

**STATE BOARD OF EQUALIZATION**

1020 N STREET, SACRAMENTO, CALIFORNIA
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)
(916) 445-6493

June 2, 1989

Mr. S--- C. H---
M--- - S---, Inc.
XX --- Avenue, Suite XX
---, California XXXXX

M--- - S---, Inc. – SR --H XX-XXXXXX
Software licenses – measure of tax

Dear Mr. H---:

Your February 24, 1989 letter to Mr. Cornelio Gomez, Return Review Unit, was referred to the legal staff for reply regarding the questions you raise in the last paragraph of that letter. You wrote:

“As for the 3rd quarter 1988, the difference of \$2400 relates to one invoice of which I felt that the client paid additional taxes in error. In April of 1986, they purchased a software license for \$40,000 plus \$2,400 of sales tax. Then in August of 1988, they moved the software license to a bigger computer for an additional cost of \$18,000. However they paid us tax on \$58,000 (\$40,000 plus \$18,000). They were treating it as if the original purchase was a lease and not a purchase. Since they had already paid tax on the \$40,000, I felt they were being taxed twice, yet they paid us an additional \$2,400 of tax for the upgrade. Please give us a rendering as to the proper way of handling this situation for now and in the future. Also, we allow customers that lease our software license a 50% credit of the lease payments towards the purchase price of the product. Are we supposed to charge them tax on the list price or the net price (list price less credit amount)?”

Opinion

Under the Sales and Use Tax Law, a "sale" means the transfer of title to tangible personal property for a consideration. The measure of the tax is the gross receipts paid by the purchaser to the retailer for the tangible property transferred. (Revenue and Taxation Code Sections 6006(a), 6012). A "lease" means the transfer of possession (but not title) of tangible property for a consideration. If a lease is subject to tax under the Sales and Use Tax Law as a continuing sale or purchase, the measure of the tax is the rental receipts paid by the lessee for the right to use the property. A "license" is included within the definition of a lease. (Revenue and Taxation Code Sections 6006, 6006.1, 6006.3, 6011; Regulation 1660.)

As applied to computer programs, if a retailer transfers title to the storage media (tape or disk) on which the program is encoded, together with a license to use that program, this constitutes a sale, not a lease, of the program. The gross receipts from this sale are the measure of tax, whether received in a lump sum or in periodic payments, and the tax is due in the quarter in which the sale occurs, regardless of when the payments will be received. By contrast, if a retailer transfers the possession of, but not the title to, the storage media on which the program is encoded together with a license to use the program, and at the termination of the license, the licensee is obligated to return or destroy the tape or disk, then the transaction is regarded as a lease, and if it is subject to tax as a continuing sale or purchase, the measure of the tax is the license fees paid by the licensee in periodic payments to the licensor. The tax is due in the quarter in which each license fee become due and payable. (Regulation 1660).

Although we cannot be sure from the facts you relate in your letter, we assume that you engage in both types of transactions involving computer products. With respect to your first question, regarding your client's overpayment of sales tax, the measure of the tax is the same regardless of whether or not your transaction with your client is regarded as a sale or a lease. In either case, it appears to us that your client did in fact overpay sales tax when it paid to you an additional consideration of \$18,000 for the license to use the software on a bigger computer, but paid you tax reimbursement measured by \$58,000, rather than \$18,000. Whether a transaction is a sale or lease, the measure of the tax is the entire consideration paid, and a purchaser or a lessee is not required to pay sales tax reimbursement or use tax on amounts not actually paid to the retailer. Thus, since it appears to us that your client first paid you \$40,000 for the purchase price of the program, and then at a later date paid you \$18,000 as additional consideration for this sale, the proper measure of tax is \$58,000, not 98,000. You are therefore correct in your view that the client has overpaid sales tax reimbursement for the additional charges for the software license.

With respect to your second question, both the measure of the sales tax and the measure of the use tax exclude from the amounts subject to tax "cash discounts allowed and taken on sales." (Revenue and Taxation Code Sections 6011(c)(1), 6012(c)(1). The measure of the tax is the actual sales price of the property sold, not the amount it is listed for. Therefore, you should not charge sales tax reimbursement to your customers on the amount represented by the 50% credit for the previously paid lease payments which you subtract from the purchase price of the software.

Mr. S--- C. H---

-3-

June 2, 1989
295.1012

Please feel free to contact me if you have any further questions or comments about this letter.

Sincerely,

John Abbott
Senior Tax Counsel

JA:cl