

**STATE BOARD OF EQUALIZATION**

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March 23, 1988

-. -. S---  
Tax Administrator  
State and Local Taxes  
N--- Corporation  
XXX South --- Boulevard  
---, --- XXXXX

N--- Corporation – SZ – XX-XXXXXX  
Optional software maintenance contracts

Dear Mr. S---:

In your December 28, 1987 letter to the Board's Department of Business Taxes, which was referred to the legal staff for reply, you write:

“We are writing to request a confirmation of your State's position on the application of sales and use tax to ‘software support’ charges.

“A customer who secures a license to use a standard or customized N--- program may also secure an optional support contract for an additional fee. This contract permits the resolution of any problems by telephone contact. In the rare event a problem is identified with the software, a revised or updated version may be supplied at no extra charge.

“Please advise us of your State's position regarding the application of sales and use tax to the above described charges.”

Opinion

Our opinion is that use tax will apply to your charges for your optional software support (maintenance) contract for the support of your standard (prewritten) computer programs, if during the period of the contract you actually transfer to your customers a revised or updated

version of the programs on tangible storage media. However, tax does not apply to these charges for maintenance of prewritten programs, if during the term of the contract, no revised or updated versions are actually transferred to your customers. In addition, tax does not apply to your charges for maintenance of your customized programs, assuming that the revised or updated versions of these programs which you transfer during the term of the contract are also customized. Our reasons for these conclusions are as follows.

Generally, use tax applies to rental payments or license fees received for the transfer of possession of tangible personal property. One exception applies to the transfer of custom computer programs, which are defined as programs written to the special order of a customer. (Revenue and Taxation Code Section 6010.9.) Nor does tax apply to custom modifications made to prewritten programs, provided the custom modification charges are separately stated. (Section 6010.9.) This exclusion from tax will likewise apply to transfers of custom revised or updated versions of these programs, regardless of whether they are includable as part of a software maintenance contract.

With respect to your prewritten programs, tax applies to optional software maintenance contracts as described in Sales and Use Tax Regulation 1502(f)(1)(C). That regulation provides as follows:

“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 not optional with the purchaser, then the charges for the maintenance contract are taxable, including charges for consultation services, as part of the sale or lease of the prewritten program.

“If the purchase of the maintenance contract is optional with the purchaser, 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.”

Since it appears that your optional software support contracts contemplate that during the term of the contract your customers will receive revised or updated versions of the prewritten programs if there is a problem identified with the program, our view is that tax would apply to your entire charge for these contracts. If, in fact, during the term of these contracts, N--- does not transfer any revised or updated versions, and the customers only receive telephone support, then no tax would apply to your charges because the customers did not receive any tangible personal property and instead only received nontaxable services. Tax applies to the entire charge if revised or updated versions are transferred because services such as telephone support are taxable when they are included as services part of the sale of, or license of, tangible property. (Revenue and Taxation Code Sections 6011(b)(1), 6012(b)(1)). We do not view the transfer of updates or revisions of programs as merely incidental to the provision of support services, even if the revisions or updates are rare.

I enclose a copy of the proposed amendments to Regulation 1502, dated October 17, 1987. These proposed amendments were approved in final form February 3, 1988 but the provisions of these amendments reflect the manner in which the Board regards that current law applies to optional software maintenance contracts.

If you have any other questions or comments about this letter, please feel free to contact me.

Sincerely,

John Abbott  
Tax Counsel

JA:jb  
Enclosure