



Interim guidance statement regarding changes made by ESSB 5814 for Custom Software

September 26, 2025

Purpose

Effective October 1, 2025, Engrossed Substitute Senate Bill 5814, Laws of 2025, Chapter 422 (ESSB 5814) makes custom software and the customization of prewritten software a retail sale subject to Washington's retailing business and occupation (B&O) tax and retail sales tax. The purpose of this interim guidance statement is to provide guidance that taxpayers can rely on while the Department of Revenue (department) creates permanent guidance.

This interim guidance is divided into the following sections

- Background and relevant law.
- What is "custom software" and the "customization of prewritten software"?
- What is the tax treatment of custom software and the customization of prewritten software?
- How do I determine where the sale of custom software takes place?
- Can custom software or the customization of prewritten software be resold?
- Does the licensing of custom software or customized prewritten software qualify for the multiple points of use (MPU) exemption?
- Do nonprofits have to pay retail sales tax on custom software and the customization of prewritten software?
- Do state and local governments have to pay retail sales tax on custom software and the customization of prewritten software?
- Affiliate sales of custom software or customized prewritten software.
- How do I determine my retailing B&O amount and the correct retail sales tax rate?

- Taxpayer instructions.

Examples found in this interim guidance statement identify a number of facts and then state a conclusion. These examples should be used only as a general guide. The tax results of other situations must be determined after a review of all facts and circumstances.

Background and relevant law

Under ESSB 5814, the sale of custom software and the customization of prewritten software is a retail sale. Prior to October 1, 2025, sales of custom software and the customization of prewritten software were taxable under the service and other activities B&O tax classification.

What is “custom software” and the “customization of prewritten software”?

“Custom software” is defined under RCW 82.04.215(3) and means “software created for a single person.”

“Customization of prewritten computer software” is defined under RCW 82.04.215(4) and means “any alteration, modification, or development of applications using or incorporating prewritten computer software for a specific person. ‘Customization of prewritten computer software’ includes individualized configuration of software to work with other software and computer hardware but does not include routine installation. Customization of prewritten computer software does not change the underlying character or taxability of the original prewritten computer software.”

WAC 458-20-15502 provides additional examples regarding what is included in custom software and the customization of prewritten software, but does not reflect changes resulting from ESSB 5814.^[1] However, the rule’s definitions and examples of prewritten software, custom software, and customization of prewritten software, remain relevant.

What is the tax treatment of custom software and the customization of prewritten software?

Effective October 1, 2025, sales of custom software and the customization of prewritten software are retail sales, subject to retailing B&O and retail sales tax. Prior to October 1, 2025, these sales were subject to service and other activities B&O tax.^[2]

Example 1 – Custom software.

Facts: Jupiter, LLC is a Washington-based software company. Monga, Inc. is a Washington-based manufacturing company that hires Jupiter, LLC to create a software program that will interface between their warehouse inventory database and their shipment software. This software program is created for use by Monga, Inc. only. The contract amount is \$100,000.

Result: The sale of custom software to a consumer is a retail sale subject to the retailing B&O tax and retail sales tax. Jupiter, LLC is making a retail sale of custom software to Monga, Inc. that is subject to retailing B&O tax. Jupiter, LLC must collect retail sales tax on the entire gross amount of \$100,000 if the sale is taxable in Washington.

Example 2 – Customization of prewritten computer software.

Facts: Advanced, Inc. is a Washington-based business that specializes in creating software specific to a client's needs, with a focus on complex industries. Advanced, Inc. enters into a contract to design and sell software to Client A, LLC. Advanced, Inc. additionally provides Client A, LLC with implementation services to integrate the software Advanced, Inc. has created. Advanced, Inc. incorporated software that was built for previous customers into the software for Client A, LLC, but the final product is specifically tailored to Client A, LLC's needs. Advanced, Inc. bills Client A, LLC a lump-sum charge of \$10,000 for its services.

Result: The sale of customization of prewritten software to a consumer is a retail sale subject to the retailing B&O tax and retail sales tax. Advanced, Inc. is creating custom software for Client A, LLC. The fact that Advanced, Inc. customized existing prewritten software does not change this result. Advanced, Inc. is subject to retailing B&O tax and must collect retail sales tax on the gross amount of \$10,000 received from Client A, LLC if the sale is taxable in Washington.

Example 3 – Customization of prewritten computer software bundled with other services.

Facts: Assume the same facts as in Example 2, but Advanced, Inc. also provides financing services to Client A, LLC separate from the sale of software. The financing services are sold as part of the lump-sum contract with Client A, LLC. The products are distinct and identifiable and sold for one non-itemized price.

Result: The sale of customization of prewritten software to a consumer is a retail sale subject to the retailing B&O tax and retail sales tax. The entire gross amount of \$10,000 is subject to retailing B&O tax and retail sales tax because it meets the definition of a bundled transaction under RCW 82.08.190 and includes a product subject to retail sales tax. Advanced, Inc. must pay retailing B&O and collect and remit retail sales tax on the entire amount received from Client A, LLC if the sale is taxable in Washington.

Example 4 – Custom software and selling price.

Facts: Advanced, Inc. contracts Client C, LLC to create custom software. Advanced Inc. itemizes the cost of the software, the software development, the software design, and the software implementation and installation. In addition, Advanced, Inc. has a separate contract for consulting services that are unrelated to the custom software being purchased and the charges for the consulting services are separately invoiced to Client C, LLC.

Result: The sale of custom software to a consumer is a retail sale subject to the retailing B&O tax and retail sales tax. The design, development, testing, implementation and installation services are part of the selling price of the custom software.^[3] Advanced, Inc. must collect and remit retail sales tax on the entire amount received from Client C, LLC if the sale is taxable in Washington. The consultation services are subject to the tax classification that applies based on the nature of those services.

How do I determine where the sale of custom software takes place?

The sale of custom software and the customization of prewritten software are retail sales. Retail sales must be sourced in accordance with RCW 82.32.730 for sales and use tax and retailing B&O tax purposes. The terms "**source**," "**sourced**," or "**sourcing**" refer to the location (as in a state, local taxing district, jurisdiction, or authority) where a sale is deemed to occur.

Custom software and the customization of prewritten software are subject to tax based on the location where the services are received by the purchaser and other default sourcing rules as follows:^[4]

1. The seller's place of business if the purchaser receives the retail service at the seller's place of business.
2. If not received at the seller's place of business, the location where the

3. If the location where the purchaser receives the retail service is not known, the purchaser's address available in the seller's business records.
4. If no address is available in the seller's business records, the purchaser's address obtained at the time of sale (e.g., purchaser's payment instrument).
5. If no address is obtained at the time of sale, the address where the retail service was provided by the seller.

"Receipt," in relevant part, generally means to make first use of the service.^[5] While not binding on the department, the department may be guided by the Streamlined Sales and Use Tax Agreement (SSUTA) when determining the location of receipt.^[6] The SSUTA does not directly address the sourcing of custom software or the customization of prewritten software, but does address the sourcing of services generally, indicating "the location (or locations) where the purchaser (or the purchaser's donee) can potentially first make use of the result of the service is the location (or locations) of the 'receipt' of the service."^[7] The SSUTA also addresses computer-related services, which contemplates sourcing to multiple locations and specific allocation rules.

Accordingly, in determining the location of receipt, the department provides the following guidance:

- **If the location of service is known:** If the purchaser receives the custom software or customization of prewritten software services at multiple known locations, the services must be sourced and allocated to those locations. The department will accept proportional allocation to each known location based on the amount of the service received at each location or equal proportional allocation to the known locations.
- **Agreed-upon allocation at time of invoice, reasonable and consistent method:** If the purchaser will receive the custom software or customization of prewritten software services in multiple locations, the seller and purchaser may allocate the sale to multiple locations based on a reasonable and consistent method.^[8] The locations and agreed-upon allocation in this instance must be provided by the purchaser by the time of the invoice. The reasonableness of the allocation will be subject to review by the department.
- **If the location of the service is unknown:** If the location of receipt is unknown, the service is deemed received at the business address of the purchaser based on their business records provided it is not used in bad

faith.^[9] If the business address is unavailable, the service may be deemed received at the purchaser's billing address as received in the ordinary course of business, provided that it is not used in bad faith or other similar purchaser address obtained at the consummation of sale.^[10]

- **Documentation:** Those that are providing custom software or customization of prewritten software services should document in their contracts, invoices, or service agreements where they will be sourcing the services.

Example 5 – Known location of receipt.

Facts: Blue, Inc., a Washington-based business, sells accounting software for cosmetologists that is uniquely designed for each end-user's purposes and qualifies as custom software. Nailraiser, LLC, located in Tacoma, Washington, engages Blue, Inc. to design a system specific to Nailraiser, LLC's needs. Blue, Inc. delivers the final product via electronic download for use at the Tacoma location. Blue, Inc. is aware that the software will be used at this location.

Result: This is a retail sale of custom software and should be sourced to Nailraiser, LLC's location in Tacoma, Washington. Retail sales are sourced to the location where the purchaser received the service. Blue, Inc. must pay the retailing B&O tax and must collect and remit retail sales tax based on Nailraiser, LLC's Tacoma location.

Example 6 – Unknown location of receipt.

Facts: Byte Forge, LLC, a Washington-based software company, designs data analytic software that can generate tailor-made outputs based on a client's unique data. Byte Forge, LLC designs and sells custom software to Plushy Bunny Toys, Inc., a toy company with locations in multiple states. Byte Forge, LLC is not aware of which Plushy Bunny Toys locations will deploy the analytic software. Byte Forge, LLC selected an address for a Plushy Bunny Toy's, Inc. office in Spokane, Washington. The contract amount is \$10,000.

Result: This is a retail sale of custom software that should be sourced to the office address in Spokane, Washington because that is the address of the purchaser as indicated by Byte Forge, LLC's records. Byte Forge, LLC must pay the retailing B&O tax and must collect and remit retail sales tax based on the address for the office location in Spokane, Washington.

Example 7 – Receipt at multiple locations of use.

Facts: Assume the same facts as in Example 6, except Byte Forge, LLC requests clarification from Plushy Bunny Toys, Inc. on where the custom software will be received. Plushy Bunny Toys, Inc. states that the custom software will be received at both their Portland, Oregon, and Spokane, Washington offices. Each location has the same number of employees that will use the software. The invoices reflect sales in the amount of \$5,000 invoiced to the Portland, Oregon office and sales in the amount of \$5,000 to the Spokane, Washington office.

Result: If the purchaser receives the custom software services in multiple locations, the seller and purchaser may allocate the sale to multiple locations based on a reasonable and consistent method. The locations and agreed-upon allocation in this instance must be provided by the purchaser by the time of the invoice. Byte Forge, LLC should source and allocate the sales to Oregon and Washington. Byte Forge, LLC may allocate sales between Oregon and Washington to each of the locations and will pay retailing B&O and collect retail sales tax on the sales in the amount of \$5,000 sourced to Washington.

Can custom software or the customization of prewritten software be resold?

Yes, in certain circumstances. Sellers of these services may use a reseller permit when subcontracting with a third-party service subcontractor in certain situations. However, providers must maintain documentation to substantiate that the services qualify for resale.

The seller of custom software or customized prewritten software may provide a reseller permit to a third-party subcontractor to document that the seller is purchasing the third-party subcontractor's services for resale purposes when both of the following factors are met:

1. The seller of the custom software or customized prewritten software is contractually responsible for providing the services to create the custom software or customized prewritten software for a third-party buyer; and
2. The seller of the custom software or customized prewritten software has no intervening use of the services provided by the third-party subcontractor.^[11]

NOTE: At the time of this interim guidance statement, the department understands that it is unlikely that custom software or the customization of prewritten software may be provided without intervening use and, therefore, most (if not all) transactions will likely not qualify for resale. However, if taxpayers believe that their circumstances would allow them to qualify as a reseller of these services, the department urges these taxpayers to request a binding letter ruling at rulings@dor.wa.gov.

Businesses providing custom software or customized prewritten software may also accept other approved exemption certificates from their customers. To be valid, these certificates must be properly completed and signed by the customer.

If a seller of custom software or the customization of prewritten software provides a subcontractor with a reseller permit or other approved exemption certificate, the seller does not need to pay retail sales tax. However, the subcontractor would still need to report the sale under the wholesaling B&O tax classification.

Does the licensing of custom software or customized prewritten software qualify for the multiple points of use (MPU) exemption?

RCW 82.08.0208(4) provides the multiple points of use (MPU) retail sales exemption for certain eligible products that are used by the purchaser concurrently inside and outside of Washington. RCW 82.12.0208(7) works in conjunction with the MPU sales tax exemption to apply use tax proportionately to the use of these products in Washington. This means that instead of paying retail sales tax at the time of purchase, buyers claiming the MPU exemption must apportion and report use tax directly to the department.

RCW 82.08.0208(4) provides the MPU retail sales exemption for certain eligible products, including services defined as a retail sale in RCW 82.04.050(6)(b) (formerly subsection (6)(c)), used by the purchaser concurrently inside and outside of Washington. Licensing, including charges for remote access, are MPU exemption-eligible because “services defined as a retail sale in RCW 82.04.050(6)(c)”^[12] are included within the list of exemption-eligible purchases.

In order to qualify for the MPU exemption, the MPU-eligible product must also be concurrently available for use inside of Washington and outside of Washington. To be "concurrently available for use within and outside this state" means that employees or other agents of the taxpayer may use the MPU-eligible product simultaneously at one or more locations within Washington and one or more locations outside of Washington.

If a service meets the statutory requirements described above, purchasers may generally use the MPU sales tax exemption and pay use tax on the amount apportioned to Washington under RCW 82.12.0208.

Therefore, if custom software or the customization of prewritten software meet the requirements of products defined under RCW 82.04.050(6)(b) and are concurrently used as defined in RCW 82.12.0208(7)(c)(i), then purchasers may generally use the MPU sales tax exemption and pay use tax on the amount apportioned to Washington under RCW 82.12.0208. However, if the MPU-eligible product is sold as part of a bundled transaction, then the MPU exemption and related apportionment is not available.^[13] A bundled transaction is the sale of two or more distinct and identifiable products sold for one nonitemized price.^[14] Pursuant to this interim guidance, the department will accept there is not a bundled transaction and the packaged products can each be taxed according to their appropriate classification if:

- The price of the MPU-eligible product is separately identified by product on a binding sales invoice or other supporting sales-related documentation made available to the customer in paper or electronic form that may include, but is not limited to: an invoice, bill of sale, receipt, contract, service agreement, lease agreement, periodic notice of rates and services, rate card, price list or the sale of any products in which the sales price varies; or
- The sale of any of the products that are negotiable based on the selection made by the purchaser of the products included in the transaction.

Do nonprofits have to pay retail sales tax on custom software and the customization of prewritten software?

In Washington, nonprofit organizations are generally taxed like any other business. They must pay B&O tax and collect and remit sales tax on gross revenues generated from the regular business activities they conduct.^[15] This

means that nonprofit organizations must collect and remit retail sales tax when making retail sales of custom software and customization of prewritten software and must pay retail sales tax when purchasing custom software and customization of prewritten software. For more information, see our Nonprofit organizations industry guide.

Do state and local governments have to pay retail sales tax on custom software and the customization of prewritten software?

In Washington, state and local governments are generally subject to retail sales tax on their purchases just like any other businesses.^[16] Sellers must collect and remit retail sales tax on sales of custom software and customization of prewritten software to state or local governments.

Custom software and customization of prewritten software sold between members of an affiliated group

The sale of custom software and the customization of prewritten software, when sold between members of an affiliated group, are generally excluded from the definition of “retail sale” under ESSB 5814. Therefore, if the exclusion requirements are otherwise met, these services would be subject to the service and other activities B&O tax classification.

How do I determine my retailing B&O amount and the correct retail sales tax rate?

Washington’s B&O tax, including the retailing B&O tax, is calculated on the gross income from activities. This means that there are no deductions for labor, materials, taxes, or other costs of doing business. The B&O tax rate varies by classification, which you can find on the department’s business & occupation tax classifications webpage. For more information regarding B&O tax generally, please see the department’s business & occupation tax webpage.

Retail sales tax collection is based on the location where the customer receives the service (destination-based sales tax). The department has dedicated tools that help businesses track and determine the location code and sales tax rate to use. This includes a sales tax rate lookup URL Interface

that provides direct access to the department's address-based rate lookup technology platform. Please see the department's Sales & use tax rates and Sales and use tax tools webpages for more information.

Taxpayer instructions

The department will continue to review these issues for purposes of developing final guidance. This interim guidance statement will remain in effect until the department issues final guidance, cancels this interim statement, or new legislation is enacted.

Please see our Services newly subject to sales tax webpage for updates, guidance, and opportunities to engage with the department.

If you have questions about this guidance, please contact the department at rulings@dor.wa.gov.

[1] RCW 82.04.050, RCW 82.04.250, and RCW 82.08.020

[2] RCW 82.04.29001 separately defines custom software and the customization of prewritten software as a service taxable under RCW 82.04.290(2). RCW 82.04.290(2) imposes a tax on persons engaged in an activity that is not explicitly taxed under another section of the tax statutes. ESSB 5814 amends RCW 82.04.050 to explicitly provide that sales of custom software and the customization of prewritten software are defined as "retail sales." As such, custom software and the customization of prewritten software are no longer taxable under RCW 82.04.290(2).

[3] RCW 82.08.010(1).

[4] RCW 82.32.730(1); see also RCW 82.32.730(9)(f) ("Receive' and 'receipt' mean taking possession of tangible personal property, making first use of digital automated services or other services, or taking possession or making first use of digital goods or digital codes, whichever comes first. . .")

[5] RCW 82.32.730(9)(f).

[6] RCW 82.02.210.

[7] SSUTA Rule 311.1 

[8] See generally, SSUTA Rule 309.3 , SSUTA Rule 311.1.

[9] RCW 82.32.730(1)(c).

[10] RCW 82.32.730(1)(d).

[11] RCW 82.08.130(2) and WAC 458-20-10201(205).

[12] Former RCW 82.04.050(6)(c) has been relettered to subsection (6)(b) as a result of the amendments in ESSB 5814.

[13] ETA 3242.2025 does not extend to apply the MPU to other types of bundled transactions as it is only applicable for sales of software maintenance agreements.

[14] RCW 82.08.190 and RCW 82.08.195.

[15] See WAC 458-20-169(4).

[16] See WAC 458-20-189(5).



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