In the Matter of the Claim ) HEARING 
for Refund Under the Sales ) DECISION AND RECOMMENDATION 
and Use Tax Law of: ) 
) 
D--- CORPORATION. ) No. SR -- XX XXXXXX-001 
) 
Claimant ) 

The above-referenced matter came on regularly for hearing before Hearing Officer Janice M. Fallman on December 21, 1989 in Arcadia, California.

Appearing for Petitioners: T--- A. A---
President
A--- H---
Witness

Appearing for the Department
Of Business Taxes: Eileen Battle
Tax Auditor

Subject of Claim

Claimant seeks a refund of tax determined for the period July 1, 1983 through March 31, 1986, measured by:

<table>
<thead>
<tr>
<th>Item</th>
<th>State, Local County &amp; LACT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxable service activities in connection with the sale of tangible personal property</td>
<td>$80,753</td>
</tr>
</tbody>
</table>
Claimant’s Contentions

Because claimant issues two separate written agreements (the first for the sale of computer software and hardware and the second for consulting, maintenance, training, and installation services), the measure of tax is limited to the gross receipts received in payment for the computer hardware and software even if both agreements were billed on the same invoice.

Summary

Claimant is a corporation engaged in the business of providing consulting services in connection with computers and their applications. In some of its bids for these consulting services, claimant also acquired and resold computer hardware and software to its clients. Claimant has never maintained computer hardware or software in inventory, nor has it displayed these items on its business premises. Claimant purchased computer software and hardware for resale by issuance of resale certificates. The equipment was generally marked up by claimant prior to resale to claimant’s clients on an invoice that also included a billing for amounts due for support services.

Claimant charged sales tax on gross receipts for computer software and hardware sold to its clients at the marked-up sales price. Claimant did not charge sales tax on the consultation services, maintenance, installation, etc., billed under separate written agreement but included on the same invoice. This was claimant’s first audit.

On January 16, 1987, a Notice of Determination was issued to claimant for the taxable period July 1, 1983 through March 31, 1986 disallowing petitioner’s exclusion of $80,753 in gross receipts received for services provided in connection with the sale of tangible personal property as nontaxable labor. These services included after-the-sale consulting with purchasers of equipment. Consultations related to business needs and applications of the purchased computers and software, training the client’s staff, troubleshooting the equipment and system for the first 90 days of its operation, and verifying the system operated as specified in claimant’s bid. During this same 90-day period, the manufacturer of the computer hardware also provided a warranty for parts and equipment.

Claimant’s agreement for this initial 90-day period also involved bringing the client’s business entity online into a fully computerized working system. If claimant’s clients wished to obtain subsequent maintenance or support services after the initial 90-day start-up period, claimant offered an Agreement for Purchase of Support Services. Additional maintenance could be obtained after the 90-day period by entering into a Maintenance Agreement. Services provided under either of these agreements after the initial 90-day period covered by claimant’s bid were not included in the audited measure of tax.

Claimant provided a representative set of documents including copies of a proposal/bid and various agreements which are representative of the disputed transactions for the taxable periods involved in this case. To wit:
1. Agreement for Purchase of Equipment dated May 31, 1984 between C--- S--- and claimant;

2. Agreement for Purchase of Support Service dated May 31, 1984, also involving C--- S---, and

3. an invoice to A--- F--- G---, Ltd., dated July 27, 1984 reflecting the merchandise thereon was to be shipped to C--- S---, and the check stub from A--- F--- check number 7598 to claimant for $25,968.74. A--- F--- is a leasing agency which provides funding to purchasers, such as C--- S---, to lease instead of buy equipment.

Claimant also acknowledged that the C--- S--- documents are representative of (1) the manner in which clients purchasing computer software and hardware, as well as contractual services and labor, entered into written agreements with claimant; (2) the manner in which clients were billed for services and materials; and (3) the manner in which they remitted payment therefor.

During the hearing, claimant stated that installation expense varied from client to client. The tax auditor determined from claimant’s proposal at page 3, “Application software”, that any conversion of data from an old system to the new system would occur prior to installation. It was therefore treated as fabrication labor.

In preparing its bid for support services, $40-$55 an hour was presumed to be included for installation and maintenance labor. The tax auditor applied a narrow definition to installation labor by determining that labor required to install canned software onto the system was de minimus and that only manual connection of the equipment and wiring were installation labor. Claimant’s Agreement for Purchase of Support Services does not separately state that portion of the price which is attributable to installation labor. At the hearing, claimant could not recall for each disputed contract what percentage of the payment for support services was attributable to installation labor as defined by the tax auditor.

The tax auditor originally determined the measure of tax to be $82,075. She subsequently allocated on percent (1%) of the total price of the bid for support services to installation labor. The revised $80,752 measure of tax in her revised audit reflects the one percent (1%) adjustment for installation labor.

The software provided in the bid is described as, “[T]he most accepted, universal software system available in the market.” Claimant has not contended that any sale of software was not a prewritten software program under the provisions of Sales and Use Tax Regulation 1502(f)(1).

During the hearing, claimant’s president stated that during any give two-month period, claimant generally entered into at least two contract in which no equipment was provided. Those
contracts in which no tangible personal property was sold are not in dispute in this case. During that same two-month period, claimant’s president estimated that on an average, it would enter into three or more contracts in which it agreed to provide hardware and software.

Claimant states that it did not, and would not, provide hardware and software to any client to whom it extended a proposal unless the client also agreed to that portion of the proposal requiring the client to enter into a simultaneous support agreement. Claimant’s president stated that it was not competitive in retailing hardware and only acquired it to accommodate clients who accepted its support services contract. Claimant also stated that all potential clients to whom it issued proposals were free to deal with any hardware or software provider they wished. However, if claimant purchased equipment ex-tax, it then marked it up for resale to its clients.

**Analysis and Conclusions**

Gross receipts are defined as the total amount of the sale price of tangible personal property sold at retail by retailers, valued in money, whether received in money or otherwise. (Revenue & Taxation Code § 6012(a)).

Revenue and Taxation Code Section 6012(b)(1) provides that gross receipts include the total amount of the sale price including any services that are part of the sale. Claimant’s transfer of title to the hardware and software in connection with rendering automatic data processing services is subject to sales tax on the gross receipts for services rendered as well as the transfer of tangible personal property.

Sales and Use Tax Regulation 1502(g) provides, in pertinent part, as follows:

“The following activities are service activities. Charges for the performance of such services are nontaxable unless the services are performed as a part of the sale of tangible personal property.

“(1) Designing and implementing computer systems (e.g., determining equipment and personnel required and how they will be utilized).

“(2) Designing storage and data retrieval systems (e.g., determining what data communications and high-speed input-output terminals are required).

“(3) Consulting services (e.g., study of all or part of a data processing system).

* * *

“(6) Providing technical help, analysts and programmers, usually on an hourly basis.

“(7) Training Services.
“(8) Maintenance of equipment. (See Regulation 1546 for application of tax to
maintenance contracts.)

“(9) Consultation as to use of equipment.”

Claimant contends that bifurcation of its client’s acceptance of a unitary bid into two
separate written agreements voids inclusion of gross receipts under the support services
agreement in the measure of tax. A contract must be viewed in its entirety including the offer,
any acceptance(s) and consideration passing between the parties.

The Agreement for Purchase of Equipment and the Agreement for Purchase of Support
Services memorialize mutually contingent contractual terms that were the subject of one
proposal. Claimant, on the other hand, argues form over substance. Claimant admitted at the
hearing that the provision of the tangible personal property in these bids was clearly conditioned
upon acceptance of support services offered in the bid. (Business Tax Law Guide Annotation
295.1690).

The disputed nontaxable labor provided under the Agreement to Provide Support
Services arose in situations in which the client accepted express terms of claimant’s singular bid.
Claimant’s candid admission that it would never provide hardware and software unless its client
also agreed to accept the support services offered in the bid demonstrates that the bid was a
non-severable offer which was capable of acceptance only by agreeing to all terms. Each term
was contingent upon acceptance of all others.

In looking to the intent of the parties, it is necessary not just to look at the underlying
writings that memorialized acceptance of claimant’s bid in a vacuum. These acceptances are
meaningless without also reviewing the offer and their interrelationship one to the other.
Claimant’s statement that the offer or proposal was not severable, made acceptance of the
resulting contract all-or-nothing. Thus, the fact that claimant memorialized his offer in two or
more “Agreements” in no way changes the result of the parties’ negotiations. The collection of
tax should not be held hostage to a retailer’s billing practices without objectively viewing the
true object of their contracts.

Several other factors provide evidentiary support for the above conclusion. (1) Claimant
often used a single invoice to bill for both the equipment sold and the support services arising out
of one proposal which indicates that the contracts were interrelated. (2) During the hearing,
claimant stated that the only warranty provided by the equipment manufacturers was for parts
and equipment. Claimant’s 90-day warranty commenced upon delivery of the equipment and
covered repair services, labor, maintenance and installation of the equipment, not just parts
replacement during this 90-day period in which claimant brought its client’s business on line. By
providing these additional services not subject to the equipment manufacturer’s limited warranty,
claimant further demonstrated that its clients had negotiated for services in connection with the sale of tangible personal property.

Whether reduced to one writing or two, claimant offered a nonseverable contract to provide services in connection with the sale of tangible personal property. Therefore, under the provisions of Revenue and Taxation Code Section 6012, only that portion of the support services contract attributable to installation labor was excludable from the gross receipts. Having provided no evidence that the tax auditor’s allowance of one percent (1%) of the support services agreement as the cost of exempt installation labor was incorrect, claimant has failed to meet its burden of proof.

Recommendation

Deny the claim for refund.

Janice M. Fallman, Hearing Officer

Date

February 28, 1990