relevant state or federal court decisions.

Statutory authority for the regulation is contained in section 270 of the TRC (72 P.S. § 7270).

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(10) Is the regulation mandated by any federal or state law or court order, or federal regulation? If yes, cite the specific law, case or regulation, and any deadlines for action.

The regulation is not mandated by federal or state law, court order, or federal regulation.

(11) Explain the compelling public interest that justifies the regulation. What is the problem it addresses?

Pursuant to Act 1997-7, various types of computer services are no longer subject to sales and use tax on or after July 1, 1997. However, certain computer software and hardware transactions remain subject to tax. The purpose of this regulation is to provide guidance concerning these transactions.

(12) State the public health, safety, environmental or general welfare risks associated with nonregulation.

There are no public health, safety, environmental or general welfare risks associated with nonregulation.

(13) Describe who will benefit from the regulation. (Quantify the benefits as completely as possible and approximate the number of people who will benefit.)

Taxpayers and tax practitioners will benefit from the Department setting forth its policy regarding computer software and hardware transactions in a regulation.

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(14) Describe who will be adversely affected by the regulation. (Quantify the adverse effects as completely as possible and approximate the number of people who will be adversely affected.)

No parties should be adversely affected by the regulation.

(15) List the persons, groups or entities that will be required to comply with the regulation. (Approximate the number of people who will be required to comply.)

All taxpayers obligated to collect or remit sales and use tax relating to computer software and hardware transactions will be required to comply with the regulation. The number of taxpayers who will be required to comply is indeterminable.

(16) Describe the communications with and input from the public in the development and drafting of the regulation. List the persons and/or groups who were involved, if applicable.

A copy of the regulation was forwarded to the Pennsylvania Bar Association; the Pennsylvania Institute of Certified Public Accountants and the Pennsylvania Chamber of Business and Industry. The regulation was listed in the Department's Agenda of Regulations published at 29 Pa.B. 3443 (July 3, 1999) and was forwarded to interested parties upon request.

(17) Provide a specific estimate of the costs and/or savings to the regulated community associated with compliance, including any legal, accounting or consulting procedures which may be required.

Compliance with the regulation could result in savings to the regulated community by reducing the possibility of assessment of penalty and interest. No legal, accounting or consulting procedures are required by the regulation.

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(18) Provide a specific estimate of the costs and/or savings to local governments associated with compliance, including any legal, accounting or consulting procedures which may be required.

This regulation does not increase costs or savings to local governments. No legal, accounting or consultant procedures are required by the regulation.

(19) Provide a specific estimate of the costs and/or savings to state government associated with the implementation of the regulation, including any legal, accounting, or consulting procedures which may be required.

This regulation does not increase costs or savings to state government. No legal, accounting or consultant procedures are required by the regulation.

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(20) In the table below, provide an estimate of the fiscal savings and costs associated with implementation and compliance for the regulated community, local government, and state government for the current year and five subsequent years. (Figures are in Millions)

	Current FY Year(1998- 1999	FY +1 Year(1999- 2000)	FY +2 Year(2000- 2001)	FY +3 Year(2001- 2002)	FY +4 Year	FY +5 Year
SAVINGS:	\$	\$	\$	\$	\$	\$
Regulated Community						
Local Government						
State Government						
Total Savings	N/A					
COSTS:						
Regulated Community						
Local Government						
State Government						
Total Costs	N/A					
REVENUE LOSSES:						
Regulated Community						
Local Government						
State Government						
Total Revenue Losses	N/A					

(20a) Explain how the cost estimates listed above were derived.

The adoption of the proposed amendments should have no impact on revenue. Rather, the changes are clarifying the Department's current policies.

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(20b) Provide the past three year expenditure history for programs affected by the regulation.

Program	FY -3	FY -2	FY -1	Current FY
N/A	N/A	N/A	N/A	N/A

(21) Using the cost-benefit information provided above, explain how the benefits of the regulation outweigh the adverse effects and costs.

N/A

(22) Describe the nonregulatory alternatives considered and the costs associated with those alternatives. Provide the reasons for their dismissal.

The Department is exercising its nonregulatory alternative with the use of a pronouncement to set forth its interpretation of computer software, hardware and related transactions in addition to promulgating a proposed rulemaking. The pronouncement will provide guidance to taxpayers pending the final adoption of the proposed rulemaking.

(23) Describe alternative regulatory schemes considered and the costs associated with those schemes. Provide the reasons for their dismissal.

See response in (22) above.

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(24) Are there any provisions that are more stringent than federal standards? If yes, identify the specific provisions and the compelling Pennsylvania interest that demands stronger regulation.

This regulation relates to the imposition of sales and use tax, there currently is no comparative Federal tax.

(25) How does this regulation compare with those of other states? Will the regulation put Pennsylvania at a competitive disadvantage with other states?

This regulation will not put Pennsylvania at a competitive disadvantage with other states. New York, New Jersey, Maryland, and West Virginia tax computer software and related transactions discussed in the regulation in the same manner as Pennsylvania. Ohio's tax treatment of computer software and related transactions is similar to Pennsylvania except that modified canned software is not subject to tax whereas in Pennsylvania it is subject to tax.

(26) Will the regulation affect existing or proposed regulations of the promulgating agency or other state agencies? If yes, explain and provide specific citations.

This regulation does not affect any other existing or proposed regulations of the Department or any other state agencies.

(27) Will any public hearings or informational meetings be scheduled? Please provide the dates, times, and locations, if available.

The regulation will be presented to the House and Senate Finance Committees and the Independent Regulatory Review Commission. The Committees may hold public hearings or informational meetings to consider the regulation. The date, time and location of such hearings or meetings can be ascertained by contacting the Committee. The Commission may hold informational meetings to consider the regulation. The date, time and location of such meetings can be ascertained by contacting the Commission. At the same time the regulation is presented to the Committees and the Commission, the regulation will be published in the Pennsylvania Bulletin and the public will be invited to comment.

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(28) Will the regulation change existing reporting, record keeping, or other paperwork requirements? Describe the changes and attach copies of forms or reports which will be required as a result of implementation, if available.

This regulation does not change existing reporting, record keeping, or other paperwork requirements.

(29) Please list any special provisions which have been developed to meet the particular needs of affected groups or persons including, but not limited to, minorities, elderly, small businesses, and farmers.

No special groups are affected by the regulation.

(30) What is the anticipated effective date of the regulation; the date by which compliance with the regulation will be required; and the date by which any required permits, licenses or other approvals must be obtained?

This regulation will be effective upon final publication in the Pennsylvania Bulletin. Compliance with the regulation is required upon publication. There are no permits, licenses or other approvals required by this regulation.

(31) Provide the schedule for continual review of the regulation.

This regulation is scheduled for review within five years of final publication. No sunset date has been assigned.

CDL-1

FACE SHEET
FOR FILING DOCUMENTS
WITH THE LEGISLATIVE REFERENCE BUREAU

(Pursuant to Commonwealth Documents Law)

#2092

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LEGISLATIVE REGULATORY
COMMISSION

DO NOT WRITE IN THIS SPACE

11/23/99
Copy below is hereby approved as to form and legality. Attorney General
By: *[Signature]*
(DEPUTY ATTORNEY GENERAL)
JAN 18 2000
DATE OF APPROVAL
 Check if applicable
Copy not approved. Objections attached.

Copy below is hereby certified to be true and correct copy of a document issued, prescribed or promulgated by:
PA Department of Revenue
(Agency)
Document/Fiscal Note No. 15-392
Date of Adoption:
By: *[Signature]*
Robert A. Judge, Sr.
Secretary of Revenue
Title:
(Executive Officer, Chairman or Secretary)

Copy below is hereby approved as to form and legality. Executive or Independent Agencies.
By: *[Signature]*
12/21/99
Date of Approval
(Deputy General Counsel)
(Chief Counsel, Independent Agency)
(Strike inapplicable title)
 Check if applicable. No Attorney General approval or objection within 30 days after submission

NOTICE OF PROPOSED RULEMAKING

DEPARTMENT OF REVENUE

Sales and Use Tax

61 Pa. Code §31.33

Computer Software, Hardware and
Related Transactions

PREAMBLE

The Department of Revenue (Department), under authority contained in section 270 of the Tax Reform Code of 1971 (TRC) (72 P.S. § 7270), proposes an amendment to 61 Pa. Code by amending Chapter 31. Imposition, to add section 31.33, (relating to computer software, hardware and related transactions) to read as set forth in Annex A.

Purpose of Regulation

Pursuant to Act 1997-7, various types of computer services are no longer subject to sales and use tax on or after July 1, 1997. However, certain computer software, hardware and related transactions remain subject to tax. The purpose of this regulation is to provide guidance concerning these transactions.

Explanation of Regulatory Requirements

Subsection (a) sets forth definitions of various terms utilized in the section. The application of tax as it relates to computer hardware is addressed in paragraph (1) of subsection (b). The application of tax as it relates to computer software, including canned and custom software, is addressed in paragraph (2) of subsection (b). Exemptions from taxation are addressed in subsection (c).

Affected Parties

All taxpayers obligated to collect or remit sales and use tax relating to computer software and hardware transactions could be affected by the regulation.

Fiscal Impact

The Department has determined that the proposed regulation will have no fiscal impact on the Commonwealth.

Paperwork

The proposed regulation will not generate additional paperwork for the public or the Commonwealth.

Effectiveness/Sunset Date

The regulation will become effective upon final publication in the Pennsylvania Bulletin. The regulation is scheduled for review within five years of final publication. No sunset date has been assigned.

Contact Person

Interested persons are invited to submit in writing any comments, suggestions, or objections regarding the proposed regulation to Anita M. Doucette, Office of Chief Counsel, PA Department of Revenue, Dept. 281061, Harrisburg, Pennsylvania 17128-1061, within thirty (30) days after the date of the publication of this notice in the Pennsylvania Bulletin.

Regulatory Review

Under section 5(a) of the Regulatory Review Act (71 P.S. § 745.5(a)), on *February 1, 2000* the Department submitted a copy of this proposed regulation to the Independent Regulatory Review Commission (IRRC) and the Chairpersons of the House Committee on Finance and the Senate Committee on Finance. In addition to submitting the proposal, the Department has provided IRRC and the Committees with a copy of a detailed Regulatory Analysis Form prepared by the Department in compliance with Executive Order 1996-1, "Regulatory Review and Promulgation." A copy of this material is available to the public upon request.

If IRRC has objections to any portion of the proposed rulemaking, it will notify the Department within 10 days of the close of the Committees' review period. The notification shall specify the regulatory review criteria which have not been met by that portion. The Regulatory Review Act specifies detailed procedures for review of objections raised, prior to final publication of the amendments, by the Department, the General Assembly and the Governor.

ROBERT A. JUDGE, SR.
SECRETARY OF REVENUE

08/24/99

CONTINUATION SHEET
FOR FILING DOCUMENTS
WITH THE LEGISLATIVE REFERENCE BUREAU
(Pursuant to Commonwealth Documents Law)

ANNEX A

Title 61. Revenue, Part I. Department of Revenue, Subpart B.
General Fund Revenues, Article II. Sales and Use Tax, Chapter
31. Imposition.

§ 31.33. Computer software, hardware and related transactions.

(a) Definitions. The following words and terms, when used in this section, have the following meanings, unless the context clearly indicates otherwise:

Canned software - All computer software that does not qualify as custom software.

Computer hardware - Any assembly of physical equipment that is united and regulated by interaction or interdependence to accomplish a set of specific computer system functions. The term includes any connected equipment which enables the computer to store, retrieve or communicate to or from a person, another computer or another device, the results of computer operations, computer programs or computer data. The term also includes associated parts, which encompass any component of computer system hardware that is used in connection with and that is necessary to the performance of the hardware's operation. Examples of computer hardware are: microcomputers; minicomputers; main-frame computers; personal computers; external hard drives; portable disk drives; memory chip; compact disc read only memory

(CD-ROM) drives; external modems; printers; scanners; servers; monitors; keyboards; mice; microphone; network interfaces; network hubs; network routers; motherboards; daughterboards; central processing units; controller cards; internal hard drives; digitizer; internal modems; network interface cards; sound cards; video cards; and network wiring and cables.

Custom software - Computer software designed, created, and developed for and to the specifications of an original purchaser.

Original purchaser - The first person for whom the custom software was designed, created, and developed, and to whom it was transferred in a sale at retail.

Storage media - The term includes hard disks, compact disks, floppy disks, magnetic tape, cards, and any other tangible medium used for the storage of computer readable information.

(b) Application.

(1) Computer hardware.

(i) The sale at retail or use of computer hardware is subject to tax.

(ii) The sale at retail or use of the services of repairing, altering or cleaning computer hardware is subject to tax.

(iii) The sale at retail or use of maintenance, service and warranty contracts for computer hardware constitutes prepayment for services to tangible personal property and is subject to tax.

(2) Computer software.

(i) Canned software. The sale at retail or use of canned software, including updates, enhancements and upgrades is subject to tax.

(A) Canned software includes custom software that is transferred pursuant to a sale at retail to any person other than the original purchaser.

(B) Computer software designed, created, and developed in order to adapt or modify canned software to the specific needs of a particular customer does not convert the canned software to custom software. Any charge for the custom software or modifications must be reasonable and must be separately stated on the sales invoice or statement to the customer in order to be exempt from tax.

(C) A vendor's transfer for consideration to a purchaser of the temporary ownership, possession or custody of a storage medium containing canned software for the purpose of being used or recorded by either the purchaser or vendor on the purchaser's computer hardware is subject to tax.

(D) The sale at retail or use of a canned software maintenance contract constitutes a prepayment for services to tangible personal property and is subject to tax. If a canned software maintenance agreement provides that the purchaser is entitled to receive both taxable components, such as canned software updates, enhancements, upgrades, or error

corrections, and nontaxable components, such as consultation, support or training services, the charge for the non-taxable component is not subject to tax if that charge is separately stated on the sales invoice.

(ii) Custom software. The sale at retail or use of custom software is not subject to tax. The sale at retail or use of custom software constitutes a purchase of a non-taxable computer programming service.

(A) The sale at retail or use of multiple copies or licenses of custom software to the original purchaser is not subject to tax.

(B) The sale at retail or use of custom software installation, custom software repair and maintenance, custom software updates, enhancements and upgrades that constitute custom software is not subject to tax.

(C) A custom software vendor's purchase of storage media used to transfer custom software to its customers, and the vendor's purchase of any related materials, including documentation and training manuals that are transferred to the customer as part of the sale at retail of custom software, are subject to tax when purchased by the custom software vendor.

(c) Exemptions from tax.

(1) The sale at retail or use of canned software and computer hardware is exempt if purchased by qualified charitable organizations, volunteer fire companies, religious organizations

and nonprofit educational institutions, unless the software is used in an unrelated trade or business; by the Federal government; or by the Commonwealth, its instrumentalities or political subdivisions, including public school districts.

(2) The manufacturing, research, mining, processing, public utility, farming, dairying, agriculture, horticulture or floriculture exemptions from tax apply to the purchase of canned computer software and computer hardware predominantly and directly used in these operations.

(3) In accordance with section 201(c)(5) of the TRC (72 P.S. § 7201(c)(5)), the manufacturing and research exemption from tax applies to the sale at retail or use of tangible personal property or taxable services by a person engaged in the business of manufacturing or researching canned software, if such property is predominately and directly used by the purchaser in the manufacture or research of canned software.

(i) The creation of custom software does not qualify as manufacturing or research.

(ii) When a purchaser of tangible personal property uses such property to both manufacture canned software and create custom software, the purchaser has the burden of establishing that the tangible personal property is predominately used in the manufacturing or research of canned software.

(4) The sale at retail of canned software and computer hardware to a vendor who will transfer ownership, custody or

possession of the canned software or computer hardware for a consideration in the ordinary course of its business is exempt from tax as a sale for resale. Canned software or computer hardware used by a vendor in producing a separate computer product for resale or in providing a service does not qualify as a sale for resale.

10/29/99

TRANSMITTAL SHEET FOR REGULATIONS SUBJECT TO THE
REGULATORY REVIEW ACT

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INDEPENDENT REGULATORY
REVIEW COMMISSION

I.D. NUMBER: 15-392
SUBJECT: Computer Software, Hardware & Related Transactions
AGENCY: DEPARTMENT OF REVENUE

TYPE OF REGULATION

- X Proposed Regulation
Final Regulation
Final Regulation with Notice of Proposed Rulemaking Omitted
120-day Emergency Certification of the Attorney General
120-day Emergency Certification of the Governor
Delivery of Tolled Regulation
a. With Revisions b. Without Revisions

FILING OF REGULATION

DATE	SIGNATURE	DESIGNATION
2/1/2000	Patty Macart	HOUSE COMMITTEE ON FINANCE
2/1/00	Gregory D. Fleming	SENATE COMMITTEE ON FINANCE
2/1/00	Kim E. Garner	INDEPENDENT REGULATORY REVIEW COMMISSION
		ATTORNEY GENERAL
2/1/00	Wayne Carey	LEGISLATIVE REFERENCE BUREAU

January 25, 2000