

Declaratory Order 2023-01

Request for Ruling Regarding the Application of Sales and Use Tax

Request for Ruling

The Taxpayer requested a ruling regarding the interpretations of Rhode Island law relating to the application of sales and use tax on the Taxpayer's various offerings.

Facts

Unless otherwise noted, the facts set forth below are taken from the facts presented in the Ruling Request received by the Tax Division on August 22, 2022. The Taxpayer is a privately held multinational company headquartered outside the United States, with a U.S. subsidiary located outside of Rhode Island. The Taxpayer provides various services to assist its customers in providing employee recognition incentives. The Taxpayer has a wholly owned subsidiary ("Subsidiary").

In providing its services, the Taxpayer, through the Subsidiary, consults with the human resources departments of its customers to develop employee recognition incentives that meet the specific needs of each customer. These services include identification of the types of behavior the customers seek to reward and discussions surrounding the specific types of rewards the customer would like to provide to its employees. The Taxpayer's employees also negotiate directly with various vendors to supply a variety of potential rewards that can be offered to the customer's employees. For customers that use an enterprise resource planning system ("ERP"),¹ the Taxpayer provides a free Application Programming Interface ("API")² to connect the ERP with the Taxpayer's website. The Taxpayer does not charge for this API and it does not provide the ERP licenses to customers.

In addition to these services, for a one-time fee, the Subsidiary also creates a website that facilitates the administration of employee incentives. The Subsidiary configures and maintains the website that is used to administer the incentives. Each website is custom designed and configured for each individual customer. The Taxpayer's customers never have control over the website; only the Subsidiary can make changes to it. Customers' human resource personnel can go to the website to retrieve custom reports on how the employee incentives are working, but that is the extent of the customers' interaction with the website. The Taxpayer uses the website to administer its customers' employee recognition incentives.

¹ The ERP is an on-demand (cloud-based) financial management, human capital management, and student information system software vendor.

² An API is a set of programming instructions that enable computer programs to communicate with each other to perform a specific function.

Customers and their employees go to the website to participate in employee incentives. In addition, the customer may have its employees access the website through an application available for mobile devices. There is no additional charge for this mobile application.

When given an award, employees receive reward points. These reward points may be redeemed for gift cards or merchandise from the Taxpayer's marketplace website. Questions regarding the spending of a reward point or the shipment of merchandise or gift cards are made to the Taxpayer's call center. The Taxpayer is required to provide a wide selection of merchandise and gift cards upon which its customers' employees can spend the reward points. Customers may request certain vendors or merchandise, but the Taxpayer has the ultimate decision on what is offered via its marketplace.

The Taxpayer purchases merchandise from U.S distributors at wholesale prices with the Subsidiary as the purchasing agent of the Taxpayer in the United States. The Subsidiary provides a resale certificate to its merchandise suppliers. The Taxpayer has suppliers drop ship merchandise to its customers' employees upon redemption of employees' reward points. The redemption price of the merchandise (inclusive of shipping, handling, and sales tax) is set by the Taxpayer and is displayed on its marketplace website. The Taxpayer purchases gift cards directly from retailers for the marketplace, usually at a discounted rate from the gift card redemption value. The gift cards are then sold on the Taxpayer's marketplace website for the gift cards' face value plus shipping and handling. Upon redemption of employees' reward points, the Subsidiary ships the retailer gift card directly to the employee. In the United States, the value of a reward point is stated in either U.S. dollars or in points that are tied to U.S. dollars (i.e., one point = \$0.05). Currently, the Taxpayer represents that sales tax is collected and remitted on the taxable merchandise sold to Rhode Island customers paid with the employees' reward points.

The Taxpayer invoices its customers when reward points are awarded, not when the reward points are redeemed. The Taxpayer invoices its customers for the value of the reward point in U.S. dollars plus a transaction fee based on the certificates' values. All sales associated with redemption of reward points for merchandise and the required amount of sales tax to remit is contained in the Taxpayer's database. There is no sales tax collected or remitted associated with the awarding of reward points to customers or use of a reward point to purchase gift cards.

The Taxpayer's Master Agreement between the Taxpayer and its customers³ grants its customers a "non-exclusive, non-transferable right to use and access the Web Site and the related software" Taxpayer's Ex. B. The website is an administrative tool used by the Taxpayer to administer employee recognition incentives on behalf of its customers.

There is a one-time charge for services provided by the Taxpayer for the consulting, startup, and website design fees. The transaction fees are calculated as a percentage of the U.S. dollar value of the reward points and are incurred upon each issuance of a reward point. If no reward points are issued in a particular period, the Taxpayer does not charge any transaction fees during that period. Revenue on the sale of gift cards and merchandise is recognized when

³ A template Master Agreement was submitted by the Taxpayer as Exhibit B to their Ruling Request. The Master Agreement dictates the terms of its agreement with its customers seeking, essentially, employee incentive programs and website design services.

employees redeem their reward points on the Taxpayer’s marketplace website. The Taxpayer represents that sales tax is currently collected and remitted on the retail sales price when tangible merchandise is sold to Rhode Island’s residents through the redemption of reward points.

Ruling Requested

The Ruling Request sets forth four specific questions:

- 1) Whether the charges for the consulting, startup, and website design fees are subject to Rhode Island sales and use tax.
- 2) Whether the transaction fees are subject to Rhode Island sales and use tax.
- 3) Whether Rhode Island sales tax must be collected on the retail sales price charged by the Taxpayer to its customers on merchandise sold by the Taxpayer.
- 4) Whether Rhode Island sales tax must be collected on the sale of gift cards.

Pertinent Statutory and Regulatory Law

Under the Rhode Island General Laws, “a tax is imposed upon sales at retail in this state, . . . at the rate of [seven percent (7%)] of the gross receipts of the retailer from the sales or rental charges” R.I. Gen. Laws §§ 44-18-4, 44-18-18. R.I. Gen. Laws § 44-18-20 imposes a complementary use tax on all tangible personal property that is stored, used, or otherwise consumed in Rhode Island. Tangible personal property is defined as “personal property which may be seen, weighed, measured, felt, or touched, or which is in any other manner perceptible to the senses.” R.I. Gen. Laws § 44-18-16. Tangible personal property “includes . . . prewritten computer software.” *Id.*

R.I. Gen. Laws § 44-18-8 defines “sale at retail” as “any sale, lease, or rentals of tangible personal property, prewritten computer software delivered electronically or by load and leave, vendor-hosted prewritten computer software, specified digital products, or services as defined in § 44-18-7.3 for any purpose other than resale, sublease, or subrent in the regular course of business.”

Under R.I. Gen. Laws § 44-18-7(1), the term “sales” means and includes “[a]ny transfer of title or possession, exchange, barter, lease, or rental, conditional or otherwise, in any manner or by any means of tangible personal property for consideration. ‘Transfer of possession,’ ‘lease,’ or ‘rental’ includes transactions found by the tax administrator to be in lieu of a transfer of title, exchange, or barter.” Per R.I. Gen. Laws § 44-18-7(14) the term “sales” also includes “[t]he sale, storage, use, or other consumption of prewritten computer software delivered electronically or by load and leave as defined in § 44-18-7.1(g)(v).” R.I. Gen. Laws § 44-18-7.1(v) states that “[l]oad and leave’ means delivery to the purchaser by use of a tangible storage media where the tangible storage media is not physically transferred to the purchaser.” Per R.I. Gen. Laws § 44-18-7(15), the term “sales” also includes “[t]he sale, storage, use, or other consumption of vendor-hosted prewritten computer software as defined in § 44-18-7.1(g)(vii).” R.I. Gen. Laws § 44-18-7.1(g)(vii) reads “[v]endor-hosted prewritten computer software’ means prewritten computer

software that is accessed through the internet and/or a vendor-hosted server regardless of whether the access is permanent or temporary and regardless of whether any downloading occurs.” R.I. Gen. Laws § 44-18-7(9)(i) includes within the definition of “sales” “[t]he furnishing for consideration of intrastate, interstate, and international telecommunications service sourced in this state in accordance with §§ 44-18.1-15 and 44-18.1-16 and all ancillary services, and any maintenance services of telecommunication equipment other than as provided for in § 44-18-12(b)(ii).”

R.I. Gen. Laws § 44-18-12(a) provides that the term “sales price”:

applies to the measure subject to sales tax and means the total amount of consideration, including cash, credit, property, and services, for which personal property or services are sold, leased, or rented, valued in money, whether received in money or otherwise, without any deduction for the following:

- (i) The seller’s cost of the property sold;
- (ii) The cost of materials used, labor or service cost, interest, losses, all costs of transportation to the seller, all taxes imposed on the seller, and any other expense of the seller;
- (iii) Charges by the seller for any services necessary to complete the sale, other than delivery and installation charges;
- (iv) Delivery charges, as defined in § 44-18-7.1(i);
- (v) Credit for any trade-in, as determined by state law; or
- (vi) The amount charged for services, as defined in § 44-18-7.3.

Under R.I. Gen Laws § 44-18-25, all gross receipts are presumed to be subject to sales and use tax “until the contrary is established to the satisfaction of the tax administrator. The burden of proving to the contrary is upon the person who makes the sale and the purchaser, unless the person who makes the sale takes from the purchaser a certificate to the effect that the purchase was for resale.” R.I. Gen. Laws § 44-18-30 provides a list of specific exemptions to the sales and use tax in Rhode Island.

Pursuant to 280-RICR-20-70-46.5(F) “[c]ustom software’ means a program created specifically for one user and prepared to the special order of that user.” “The sale of custom software . . . is not subject to tax. This includes any services incidental thereto and any modifications. If custom software sold to a single purchaser is later sold to others, the later sales are considered sales of prewritten software and are subject to tax.” 280-RICR 20-70-46.7(E).

280-RICR-20-70-46.5(K) provides in relevant part:

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; provided, however, 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.”

Taxpayers claiming statutory tax benefits must demonstrate not only that a tax exemption or deduction exists but that they clearly and unequivocally come within the ambit of its provisions. *Cookson v. Clark*, 610 A.2d 1095, 1098 (R.I. 1992); *R.I. Lithograph Corp. v. Clark*, 519 A.2d 589, 591 (R.I. 1987). Furthermore, statutes conferring such tax benefits must be strictly and narrowly construed, *Fleet Credit Corp. v. Frazier*, 726 A.2d 452, 454 (R.I. 1999); *Rice Mach. Co. v. Norberg*, 391 A.2d 66, 70 (R.I. 1978); *Red Fox Gingerale Co. v. Norberg*, 217 A.2d 466, 467 (R.I. 1966), with all doubts and ambiguities resolved against the taxpayer and in favor of the taxing authorities. *Roger Williams Gen. Hosp. v. Littler*, 566 A.2d 948, 950 (R.I. 1989); *Am. Hoescht Corp. v. Norberg*, 462 A.2d 369, 371 (R.I. 1983).

Discussion

Consulting, Startup, and Website Design Fees

Based on the facts provided, the computer software that the Taxpayer sells directly to its customers is “tangible personal property” subject to Rhode Island sales tax pursuant to R.I. Gen. Laws § 44-18-18. Infrastructure as a service (“IaaS”), platform as a service (“PaaS”), and software as a service (“SaaS”) are taxable as long as there is a charge to a Rhode Island customer for the use of the virtual infrastructure, platform, or for software that is accessed through the internet or on a vendor-hosted server. To the extent the Taxpayer charges Rhode Island customers to access its website and software services, those charges are taxable as IaaS, PaaS, SaaS, and as part of the sale and/or license of the software to the customer under R.I. Gen. Laws §§ 44-18-7(15), 44-18-8, 44-18-18 and 44-18-12(a).

Transaction Fees

The Taxpayer acknowledges that its Master Agreement with its customers provides a “license” to access and use the website and software. *See* Ruling Request at 6; Ruling Request, Ex. B (Master Agreement) § 3.1.1. Based on the facts in the Ruling Request and the language in the Master Agreement, the transaction fees charged by the Taxpayer to its customers in Rhode Island for the issuance of reward certificates are taxable.

Merchandise and Gift Cards

All sales of merchandise to Rhode Island consumers are subject to the sales tax at the rate of 7% of the gross receipts of the retailer from the sale, even when points are used to purchase merchandise. R.I. Gen. Laws §§ 44-18-4, 44-18-18. The sale of gift cards to Rhode Island consumers is not subject to tax. *See* RICR 20-70-43.5 (“The sale of gift certificates is not taxable, but when the owner of a gift certificate receives tangible personal property by use of such a certificate, or a part thereof, the transaction is a sale and taxable as such.”).

Custom Software

The Taxpayer argues that, “even if [it] is determined to be selling software, such software should be considered custom software and therefore not subject to Rhode Island sales and use tax.” Ruling Request at 6. Despite the Taxpayer’s assertions to the contrary, based on the facts as stated in the Ruling Request, the websites designed for the Taxpayer’s customers are not custom software, but rather are SaaS, which is taxable.

Ruling

Based on the facts provided by the Taxpayer, the Taxpayer’s consulting, startup, website design, and transaction fees are subject to Rhode Island sales and use tax. The Taxpayer’s sale of merchandise to Rhode Island consumers is subject to sales tax. The Taxpayer’s sale of gift cards to Rhode Island consumers is not subject to tax.

This response is limited to the facts stated therein and may be relied upon by the Taxpayer and shall be valid unless (1) expressly revoked; (2) the applicable statutory provisions of law are amended in a manner that requires a different result; (3) the underlying facts described herein materially change; or (4) a decision on point has been issued by the Rhode Island or federal court.

Neena S. Savage
Tax Administrator
March 7, 2023