STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
450 N STREET, SACRAMENTO, CALIFORNIA
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)
(916) 324-3828

September 22, 1993

[X]

Dear [X]:

This is in response to your inquiry of July 1, 1993, regarding the sales and use tax consequences of the computer software your company sold. You state that:

> "[X] is an insurance holding company and is not in the software sales business. During the past several years our company programmers developed an in-house software system that we use to run our insurance business.
>
> "Recently, another insurance company became interested in the software and as a result, [X] sold them the application for $150,000. To the best of my knowledge, this was a one time event unless, of course, still another insurance company comes along that wants to buy it.
>
> "Under regulation 1502 a definition of a (Prewritten Program) includes a program developed for in-house use which is subsequently offered for sale. On that basis alone it would seem that the sale was a taxable event. However, under regulation 1595 covering (Occasional Sales) it states that tax does not apply to a sale of property held or used in the course of an activity not requiring the holding of a sellers permit. Based on the guidelines contained in that regulation we would not be required to hold a seller's permit."

Since you state that [X] is an insurance holding company, we assume that it is not itself an insurance company authorized to do insurance business by the California Department of Insurance and that it does not pay the insurance gross premiums tax. Further, we assume when you say [X] sold to "another insurance company" you mean an insurance company not owned by [X]. We assume that by "this was a one-time event," you mean that [X] has made only one sale of the software to an unrelated insurance company. We assume [X] transfers the software in question on tangible storage media.

You ask whether your sale of the software qualifies as an exempt occasional sale. I will also address the issue of the application of sales and use tax to sales to an insurance company.

Sales and Use Tax Law – In General

Revenue and Taxation Code section 6051 imposes a sales tax on all retailers measured by their gross receipts from retail sales of tangible personal property occurring in this state. The sales tax is imposed upon the retailer, but the retailer may collect sales tax reimbursement (usually itemized on the invoice as "sales tax") from the purchaser if the contract of sale so provides. (Civ. Code § 1656.1.)

"A 'retail sale' or 'sale at retail' means a sale for any purpose other than resale in the regular course of business in the form of tangible personal property." (Rev. & Tax Code § 6007.)

A use tax is imposed on the storage, use, or other consumption in this state of tangible personal property purchased from any retailer for storage, use, or other consumption in this state. (Rev. & Tax. Code § 6201.) A retailer engaged in business in this state must collect the use tax from the purchaser and pay it to this state. (Rev. & Tax. Code § 6203.) Generally, if a sale of property is subject to sales tax, the storage, use, or other consumption in this state, of the property, is exempt from use tax. (Rev. & Tax. Code § 6401.) If a sale of property is not subject to sales tax, the storage, use, or other consumption in this state, of the property, is subject to use tax unless an exemption applies.

Occasional Sales and Seller's Permit

Under Revenue and Taxation Code section 6006.5(a), an occasional sale includes:

> "A sale of property not held or used by a seller in the course of activities for which he or she is required to hold a seller's permit or permits or would be required to hold a seller's permit or permits if the activities were conducted in this state, provided the sale is not one of a series of sales sufficient in number, scope, and character to constitute an activity for which he or she is required to hold a seller's permit or would be required to hold a seller's permit if the activity were conducted in this state."

Occasional sales, as defined above, are exempt from sales and use tax. (Rev. & Tax. Code § 6367 (this exemption does not apply to sales of vehicles, vessels, or aircraft).) Regulation 1595(a) (1) provides that persons making 3 or more sales for substantial amounts, or a substantial number of sales for relatively small amounts, in a 12 month period, are required to hold a seller's permit. Thus, if [X] made three or more sales of tangible personal property for substantial amounts or made a substantial number of sales for relatively small amounts, in any period of 12 months, [X] would be required to have a seller's permit. We will look to all [X]'s sales of tangible personal property, not just its software sales, in determining whether the sale of software was one of a series of sales for which a permit was required. If it was, its sales (including its sale of the software) do not qualify for the occasional sale exemption.

There is an additional reason that [X] may have been required to have a seller's permit. Revenue and Taxation Code section 6014 defines "seller" to include every person engaged in the business of selling tangible personal property, and Revenue and Taxation Code section 6066 requires every such seller to obtain a seller's permit. You state: "To the best of my knowledge, this was a one time event unless, of course, still another insurance company comes along that wants to buy it." If [X] is taking any positive steps to offer the program for sale (e.g., advertising it for sale or in some other manner letting the industry know the program is for sale), [X] is a seller under Section 6014 and is required to hold a permit by section 6066. If so, its sale of the software was not an occasional sale.

If [X] has made only one sale of the software, made no other sales of tangible personal property, and is not trying to sell the software, then the sale of the program is an occasional sale as long as [X] does not make two or more other sales of tangible personal property within 12 months of this sale. If [X] transferred the software to its subsidiaries by selling it to them (or made sales of any other tangible personal property to its subsidiaries), these sales are also considered when determining the number of sales within a 12 month period. If this is an occasional sale, the sale is exempt from tax.

Sales by Insurance Companies

Section 28 of Article XIII of the California Constitution provides generally that insurance companies doing business in California must pay the state a tax based on gross premiums. Section 28(f) of Article XIII of the California Constitution provides that the gross premiums tax on insurance companies is "in lieu" of all other taxes, with certain exceptions not relevant here. Mutual Life Ins. Co. of New York v. City of Los Angeles (1990) 50 Cal.3d 402 held the "in lieu" provision applied to all activities of an insurance company.

If you had been a company selling insurance, registered to do business as an insurance company with the Department of Insurance and paying gross premium tax, your sales of the computer software would not be subject to sales tax because the gross premium tax you would have paid is "in lieu" of all other taxes. However, even when sales tax does not apply to sales by insurance companies, if they are seller's required to hold a seller's permit, they are required to collect use tax from consumers when making sales of tangible personal property. (Reg. 1567(b).) Therefore, even if you were an insurance company and not subject to sales tax, you would generally be required to collect use tax from purchasers of your software. Based on our understanding that [X] is not itself an insurer, it would not be exempt from sales tax on its sales.

Similar to the discussion above, use tax does not apply in this state to the storage, use or other consumption of tangible personal property by insurance companies. (Reg. 1567 (b) .) Thus, if you had sold the software to a company selling insurance, registered to do business as an insurance company with the Department of Insurance and paying gross premium tax, use tax would not apply. However, if the company you sold the software to is not itself an insurer, it would not be exempt from use tax on this sale.

In summary, if the sale of the software was an occasional sale as discussed above, neither sales nor use tax applies. If the sale does not qualify as an occasional sale, sales tax applies if the seller is not an insurance company, without regard to whether the purchaser is an insurance company. If the seller is an insurance company, use tax would apply if the purchaser is not an insurance company. However, even if the sale does not qualify as an occasional sale, neither sales nor use tax applies if both the seller and the buyer are insurance companies paying the California gross premiums tax.

If you have any further questions, please feel free to write again.

Very truly yours,

Rachel M. Aragon
Staff Counsel