

News Release

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MTF Analysis: New Computer and Software Services Tax Most Burdensome in the Nation

Massachusetts now has the most burdensome tax on computer and software services in the nation, according to a 50-state analysis released today by the Massachusetts Taxpayers Foundation (MTF). By extending the 6.25 percent sales tax to 10 new categories of professional services associated with computer systems and software, this new law strikes at the heart of the innovation economy that is central to the state's economic future.

The Foundation's detailed analysis shows that no other state taxes so many services at such a high rate. The attached Excel file compares Massachusetts to each of the 49 other states on the tax treatment of 11 different categories. These categories include: computer system design services; services related to the planning, consulting, design, and integration of computer hardware and software; and services to modify, integrate, enhance, install, or configure software. It also details the taxation of upgrades to prewritten software, which Massachusetts has taxed since 2006. To determine the taxability of these services in each state, the Foundation performed an exhaustive analysis of the statutes, tax regulations, department directives, revenue and tax letter rulings, taxpayer information sheets and more from each of the 50 states.

- Massachusetts is the only state that singles out computer and software services for taxation. Four other states tax such computer system design and related services at a rate lower than Massachusetts. Three of those states—Hawaii, New Mexico, South Dakota—tax all professional services, and Hawaii and New Mexico offer high technology industry tax incentives. Connecticut, which taxes selected professional services such as management consulting, public relations, and personnel training at 6.35 percent, taxes computer services at a reduced rate of one percent.

Of the remaining 40 states with a sales tax, none taxes any computer system design services, including the planning, consulting, design, and integration of computer hardware and software. Maryland, one of our competitors, unsuccessfully tried to implement a computer services tax. Maryland passed the tax in late 2007, but public reaction was so strong that the tax was repealed before taking effect on July 1, 2008. Pennsylvania repealed a similar tax in 1997.

At least 28 states offer one or more tax incentives related to software, computer services, or data centers. These include states like Virginia and North Carolina that can also offer an educated workforce, lower overall business costs, and less burdensome regulations than Massachusetts.

- Contrary to public statements, this tax does not align Massachusetts with 30 or more other states—no other state uses the terms or definitions found in the new law. In reality, prior to enactment of this tax, Massachusetts was in the mainstream with most other states in its tax treatment of computer software.

The Massachusetts Department of Revenue (DOR) issued regulation 830 CMR 64H.1.3 in 2006 to explain the state's taxes on computer products and software. In that regulation, DOR used the same language currently used by more than 23 other states in explaining how computer products and software would be taxed. DOR clarified that, as in most other states, upgrades to prewritten computer software, such as security patches and bug fixes, are subject to the sales tax in Massachusetts. As the Foundation's analysis shows, this is the only type of software service that most other states in the country also tax.¹

Rather than taxing computer and software services, at least 22 other states have opted to modernize their tax codes by applying the sales tax to digital goods that have taxable, tangible counterparts. While other states subject e-books, digital music, and digital movies to the sales tax, Massachusetts has specifically exempted these items from its sales tax.

“Repealing the tax would return Massachusetts to the mainstream of the 50 states,” said MTF President Michael J. Widmer. “With Massachusetts losing 3,000 jobs since January, placing the highest tax burden in the country on innovation and technology—the state's greatest economic strength—is simply bad policy.”

The Massachusetts Taxpayers Foundation is a nationally recognized, independent, nonprofit research organization whose purpose is to promote the most effective use of tax dollars, improve the operations of state and local governments, and foster positive economic policies. Over the past 15 years the Foundation has won 16 national awards for its work on health care access and costs, transportation reform, business costs, capital spending, state finances, MBTA restructuring, state government reform, and municipal health reform.

¹ In 830 CMR 64H.1.3, DOR also clarified that electronic downloads of prewritten computer software are taxable, as well as software as a service (SaaS). Several other states take a similar approach.