STATE BOARD OF EQUALIZATION
LEGAL DIVISION (MIC:82)
450 N STREET, SACRAMENTO, CALIFORNIA
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0082)
Telephone: (916) 324-2614
FAX: (916) 323-3387

January 18, 1996

Mr. S--- P---
Controller
H--- C--- C---, Inc.
XXX --- Road, Suite XXX
---, CA XXXXX

Re: H--- C--- C---, Inc.
Account No. SR -- XX-XXXXXX

Dear Mr. P---:

This is in response to your letter dated October 23, 1995, regarding the application of tax to the Software License and Support Rental Agreement dated September 28, 1995, entered between H--- C--- C---, Inc. ("HCC") and M--- Hospital of Southern California. You state:

"We recently signed a contract with a client in which, for the first time, we licensed our software program on a rental basis. Also 'rented' out is the use of OUR hardware (on which we paid California sales tax, as well as a third-party software license (Oracle, on which we also paid sales tax). Finally, the monthly charge to the client also includes an installment for installation and upgrade work."

DISCUSSION

Retail sales of tangible personal property in California are subject to sales tax, measured by the gross receipts, unless the sale is specifically exempt from taxation by statute. (Rev. & Tax. Code § 6051.) The term "sale" includes any lease of tangible personal property for consideration, except as discussed below. (Rev. & Tax. Code § 6006(g).) The term "gross receipts" includes charges for any services that are a part of the sale of the tangible personal property. (Rev. & Tax. Code § 6012(b)(1).) If the services are not part of the sale of tangible personal property, tax does not apply to charges for such services if they do not themselves constitute sales of tangible personal property. (Reg. 1501; see Rev. & Tax. Code § 6006(b).)

Regulation 1502, a copy of which is enclosed, explains the application of tax to sales involving computers, programs and data processing. The sale of HCC's prewritten computer programs transferred to the customer in the form of storage media constitutes a sale of tangible personal property. (See Reg. 1502(f)(1).) Tax applies to the entire amount charged for the prewritten programs, including all license fees. (Reg. 1502(f)(1)(B).)

Labor charges for installation of prewritten computer programs are excluded from the measure of tax. (Rev. & Tax. Code § 6012(c)(3).) Installation includes the actual installation of the software, and the testing of the prewritten programs on the purchaser's computer to insure that the programs operate as required. (Reg. 1502(f)(1)(E).) This exclusion does not encompass any other services, such as converting a customer's data into a format suitable to be used with new software. (See Reg. 1502(g).) Conversion services are part of the sale of the prewritten program. Therefore, charges attributable to such services are taxable.

The sale of software maintenance contracts (improvements and error corrections provided on storage media) for prewritten computer programs is regarded as a sale of tangible personal property, the charge for which is subject to tax. If consultation services are provided as part of the maintenance contract, and the maintenance contract cannot be purchased without those services, the charge for the consultation services are taxable as part of the sale of tangible personal property. (Reg. 1502(f)(1)(C).) However, if HCC's customer contracts for optional consultation services for a separately stated price, in addition to charges made for the storage media, the charges for such consultation services are nontaxable. (*Id.*)

Charges for training services are nontaxable except where the training services are provided as part of the sale of tangible personal property. (Reg. 1502(e).) If the training services provided by HCC are provided as a part of the sale of tangible personal property, rather than an optional service which was specifically negotiated by the parties, such services are taxable.

Lastly, with regard to the license of hardware and third party software transferred on storage media, we assume that title to such hardware and software does not pass to HCC's customers. Revenue and Taxation Code section 6006.3 provides that the term "lease" includes rental, hire and license. A lease of tangible personal property in California is a continuing sale and purchase unless the lessor leases it in substantially the same form as acquired, and has timely paid California sales tax reimbursement or use tax measured by the lessor's purchase price of the property. (Rev. & Tax. Code §§ 6006(g)(5), 6006.1; Reg. 1660(c)(2).)

You state that HCC has paid "sales tax" on the hardware and the third party software. Our understanding is that HCC timely paid sales tax reimbursement to its vendor measured by the sales price. Moreover, we assume that HCC is leasing the hardware and the third party software in substantially the same form as acquired (that is, we assume that HCC transferred physical possession of the storage media on which the original third-party software was

acquired). Therefore, tax does not apply to the amounts charged by HCC for the lease of the hardware and the third party software.

If you have any further questions, please feel free to write again.

Sincerely,

Sophia H. Chung
Staff Counsel

SHC:rz

Enclosure: Regulation 1502

cc: --- District Administrator - --