

Riverside County

Sales Tax Training & Software Taxability Overview June 2011 – MAM Meeting



Presented by:

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Topics of Discussion



- Overview of Sales and Use Tax
- Taxability of Common Purchases
- Software Discussion
- Software Taxability Reference Guide

General Overview - Sales & Use Tax

- Consumption based excise tax
- Applies to tangible personal property (TPP)
- Transaction based
 - Sale – revenues generated by the County's sales of TPP
 - Consumption – purchases of TPP used for County operations
- Presumption – all sales of TPP are subject to tax unless specifically exempted (GUILTY until proven *innocent*)

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Reporting Responsibilities

- County as consumer of TPP
 - Applies to purchase and use of property in California
 - Sales Tax - Reimburse vendor for tax they pay to State
 - CA vendors (inform them if no tax billed)
 - There is no general exemption for County Governments
 - Use Tax - Pay use tax to directly to state for non-California vendors
 - Some non-California based sellers may be registered to collect tax. In such situations, pay tax to vendor and treat as a CA vendor
- County as seller of TPP
 - County primarily provides services – Not Taxable
 - There are some activities that result in TPP being sold
 - Charge and collect sales tax on sales of TPP
 - Update proper reporting department when TPP sold

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Discussion of Application of Sales Tax for Common Purchases Made by County Governments

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Labor Charges

- Professional fees and Services unrelated to the sale of TPP are exempt
 - Consulting, legal, research, etc.
- Services related to the sale of TPP
 - **Exempt**
 - **Repair** – charges for restoring tangible personal property to its original condition
 - **Installation** – charges for labor or services used in installing or applying the property sold
 - Does not have to be separately stated
 - **Taxable**
 - **Fabrication** – labor which changes the identity of the tangible personal property from one form to another
 - **Assembly** – assembly charges for new products

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Leases

- Leases (“continuing sale or purchase”)
 - Rental, hire or license for tangible property
 - Nominal buyout option – Lesser of one percent or \$100
 - If nominal option, contract will be treated as an outright sale and **not as a lease**.
- Application of Tax
 - Default: Tax due on each rental payment
 - Election: **Lessor** can elect to pay tax on the original purchase price of the leased property. Thereafter, no tax is due on rental payments.

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Leases (continued)

- Election Specifics
 - Irrevocable
 - Must occur in first reporting period after placing the property in rental inventory
- Compliance issues
 - State Board of Equalization audit policy looks to the Lessor for compliance
 - Lessee has limited visibility to payment of tax on original purchase by Lessor (per invoices)
- Exclusions:
 - Use of property less than 24 hours & \$20 with restricted use; linens with laundry services; motion picture films or video tapes; household furnishing with living quarters; mobile transportation equipment (Lessor owes tax on its use); and
- Tax-paid property in substantially the same form.

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Construction Contracts

- Contractor provides materials, fixtures and occasionally equipment under their contracts
- All contractors have a presence in CA and are obligated to properly administer the tax
 - **ERS's experience shows that most use tax accruals for construction contracts result in overpayments**
- Contractors may or may not charge tax on invoice
 - As consumers, contractors generally pay tax on their purchase of materials and fixtures installed and do not bill sales or use tax.
 - As retailers, contractors generally will collect tax on equipment sales
- NOTE: Separately stated materials are not taxable sales

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Transportation

- Actual shipping cost of common carrier is exempt from sales or use tax
- Shipping provided by retailers vehicle are taxable if item purchased is taxable (if exempt sale, no tax on related shipping)
- Shipping and handling combined charges
 - Many vendors charge shipping and handling
 - Only the actual shipping costs by common carrier are exempt*
 - Handling charges are taxable if items purchased are subject to tax

* Determining the actual shipping cost may be difficult and time consuming. An alternative is to use an estimated shipping and handling percentage to determine a taxable handling amount.

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Other Exemptions

- Subscriptions – publications issued more than 4 times and less than 60 times a year are exempt
- Purchases from the U.S. Government and its instrumentalities are exempt

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Software Purchases Overview

- Two main considerations that impact taxability of software
 - Type of Software
 - How is was received from seller



Software Purchases Overview

- Type of Software
 - Custom Program – Always exempt from tax
 - Designed for specific single user at their instruction
 - Canned software is treated as custom if more than 50% of cost is directly related to new programming charges (partially taxable if less than 50%)
 - Canned
 - Off the shelf software, or
 - Additional copy of custom software sold to unrelated party

Software Purchases Overview

- Method of delivery – Canned Software
 - Tangible Property – CD, disk or other physical media provided to customer that includes software – TAXABLE
 - Dongles – Required use equates to tangible media - TAXABLE
 - Electronic Delivery – Software is delivered via electronic means (downloaded via internet or phone lines) - EXEMPT
 - Application Service Provider “CLOUD” – Software provided/hosted over internet or network - EXEMPT
 - Load and Leave – Software is loaded by vendor, who then takes the physical media and never leaves it with customer – EXEMPT
 - Customer never has possession or control over physical media

Please note – manuals printed or provided via physical media do not change the taxability of software



Software Purchases Overview

- Software licenses are taxable unless **YOU** can prove exempt delivery with documentation and support
 - “PRESUMED GUILTY”
- Taxability of renewals and additional site licenses **FOLLOW** the original software sale
 - New contracts and software delivery can be established (must be proactive)

Software Maintenance Overview

- Mandatory vs. Optional
 - Mandatory
 - Mandatory software maintenance follows taxability of original software purchase
 - Optional
 - Updates/enhancements delivered via physical media - 50% Taxable
 - Updates/enhancements sent electronically - Exempt



Documentation of Delivery

- Documentation of software delivery often is not considered important until sales tax audit –
- “Of course we received the software electronically” but...
 - Audits generally are 3 to 5 years olds – old documents are difficult to locate
 - States are aggressively pursuing audit dollars in this area as potential liability can be very high
 - Proving a negative can be difficult – evidence needs to be provided that no physical media was delivered

Documentation of Delivery

- Document delivery of transaction at the time of the transaction or the knowledge and resources may be **LOST** when needed for audit support
- Be proactive, **your budget dollars are in jeopardy...**
 - Document delivery method in contract and purchase order
 - Work with vendor to ensure language/terms are consistent
 - Havel actual deliver terms stated in language of contract and PO
 - Invoicing
 - Don't pay invoice unless delivery terms are stated on invoices – **Check with Management first on this approach!**
 - Often vendor **invoices have default shipping terms** that indicate something was shipped even though delivery was electronic

Documentation of Software Delivery

- Document delivery **at the time the software is actually received**
 - Person who receives software should develop protocols for saving print screens or emails at the time the software is downloaded via internet – **HAVE PROOF**
 - Develop “Certificate of Electronic Delivery” signed by both parties

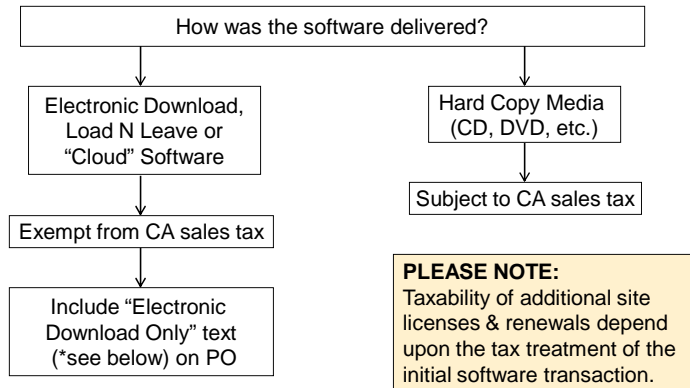


Planning Transactions

- Develop an organizational policy that incorporates the following:
 - Receive software in electronic form, unless not practical
 - **GET HELP** for major dollar purchases
 - Request vendor to separate bundled software and services, or **ALL** could be taxable
 - Incorporate language into contracts, PO and Vendor Invoice to detail software delivery
 - Work with seller to make decisions on transaction



SOFTWARE TAXABILITY REFERENCE GUIDE



****“ELECTRONIC DOWNLOAD ONLY” TEXT FOR CONTRACTS, POs AND INVOICES:**

“All software sold under this agreement are delivered via electronic download only. No tangible media of software programming language will be available or shipped under this agreement at any time. Access to the products purchased under this agreement is in no way dependent upon any tangible media that may have been received prior to, or separately from this agreement.

To support the California Sales and Use tax exempt status of electronically downloaded software based on California Regulation 1502(f)(1)(D), vendor invoices for all purchases made under this agreement must accurately reflect that distribution is solely via electronic download and that no tangible media or documentation will be shipped or received.”

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