

BOARD OF EQUALIZATION

BUSINESS TAXES APPEALS REVIEW SECTION

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| In the Matter of the Petition |) | |
| for Redetermination Under the |) | DECISION AND RECOMMENDATION |
| Sales and Use Tax Law of: |) | |
| |) | |
| J. S--- M--- |) | No. SR -- XX XXXXXXX-010 |
| ET AL. |) | |
| dba H--- C--- R--- |) | |
| |) | |
| <u>Petitioner</u> |) | |

The Appeals conference in the above-referenced matter was held by Senior Staff Counsel H. L. Cohen on September 23, 1992 in San Francisco, California.

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|---------------------------|-----------------|
| Appearing for Petitioner: | Mr. I. B--- |
| | Mr. T. L--- |
| | Attorney at Law |

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| Appearing for the Sales and Use Tax Department: | Mr. A. Viripaeff Supervising Tax Auditor San Francisco District |
| | Mr. A. Hoppe Tax Auditor San Francisco District |

Protested Item

The protested tax liability for the period October 1, 1987 through May 31, 1990 is measured by:

| | <u>Item</u> | <u>State, Local and County</u> |
|----|-----------------------------------------------------------|------------------------------------|
| A. | Claimed exempt sales in interstate Commerce disallowed | \$177,847 |

Contention

Petitioner contends that the sales in question were valid sales in interstate commerce or sales of custom computer software.

Summary

Petitioner was a partnership which was engaged in sales of computer software and hardware. The partnership ceased operating May 31, 1990. There was no prior audit.

The computer systems which petitioner sold were sold primarily to physicians and dentists. In making sales of the systems, petitioner itemized its billings, separately listing charges for hardware, software, and sales tax reimbursement on hardware charges. Petitioner did not charge sales tax reimbursement on software charges and did not pay tax to the Board on these charges. The software was fabricated by H--- C--- C---, Inc. (HCC), a Nebraska corporation, which shipped the software directly to the purchasers from its offices in Nebraska.

The auditor concluded that prior to October 1, 1988, the transactions consisted of the following steps:

1. Petitioner solicited the sale of the system;
2. Petitioner billed the customer for hardware, software, training, and sales tax reimbursement on the hardware.
3. Petitioner received payment from the customer in full.
4. Petitioner paid HCC for the software.
5. HCC paid petitioner a commission.

The auditor concluded that beginning October 1, 1988, the transactions consisted of the following steps:

1. Petitioner solicited the sale of the system.
2. The customer was billed for hardware, training, and sales tax reimbursement on the hardware by petitioner.
3. The customer was billed by HCC for the software.
4. The customer made out one check to petitioner and one check to HCC. The checks were sent to petitioner. Petitioner forwarded to HCC the check which was made out to HCC.
5. The customer signed an agreement acknowledging that HCC was the seller of the software and that petitioner was the authorized agent of HCC.

The auditor concluded that prior to October 1, 1988, petitioner was the seller of the software and that petitioner was liable for sales tax on the gross receipts from the sale of the software. This conclusion was based on the fact that petitioner billed customers for the software and was paid directly by the customers. For the period beginning October 1, 1988, the auditor regarded HCC as the seller of the software because it billed the customers and the customers issued checks made out to HCC.

Petitioner contends that in practice, petitioner always acted as an agent of HCC in selling the software. It received a commission for each sale which it made. The difference between the billing and payment methods should not be regarded as an indication that petitioner was the seller. Petitioner submitted a copy of an agreement effective January 1, 1988 in which HCC appointed petitioner to sell its products. The customers were to be regarded as customers of HCC. Petitioner was to receive a commission. Petitioner states that there was a similar agreement for 1987, but has been unable to furnish a copy of it. Petitioner argues that the collection of payments from the customers does not affect petitioner's status as an agent of HCC.

Petitioner also contends that the software constituted customized computer programs. The programs contained information unique to each customer. This unique information included the tax rate in effect in the buyer's state, passwords, telephone numbers, provider numbers, hospitals, specialties, social security numbers, federal identification numbers, insurance forms utilized, office locations, and fee schedules.

Analysis and Conclusions

I agree with petitioner that the fact that it received payment for the software does not conclusively show that petitioner was selling the software on its own behalf rather than as an agent of HCC. However, the manner of billing and payment prior to October 1, 1988 does create an inference that petitioner was the seller. It is necessary that petitioner rebut this inference. The agreement which petitioner submitted does in fact rebut the inference but it covers only calendar year 1988. I conclude that for that calendar year, petitioner should be regarded as the agent of HCC and should not be liable for the sales tax on the charges for the software in that period.

Petitioner contends, in addition to being an agent in the sale of the software, that the software was custom computer programs or customized computer programs and thus not subject to tax. Sales and Use Tax Regulation 1502 provides, in subdivision (f)(2):

“(A) Tax does not apply to the sale or lease of a custom computer program, other than a basic operational program, regardless of the form in which the program is transferred. Nor does the tax apply to the transfer of a custom program, or custom programming services performed, in connection with the sale or lease of computer equipment, whether or not the charges for the custom program or programming are separately stated.

“(B) However, charges for custom modifications to prewritten programs are nontaxable only if the charges for the modifications are separately stated. Otherwise, the charges are taxable as services part of the sale of the prewritten program.

“When the charges for modification of a prewritten program are not separately stated, tax applies to the entire charge made to the customer for the modified program unless the modification is so significant that the new program qualifies as a custom program. If the prewritten program was previously marketed, the new program will qualify as a custom program, if the price of the prewritten program was 50% or less of the price of the new program. If the prewritten program was not previously marketed, the new program will qualify as a custom program, if the charge made to the customer for custom programming services, as evidenced in the records of the seller, was more than 50% of the contract price to the customer.”

There was no separate charge for customizing nor was there any evidence that the cost of the customizing was more than 50 percent of the contract price. The programs therefore cannot be regarded as customized programs. Further, the programs do not qualify as custom programs. The work of adding customer names or file headings to an existing program does not make the program a custom program. The classification of the program sold by petitioner as prewritten is further bolstered by the fact that more than one-half of the programs were sold for the same price, \$3,795. This price is too low to provide for the effort of creating a new custom program and the set price is indicative of a prewritten program rather than a custom program.

Recommendation

Delete calendar year 1988 sales of software from the amount subject to tax. Deny the petition in all other respects.

11-6-92

H. L. Cohen, Senior Staff Counsel

Date