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STATE OF CALIFORNIA

**STATE BOARD OF EQUALIZATION**

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April 19, 1996

E. L. Sorensen, Jr.  
*Executive Director*

Mr. G--- D. G---  
Senior Manager

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--- --- Center  
--- ---, California XXXXX

Re: Unidentified Taxpayer

Dear Mr. G---:

This is in response to your letter dated March 21, 1996 requesting a private letter ruling on the application of tax to software maintenance agreements. I initially note that the Board staff does not issue rulings. Revenue and Taxation Code section 6596 sets forth the circumstances under which a taxpayer may be relieved of liability for taxes when relying on a written response to a written request for an opinion. In order to come within the provisions of section 6596, all relevant facts, including the identity of the taxpayer, must be disclosed. This opinion does not come within section 6596 because you have not identified your client. You should provide us with the identity of your client (as well as all relevant facts) in your initial letter to us if you wish an opinion letter coming within the provisions of section 6596.

You state:

“ABC, a software developer and publisher, sells software licenses and software maintenance agreements to its customers. Maintenance agreements are optional, but due to the complexity of the software the vast majority of customers elect to purchase them. Maintenance agreements are typically sold in 12 month terms which renew annually unless terminated by either party. Currently, the software licenses and the updates provided in the software maintenance agreements are delivered in tangible form.

“ABC will have the capacity to deliver software and updates electronically in the near future. As a result, future software licenses and maintenance agreements may not include a transfer of tangible personal property.”

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

**“Issue 1**

“Some ABC customers have requested to terminate their existing maintenance agreements at the end of their 12 month term and sign new agreements detailing that the updates be transmitted electronically. If updates, under the first agreement, are sent in tangible form, but the renewal for the second year agreements includes updates delivered electronically only, will the second year maintenance agreement be exempt from sales tax under Regulation 1502(f)(1)(D)?

“If yes, what verbiage must be included in the new maintenance agreement to assure that it qualifies for the exemption?”

Regulation 1502(f)(1)(D) provides that tax does not apply to the sale or lease of software that is transferred by remote telecommunications (e.g., modem or e-mail) where the purchaser does not obtain possession of any tangible personal property, such as storage media, in the transaction. In this type of situation, we do not regard the transfer of the software as the sale of tangible personal property inside this state.

You state that some ABC customers have requested to terminate their existing maintenance agreements at the end of their 12 month term and sign *new* agreements requiring the delivery of future updates by electronic transmission. You also indicate in your second sentence of “Issue 1” that customers will “renew” their maintenance agreements to include electronic transmission. Based on these statements, it is somewhat unclear whether new agreements will be entered into or whether ABC will simply renew the previous agreements but send all updates via electronic transmission. In any event, we will regard ABC’s maintenance agreements as the transfer of non-taxable tangible personal property where ABC and its customers actually terminate their previous agreements requiring the transfer of updates in tangible form, enter into new (and valid) agreements requiring the transmission of updates via electronic transmission, and ABC actually transfers the updates via electronic transmission to its customers.

You also ask what language must be included in the new maintenance agreements to insure that they qualify for the exemption. The Board’s staff does not provide contractual language to taxpayers that guarantees that a particular transaction will not be subject to tax. However, where the agreement sets forth the requisite elements of Regulation 1502(f)(1)(D) and ABC and its customers comply with the agreement, the transfer of the software updates by electronic transmission will not be subject to tax.

**“Issue 2**

“On occasion, ABC’s customers will purchase additional software licenses throughout the year. In order to have all of the software maintenance agreements expire at the same time, ABC’s practice has been to terminate the existing maintenance agreements, (granting credit for the unused portion) and then have the customer sign new 12 month maintenance agreements for both the pre-existing and newly purchased licenses, all of which have the same term.

“If the new maintenance agreements require electronic software transmission, will California allow a sales tax credit for the terminated, tangibly transferred, maintenance agreement?”

The sale of the initial maintenance agreement was a taxable sale. (Reg. 1502(f)(1)(C).) A customer’s return of only a portion of a maintenance agreement does not qualify as “returned merchandise” pursuant to Regulation 1655(a). There is no other provision which allows ABC to claim a credit (or deduction) based on the customer’s return of an unused portion of the maintenance agreement.

**“Issue 3**

“As ABC begins selling software electronically, it may wish to send documentation in tangible form to its customer. This documentation may be sent either on paper or a CD ROM. Does the form of the documentation, i.e., CD ROM, taint the exemption for the electronic transfer of the software? What is the tax treatment if the ABC invoice includes a separate charge for the documentation?”

Regulation 1502(f)(1)(D) provides, in pertinent part:

“If the transfer of a prewritten program is a nontaxable transaction, then the seller is the consumer of tangible personal property used to produce written documentation or manuals **(including documentation or manuals in machine readable form)** designed to facilitate the use of the program and transferred to the customer for no additional charge. If a separate charge is made for the documentation or manuals, then tax applies to the separate charge.” (Emphasis added.)

We assume that the CD-ROMs do not contain any software such as a search engine in which to access particular information on the disk. Under these facts, ABC's transfer of software documentation (and not the software itself) to its customers in either CD ROM or paper form is subject to tax where it makes a separate charge to its customers for such documentation. Where no charge is made, ABC is the consumer of its documentation materials.

If you have any further questions, please write again.

Sincerely,

Warren L. Astleford  
Staff Counsel

WLA:rz

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cc: San Francisco District Administrator - (BH)