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November 21, 1994

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**SENT BY FAX****Attention: Mr. R--- G---**

H--- - P--- C---  
Financial Services Center Tax Department  
P. O. Box XXXX  
--- ---, CO XXXXX

Re: SY - XX-XXXXXX

Dear Mr. G---:

This is in response to your September 27, 1994 letter to Assistant Chief Counsel Gary Jugum regarding the application of tax to software licensing and maintenance agreements.

You state that H--- - P--- ("H---") routinely purchases non-custom, prewritten software from vendors who ship a master disk/tape to H--- in --- ---, California. This master is installed on one of H---'s computer servers such that H--- employees throughout the world may log-on to the server from remote locations and download the software to their personal workstation. H--- provides the software vendor with an initial payment for a certain number of licenses and agrees to pay a fixed price for each additional license purchased. H--- sometimes purchases an optional maintenance agreement from the vendor entitling it to receive software updates and technical support for the software via telephone. Software updates consist of computer disks which are sent to H--- in --- --- for installation.

You ask a series of questions based on the above facts. For purposes of clarity, we have responded to each of your questions separately.

- "(1) The majority of the licenses purchased by H--- are associated with installations at H--- sites not located in California. In the network-distribution scenario ... described above, is the taxability of the software governed

by the location where the vendor shipped the master disks (server location) or where the user/licensee is located?"

California imposes sales tax a retailer's gross receipts from the retail sale of tangible personal property in this state unless the sale is specifically exempt from taxation by statute. (Rev. & Tax. Code § 6051.) When sales tax does not apply, use tax is imposed on the sales price of property purchased from a retailer for the storage, use or other consumption in California. (Rev. & Tax. Code §§ 6201, 6401.) Thus, tax applies if a sale or use of tangible personal property occurs inside this state.

It is not clear whether the sale of software occurs in California. If so, sales tax applies to the gross receipts from the sale. If not, H--- is purchasing the software for use in California at its server location in this state and that use is subject to use tax. The measure of the sales or use tax includes all amounts charged by the vendor for the sale of the software including all license and other end user fees. (Reg. 1502(f)(1)(B).) This means that H---'s initial payment for a certain number of licenses as well as additional license fees purchased after the initial sale of software are subject to tax. All charges paid for software updates provided to H--- in tangible form are also subject to tax.

"(2) Is the taxability of the software maintenance governed by where the vendor ships the update disks (server location) or where the user/licensee is located?"

Sales of optional software maintenance agreements are discussed in Sales and Use Tax Regulation 1502(f)(1)(C):

"Maintenance contracts sold in connection with the sale or lease of prewritten computer programs generally provide that the purchaser will be entitled to receive, during the contract period, storage media on which prewritten program improvements or error corrections have been recorded. The maintenance contract also may provide that the purchaser will be entitled to receive, during the contract period, telephone or on-site consultation services.

"....

"If the purchase of the maintenance contract is optional with the purchase, but the purchaser does not have the option to purchase the consultation services in addition to the sale or lease of storage media containing program improvements or error corrections, then the charges for the consultation services are taxable as part of the sale or lease of the storage media. If, however, the purchaser may, at its option, contract for the

consultation services for a separately stated price, in addition to the charges made for the storage media, then the charges for the consultation services are nontaxable."

This means that a maintenance agreement to provide program updates on storage media is regarded as a contract for the sale of tangible personal property. Sales or use tax applies if the sale or use of the property occurs in California. (Rev. & Tax. Code §§ 6051, 6201, 6401.) Under the facts of your letter, the measure of tax includes all charges made for the updates since the sale or use of the update media will occur in California. (The fact that the remote locations outside California will access the software on H---'s server is irrelevant since the place of use is H---'s server in --- ---.) The measure of tax also includes charges for consultation services unless the consultation is optional and such fees are separately stated. (Reg. 1502(f)(1)(C).)

"(3) If at some point during the software licensing agreement outlined above, the vendor begins sending software upgrades by `remote telecommunications' will this affect the taxability of licenses and maintenance fees purchased after the electronic reception of the upgrade? (An upgrade constitutes a whole new version of the software, not just a portion.)"

The sale of a prewritten program is not taxable if the program is transferred by remote telecommunications from the seller's place of business to the purchaser's computer provided the purchaser does not obtain possession of tangible personal property, such as storage media, in the transaction. (Reg. 1502(f)(1)(D).) This type of transaction is not subject to tax since the transfer of software via telecommunications is not regarded as the sale or use of tangible personal property inside this state.

You state that H--- purchased computer software from its vendor and received shipment of a master disk/tape in --- ---, California. As discussed above (question 1), sales or use tax was due on this transaction measured by the entire sales price, including any license fees paid after the original sale that related to the sale of the tangible personal property. H---'s subsequent purchase and receipt of software updates, whether by physical receipt of updated disks or via remote telecommunications from H---'s vendor, do not affect the application of tax on H---'s original transaction with its vendor, or the fact that tax applies to any additional license fees paid with respect to software that had been transferred in tangible form. The same rules apply to any maintenance contracts involving the transfer of updates in tangible form.

Tax does not apply to charges for maintenance contracts that provide for updates via telecommunications with no transfer of tangible personal property. (Reg. 1502(f)(1)(D).) H---'s future receipt of updates via telecommunications will not, however, affect the application of tax on previously received update disks from the vendor nor to additional user fees related to any sale of software transferred in tangible form.

If you have any further questions, please write again.

Sincerely,

Warren L. Astleford  
Staff Counsel

WLA:plh  
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cc: --- --- District Administrator - --