Regulation 1502, *Computers, Programs, and Data Processing*

Complete Rule Making File

OAL Approval

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State of California
Office of Administrative Law

In re: **Board of Equalization**	**NOTICE OF APPROVAL OF REGULATORY ACTION**
Regulatory Action:	**Government Code Section 11349.3**
Title 18, California Code of Regulations	**OAL File No. 2009-0403-04 S**
Adopt sections: **Amend sections: 1502** **Repeal sections:**	

Board of Equalization proposed this action to amend the definition of a computer "program" in title 18, California Code of Regulations, sec. 1502(b)(10) in order to clarify and make the regulatory definition consistent with related statutory definitions in Revenue and Taxation Code section 6010.9(c) and (d).

OAL approves this regulatory action pursuant to section 11349.3 of the Government Code. This regulatory action becomes effective on 6/11/2009.

Date: 5/12/2009

Richard L. Smith

Richard L. Smith
Staff Counsel

For: SUSAN LAPSLEY
Director

Original: Ramon Hirsig
Copy: Richard Bennion

RECEIVED
MAY 13 2009
Board Proceedings

STATE OF CALIFORNIA ARNOLD SCHWARZENEGGER, Governor

OFFICE OF ADMINISTRATIVE LAW
300 Capitol Mall, Suite 1250
Sacramento, CA 95814
(916) 323-6225 FAX (916) 323-6826

SUSAN LAPSLEY
Director

MEMORANDUM

TO: Richard Bennion
FROM: OAL Front Desk LW
DATE: 5/14/2009
RE: Return of Approved Rulemaking Materials
OAL File No. 2009-0403-04S

OAL hereby returns this file your agency submitted for our review (OAL File No. 2009-0403-04S regarding Computers, Programs, and Data Processing).

If this is an approved file, it contains a copy of the regulation(s) stamped "ENDORSED APPROVED" by the Office of Administrative Law and "ENDORSED FILED" by the Secretary of State. The effective date of an approved file is specified on the Form 400 (see item B.5). (Please Note: The 30th Day after filing with the Secretary of State is calculated from the date the Form 400 was stamped "ENDORSED FILED" by the Secretary of State.)

DO NOT DISCARD OR DESTROY THIS FILE

Due to its legal significance, you are required by law to preserve this rulemaking record. Government Code section 11347.3(d) requires that this record be available to the public and to the courts for possible later review. Government Code section 11347.3(e) further provides that "....no item contained in the file shall be removed, altered, or destroyed or otherwise disposed of." See also the Records Management Act (Government Code section 14740 et seq.) and the State Administrative Manual (SAM) section 1600 et seq.) regarding retention of your records.

If you decide not to keep the rulemaking records at your agency/office or at the State Records Center, you may transmit it to the State Archives with instructions that the Secretary of State shall not remove, alter, or destroy or otherwise dispose of any item contained in the file. See Government Code section 11347.3(f).

Enclosures

STATE OF CALIFORNIA–OFFICE OF ADMINISTRATIVE LAW

NOTICE PUBLICATION/REGULATIONS SUBMISSION

REGULAR

(See instructions on reverse)

For use by Secretary of State only

STD. 400 (REV. 01-09)

OAL FILE NUMBERS	NOTICE FILE NUMBER	REGULATORY ACTION NUMBER	EMERGENCY NUMBER
	Z-2009-0113-01	2009-0403-04S	

For use by Office of Administrative Law (OAL) only

ENDORSED FILED IN THE OFFICE OF

2009 MAY 12 PM 1:47

Debra Bowen

DEBRA BOWEN
SECRETARY OF STATE

NOTICE | REGULATIONS

AGENCY WITH RULEMAKING AUTHORITY
State Board of Equalization

AGENCY FILE NUMBER (If any)

A. PUBLICATION OF NOTICE (Complete for publication in Notice Register)

1. SUBJECT OF NOTICE	TITLE(S)	FIRST SECTION AFFECTED	2. REQUESTED PUBLICATION DATE

3. NOTICE TYPE	4. AGENCY CONTACT PERSON	TELEPHONE NUMBER	FAX NUMBER (Optional)
☐ Notice re Proposed Regulatory Action ☐ Other			

OAL USE ONLY	ACTION ON PROPOSED NOTICE	NOTICE REGISTER NUMBER	PUBLICATION DATE
	☐ Approved as Submitted ☐ Approved as Modified ☐ Disapproved/ Withdrawn	09-#4-Z	1-23-2009

B. SUBMISSION OF REGULATIONS (Complete when submitting regulations)

1a. SUBJECT OF REGULATION(S)
Computers, Programs, and Data Processing

1b. ALL PREVIOUS RELATED OAL REGULATORY ACTION NUMBER(S)

SPECIFY CALIFORNIA CODE OF REGULATIONS TITLE(S) AND SECTION(S) **(Including title 26, if toxics related)**

SECTION(S) AFFECTED (List all section number(s) individually. Attach additional sheet if needed.)

ADOPT

AMEND
1502

REPEAL

TITLE(S)
18

3. TYPE OF FILING

- ☒ Regular Rulemaking (Gov. Code §11346)
- ☐ Resubmittal of disapproved or withdrawn nonemergency filing (Gov. Code §§11349.3, 11349.4)
- ☐ Emergency (Gov. Code, §11346.1(b))
- ☐ Certificate of Compliance: The agency officer named below certifies that this agency complied with the provisions of Gov. Code §§11346.2-11347.3 either before the emergency regulation was adopted or within the time period required by statute.
- ☐ Resubmittal of disapproved or withdrawn emergency filing (Gov. Code, §11346.1)
- ☐ Emergency Readopt (Gov. Code, §11346.1(h))
- ☐ File & Print
- ☐ Other (Specify) _____
- ☐ Changes Without Regulatory Effect (Cal. Code Regs., title 1, §100)
- ☐ Print Only

4. ALL BEGINNING AND ENDING DATES OF AVAILABILITY OF MODIFIED REGULATIONS AND/OR MATERIAL ADDED TO THE RULEMAKING FILE (Cal. Code Regs. title 1, §44 and Gov. Code §11347.1)

5. EFFECTIVE DATE OF CHANGES (Gov. Code, §§ 11343.4, 11346.1(d); Cal. Code Regs., title 1, §100)

- ☒ Effective 30th day after filing with Secretary of State
- ☐ Effective on filing with Secretary of State
- ☐ §100 Changes Without Regulatory Effect
- ☐ Effective other (Specify) _____

6. CHECK IF THESE REGULATIONS REQUIRE NOTICE TO, OR REVIEW, CONSULTATION, APPROVAL OR CONCURRENCE BY, ANOTHER AGENCY OR ENTITY

- ☐ Department of Finance (Form STD. 399) (SAM §6660)
- ☐ Fair Political Practices Commission
- ☐ State Fire Marshal
- ☐ Other (Specify) _____

7. CONTACT PERSON	TELEPHONE NUMBER	FAX NUMBER (Optional)	E-MAIL ADDRESS (Optional)
Richard E. Bennion	(916) 445-2130	(916) 324-3984	rbennion@boe.ca.gov

8. **I certify that the attached copy of the regulation(s) is a true and correct copy of the regulation(s) identified on this form, that the information specified on this form is true and correct, and that I am the head of the agency taking this action, or a designee of the head of the agency, and am authorized to make this certification.**

SIGNATURE OF AGENCY HEAD OR DESIGNEE: Diane G. Olson

DATE: 4/3/09

TYPED NAME AND TITLE OF SIGNATORY
Diane G. Olson, Chief, Board Proceedings Division

For use by Office of Administrative Law (OAL) only

ENDORSED APPROVED

MAY 12 2009

Office of Administrative Law

Regulation 1502. Computers, Programs, and Data Processing.

(a) IN GENERAL. "Automatic data processing services" are those rendered in performing all or part of a series of data processing operations through an interacting assembly of procedures, processes, methods, personnel, and computers.

Automatic data processing services may be provided by manufacturers of computers, data processing centers, systems designers, consultants, software companies, etc. In addition, there are banks and other businesses which own or lease computers and use them primarily for their own purposes but occasionally provide services to others. Businesses rendering automatic data processing services will be referred to herein as "data processing firms."

(b) DEFINITIONS OF TERMS.

(1) APPLICATION. The specific job performance by an automatic data processing installation. For example, data processing for a payroll may be referred to as a payroll application.

(2) CODING. The list, in computer code, of the successive computer instructions representing successive computer operations for solving a specific problem.

(3) COMPUTER. A computer is an electronic device (including word processing equipment and testing equipment) or combination of components, which is programmable and which includes a processor (central processing unit or microprocessor), internal memory, and input and output connections. Manufacturing equipment which incorporates a computer is a computer for purposes of this regulation. However, the term does not include manufacturing equipment which operates under the control of mechanical or electronic accessories, the attachment of the equipment of which is required for the machine to operate. An electronic device otherwise qualifying as a computer remains a computer even though it may be used for information processing, data acquisition, process control, or for the control of manufacturing machinery or equipment.

(4) CUSTOM COMPUTER PROGRAM AND PROGRAMMING. A computer program prepared to the special order of the customer. A program prepared to the special order of the customer qualifies as a custom program even though it may incorporate preexisting routines, utilities, or similar program components. It includes those services represented by separately stated charges for modifications to an existing prewritten program which are prepared to the special order of the customer.

(5) DATA ENTRY (INCLUDING ENCODING). Recording information in or on storage media by punching holes or inserting magnetic bits to represent letters, digits, and special characters.

(6) DIGITAL PRE-PRESS INSTRUCTION. The creation of original information in electronic form by combining more than one computer program into specific instructions or information necessary to prepare and link files for electronic transmission for output, within the printing industry, to film, plate, or direct to press, which is then transferred on electronic media such as tape or compact disc.

(7) INPUT. The information or data transferred, or to be transferred, from storage media into the internal storage of the computer.

(8) OUTPUT. The information transferred from the internal storage of the computer to storage media or tabulated listing.

(9) PREWRITTEN PROGRAM. A program held or existing for general or repeated sale or lease. The term also includes a program developed for in-house use which is subsequently offered for sale or lease as a product.

(10) PROGRAM. "Program" is the complete plan for the solution of a problem, i.e., the complete sequence of automatic data processing equipment instructions necessary to solve a problem, and includes both systems and application programs and subdivisions thereof. "Subdivision" includes, without limitation, assemblers, compilers, generators, procedures, functions, routines, and utility programs. "Problem" means

and includes any problem that may be addressed or resolved by a program or subdivision; and the "problem" addressed need not constitute the full array of a purchaser's or user's problems, requirements, and desired features. "Problem" further includes, without limitation, any problem associated with: information processing; the manipulation or storage of data; the input or output of data; the transfer of data or programs, including subdivisions; the translation of programs, including subdivisions, into machine code; defining procedures, functions, or routines; executing programs or subdivisions that may be invoked within a program; and the control of equipment, mechanisms, or special purpose hardware.~~The complete plan for the solution of a problem, i.e., the complete sequence of automatic data processing equipment instructions necessary to solve a problem; includes both systems and application programs and subdivisions such as assemblers, compilers, routines, generators, and utility programs.~~

(11) PROOF LISTING. A tabulated listing of input.

(12) SOURCE DOCUMENTS. A document supplied by a customer of a data processing firm from which basic data are extracted (e.g., sales invoice).

(13) STORAGE MEDIA. Includes hard disks, floppy disks, diskettes, magnetic tape, cards, paper tape, drums and other devices upon which information is recorded.

(c) BASIC APPLICATIONS OF TAX.

(1) The transfer of title, for a consideration, of tangible personal property, including property on which or into which information has been recorded or incorporated, is a sale subject to tax.

(2) Charges for producing, fabricating, processing, printing, imprinting, or otherwise physically altering, modifying or treating consumer-furnished tangible personal property (cards, tapes, disks, etc.), including charges for recording or otherwise incorporating information on or into such tangible personal property, are generally subject to tax.

(3) A transfer for a consideration of the title or possession of tangible personal property which has been produced, fabricated, or printed to the special order of the customer, including property on which or into which information has been recorded or incorporated, is generally a sale subject to tax. However, if the contract is for the service of researching and developing original information for a customer, tax does not apply to the charges for the service. The tangible personal property used to transmit the original information is merely incidental to the service.

(4) Charges for the transfer of computer-generated output are subject to tax where the true object of the contract is the output and not the services rendered in producing the output. Examples include artwork, graphics, and designs. However, the transfer by the seller of the original information created by digital pre-press instruction is not subject to tax if the original information is a custom computer program as explained in subdivision (f)(2)(F).

(5) Charges for processing customer-furnished information (sales data, payroll data, etc.) are generally not subject to tax. (For explanation and specific application of tax, see subdivision (d).)

(6) Leases of tangible personal property may be subject to tax under certain conditions. (See Regulation 1660 for application of tax to leases.)

(7) Charges made for the use of a computer, on a time-sharing basis, where access to the computer is by means of remote telecommunication are not subject to tax. (See subdivision (i).)

(8) Generally data processing firms are consumers of all tangible personal property, including cards and forms, which they use in providing nontaxable services unless a separate charge is made to customers for the materials, in which case tax applies to the charge made for the materials.

(d) MANIPULATION OF CUSTOMER-FURNISHED INFORMATION AS SALE OR SERVICE.

(1) GENERAL. Generally tax applies to the conversion of customer-furnished data from one physical form of recordation to another physical form of recordation. However, if the contract is for the service of

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developing original information from customer-furnished data, tax does not apply to the charges for the service. The tangible personal property used to transmit the original information is merely incidental to the service.

(2) DATA ENTRY AND VERIFICATION. This covers situations where a data processing firm's agreement provides only for data entry, data verification, and proof listing of data, or any combination of these operations. It does not include contracts under which these services are performed as steps in processing of customer-furnished information as discussed under subdivision (d)(5).

Agreements providing solely for data entry and verification, or data entry, providing a proof list and/or verifying of data are regarded as contracts for the fabrication of storage media and sales of proof lists. Charges therefore are taxable, whether the storage media are furnished by the customer or by the data processing firm.

Tax also applies to charges for the imprinting of characters on a document to be used as the input medium in an optical character recognition system. The tax application is the same regardless of which type of storage media is used in the operation.

(3) ADDRESSING (INCLUDING LABELS) FOR MAILING. Where the data processing firm addresses, through the use of its computer or otherwise, material to be mailed, with names and addresses furnished by the customer or maintained by the data processing firm for the customer, tax does not apply to the charge for addressing. Similarly, where the data processing firm prepares, through the use of its computer or otherwise, labels to be affixed to material to be mailed, with names and addresses furnished by the customer or maintained by the data processing firm for the customer, tax does not apply to the charge for producing the labels, whether or not the data processing firm itself affixes the labels to the material to be mailed. (For the sale of mailing list by the proprietor of such list, as a sale of tangible personal property or as a nontaxable addressing, see Regulation 1504 "Mailing Services.")

(4) MICROFILMING AND PHOTORECORDING. Tax applies to charges for microfilming or photo recording except, as provided in subdivision (d)(5), where the microfilming or photo recording is done under a contract for the processing of customer-furnished information. Tax applies to a contract where data on magnetic tape are converted into combinations of alphanumeric printing, curve plotting and/or line drawings, and put on microfilm or photo recording paper.

(5) PROCESSING OF CUSTOMER-FURNISHED INFORMATION.

(A) "Processing of customer-furnished information" means the developing of original information from data furnished by the customer. Examples of automatic data processing processes which result in original information are summarizing, computing, extracting, sorting, and sequencing. Such processes also include the updating of a continuous file of information maintained by the customer with the data processing firm.

(B) "Processing of customer-furnished information" does not include: (1) an agreement providing solely for the reformatting of data or for the preparation of a proof listing or the performance of an edit routine or other pre-processing, (2) the using of a computer as a mere printing instrument, as in the preparation of personalized computer-printed letters, (3) the mere converting of data from one medium to another, (4) an agreement under which a person undertakes to prepare artwork, drawings, illustrations, or other graphic material unless the provisions of subdivision (f)(2)(F) apply regarding digital pre-press instruction and custom computer programs. Additionally, graphic material furnished incidentally to the performance of a service is not subject to tax. For example, graphics furnished in connection with the performance of architectural, engineering, accounting, or similar professional services are not subject to tax. With respect to typography, clip art combined with text on the same page is considered composed type as explained in Regulation 1541.

(C) Contracts for the processing of customer-furnished information usually provide that the data processing firm will receive the customer's source documents, record data on storage media, make necessary corrections, process the information, and then record and transfer the output to the customer.

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Where a data processing firm enters into a contract for the processing of customer-furnished information, the transfer of the original information to the customer is considered to be the rendering of a service. Except as described in subdivisions (c)(8) and (d)(5)(E), tax does not apply to the charges made under contracts providing for the transfer of the original information whether the original information is transferred on storage media, microfilm, microfiche, photo recording paper, input media for an optical character recognition system, punched cards, preprinted forms, or tabulated listing. The breakdown of the total charge into separate charges for each operation involved in processing the customer-furnished information will not change the application of tax.

(D) The furnishing of computer programs and data by the customer for processing under direction and control of the data processing firm will not alter the application of tax, notwithstanding that charges are based on computer time.

(E) Taxable Items. Where a data processing firm has entered into a contract which is regarded as a service contract under subdivision (d)(5)(C) and the data processing firm, pursuant to the contract, transfers to its customer tangible property other than property containing the original information, such as: duplicate copies of storage media; inventory control cards for use by the customer; membership cards for distribution by the customer; labels (other than address labels); microfiche duplicates; or similar items for use, tax applies to the charges made for such items. If no separate charge is made, tax applies to that portion of the charge made by the data processing firm which the cost of the additional computer time (if any), cost of materials, and labor cost to produce the items bear to the total job cost.

(F) Additional Copies. When additional copies of records, reports, tabulation, etc., are provided, tax applies to the charges made for the additional copies. "Additional copies" are all copies (other than carbon copies), whether the copies are prepared by rerunning the same program, by using multiple simultaneous printers, by looping a program such that the program is run continuously, by using different programs to produce the same output product, or by other means. Where additional copies are prepared the tax will be measured by the charge made by the data processing firm to the customer. If no separate charge is made for the additional copies, tax applies to that portion of the gross receipts which the cost of the additional computer time (if any), the cost of materials and labor cost to produce the additional copies bear to the total job cost. Charges for copies produced by means of photocopying, multi-lithing, or by other means are subject to tax.

(e) TRAINING SERVICES AND MATERIALS. Data processing firms provide a number of training services, such as data entry and verification, programming, and specialized training in systems design.

(1) Charges for training services are nontaxable, except as provided in subdivision (g) where the training services are provided as part of the sale of tangible personal property. The data processing firm is the consumer of tangible personal property which is used in training others, or provided to trainees without a separate charge as a part of the training services.

(2) Tax applies to charges for training materials, including books, furnished to trainees for a charge separate from the charge for training services.

(3) Where a person sells tangible personal property, such as computers or programs, and provides training materials to the customer without making an additional charge for the training materials, this is a sale of the training materials. The selling price of the training materials is considered to be included in the sales price of the tangible personal property.

(f) COMPUTER PROGRAMS.

(1) PREWRITTEN (CANNED) PROGRAMS. Prewritten programs may be transferred to the customer in the form of storage media or by listing the program instructions on coding sheets. In some cases they are usable as written; however, in other cases it is necessary that the program be modified, adapted, and tested to meet the customer's particular needs. Tax applies to the sale or lease of the storage media or coding sheets on which or into which such prewritten (canned) programs have been recorded, coded, or punched.

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(A) Tax applies whether title to the storage media on which the program is recorded, coded, or punched passes to the customer, or the program is recorded, coded, or punched on storage media furnished by the customer. The temporary transfer of possession of a program, for a consideration, for the purpose of direct use or to be recorded or punched by the customer, or by the lessor on the customer's premises, is a lease of tangible personal property. The tax applies unless the property is leased in substantially the same form as acquired by the lessor and the lessor has paid sales tax reimbursement or use tax with respect to the property.

(B) Tax applies to the entire amount charged to the customer. Where the consideration consists of license fees, all license fees, including site licensing and other end users fees, are includable in the measure of tax. Tax does not apply, however, to license fees or royalty payments that are made for the right to reproduce or copy a program to which a federal copyright attaches in order for the program to be published and distributed for a consideration to third parties, even if a tangible copy of the program is transferred concurrently with the granting of such right. Any storage media used to transmit the program is merely incidental.

(C) 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, that is, if the purchaser must purchase the maintenance contract in order to purchase or lease a prewritten computer program, then the charges for the maintenance contract are taxable as part of the sale or lease of the prewritten program. Tax applies to any charge for consultation services provided in connection with a maintenance contract except as provided below.

For reporting periods commencing on or after January 1, 2003, if the purchase of the maintenance contract is optional with the purchaser, that is, if the purchaser may purchase the prewritten software without also purchasing the maintenance contract, and there is a single lump sum charge for the maintenance contract, 50 percent of the lump sum charge for the maintenance contract is for the sale of tangible personal property and tax applies to that amount; the remaining 50 percent of the lump sum charge is nontaxable charges for repair.

If no tangible personal property whatsoever is transferred to the customer during the period of the maintenance contract, tax does not apply to any portion of the charge. Tax does not apply to a separately stated charge for consultation services if the purchaser is not required to purchase those services in order to purchase or lease any tangible personal property, such as a prewritten computer program or a maintenance contract.

(D) The sale or lease of a prewritten program is not a taxable transaction if the program is transferred by remote telecommunications from the seller's place of business, to or through the purchaser's computer, and the purchaser does not obtain possession of any tangible personal property, such as storage media, in the transaction. Likewise, the sale of a prewritten program is not a taxable transaction if the program is installed by the seller on the customer's computer except when the seller transfers title to or possession of storage media or installation of the program is a part of the sale of the computer.

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 purchaser for no additional charge. If a separate charge is made for the documentation or manuals, then tax applies to the separate charge.

(E) The transfer of a prewritten program on storage media is not a sale for resale when the storage media, or an exact copy, will be used to produce additional copies of the program. Charges for testing a prewritten program on the purchaser's computer to insure that such a program operates as required are installation charges and are nontaxable.

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(2) CUSTOM PROGRAMS

(A) Tax does not apply to the sale or lease of a custom computer program, other than a basic operational program, regardless of the form in which the program is transferred. Nor does the tax apply to the transfer of a custom program, or custom programming services performed, in connection with the sale or lease of computer equipment, whether or not the charges for the custom program or programming are separately stated.

(B) However, charges for custom modifications to prewritten programs are nontaxable only if the charges for the modifications are separately stated. Otherwise, the charges are taxable as part of the sale of the prewritten program.

When the charges for modification of a prewritten program are not separately stated, tax applies to the entire charge made to the customer for the modified program unless the modification is so significant that the new program qualifies as a custom program. If the prewritten program was previously marketed, the new program will qualify as a custom program, if the price of the prewritten program was 50 percent or less of the price of the new program. If the prewritten program was not previously marketed, the new program will qualify as a custom program if the charge made to the customer for custom programming services, as evidenced in the records of the seller, is more than 50 percent of the contract price to the customer.

(C) Charges for any written documentation or manuals designed to facilitate the use of a custom computer program by the customer are nontaxable, whether separately stated or not. The vendor of the custom computer program is the consumer of the written documentation or manuals, or of any tangible personal property used by the vendor in producing the written documentation or manuals.

(D) A custom computer program includes a program prepared to the special order of a customer who will use the program to produce and sell or lease copies of the program, and the charge for such custom computer program is not subject to tax. Sales or leases of the copies, however, are taxable as sales of prewritten computer programs.

(E) A computer program prepared to the special order of a customer to operate for the first time in connection with a particular basic operating system is a custom computer program even though a different version currently operates in connection with an incompatible basic operating system.

(F) Digital pre-press instruction is a custom computer program under section 6010.9 of the Revenue and Taxation Code, the sale of which is not subject to tax, provided the digital pre-press instruction is prepared to the special order of the purchaser. Digital pre-press instruction shall not, however, be regarded as a custom computer program if it is a "canned" or prewritten computer program which is held or existing for general or repeated sale or lease, even if the digital pre-press instruction was initially developed on a custom basis or for in-house use. The sale of such canned or prewritten digital pre-press instruction in tangible form is a sale of tangible personal property, the retail sale of which is subject to tax.

(g) SERVICE CHARGES. The following activities are service activities. Charges for the performance of such services are nontaxable unless the services are performed as a part of the sale of tangible personal property.

(1) Designing and implementing computer systems (e.g., determining equipment and personnel required and how they will be utilized).

(2) Designing storage and data retrieval systems (e.g., determining what data communications and high-speed input-output terminals are required).

(3) Consulting services (e.g., study of all or part of a data processing system).

(4) Feasibility studies (e.g., studies to determine what benefits would be derived if procedures were automated).

(5) Evaluation of bids (e.g., studies to determine which manufacturer's proposal for computer equipment would be most beneficial).

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(6) Providing technical help, analysts, and programmers, usually on an hourly basis.

(7) Training Services.

(8) Maintenance of equipment. (See Regulation 1546 for application of tax to maintenance contracts.)

(9) Consultation as to use of equipment.

(h) PICK-UP AND DELIVERY CHARGES. If the data processing firm's billing is for nontaxable processing of customer-furnished information, the tax will not apply to pick-up and delivery charges. If pick-up and delivery charges are made in conjunction with the sale of tangible personal property or the processing of customer-furnished tangible personal property, the tax will apply to the pick-up charges. Tax will apply to the delivery charges to the extent specified in Regulation 1628, "Transportation Charges."

(i) RENTAL OF COMPUTERS. A lease includes a contract, by which a person secures for a consideration the use of a computer which is not on his or her premises, if the person or his or her employees, while on the premises where the computer is located operate the computer, or direct and control its operation. A lease does not include a contract whereby a person secures access by means of remote telecommunication to a computer which is not on his or her premises, if the person or his or her employees operate the computer or direct and control its operation by means of remote telecommunication. (See Regulation 1660 for application of tax to leases.)

NOTE: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 995.2, 6006, 6007, 6010, 6010.9, 6011, 6012, 6015, and 6016, Revenue and Taxation Code.

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Petitioner:

Phillip Craigie, V-00757
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Imperial, CA 92251

Agency contact:

Timothy Lockwood, Chief of Regulations & Policy Management Branch
Department of Corrections and Rehabilitation
P.O. BOX 942883
Sacramento, CA 94283-0001

Please note the following timelines:
Publication of Petition in Notice Register: May 22, 2009
Deadline for Public Comments: June 22, 2009
Deadline for Agency Response: July 6, 2009
Deadline for Petitioner Rebuttal: No later than 15 days after receipt of the agency's response
Deadline for OAL Decision: September 21, 2009

The attachments are not being printed for practical reasons or space considerations. However, if you would like to view the attachments please contact Margaret Molina at (916) 324-6044 or mmolina@oal.ca.gov.

SUMMARY OF REGULATORY ACTIONS

REGULATIONS FILED WITH SECRETARY OF STATE

This Summary of Regulatory Actions lists regulations filed with the Secretary of State on the dates indicated. Copies of the regulations may be obtained by contacting the agency or from the Secretary of State, Archives, 1020 O Street, Sacramento, CA 95814, (916) 653-7715. Please have the agency name and the date filed (see below) when making a request.

File# 2009-0409-02
ATHLETIC COMMISSION
Professional Boxer's Pension Plan

This rulemaking amends California Code of Regulations, Title 4 section 406 to reduce the qualifying age of retired professional boxers from 55 to 50 to receive distributions from the pension plan.

Title 4
California Code of Regulations
AMEND: 406
Filed 05/12/2009
Effective 05/12/2009
Agency Contact: Bill Douglas (916) 263-2195

File# 2009-0403-04
BOARD OF EQUALIZATION
Computers, Programs, and Data Processing

Board of Equalization amended the definition of a computer "program" in title 18, California Code of Regulations, sec. 1502(b)(10) in order to clarify and make the regulatory definition consistent with related statutory definitions in Revenue and Taxation Code section 6010.9(c) and (d).

Title 18
California Code of Regulations
AMEND: 1502
Filed 05/12/2009
Effective 06/11/2009
Agency Contact:
Richard Bennion (916) 445-2130

File# 2009-0402-01
CALIFORNIA GAMBLING CONTROL COMMISSION
Designation Pursuant to B&P Code Section 19981, Subdivision (a)

California Gambling Control Commission adopted title 4, California Code of Regulations, section 12591 to designate Commission employees who will be subject to the statutory ban on specified activities, pursuant to Bus. & Prof. Code sec. 19981(a), for three years following separation from employment with the Commission.

Title 4
California Code of Regulations
ADOPT: 12591
Filed 05/12/2009
Effective 06/11/2009
Agency Contact: James Allen (916) 263-4024

File# 2009-0330-01
COMMISSION ON TEACHER CREDENTIALING
Teacher Credentialing

This change without regulatory effect amends or repeals regulations of the Commission in response to statutory changes that changed the name of permits or made certain permits obsolete, or now require the submission of fingerprints via livescan, or removed professional growth and successful service criteria that are no longer required. Additionally, regulations past the date in their sunset provisions were deleted.

Rulemaking File Index

Title 18. Public Revenue

Sales and Use Tax

Regulation 1502, *Computers, Programs, and Data Processing*

1. *Final Statement of Reasons*
2. *Updated Informative Digest*
3. *Chief Counsel Matters, December 17, 2008, Item J4*
   - Chief Counsel Memo
   - Proposed Text of Regulation 1502
4. *Reporter's Transcript Chief Counsel Matters, December 17, 2008,*
5. *Estimate of Cost or Savings, January 9, 2009*
6. *Economic and Fiscal Impact Statements, January 13, 2009*
7. *Notice of Publications*
   - Form 400 submitted to OAL January 13, 2009
   - Notice and Proposed Text of Regulations 1502
   - Email sent to Interested Parties, January 29, 2009
   - CA Regulatory Notice Register 2009, Volume No. 4-Z
8. *Notice to Interested Parties, January 29, 2009*

   The following items are exhibited:

   - Notice of Hearing
   - Initial Statement of Reasons
   - Proposed Text of Regulations 1502
   - Regulation History
9. *Statement of Compliance*
10. *Reporter's Transcript, Item F1, Public Hearing, March 16, 2009*
11. *Minutes, March 16, 2009, and Exhibits*

    The following items are exhibited:

    - Notice of Proposed Regulatory Action
    - Initial Statement of Reasons
    - Proposed Text of Regulation 1502
    - Regulation History

VERIFICATION

I, Richard E. Bennion, Regulations Coordinator of the State Board of Equalization, state that the rulemaking file of which the contents as listed in the index is complete, and that the record was closed on April 2, 2009 and that the attached copy is complete.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

April 2, 2009

Richard E. Bennion
Regulations Coordinator
State Board of Equalization

Title 18, Public Revenue

Sales and Use Tax Regulation 1502, Computers, Programs, and Date Processing

FINAL STATEMENT OF REASONS
Overview/Non-Controlling Summary

Update

Regulation 1502 interprets and explains the Sales and Use Tax Law as it applies to sales of computers and computer programs, including data processing programs. It explains the situations where sales of such property are subject to sales and use tax and where they are not. There have not been any changes to applicable laws or the effect of the proposed amendments to Regulation 1502 described in the Notice of Proposed Regulatory Action. However, there is an additional legal basis for the Board of Equalization's adoption of the proposed amendments, as explained in the Updated Informative Digest.

Specific Purpose

The purpose of the proposed amendments is to interpret, implement, and make specific Revenue and Taxation Code section 6010.9 as it applies to sales and purchases of computer programs.

Necessity

The amendment is necessary to clarify the definition of "computer program" and the application of tax to sales and purchases of computer programs for taxpayers that engage in such transactions.

Factual Basis

Regulation 1502, Computers, Programs, and Data Processing, is proposed to be amended to interpret, implement, and make specific Revenue and Taxation Code section 6010.9. Regulation 1502, in part, provides definitions of various terms used in the regulation. Amendments are proposed to clarify the statutory definition of "computer program." Specifically, the regulatory amendments are necessary to: (1) clarify that: the statutory definition of "computer program" includes subdivisions such as routines and similar programming building blocks, as described in Revenue and Taxation Code section 6010.9, subdivision (c); and (2) further clarify that the term "program" in Regulation 1502 is consistent and in harmony with the definitional and related explanatory provisions pertaining to "computer programs" in Revenue and Taxation Code section 6010.9, subdivision (c), and "custom computer programs" and "existing prewritten programs" in Revenue and Taxation Code section 6010.9, subdivision (d).

The amendments delete the current language in Regulation 1502, subdivision (b)(10), defining "program" and replace it with new language clarifying the statutory definition of "computer program."

Local Mandate Determination

The Board has determined that the proposed amendments do not impose a mandate on local agencies or school districts. Further, the Board has determined that the amendments and regulations will result in no direct or indirect cost or savings to ay State agency, any costs to local agencies or school districts that are required to be reimbursed under Part 7 (commencing with section 17500) of Division 4 of Title 2 of the Government Code or other non-discretionary costs or savings imposed on local agencies, or cost or savings in federal funding to the State of California.

Response to Public Comment

On March 16, 2009, the Board of Equalization held a public hearing on the proposed amendments to Regulation 1502. No one appeared at the public hearing and no written comments were received.

Small Business Impact

The State Board of Equalization has determined that the adoption of the amendments to Regulation 1502 will have no significant statewide adverse economic impact directly affecting small business. The adoption of the proposed amendments to this regulation will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California. The amendments to the regulation as proposed will not be detrimental to California business in competing with businesses in other states. The proposed regulation may affect small business.

Cost Impact on Private Persons or Business

The Board of Equalization is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the amended regulation.

Federal Regulations

Regulation 1502 and the proposed amendments have no comparable federal regulations.

Alternatives Considered

By its motion, the Board of Equalization determined no alternative to amending the regulation would be more effective in carrying out the purpose for which the regulation is proposed or would be as effective and less burdensome to affected private persons than the adopted regulation.

Authority

Section 7051, Revenue and Taxation Code.

Reference

Section 6010.9, Revenue and Taxation Code.

Title 18. Public Revenue

Sales and Use Tax Regulation 1502, Computers, Programs, and Date Processing

UPDATED INFORMATIVE DIGEST

Revenue and Taxation Code section 6010.9, subdivisions (c) and (d), state that:

> (c) "Computer Program" means the complete plan for the solution of a problem, such as the complete sequence of automatic data-processing equipment instructions necessary to solve a problem and includes both systems and application programs and subdivisions, such as assemblers, compilers, routines, generators, and utility programs.
>
> (d) "Custom computer program" means a computer program prepared to the special order of the customer and includes those services represented by separately stated charges for modifications to an existing prewritten program which are prepared to the special order of the customer. The term does not include a "canned" or prewritten computer program which is held or existing for general or repeated sale or lease, even if the prewritten or "canned" program was initially developed on a custom basis or for in-house use. Modification to an existing prewritten program to meet the customer's needs is custom computer programming only to the extent of the modification."

Statutes and regulations should be interpreted logically and consistently. In particular, statutes and regulations should be interpreted so as to be internally consistent. (*California Mfrs. Assn. v. Public Utilities Com.* (1979) 24 Cal.3d 836, 844; *Carrisales v. Department of Corrections* (1999) 21 Cal.4th 1132, 1135.) The phrase "complete plan for the solution of a problem" should be defined broadly enough to encompass all of the different types of "problems" that a program or subdivision of a program, such as an assembler, compiler, routine, generator, or utility program, may be created or used to address or solve. Such software building blocks obviously are created and used to solve numerous and diverse programming problems from both the programmer's and customer's perspective. Considered individually and, in and of themselves, however, such software building blocks, including without limitation subdivisions and routines, may not be capable of fulfilling a specific purchaser's or user's complete and ultimate software needs under all circumstances. Therefore, the Board has concluded that to narrowly define a computer problem as only one that satisfies the full array of a purchaser's software needs in each and every instance would improperly create an internal conflict within the definitional provisions of the statute and regulation because these provisions expressly include such software building blocks as subdivisions and routines within their definition of "program." The proposed regulatory amendment is intended to clarify the statute and regulation to preclude such an impermissibly narrow interpretation, and prevent an internally self-contradictory construction of the definitional provisions set forth in Revenue and Taxation Code section 6010.9.

In addition to the basis for the regulatory action provided in the Initial Statement of Reasons, the Board of Equalization has concluded that the word "problem," as used in subdivision (c) of the statute, refers to any problem that can be solved by a computer program or a subdivision. This

would mean that a sequence of automatic data processing equipment instructions would constitute a "computer program" when the instructions provide the complete solution to any problem that can be solved by a computer program or subdivision.

The Board of Equalization has concluded that narrowly defining the word "problem," as used in subdivision (c) of the statute, so that a sequence of automatic data processing equipment instructions does not constitute a "computer program" until the instructions satisfy the full array of a specific purchaser's software needs in each and every instance would violate the principle of *in pari materia* by ignoring express provisions in subdivision (d) of the same statute.

> Statutes *in pari materia* are those which relate to the same person or thing, or to the same class of persons or things. In the construction of a particular statute, or in the interpretation of any of its provisions, all acts relating to the same subject, or having the same general purpose, should be read in connection with it, as together constituting one law. . . .
>
> [¶] . . . [¶]
>
> And particularly in the construction of statutes relating to revenue and taxation is the rule applicable and invariably invoked upon the theory that all such statutes constitute one law.

(*Old Homestead Bakery, Inc. v. Marsh* (1925) 75 Cal. App. 247, 259-260. See also *Willbarb Petroleum Carriers, Inc. v. Cory* (1989) 208 Cal.App.3d 269, 274; *Lucchesi v. St. Bd. of Equal.* (1934) 137 Cal. App. 478, 482.)

A narrow interpretation of the word "problem," as used in subdivision (c) of the statute, that limits the definition of "computer program" so that it only encompasses programs that meet each and every need of a specific customer would not be in *pari materia* with the express language of subdivision (d) of the same statute. This is because the last sentence of subdivision (d) expressly refers to an "existing pre-written program" and explains that a "[m]odification to an existing prewritten program to meet the customer's needs is custom computer programming only to the extent of the modification." The Legislature would not have used this type of language in subdivision (d) unless the Legislature intended for a pre-written program to constitute a computer program within the meaning of the Sales and Use Tax Law, even when it requires modification to satisfy a specific customer's needs.

Furthermore, "[o]ne of the primary rules of statutory construction is that we must give a provision a reasonable and commonsense interpretation which will result in wise policy consistent with constitutional requirements, rather than with mischief or absurdity." (*Chahine v. St. Bd. of Equal.* (1990) 222 Cal.App.3d 485, 490.) The Board of Equalization has also concluded that narrowly interpreting the word "problem" would improperly and impermissibly lead to an absurdity by entirely excluding some software the statute clearly describes as pre-written programs from the definition of the term "computer program" for sales and use tax purposes.

State of California

Board of Equalization
Legal Department-MIC:83
Office of the Chief Counsel
(916) 445-4380 (8) 485-4380
Fax: (916) 323-3387

Memorandum

To: Honorable Judy Chu, Ph.D., Chair
Honorable Betty T. Yee, Vice Chairwoman
Honorable Bill Leonard
Honorable Michelle Steel
Honorable John Chiang

Date: December 4, 2008

From: Kristine Cazadd
Chief Counsel

Subject: Board Meeting, December 17, 2008 - Chief Counsel Matter ____
Regulation 1502. *Computers, Programs, and Data Processing*

The Legal Department requests that the Board authorize the staff to commence a new rulemaking proceeding by publishing a proposed amendment to Board Sales and Use Tax Regulation 1502, subdivision (b), which adds a new provision that defines the phrase "complete plan for the solution of a problem" as follows:

> **COMPLETE PLAN FOR THE SOLUTION OF A PROBLEM.** Complete plan for the solution of a problem" means a plan for the solution of any problem which a program (or subdivision thereof such as a procedure, function, or routine) may be created or used to address or solve, and need not include or constitute a complete plan for the solution of the full array of a purchaser's problems, requirements, or desired features; and includes, without limitation, any problem associated with: information processing; the manipulation and storage of data; the input and output of data; the transfer of data and programs (including any subdivision thereof such as a procedure, function, or routine); the translation of programs (including any subdivision thereof such as a procedure, function, or routine) into machine code; defining procedures, functions, and routines; executing programs or subdivisions thereof such as procedures, functions, and routines that may be invoked within a program; and the control of equipment, mechanisms, or special purpose hardware.

This language would be added to a new subdivision (b)(3) and the current subdivision (b)(3) would be renumbered as subdivision (b)(4) with subsequent subdivisions being renumbered accordingly. The proposed language will define the phrase "complete plan for the solution of a problem" which is used in current subdivision (b)(10) in defining "program." Subdivision (b)(10) currently provides as follows:

> The complete plan for the solution of a problem, i.e., the complete sequence of automatic data processing equipment instructions necessary to solve a problem; includes both systems

and application programs and subdivisions such as assemblers, compilers, routines, generators, and utility programs.

The purpose for the recommended revision is to more precisely define the phrase "complete plan for the solution of a problem" to clarify that such problems include any problem that a program – including subdivisions and routines per subdivision (b)(10) – may be created or used to address or solve. The regulation is necessary to clarify that the definition for the phrase "complete plan for the solution of a problem" must be consistent with:

(1) Revenue and Taxation Code section 6010.9, subdivision (c) and Board Sales and Use Tax Regulation 1502 (b)(10), which define "computer program" to mean the "complete plan for the solution of a problem, such as the complete sequence of automatic data-processing equipment instructions necessary to solve a problem *and includes both systems and application programs and subdivisions, such as assemblers, compilers, routines, generators, and utility programs*." (Emphasis added.)

Statutes and regulations must be defined logically and consistently. In particular, laws should be interpreted so as to be internally consistent. The phrase "complete plan for the solution of a problem" should be defined broadly enough to encompass all of the different types of "problems" that a program or subdivisions of a program, such as an assembler, compiler, routine, generator, or utility program may be created or used to address or solve. Such software building blocks obviously are created and used to solve numerous and diverse programming problems, even if, in and of themselves, they may not be capable of fulfilling any specific purchaser's complete and ultimate software needs. Therefore, to narrowly define a computer problem as only one that satisfies the full array of a purchaser's software needs in each and every instance would improperly create an internal conflict within the definitional provisions of the statute and regulation because these provisions expressly include such software building blocks as subdivisions and routines within the definition of "program." The proposed regulatory amendment will clarify the statute and regulation to prevent and preclude such an impermissibly narrow interpretation.

(2) Revenue and Taxation Code section 6010.9, subdivision (d), which provides that: "custom computer program" means a computer program prepared to the special order of the customer and includes those services represented by separately stated charges for modifications to an *existing prewritten program which are prepared to the special order of the customer.* The term does not include a "canned" or prewritten computer program which is held or existing for general or repeated sale or lease, *even if the prewritten or ''canned'' program was initially developed on a custom basis or for in-house use Modification to an existing prewritten program to meet the customer's need is custom computer programming only to the extent of the modification.*" (Emphasis added.)

Statutory provisions should be interpreted to be consistent with related statutes. With respect to the above-quoted statutory language, if an existing prewritten program does not "*meet the customer's needs*" and, thus, needs custom "*modification*," then it cannot be said to be capable of fulfilling such customer's complete and ultimate software needs. Nevertheless, the statute expressly deems such prewritten software requiring modification and customization to be "programs." Thus, it is obvious that the Legislature did not mean

to exclude prewritten software that did not fully satisfy each and every need of a customer from the definition of computer program. To do so would, in fact, be absurd. If millions of lines of sophisticated prewritten compiled computer code needed the entry of one data item to be functional for an intended customer's use, is it logical to exclude those millions of lines of code from the definition of a "program," yet define the entry of the one data item by a nonprogrammer as creating a "custom program?"

Therefore, to define a computer program as only one that satisfies the full array of the customer's software needs in each and every instance would improperly create a conflict with section 6010.9, which expressly addresses the sales and use tax consequences of defining a program as either custom or prewritten (or "canned").

Attached to this memorandum is Regulation 1502 incorporating the proposed language, with the new provision underscored.

If you have any questions, please do not hesitate to contact the Litigation Division, Assistant Chief Counsel, Robert W. Lambert at (916) 324-6593.

Approved: _____
Ramon J. Hirsig
Executive Director

KC/ML/gm
ChiefCounsel/Final/ACCMemoRegulation1502
LegalAffairs/Litigation/1BoardMemos/statusclosedandopensession/salesanduse

STATE BOARD OF EQUALIZATION

BOARD APPROVED

At the 12/17/2008 2008 Board Meeting

Diane G. Olson, Chief
Board Proceedings Division

cc: (w/ Attachment)

Mr. Ramon Hirsig	(MIC: 73)
Ms. Randie Henry	(MIC: 43)
Ms. Freda Orendt	(MIC: 47)
Mr. Stephen Rudd	(MIC: 46)
Mr. Joseph D. Young	(MIC: 49)
Mr. Jeffrey McGuire	(MIC: 92)
Ms. Jean Ogrod	(MIC: 82)
Mr. Robert Lambert	(MIC: 82)
Mr. Jefferson D. Vest	(MIC: 85)
Mr. Robert Stipe	(MIC: 82)
Mr. Jeffrey H. Graybill	(MIC: 82)

State of California

BOARD OF EQUALIZATION

SALES AND USE TAX REGULATION

REGULATION 1502. COMPUTERS, PROGRAMS, AND DATA PROCESSING.

Reference: Sections 995.2, 6006, 6007, 6010, 6010.9, 6011, 6012, 6015, and 6016, Revenue and Taxation Code.

(a) IN GENERAL. "Automatic data processing services" are those rendered in performing all or part of a series of data processing operations through an interacting assembly of procedures, processes, methods, personnel, and computers.

Automatic data processing services may be provided by manufacturers of computers, data processing centers, systems designers, consultants, software companies, etc. In addition, there are banks and other businesses which own or lease computers and use them primarily for their own purposes but occasionally provide services to others. Businesses rendering automatic data processing services will be referred to herein as "data processing firms."

(b) DEFINITIONS OF TERMS.

(1) APPLICATION. The specific job performance by an automatic data processing installation. For example, data processing for a payroll may be referred to as a payroll application.

(2) CODING. The list, in computer code, of the successive computer instructions representing successive computer operations for solving a specific problem.

(3) COMPLETE PLAN FOR THE SOLUTION OF A PROBLEM. "Complete plan for the solution of a problem" means a plan for the solution of any problem which a program (or subdivision thereof such as a procedure, function, or routine) may be created or used to address or solve, and need not include or constitute a complete plan for the solution of the full array of a purchaser's problems, requirements, or desired features; and includes, without limitation, any problem associated with: information processing; the manipulation and storage of data; the input and output of data; the transfer of data and programs (including any subdivision thereof such as a procedure, function, or routine); the translation of programs (including any subdivision thereof such as a procedure, function, or routine) into machine code; defining procedures, functions, and routines; executing programs or subdivisions thereof such as procedures, functions, and routines that may be invoked within a program; and the control of equipment, mechanisms, or special purpose hardware.

(4) COMPUTER. A computer is an electronic device (including word processing equipment and testing equipment) or combination of components, which is programmable and which includes a processor (central processing unit or microprocessor), internal memory, and input and output connections. Manufacturing equipment which incorporates a computer is a computer for purposes of this regulation. However, the term does not include manufacturing equipment which operates under the control of mechanical or electronic accessories, the attachment of the equipment of which is required for the machine to operate. An electronic device otherwise qualifying as a computer remains a computer even though it may be used for information processing, data acquisition, process control, or for the control of manufacturing machinery or equipment.

(5) CUSTOM COMPUTER PROGRAM AND PROGRAMMING. A computer program prepared to the special order of the customer. A program prepared to the special order of the customer qualifies as a custom program even though it may incorporate preexisting routines, utilities, or similar program components. It includes those services represented by separately stated charges for modifications to an existing prewritten program which are prepared to the special order of the customer.

(6) DATA ENTRY (INCLUDING ENCODING). Recording information in or on storage media by punching holes or inserting magnetic bits to represent letters, digits, and special characters.

(7) DIGITAL PRE-PRESS INSTRUCTION. The creation of original information in electronic form by combining more than one computer program into specific instructions or information necessary to prepare and link files for electronic transmission for output, within the printing industry, to film, plate, or direct to press, which is then transferred on electronic media such as tape or compact disc.

(8) INPUT. The information or data transferred, or to be transferred, from storage media into the internal storage of the computer.

(9) OUTPUT. The information transferred from the internal storage of the computer to storage media or tabulated listing.

(10) PREWRITTEN PROGRAM. A program held or existing for general or repeated sale or lease. The term also includes a program developed for in-house use which is subsequently offered for sale or lease as a product.

(11) PROGRAM. The complete plan for the solution of a problem, i.e., the complete sequence of automatic data processing equipment instructions necessary to solve a problem; includes both systems and application programs and subdivisions such as assemblers, compilers, routines, generators, and utility programs.

(12) PROOF LISTING. A tabulated listing of input.

(13) SOURCE DOCUMENTS. A document supplied by a customer of a data processing firm from which basic data are extracted (e.g., sales invoice).

(14) STORAGE MEDIA. Includes hard disks, floppy disks, diskettes, magnetic tape, cards, paper tape, drums and other devices upon which information is recorded.

(c) BASIC APPLICATIONS OF TAX.

(1) The transfer of title, for a consideration, of tangible personal property, including property on which or into which information has been recorded or incorporated, is a sale subject to tax.

(2) Charges for producing, fabricating, processing, printing, imprinting, or otherwise physically altering, modifying or treating consumer-furnished tangible personal property (cards, tapes, disks, etc.), including charges for recording or otherwise incorporating information on or into such tangible personal property, are generally subject to tax.

(3) A transfer for a consideration of the title or possession of tangible personal property which has been produced, fabricated, or printed to the special order of the customer, including property on which or into which information has been recorded or incorporated, is generally a sale subject to tax. However, if the contract is for the service of researching and developing original information for a customer, tax does not apply to the charges for the service. The tangible personal property used to transmit the original information is merely incidental to the service.

(4) Charges for the transfer of computer-generated output are subject to tax where the true object of the contract is the output and not the services rendered in producing the output. Examples include artwork, graphics, and designs. However, the transfer by the seller of the original information created by digital pre-press instruction is not subject to tax if the original information is a custom computer program as explained in subdivision (f)(2)(F).

(5) Charges for processing customer-furnished information (sales data, payroll data, etc.) are generally not subject to tax. (For explanation and specific application of tax, see subdivision (d).)

(6) Leases of tangible personal property may be subject to tax under certain conditions. (See Regulation 1660 for application of tax to leases.)

(7) Charges made for the use of a computer, on a time-sharing basis, where access to the computer is by means of remote telecommunication are not subject to tax. (See subdivision (i).)

(8) Generally data processing firms are consumers of all tangible personal property, including cards and forms, which they use in providing nontaxable services unless a separate charge is made to customers for the materials, in which case tax applies to the charge made for the materials.

(d) MANIPULATION OF CUSTOMER-FURNISHED INFORMATION AS SALE OR SERVICE.

(1) GENERAL. Generally tax applies to the conversion of customer-furnished data from one physical form of recordation to another physical form of recordation. However, if the contract is for the service of developing original information from customer-furnished data, tax does not apply to the charges for the service. The tangible personal property used to transmit the original information is merely incidental to the service.

(2) DATA ENTRY AND VERIFICATION. This covers situations where a data processing firm's agreement provides only for data entry, data verification, and proof listing of data, or any combination of these operations. It does not include contracts under which these services are performed as steps in processing of customer-furnished information as discussed under subdivision (d)(5).

Agreements providing solely for data entry and verification, or data entry, providing a proof list and/or verifying of data are regarded as contracts for the fabrication of storage media and sales of proof lists. Charges therefore are taxable, whether the storage media are furnished by the customer or by the data processing firm.

Tax also applies to charges for the imprinting of characters on a document to be used as the input medium in an optical character recognition system. The tax application is the same regardless of which type of storage media is used in the operation.

(3) ADDRESSING (INCLUDING LABELS) FOR MAILING. Where the data processing firm addresses, through the use of its computer or otherwise, material to be mailed, with names and addresses furnished by the customer or maintained by the data processing firm for the customer, tax does not apply to the charge for addressing. Similarly, where the data processing firm prepares, through the use of its computer or otherwise, labels to be affixed to material to be mailed, with names and addresses furnished by the customer or maintained by the data processing firm for the customer, tax does not apply to the charge for producing the labels, whether or not the data processing firm itself affixes the labels to the material to be mailed. (For the sale of mailing list by the proprietor of such list, as a sale of tangible personal property or as a nontaxable addressing, see Regulation 1504 "Mailing Services.")

(4) MICROFILMING AND PHOTORECORDING. Tax applies to charges for microfilming or photo recording except, as provided in subdivision (d)(5), where the microfilming or photo recording is done under a contract for the processing of customer-furnished information. Tax applies to a contract where data on magnetic tape are converted into combinations of alphanumeric printing, curve plotting and/or line drawings, and put on microfilm or photo recording paper.

(5) PROCESSING OF CUSTOMER-FURNISHED INFORMATION.

(A) "Processing of customer-furnished information" means the developing of original information from data furnished by the customer. Examples of automatic data processing processes which result in original information are summarizing, computing, extracting, sorting, and sequencing. Such processes also include the updating of a continuous file of information maintained by the customer with the data processing firm.

(B) "Processing of customer-furnished information" does not include: (1) an agreement providing solely for the reformatting of data or for the preparation of a proof listing or the performance of an edit routine or other pre-processing, (2) the using of a computer as a mere printing instrument, as in the preparation of personalized computer-printed letters, (3) the mere converting of data from one medium to

another, (4) an agreement under which a person undertakes to prepare artwork, drawings, illustrations, or other graphic material unless the provisions of subdivision (f)(2)(F) apply regarding digital pre-press instruction and custom computer programs. Additionally, graphic material furnished incidentally to the performance of a service is not subject to tax. For example, graphics furnished in connection with the performance of architectural, engineering, accounting, or similar professional services are not subject to tax. With respect to typography, clip art combined with text on the same page is considered composed type as explained in Regulation 1541.

(C) Contracts for the processing of customer-furnished information usually provide that the data processing firm will receive the customer's source documents, record data on storage media, make necessary corrections, process the information, and then record and transfer the output to the customer.

Where a data processing firm enters into a contract for the processing of customer-furnished information, the transfer of the original information to the customer is considered to be the rendering of a service. Except as described in subdivisions (c)(8) and (d)(5)(E), tax does not apply to the charges made under contracts providing for the transfer of the original information whether the original information is transferred on storage media, microfilm, microfiche, photo recording paper, input media for an optical character recognition system, punched cards, preprinted forms, or tabulated listing. The breakdown of the total charge into separate charges for each operation involved in processing the customer-furnished information will not change the application of tax.

(D) The furnishing of computer programs and data by the customer for processing under direction and control of the data processing firm will not alter the application of tax, notwithstanding that charges are based on computer time.

(E) Taxable Items. Where a data processing firm has entered into a contract which is regarded as a service contract under subdivision (d)(5)(C) and the data processing firm, pursuant to the contract, transfers to its customer tangible property other than property containing the original information, such as: duplicate copies of storage media; inventory control cards for use by the customer; membership cards for distribution by the customer; labels (other than address labels); microfiche duplicates; or similar items for use, tax applies to the charges made for such items. If no separate charge is made, tax applies to that portion of the charge made by the data processing firm which the cost of the additional computer time (if any), cost of materials, and labor cost to produce the items bear to the total job cost.

(F) Additional Copies. When additional copies of records, reports, tabulation, etc., are provided, tax applies to the charges made for the additional copies. "Additional copies" are all copies (other than carbon copies), whether the copies are prepared by rerunning the same program, by using multiple simultaneous printers, by looping a program such that the program is run continuously, by using different programs to produce the same output product, or by other means. Where additional copies are prepared the tax will be measured by the charge made by the data processing firm to the customer. If no separate charge is made for the additional copies, tax applies to that portion of the gross receipts which the cost of the additional computer time (if any), the cost of materials and labor cost to produce the additional copies bear to the total job cost. Charges for copies produced by means of photocopying, multi-lithing, or by other means are subject to tax.

(e) TRAINING SERVICES AND MATERIALS. Data processing firms provide a number of training services, such as data entry and verification, programming, and specialized training in systems design.

(1) Charges for training services are nontaxable, except as provided in subdivision (g) where the training services are provided as part of the sale of tangible personal property. The data processing firm is the consumer of tangible personal property which is used in training others, or provided to trainees without a separate charge as a part of the training services.

(2) Tax applies to charges for training materials, including books, furnished to trainees for a charge separate from the charge for training services.

(3) Where a person sells tangible personal property, such as computers or programs, and provides training materials to the customer without making an additional charge for the training materials, this is a sale of the training materials. The selling price of the training materials is considered to be included in the sales price of the tangible personal property.

(f) COMPUTER PROGRAMS.

(1) PREWRITTEN (CANNED) PROGRAMS. Prewritten programs may be transferred to the customer in the form of storage media or by listing the program instructions on coding sheets. In some cases they are usable as written; however, in other cases it is necessary that the program be modified, adapted, and tested

to meet the customer's particular needs. Tax applies to the sale or lease of the storage media or coding sheets on which or into which such prewritten (canned) programs have been recorded, coded, or punched.

(A) Tax applies whether title to the storage media on which the program is recorded, coded, or punched passes to the customer, or the program is recorded, coded, or punched on storage media furnished by the customer. The temporary transfer of possession of a program, for a consideration, for the purpose of direct use or to be recorded or punched by the customer, or by the lessor on the customer's premises, is a lease of tangible personal property. The tax applies unless the property is leased in substantially the same form as acquired by the lessor and the lessor has paid sales tax reimbursement or use tax with respect to the property.

(B) Tax applies to the entire amount charged to the customer. Where the consideration consists of license fees, all license fees, including site licensing and other end users fees, are includable in the measure of tax. Tax does not apply, however, to license fees or royalty payments that are made for the right to reproduce or copy a program to which a federal copyright attaches in order for the program to be published and distributed for a consideration to third parties, even if a tangible copy of the program is transferred concurrently with the granting of such right. Any storage media used to transmit the program is merely incidental.

(C) 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, that is, if the purchaser must purchase the maintenance contract in order to purchase or lease a prewritten computer program, then the charges for the maintenance contract are taxable as part of the sale or lease of the prewritten program. Tax applies to any charge for consultation services provided in connection with a maintenance contract except as provided below.

For reporting periods commencing on or after January 1, 2003, if the purchase of the maintenance contract is optional with the purchaser, that is, if the purchaser may purchase the prewritten software without also purchasing the maintenance contract, and there is a single lump sum charge for the maintenance contract, 50 percent of the lump sum charge for the maintenance contract is for the sale of tangible personal property and tax applies to that amount; the remaining 50 percent of the lump sum charge is nontaxable charges for repair.

If no tangible personal property whatsoever is transferred to the customer during the period of the maintenance contract, tax does not apply to any portion of the charge. Tax does not apply to a separately stated charge for consultation services if the purchaser is not required to purchase those services in order to purchase or lease any tangible personal property, such as a prewritten computer program or a maintenance contract.

(D) The sale or lease of a prewritten program is not a taxable transaction if the program is transferred by remote telecommunications from the seller's place of business, to or through the purchaser's computer, and the purchaser does not obtain possession of any tangible personal property, such as storage media, in the transaction. Likewise, the sale of a prewritten program is not a taxable transaction if the program is installed by the seller on the customer's computer except when the seller transfers title to or possession of storage media or installation of the program is a part of the sale of the computer.

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 purchaser for no additional charge. If a separate charge is made for the documentation or manuals, then tax applies to the separate charge.

(E) The transfer of a prewritten program on storage media is not a sale for resale when the storage media, or an exact copy, will be used to produce additional copies of the program. Charges for testing a prewritten program on the purchaser's computer to insure that such a program operates as required are installation charges and are nontaxable.

(2) CUSTOM PROGRAMS

(A) Tax does not apply to the sale or lease of a custom computer program, other than a basic operational program, regardless of the form in which the program is transferred. Nor does the tax apply to the transfer of a custom program, or custom programming services performed, in connection with the sale or lease of computer equipment, whether or not the charges for the custom program or programming are separately stated.

(B) However, charges for custom modifications to prewritten programs are nontaxable only if the charges for the modifications are separately stated. Otherwise, the charges are taxable as part of the sale of the prewritten program.

When the charges for modification of a prewritten program are not separately stated, tax applies to the entire charge made to the customer for the modified program unless the modification is so significant that the new program qualifies as a custom program. If the prewritten program was previously marketed, the new program will qualify as a custom program, if the price of the prewritten program was 50 percent or less of the price of the new program. If the prewritten program was not previously marketed, the new program will qualify as a custom program if the charge made to the customer for custom programming services, as evidenced in the records of the seller, is more than 50 percent of the contract price to the customer.

(C) Charges for any written documentation or manuals designed to facilitate the use of a custom computer program by the customer are nontaxable, whether separately stated or not. The vendor of the custom computer program is the consumer of the written documentation or manuals, or of any tangible personal property used by the vendor in producing the written documentation or manuals.

(D) A custom computer program includes a program prepared to the special order of a customer who will use the program to produce and sell or lease copies of the program, and the charge for such custom computer program is not subject to tax. Sales or leases of the copies, however, are taxable as sales of prewritten computer programs.

(E) A computer program prepared to the special order of a customer to operate for the first time in connection with a particular basic operating system is a custom computer program even though a different version currently operates in connection with an incompatible basic operating system.

(F) Digital pre-press instruction is a custom computer program under section 6010.9 of the Revenue and Taxation Code, the sale of which is not subject to tax, provided the digital pre-press instruction is prepared to the special order of the purchaser. Digital pre-press instruction shall not, however, be regarded as a custom computer program if it is a "canned" or prewritten computer program which is held or existing for general or repeated sale or lease, even if the digital pre-press instruction was initially developed on a

custom basis or for in-house use. The sale of such canned or prewritten digital pre-press instruction in tangible form is a sale of tangible personal property, the retail sale of which is subject to tax.

(g) SERVICE CHARGES. The following activities are service activities. Charges for the performance of such services are nontaxable unless the services are performed as a part of the sale of tangible personal property.

(1) Designing and implementing computer systems (e.g., determining equipment and personnel required and how they will be utilized).

(2) Designing storage and data retrieval systems (e.g., determining what data communications and high-speed input-output terminals are required).

(3) Consulting services (e.g., study of all or part of a data processing system).

(4) Feasibility studies (e.g., studies to determine what benefits would be derived if procedures were automated).

Regulation 1502. (Continued)

(5) Evaluation of bids (e.g., studies to determine which manufacturer's proposal for computer equipment would be most beneficial).

(6) Providing technical help, analysts, and programmers, usually on an hourly basis.

(7) Training Services.

(8) Maintenance of equipment. (See Regulation 1546 for application of tax to maintenance contracts.)

(9) Consultation as to use of equipment.

(h) PICK-UP AND DELIVERY CHARGES. If the data processing firm's billing is for nontaxable processing of customer-furnished information, the tax will not apply to pick-up and delivery charges. If pick-up and delivery charges are made in conjunction with the sale of tangible personal property or the processing of customer-furnished tangible personal property, the tax will apply to the pick-up charges. Tax will apply to the delivery charges to the extent specified in Regulation 1628, "Transportation Charges."

(i) RENTAL OF COMPUTERS. A lease includes a contract, by which a person secures for a consideration the use of a computer which is not on his or her premises, if the person or his or her employees, while on the premises where the computer is located operate the computer, or direct and control its operation. A lease does not include a contract whereby a person secures access by means of remote telecommunication to a computer which is not on his or her premises, if the person or his or her employees operate the computer or direct and control its operation by means of remote telecommunication. (See Regulation 1660 for application of tax to leases.)

History: Adopted February 17, 1972, effective March 25, 1972.

Amended November 18, 1987, effective March 4, 1988. In subdivision (b), amended the regulation to conform several definitions to industry standards. In subdivision (c), amended the regulation to make clear and specific the basic application of tax. In subdivision (f), amended the regulation to make clear and specific the application of tax to prewritten computer programs.

Amended June 24, 1998, effective January 29, 1999. Subdivision (b) amended to delete last sentence and add new second sentence. Subdivision (f)(1)(D) amended to add new last sentence.

Amended September 1, 1999, effective December 3, 1999. Subdivision (b)–definition "Electronic or Pre-Press Instruction" added. Language added to subdivision (c)(4) and to (d)(5)(B)4 emphasizing that only the sale of digital pre-press instructions that qualify as custom computer programs may be non-taxable. Also added to the last sentence in subdivision (d)(5)(B), language to harmonize Regulation 1502 with a simultaneous change to Regulation 1541 concerning customer furnished information; also added an example that with respect to typography, clip art and text combined on the same page is considered composed type. New subdivision (f)(2)(F) added.

Amended September 11, 2002, operative January 1, 2003. Word "paragraph" changed to "subdivision" throughout. Word "subdivision" added before, and words "above" and "below" deleted after, subdivision numbers in cross references. Word "section" deleted throughout. Word "exempt" replaced with "nontaxable" throughout. Subdivision (b)-list reformatted as separate subdivisions (1)-(13); titles in all new subdivisions capitalized; substance of former un-numbered paragraph, regarding electronic or digital pre-press instructions, transferred to new subdivision (b)(6) and re-written to conform to recent amendments to Regulation 1540 and 1541 in this area with title "Electronic or Digital Pre-Press Instruction" changed to "DIGITAL PRE-PRESS INSTRUCTION" and words "electronic or" deleted throughout accordingly; definitions for "Keystroke," "Off-line," and "On-line," deleted; cross-reference to subdivision (d)(5) deleted. Subdivision (d)(3) word "regardless" deleted and words "or not", "For the S", and "the" added. Subdivision (d)(5)- subdivision (C)- "rendition" replaced with "rendering." Subdivision (f)(1)(C)- in first un-numbered paragraph, phrase "that ... program" and new second sentence added and phrase "including ... services" deleted. Second un-numbered paragraph replaced with new second and third un-numbered paragraphs. Subdivision (f)(2)(B)- word "services" deleted for clarity, and "%" replaced with "percent." Subdivision (f)(2)(C)-"Any" replaced with "Charges for any"; words "separately stated" added and phrase "a ... manuals" deleted. Subdivision (f)(2)(D)-phrase "and ... tax" added to first sentence; "The" replaced with "Sales or leases of the" and words "sales of" added to second sentence, and third sentence deleted. Subdivision (f)(2)(F)- current language replaced with new language to conform the definition of digitized pre-press instructions to that promulgated in recent amendments to Regulations 1540 and 1541. Subdivision (g)- gender-neutral language added.

Regulations are issued by the State Board of Equalization to implement, interpret or make specific provisions of the California Sales and Use Tax Law and to aid in the administration and enforcement of that law. If you are in doubt about how the Sales and Use Tax Law applies to your specific activity or transaction, you should write the nearest State Board of Equalization office. Requests for advice regarding a specific activity or transaction should be in writing and should fully describe the facts and circumstances of the activity or transaction.

7

BEFORE THE CALIFORNIA STATE BOARD OF EQUALIZATION

450 N Street, Room 121

Sacramento, California

REPORTER'S TRANSCRIPT

DECEMBER 17, 2008

ITEM J4

CHIEF COUNSEL MATTERS

RULEMAKING

Reported by: Beverly D. Toms

No. CSR 1662

1 Sacramento, California
2 December 17, 2008
3 ---oOO---
4 DR. CHU: So that brings us to Item J4,
5 Proposed Amendments to Sales and Use Tax Regulation
6 1502, Computers, Programs and Data Processing.
7 MR. LAMBERT: Good morning, Madam Chairwoman
8 and Members of the Board. We're here at this time to
9 request that the Board authorize us to commence a new
10 rulemaking procedure by publish -- authorizing the
11 publication of a proposed amendment to the Board's Sales
12 and Use Tax Regulation 1502 having to do with the
13 definition of a computer program. Very, very briefly,
14 this has been necessitated by the -- several taxpayers
15 advocating a new and very different interpretation of
16 what a computer program is than the Board's
17 long-standing historical position, and we think
18 clarification is needed.
19 DR. CHU: Any comments?
20 MR. LEONARD: Question.
21 DR. CHU: Mr. Leonard.
22 MR. LEONARD: What's the next step when we
23 adopt these?
24 MR. LAMBERT: I believe the next step is we
25 would send -- send a -- prepare a rulemaking package.
26 We'd have Board Proceedings prepare an interested
27 parties list. And we'll eventually bring it back to the
28 Board for a second meeting. I think --

1 in this mix.
2 MR. LAMBERT: Right, there will be a public
3 hearing. And they will definitely be given notice
4 during the interested parties process. We'll give you
5 the names of anybody we can add to that.
6 MS. OLSON: Okay.
7 MR. LEONARD: Well, I --
8 MS. MANDEL: He keeps saying -- he -- he means
9 the formal rulemaking process, that they'll be -- that
10 the people who -- because this is -- you're talking
11 about publication into the formal rulemaking process?
12 MR. LAMBERT: Right now, yes.
13 MS. MANDEL: Right.
14 MR. LEONARD: And I'm asking for really some
15 kind of interested parties type of discussion. The
16 public hearing tend to be people without dialogue. They
17 read statements, and the clock runs and we move on.
18 I -- I don't want any unintended consequences
19 as we try to -- to deal with the creativity of a couple
20 of -- of companies; that we don't unintentionally change
21 the rules on all of the other computer programmers and
22 computer programs out there. That's --
23 MR. LAMBERT: I don't think that's the case,
24 but it's your pleasure. I propose -- I think our
25 proposal is to not have the full blown interested
26 parties process, but that's obviously at the Board's
27 pleasure.
28 MS. MANDEL: And when people make comments in

1 statements. And we'll have to respond to all their
2 input in a document we file with the Office of
3 Administrative Law.
4 MR. LEONARD: And --
5 DR. CHU: Mr. Leonard.
6 MR. LEONARD: And my point was, is that if
7 we're going to do it that way, that in the mailing that
8 we make -- they get clear notice that if you have any
9 comments on this, you -- you don't wait for the public
10 hearing. Submit comments now.
11 MR. LAMBERT: No, I think these are law firms
12 so I think they're going to probably dot their "i's" and
13 cross their "t's".
14 MR. LEONARD: Well, I -- well, I hope our list
15 is beyond law firms. I think there are a lot of
16 companies that engage in computer programming --
17 MR. LAMBERT: Oh, yes, it is. The --
18 MR. LEONARD: -- services, and they -- they may
19 not have any idea that this is an issue. I mean, I
20 don't know how they missed it, but they --
21 MR. LAMBERT: Right.
22 MR. LEONARD: -- some computer programmers
23 don't --
24 MR. LAMBERT: Well, right now --
25 MR. LEONARD: -- face the daylight often.
26 MR. LAMBERT: This issue has brought --
27 potentially brought implications, which is another
28 reason why we want to clarify what our position on the

1 REPORTER'SCERTIFICATE

2

3 State of California)

4) ss

5 County of Sacramento)

6

7 I, BEVERLY D. TOMS, Hearing Reporter for the

8 California State Board of Equalization certify that on

9 January 17, 2008 I recorded verbatim, in shorthand, to

10 the best of my ability, the proceedings in the

11 above-entitled hearing; that I transcribed the shorthand

12 writing into typewriting; and that the preceding 8

13 pages constitute a complete and accurate transcription

14 of the shorthand writing.

15

16 Dated: January 14, 2008.

17

18

19

20 _____

21 BEVERLY D. TOMS

22 Hearing Reporter

23

24

25

26

27

28

ESTIMATE OF COST OR SAVINGS RESULTING FROM PROPOSED REGULATORY ACTION

Proposed Amendment of Sales and Use Tax Regulation 1502, *Computers, Programs, And Data Processing*

STATEMENT OF COST OR SAVINGS FOR NOTICE OF PUBLIC HEARING

The State Board of Equalization has determined that the proposed action does not impose a mandate on local agencies or school districts. Further, the Board has determined that the action will result in no direct or indirect cost or savings to any State agency, any local agency or school district that is required to be reimbursed under Part 7 (commencing with Section 17500) of Division 4 of Title 2 of the Government Code or other non-discretionary cost or savings imposed on local agencies, or cost or savings in Federal funding to the State of California.

The cost impact on private persons or businesses will be insignificant. This proposal will not have a significant adverse economic impact on businesses.

This proposal will not be detrimental to California businesses in competing with businesses in other states.

This proposal will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses or create or expand business in the State of California.

Statement Prepared by _____ Date 1-9-09
Regulations Coordinator

Approved by _____ Date 1/9/09
Chief Counsel

If Costs or Savings are Identified, Signatures of Chief, Fiscal Management Division, and Chief, Board Proceedings Division, are Required

Approved by _____ Date _____
Chief, Financial Management Division

Approved by _____ Date _____
Chief, Board Proceedings Division

NOTE: **SAM Section 6660 requires that estimates resulting in cost or savings be submitted for Department of Finance concurrence before the notice of proposed regulatory action is released.**

Board Proceedings Division
10/7/05

STATE OF CALIFORNIA

ECONOMIC AND FISCAL IMPACT STATEMENT
(REGULATIONS AND ORDERS)

399 (Rev. 2-98) *See SAM Sections 6600 - 6680 for Instructions and Code Citations*

DEPARTMENT NAME	CONTACT PERSON	TELEPHONE NUMBER
State Board of Equalization	Richard E. Bennion	916-445-2130
DESCRIPTIVE TITLE FROM *NOTICE REGISTER* OR FORM 400		NOTICE FILE NUMBER
Title 18, Section 1502, Computers, Programs, and Data Processing		Z

ECONOMIC IMPACT STATEMENT

A. ESTIMATED PRIVATE SECTOR COST IMPACTS *(Include calculations and assumptions in the rulemaking record.)*

1. Check the appropriate box(es) below to indicate whether this regulation:

- ☐ a. Impacts businesses and/or employees
- ☐ b. Impacts small businesses
- ☐ c. Impacts jobs or occupations
- ☐ d. Impacts California competitiveness
- ☐ e. Imposes reporting requirements
- ☐ f. Imposes prescriptive instead of performance standards
- ☐ g. Impacts individuals
- ☑ h. None of the above *(Explain below. Complete the Fiscal Impact Statement as appropriate.)*

h. *(cont.)* No significant adverse economic impact on business or employees,small business,jobs or occupations.

(If any box in Items 1 a through g is checked, complete this Economic Impact Statement.)

2. Enter the total number of businesses impacted:_____ Describe the types of businesses *(Include nonprofits)*:_____

Enter the number or percentage of total businesses impacted that are small businesses:_____

Enter the number of businesses that will be created: _____ eliminated: _____

Explain:_____

4. Indicate the geographic extent of impacts: ☐ Statewide ☐ Local or regional *(list areas)*: _____

5. Enter the number of jobs created:_____ or eliminated:_____ Describe the types of jobs or occupations impacted:_____

6. Will the regulation affect the ability of California businesses to compete with other states by making it more costly to produce goods or services here?

☐ Yes ☐ No If yes, explain briefly:_____

B. ESTIMATED COSTS *(Include calculations and assumptions in the rulemaking record.)*

1. What are the total statewide dollar costs that businesses and individuals may incur to comply with this regulation over its lifetime? $_____

a. Initial costs for a small business: $_____ Annual ongoing costs: $_____ Years: _____

b. Initial costs for a typical business: $_____ Annual ongoing costs: $_____ Years: _____

c. Initial costs for an individual: $_____ Annual ongoing costs: $_____ Years: _____

d. Describe other economic costs that may occur:_____

ECONOMIC AND FISCAL IMPACT STATEMENT *cont. (STD. 399, Rev. 2-98)*

2. If multiple industries are impacted, enter the share of total costs for each industry: _____

3. If the regulation imposes reporting requirements, enter the annual costs a typical business may incur to comply with these requirements. *(Include the dollar costs to do programming, record keeping, reporting, and other paperwork, whether or not the paperwork must be submitted.):* $_____

4. Will this regulation directly impact housing costs? ☐ Yes ☐ No If yes, enter the annual dollar cost per housing unit: $_____ and the number of units: _____

5. Are there comparable Federal regulations? ☐ Yes ☐ No Explain the need for State regulation given the existence or absence of Federal regulations: _____

Enter any additional costs to businesses and/or individuals that may be due to State - Federal differences: $_____

C. ESTIMATED BENEFITS *(Estimation of the dollar value of benefits is not specifically required by rulemaking law, but encouraged.)*

1. Briefly summarize the benefits that may result from this regulation and who will benefit: _____

2. Are the benefits the result of: ☐ specific statutory requirements, or ☐ goals developed by the agency based on broad statutory authority?

   Explain: _____

3. What are the total statewide benefits from this regulation over its lifetime? $_____

D. ALTERNATIVES TO THE REGULATION *(Include calculations and assumptions in the rulemaking record. Estimation of the dollar value of benefits is not specifically required by rulemaking law, but encouraged.)*

1. List alternatives considered and describe them below. If no alternatives were considered, explain why not: _____

2. Summarize the total statewide costs and benefits from this regulation and each alternative considered:

Regulation:	Benefit: $_____	Cost: $_____
Alternative 1:	Benefit: $_____	Cost: $_____
Alternative 2:	Benefit: $_____	Cost: $_____

3. Briefly discuss any quantification issues that are relevant to a comparison of estimated costs and benefits for this regulation or alternatives: _____

4. Rulemaking law requires agencies to consider performance standards as an alternative, if a regulation mandates the use of specific technologies or equipment, or prescribes specific actions or procedures. Were performance standards considered to lower compliance costs? ☐ Yes ☐ No

   Explain: _____

E. MAJOR REGULATIONS *(Include calculations and assumptions in the rulemaking record.)*

Cal/EPA boards, offices and departments are subject to the following additional requirements per Health and Safety Code section 57005.

ECONOMIC AND FISCAL IMPACT STATEMENT *cont. (STD. 399, Rev. 2-98)*

1. Will the estimated costs of this regulation to California business enterprises exceed $10 million ? ☐ Yes No *(If No, skip the rest of this section)*

2. Briefly describe each equally as effective alternative, or combination of alternatives, for which a cost-effectiveness analysis was performed:

   Alternative 1:_____

   Alternative 2:_____

3. For the regulation, and each alternative just described, enter the estimated total cost and overall cost-effectiveness ratio:

Regulation:	$ _____	Cost-effectiveness ratio: _____
Alternative 1:	$ _____	Cost-effectiveness ratio: _____
Alternative 2:	$ _____	Cost-effectiveness ratio: _____

FISCAL IMPACT STATEMENT

A. FISCAL EFFECT ON LOCAL GOVERNMENT *(Indicate appropriate boxes 1 through 6 and attach calculations and assumptions of fiscal impact for the current year and two subsequent Fiscal Years)*

☐ 1. Additional expenditures of approximately $_____in the current State Fiscal Year which are reimbursable by the State pursuant to Section 6 of Article XIII B of the California Constitution and Sections 17500 et seq. of the Government Code. Funding for this reimbursement:

☐ a. is provided in (Item_____,Budget Act of_____) or (Chapter_____,Statutes of_____

☐ b. will be requested in the_____Governor's Budget for appropriation in Budget Act of _____.
(FISCAL YEAR)

☐ 2. Additional expenditures of approximately $_____in the current State Fiscal Year which are not reimbursable by the State pursuant to Section 6 of Article XIII B of the California Constitution and Sections 17500 et seq. of the Government Code because this regulation:

☐ a. implements the Federal mandate contained in_____

☐ b. implements the court mandate set forth by the_____

court in the case of_____vs._____

☐ c. implements a mandate of the people of this State expressed in their approval of Proposition No._____at the_____ election;
(DATE)

☐ d. is issued only in response to a specific request from the _____

_____, which is/are the only local entity(s) affected;

☐ e. will be fully financed from the _____authorized by Section
(FEES, REVENUE, ETC.)

_____of the_____Code;

☐ f. provides for savings to each affected unit of local government which will, at a minimum, offset any additional costs to each such unit.

☐ 3. Savings of approximately $_____annually.

☐ 4. No additional costs or savings because this regulation makes only technical, non-substantive or clarifying changes to current law and regulations.

ECONOMIC AND FISCAL IMPACT STATEMENT *cont. (STD. 399, Rev. 2-98)*

☑ 5. No fiscal impact exists because this regulation does not affect any local entity or program.

☐ 6. Other.

B. FISCAL EFFECT ON STATE GOVERNMENT *(Indicate appropriate boxes 1 through 4 and attach calculations and assumptions of fiscal impact for the current year and two subsequent Fiscal Years.)*

☐ 1. Additional expenditures of approximately $_____ in the current State Fiscal Year. It is anticipated that State agencies will:

☐ a. be able to absorb these additional costs within their existing budgets and resources.

☐ b. request an increase in the currently authorized budget level for the _____ fiscal year.

☐ 2. Savings of approximately $_____ in the current State Fiscal Year.

☑ 3. No fiscal impact exists because this regulation does not affect any State agency or program.

☐ 4. Other.

C. FISCAL EFFECT ON FEDERAL FUNDING OF STATE PROGRAMS *(Indicate appropriate boxes 1 through 4 and attach calculations and assumptions of fiscal impact for the current year and two subsequent Fiscal Years.)*

☐ 1. Additional expenditures of approximately $_____ in the current State Fiscal Year.

☐ 2. Savings of approximately $_____ in the current State Fiscal Year.

☑ 3. No fiscal impact exists because this regulation does not affect any federally funded State agency or program.

☐ 4. Other.

SIGNATURE		TITLE Regulations Coordinator
AGENCY SECRETARY [1] APPROVAL/CONCURRENCE		DATE 1/13/09
DEPARTMENT OF FINANCE [2] APPROVAL/CONCURRENCE	PROGRAM BUDGET MANAGER Exempt under SAM section 6660	DATE

1. *The signature attests that the agency has completed the STD. 399 according to the instructions in SAM sections 6600-6680, and understands the impacts of the proposed rulemaking. State boards, offices, or departments not under an Agency Secretary must have the form signed by the highest ranking official in the organization.*

2. *Finance approval and signature is required when SAM sections 6600-6670 require completion of the Fiscal Impact Statement in the STD. 399.*

STATE OF CALIFORNIA--OFFICE OF ADMINISTRATIVE LAW

NOTICE PUBLICATION/REGULATIONS SUBMISSION

(See instructions on reverse)

For use by Secretary of State only

STD. 400 (REV. 01-08)

OAL FILE NUMBERS	NOTICE FILE NUMBER	REGULATORY ACTION NUMBER	EMERGENCY NUMBER
	Z-2009-0113-01		

For use by Office of Administrative Law (OAL) only

APPROVED FOR FILING PUBLICATION DATE

JAN 13 2009 JAN 23 2009

Office of Administrative Law

NOTICE | REGULATIONS

AGENCY WITH RULEMAKING AUTHORITY
State Board of Equalization

AGENCY FILE NUMBER (If any)

A. PUBLICATION OF NOTICE (Complete for publication in Notice Register)

1. SUBJECT OF NOTICE	TITLE(S)	FIRST SECTION AFFECTED	2. REQUESTED PUBLICATION DATE
Computers, Programs, and Data Processing	18	1502	January 23, 2009

3. NOTICE TYPE	4. AGENCY CONTACT PERSON	TELEPHONE NUMBER	FAX NUMBER (Optional)
[X] Notice re Proposed Regulatory Action [ ] Other	Richard E. Bennion	(916) 445-2130	(916) 324-3984

OAL USE ONLY	ACTION ON PROPOSED NOTICE	NOTICE REGISTER NUMBER	PUBLICATION DATE
	[ ] Approved as Submitted [ ] Approved as Modified [ ] Disapproved/ Withdrawn		

B. SUBMISSION OF REGULATIONS (Complete when submitting regulations)

1a. SUBJECT OF REGULATION(S)

1b. ALL PREVIOUS RELATED OAL REGULATORY ACTION NUMBER(S)

2. SPECIFY CALIFORNIA CODE OF REGULATIONS TITLE(S) AND SECTION(S) **(Including title 26, if toxics related)**

SECTION(S) AFFECTED (List all section number(s) individually. Attach additional sheet if needed.)

ADOPT

AMEND

TITLE(S)

REPEAL

3. TYPE OF FILING

[ ] Regular Rulemaking (Gov. Code §11346)

[ ] Resubmittal of disapproved or withdrawn nonemergency filing (Gov. Code §§11349.3, 11349.4)

[ ] Emergency (Gov. Code, §11346.1(b))

[ ] Certificate of Compliance: The agency officer named below certifies that this agency complied with the provisions of Gov. Code §§11346.2-11347.3 either before the emergency regulation was adopted or within the time period required by statute.

[ ] Resubmittal of disapproved or withdrawn emergency filing (Gov. Code, §11346.1)

[ ] Emergency Readopt (Gov. Code, §11346.1(h))

[ ] File & Print

[ ] Other (Specify) _____

[ ] Changes Without Regulatory Effect (Cal. Code Regs., title 1, §100)

[ ] Print Only

4. ALL BEGINNING AND ENDING DATES OF AVAILABILITY OF MODIFIED REGULATIONS AND/OR MATERIAL ADDED TO THE RULEMAKING FILE (Cal. Code Regs. title 1, §44 and Gov. Code §11347.1)

5. EFFECTIVE DATE OF CHANGES (Gov. Code, §§ 11343.4, 11346.1(d); Cal. Code Regs., title 1, §100)

[ ] Effective 30th day after filing with Secretary of State

[ ] Effective on filing with Secretary of State

[ ] §100 Changes Without Regulatory Effect

[ ] Effective other (Specify) _____

6. CHECK IF THESE REGULATIONS REQUIRE NOTICE TO, OR REVIEW, CONSULTATION, APPROVAL OR CONCURRENCE BY, ANOTHER AGENCY OR ENTITY

[ ] Department of Finance (Form STD. 399) (SAM §6660)

[ ] Fair Political Practices Commission

[ ] State Fire Marshal

[ ] Other (Specify) _____

7. CONTACT PERSON	TELEPHONE NUMBER	FAX NUMBER (Optional)	E-MAIL ADDRESS (Optional)

8.

I certify that the attached copy of the regulation(s) is a true and correct copy of the regulation(s) identified on this form, that the information specified on this form is true and correct, and that I am the head of the agency taking this action, or a designee of the head of the agency, and am authorized to make this certification.

SIGNATURE OF AGENCY HEAD OR DESIGNEE

DATE

TYPED NAME AND TITLE OF SIGNATORY

RECEIVED FOR FILING PUBLICATION
JAN 13 2009 JAN 23 2009
Administrative Law

NOTICE IS HEREBY GIVEN

The State Board of Equalization, pursuant to the authority vested in it by section 15606(a) of the Government Code, proposes to amend Regulation 1502, Computers, Programs, and Data Processing, in Title 18, Division 2, Chapter 4, of the California Code of Regulations, relating to sales and use tax. A public hearing on the proposed regulations will be held in Room 121, 450 N Street, Sacramento, at 9:30 a.m., or as soon thereafter as the matter may be heard, on March 16, 2009. At the hearing, any person interested may present statements or arguments orally or in writing relevant to the proposed regulatory action. The Board will consider written statements or arguments if received by March 16, 2009.

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Current law, Revenue and Taxation Code section 6010.9, provides that "sale" and "purchase," for sales and use tax purposes, generally do not include the design, development, writing, translation, fabrication, lease, or transfer, for a consideration, of title or possession of a custom computer program. The statute includes definitional sections.

Regulation 1502, Computers, Programs, and Data Processing, is proposed to be amended to interpret, implement, and make specific Revenue and Taxation Code section 6010.9. Amendments are proposed to clarify the statutory definition of "computer program." Specifically, the amendments are necessary to clarify that: (1) the definition of "computer program" includes subdivisions such as routines and similar programming building blocks, as described in Revenue and Taxation Code section 6010.9, subdivision (c); and (2) the definition of "computer program" contained in subdivision (c) is consistent and in harmony with the definitional and related explanatory provisions pertaining to "customer computer programs" and "existing prewritten programs" set forth in subdivision (d).

COST TO LOCAL AGENCIES AND SCHOOL DISTRICTS

The State Board of Equalization has determined that the proposed amendments and regulations do not impose a mandate on local agencies or school districts. Further, the Board has determined that the amendments and regulations will result in no direct or indirect cost or savings to any State agency, any costs to local agencies or school districts that are required to be reimbursed under Part 7 (commencing with section 17500) of Division 4 of Title 2 of the Government Code or other non-discretionary costs or savings imposed on local agencies, or cost or savings in federal funding to the State of California.

EFFECT ON BUSINESS

Pursuant to Government Code section 11346.5(a)(8), the Board of Equalization made an initial determination that the adoption of the amendments to Regulation 1502 will have no significant statewide adverse economic impact directly affecting business.

The adoption of the proposed amendment to this regulation will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California.

The amendment to the regulation as proposed will not be detrimental to California businesses in competing with businesses in other states.

The proposed regulations may affect small business.

COST IMPACT ON PRIVATE PERSON OR BUSINESSES

That Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

SIGNIFICANT EFFECT ON HOUSING COSTS

No significant effect.

FEDERAL REGULATIONS

Regulation 1502 and the proposed changes have no comparable federal regulations.

AUTHORITY

Section 7051, Revenue and Taxation Code.

REFERENCE

Section 6010.9 Revenue and Taxation Code.

CONTACT

Questions regarding the substance of the proposed regulation should be directed to Ms. Lisa Andrews (916) 322-5989, at 450 N Street, Sacramento, CA 95814, e-mail Lisa.Andrews@boe.ca.gov or MIC:50, P.O. Box 942879, 450 N Street, Sacramento, CA 94279-0050.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Regulations Coordinator, telephone (916) 445-2130, fax (916) 324-3984 , e-mail Richard.Bennion@boe.ca.gov or by mail at State Board of Equalization, Attn: Rick Bennion MIC:81, P.O. Box 942879, 450 N Street, Sacramento, CA 94279-0080.

ALTERNATIVES CONSIDERED

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which this action is proposed, or be as effective and less burdensome to affected private persons than the proposed action.

AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Board has prepared an initial statement of reasons and an underscored version (express terms) of the proposed regulation. Both of these documents and all information on which the proposal is based are available to the public upon request. The Rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed regulation are available on the Internet at the Board's web site http://www.boe.ca.gov.

AVAILABILITY OF FINAL STATEMENT OF REASONS

The final statement of reasons will be made available on the Internet at the Board's web site following its public hearing of the proposed regulation. It is also available for your inspection at 450 N Street, Sacramento, California.

ADDITIONAL COMMENTS

Following the hearing, the State Board of Equalization may in accordance with law adopt the proposed regulation if the text remains substantially the same as described in the text originally made available to the public. If the State Board of Equalization makes modifications which are substantially related to the originally proposed text, the Board will make the modified text, with the changes clearly indicated, available to the public for fifteen days before adoption of the regulation. The text of any modified regulation will be mailed to those interested parties who commented on the proposed regulatory action orally or in writing or who asked to be informed of such changes. The modified regulation will be available to the public from Mr. Bennion. The State Board of Equalization will consider written comments on the modified regulation for fifteen days after the date on which the modified regulation is made available to the public.

Proposed Amendments to Regulation 1502

Regulation 1502. Computers, Programs, and Data Processing.

(a) IN GENERAL. "Automatic data processing services" are those rendered in performing all or part of a series of data processing operations through an interacting assembly of procedures, processes, methods, personnel, and computers.

Automatic data processing services may be provided by manufacturers of computers, data processing centers, systems designers, consultants, software companies, etc. In addition, there are banks and other businesses which own or lease computers and use them primarily for their own purposes but occasionally provide services to others. Businesses rendering automatic data processing services will be referred to herein as "data processing firms."

(b) DEFINITIONS OF TERMS.

(1) APPLICATION. The specific job performance by an automatic data processing installation. For example, data processing for a payroll may be referred to as a payroll application.

(2) CODING. The list, in computer code, of the successive computer instructions representing successive computer operations for solving a specific problem.

(3) COMPUTER. A computer is an electronic device (including word processing equipment and testing equipment) or combination of components, which is programmable and which includes a processor (central processing unit or microprocessor), internal memory, and input and output connections. Manufacturing equipment which incorporates a computer is a computer for purposes of this regulation. However, the term does not include manufacturing equipment which operates under the control of mechanical or electronic accessories, the attachment of the equipment of which is required for the machine to operate. An electronic device otherwise qualifying as a computer remains a computer even though it may be used for information processing, data acquisition, process control, or for the control of manufacturing machinery or equipment.

(4) CUSTOM COMPUTER PROGRAM AND PROGRAMMING. A computer program prepared to the special order of the customer. A program prepared to the special order of the customer qualifies as a custom program even though it may incorporate preexisting routines, utilities, or similar program components. It includes those services represented by separately stated charges for modifications to an existing prewritten program which are prepared to the special order of the customer.

(5) DATA ENTRY (INCLUDING ENCODING). Recording information in or on storage media by punching holes or inserting magnetic bits to represent letters, digits, and special characters.

(6) DIGITAL PRE-PRESS INSTRUCTION. The creation of original information in electronic form by combining more than one computer program into specific instructions or information necessary to prepare and link files for electronic transmission for output, within the printing industry, to film, plate, or direct to press, which is then transferred on electronic media such as tape or compact disc.

(7) INPUT. The information or data transferred, or to be transferred, from storage media into the internal storage of the computer.

(8) OUTPUT. The information transferred from the internal storage of the computer to storage media or tabulated listing.

(9) PREWRITTEN PROGRAM. A program held or existing for general or repeated sale or lease. The term also includes a program developed for in-house use which is subsequently offered for sale or lease as a product.

(10) PROGRAM. "Program" is the complete plan for the solution of a problem, i.e., the complete sequence of automatic data processing equipment instructions necessary to solve a problem, and includes both systems and application programs and subdivisions thereof. "Subdivision" includes, without limitation, assemblers, compilers, generators, procedures, functions, routines, and utility programs. "Problem" means

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and includes any problem that may be addressed or resolved by a program or subdivision; and the "problem" addressed need not constitute the full array of a purchaser's or user's problems, requirements, and desired features. "Problem" further includes, without limitation, any problem associated with: information processing; the manipulation or storage of data; the input or output of data; the transfer of data or programs, including subdivisions; the translation of programs, including subdivisions, into machine code; defining procedures, functions, or routines; executing programs or subdivisions that may be invoked within a program; and the control of equipment, mechanisms, or special purpose hardware.~~The complete plan for the solution of a problem, i.e., the complete sequence of automatic data processing equipment instructions necessary to solve a problem; includes both systems and application programs and subdivisions such as assemblers, compilers, routines, generators, and utility programs.~~

(11) PROOF LISTING. A tabulated listing of input.

(12) SOURCE DOCUMENTS. A document supplied by a customer of a data processing firm from which basic data are extracted (e.g., sales invoice).

(13) STORAGE MEDIA. Includes hard disks, floppy disks, diskettes, magnetic tape, cards, paper tape, drums and other devices upon which information is recorded.

(c) BASIC APPLICATIONS OF TAX.

(1) The transfer of title, for a consideration, of tangible personal property, including property on which or into which information has been recorded or incorporated, is a sale subject to tax.

(2) Charges for producing, fabricating, processing, printing, imprinting, or otherwise physically altering, modifying or treating consumer-furnished tangible personal property (cards, tapes, disks, etc.), including charges for recording or otherwise incorporating information on or into such tangible personal property, are generally subject to tax.

(3) A transfer for a consideration of the title or possession of tangible personal property which has been produced, fabricated, or printed to the special order of the customer, including property on which or into which information has been recorded or incorporated, is generally a sale subject to tax. However, if the contract is for the service of researching and developing original information for a customer, tax does not apply to the charges for the service. The tangible personal property used to transmit the original information is merely incidental to the service.

(4) Charges for the transfer of computer-generated output are subject to tax where the true object of the contract is the output and not the services rendered in producing the output. Examples include artwork, graphics, and designs. However, the transfer by the seller of the original information created by digital pre-press instruction is not subject to tax if the original information is a custom computer program as explained in subdivision (f)(2)(F).

(5) Charges for processing customer-furnished information (sales data, payroll data, etc.) are generally not subject to tax. (For explanation and specific application of tax, see subdivision (d).)

(6) Leases of tangible personal property may be subject to tax under certain conditions. (See Regulation 1660 for application of tax to leases.)

(7) Charges made for the use of a computer, on a time-sharing basis, where access to the computer is by means of remote telecommunication are not subject to tax. (See subdivision (i).)

(8) Generally data processing firms are consumers of all tangible personal property, including cards and forms, which they use in providing nontaxable services unless a separate charge is made to customers for the materials, in which case tax applies to the charge made for the materials.

(d) MANIPULATION OF CUSTOMER-FURNISHED INFORMATION AS SALE OR SERVICE.

(1) GENERAL. Generally tax applies to the conversion of customer-furnished data from one physical form of recordation to another physical form of recordation. However, if the contract is for the service of

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developing original information from customer-furnished data, tax does not apply to the charges for the service. The tangible personal property used to transmit the original information is merely incidental to the service.

(2) DATA ENTRY AND VERIFICATION. This covers situations where a data processing firm's agreement provides only for data entry, data verification, and proof listing of data, or any combination of these operations. It does not include contracts under which these services are performed as steps in processing of customer-furnished information as discussed under subdivision (d)(5).

Agreements providing solely for data entry and verification, or data entry, providing a proof list and/or verifying of data are regarded as contracts for the fabrication of storage media and sales of proof lists. Charges therefore are taxable, whether the storage media are furnished by the customer or by the data processing firm.

Tax also applies to charges for the imprinting of characters on a document to be used as the input medium in an optical character recognition system. The tax application is the same regardless of which type of storage media is used in the operation.

(3) ADDRESSING (INCLUDING LABELS) FOR MAILING. Where the data processing firm addresses, through the use of its computer or otherwise, material to be mailed, with names and addresses furnished by the customer or maintained by the data processing firm for the customer, tax does not apply to the charge for addressing. Similarly, where the data processing firm prepares, through the use of its computer or otherwise, labels to be affixed to material to be mailed, with names and addresses furnished by the customer or maintained by the data processing firm for the customer, tax does not apply to the charge for producing the labels, whether or not the data processing firm itself affixes the labels to the material to be mailed. (For the sale of mailing list by the proprietor of such list, as a sale of tangible personal property or as a nontaxable addressing, see Regulation 1504 "Mailing Services.")

(4) MICROFILMING AND PHOTORECORDING. Tax applies to charges for microfilming or photo recording except, as provided in subdivision (d)(5), where the microfilming or photo recording is done under a contract for the processing of customer-furnished information. Tax applies to a contract where data on magnetic tape are converted into combinations of alphanumeric printing, curve plotting and/or line drawings, and put on microfilm or photo recording paper.

(5) PROCESSING OF CUSTOMER-FURNISHED INFORMATION.

(A) "Processing of customer-furnished information" means the developing of original information from data furnished by the customer. Examples of automatic data processing processes which result in original information are summarizing, computing, extracting, sorting, and sequencing. Such processes also include the updating of a continuous file of information maintained by the customer with the data processing firm.

(B) "Processing of customer-furnished information" does not include: (1) an agreement providing solely for the reformatting of data or for the preparation of a proof listing or the performance of an edit routine or other pre-processing, (2) the using of a computer as a mere printing instrument, as in the preparation of personalized computer-printed letters, (3) the mere converting of data from one medium to another, (4) an agreement under which a person undertakes to prepare artwork, drawings, illustrations, or other graphic material unless the provisions of subdivision (f)(2)(F) apply regarding digital pre-press instruction and custom computer programs. Additionally, graphic material furnished incidentally to the performance of a service is not subject to tax. For example, graphics furnished in connection with the performance of architectural, engineering, accounting, or similar professional services are not subject to tax. With respect to typography, clip art combined with text on the same page is considered composed type as explained in Regulation 1541.

(C) Contracts for the processing of customer-furnished information usually provide that the data processing firm will receive the customer's source documents, record data on storage media, make necessary corrections, process the information, and then record and transfer the output to the customer.

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Where a data processing firm enters into a contract for the processing of customer-furnished information, the transfer of the original information to the customer is considered to be the rendering of a service. Except as described in subdivisions (c)(8) and (d)(5)(E), tax does not apply to the charges made under contracts providing for the transfer of the original information whether the original information is transferred on storage media, microfilm, microfiche, photo recording paper, input media for an optical character recognition system, punched cards, preprinted forms, or tabulated listing. The breakdown of the total charge into separate charges for each operation involved in processing the customer-furnished information will not change the application of tax.

(D) The furnishing of computer programs and data by the customer for processing under direction and control of the data processing firm will not alter the application of tax, notwithstanding that charges are based on computer time.

(E) Taxable Items. Where a data processing firm has entered into a contract which is regarded as a service contract under subdivision (d)(5)(C) and the data processing firm, pursuant to the contract, transfers to its customer tangible property other than property containing the original information, such as: duplicate copies of storage media; inventory control cards for use by the customer; membership cards for distribution by the customer; labels (other than address labels); microfiche duplicates; or similar items for use, tax applies to the charges made for such items. If no separate charge is made, tax applies to that portion of the charge made by the data processing firm which the cost of the additional computer time (if any), cost of materials, and labor cost to produce the items bear to the total job cost.

(F) Additional Copies. When additional copies of records, reports, tabulation, etc., are provided, tax applies to the charges made for the additional copies. "Additional copies" are all copies (other than carbon copies), whether the copies are prepared by rerunning the same program, by using multiple simultaneous printers, by looping a program such that the program is run continuously, by using different programs to produce the same output product, or by other means. Where additional copies are prepared the tax will be measured by the charge made by the data processing firm to the customer. If no separate charge is made for the additional copies, tax applies to that portion of the gross receipts which the cost of the additional computer time (if any), the cost of materials and labor cost to produce the additional copies bear to the total job cost. Charges for copies produced by means of photocopying, multi-lithing, or by other means are subject to tax.

(e) TRAINING SERVICES AND MATERIALS. Data processing firms provide a number of training services, such as data entry and verification, programming, and specialized training in systems design.

(1) Charges for training services are nontaxable, except as provided in subdivision (g) where the training services are provided as part of the sale of tangible personal property. The data processing firm is the consumer of tangible personal property which is used in training others, or provided to trainees without a separate charge as a part of the training services.

(2) Tax applies to charges for training materials, including books, furnished to trainees for a charge separate from the charge for training services.

(3) Where a person sells tangible personal property, such as computers or programs, and provides training materials to the customer without making an additional charge for the training materials, this is a sale of the training materials. The selling price of the training materials is considered to be included in the sales price of the tangible personal property.

(f) COMPUTER PROGRAMS.

(1) PREWRITTEN (CANNED) PROGRAMS. Prewritten programs may be transferred to the customer in the form of storage media or by listing the program instructions on coding sheets. In some cases they are usable as written; however, in other cases it is necessary that the program be modified, adapted, and tested to meet the customer's particular needs. Tax applies to the sale or lease of the storage media or coding sheets on which or into which such prewritten (canned) programs have been recorded, coded, or punched.

The proposed amendments contained in this document may not be adopted. Any revisions that are adopted may differ from this text.

(A) Tax applies whether title to the storage media on which the program is recorded, coded, or punched passes to the customer, or the program is recorded, coded, or punched on storage media furnished by the customer. The temporary transfer of possession of a program, for a consideration, for the purpose of direct use or to be recorded or punched by the customer, or by the lessor on the customer's premises, is a lease of tangible personal property. The tax applies unless the property is leased in substantially the same form as acquired by the lessor and the lessor has paid sales tax reimbursement or use tax with respect to the property.

(B) Tax applies to the entire amount charged to the customer. Where the consideration consists of license fees, all license fees, including site licensing and other end users fees, are includable in the measure of tax. Tax does not apply, however, to license fees or royalty payments that are made for the right to reproduce or copy a program to which a federal copyright attaches in order for the program to be published and distributed for a consideration to third parties, even if a tangible copy of the program is transferred concurrently with the granting of such right. Any storage media used to transmit the program is merely incidental.

(C) 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, that is, if the purchaser must purchase the maintenance contract in order to purchase or lease a prewritten computer program, then the charges for the maintenance contract are taxable as part of the sale or lease of the prewritten program. Tax applies to any charge for consultation services provided in connection with a maintenance contract except as provided below.

For reporting periods commencing on or after January 1, 2003, if the purchase of the maintenance contract is optional with the purchaser, that is, if the purchaser may purchase the prewritten software without also purchasing the maintenance contract, and there is a single lump sum charge for the maintenance contract, 50 percent of the lump sum charge for the maintenance contract is for the sale of tangible personal property and tax applies to that amount; the remaining 50 percent of the lump sum charge is nontaxable charges for repair.

If no tangible personal property whatsoever is transferred to the customer during the period of the maintenance contract, tax does not apply to any portion of the charge. Tax does not apply to a separately stated charge for consultation services if the purchaser is not required to purchase those services in order to purchase or lease any tangible personal property, such as a prewritten computer program or a maintenance contract.

(D) The sale or lease of a prewritten program is not a taxable transaction if the program is transferred by remote telecommunications from the seller's place of business, to or through the purchaser's computer, and the purchaser does not obtain possession of any tangible personal property, such as storage media, in the transaction. Likewise, the sale of a prewritten program is not a taxable transaction if the program is installed by the seller on the customer's computer except when the seller transfers title to or possession of storage media or installation of the program is a part of the sale of the computer.

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 purchaser for no additional charge. If a separate charge is made for the documentation or manuals, then tax applies to the separate charge.

(E) The transfer of a prewritten program on storage media is not a sale for resale when the storage media, or an exact copy, will be used to produce additional copies of the program. Charges for testing a prewritten program on the purchaser's computer to insure that such a program operates as required are installation charges and are nontaxable.

The proposed amendments contained in this document may not be adopted. Any revisions that are adopted may differ from this text.

(2) CUSTOM PROGRAMS

(A) Tax does not apply to the sale or lease of a custom computer program, other than a basic operational program, regardless of the form in which the program is transferred. Nor does the tax apply to the transfer of a custom program, or custom programming services performed, in connection with the sale or lease of computer equipment, whether or not the charges for the custom program or programming are separately stated.

(B) However, charges for custom modifications to prewritten programs are nontaxable only if the charges for the modifications are separately stated. Otherwise, the charges are taxable as part of the sale of the prewritten program.

When the charges for modification of a prewritten program are not separately stated, tax applies to the entire charge made to the customer for the modified program unless the modification is so significant that the new program qualifies as a custom program. If the prewritten program was previously marketed, the new program will qualify as a custom program, if the price of the prewritten program was 50 percent or less of the price of the new program. If the prewritten program was not previously marketed, the new program will qualify as a custom program if the charge made to the customer for custom programming services, as evidenced in the records of the seller, is more than 50 percent of the contract price to the customer.

(C) Charges for any written documentation or manuals designed to facilitate the use of a custom computer program by the customer are nontaxable, whether separately stated or not. The vendor of the custom computer program is the consumer of the written documentation or manuals, or of any tangible personal property used by the vendor in producing the written documentation or manuals.

(D) A custom computer program includes a program prepared to the special order of a customer who will use the program to produce and sell or lease copies of the program, and the charge for such custom computer program is not subject to tax. Sales or leases of the copies, however, are taxable as sales of prewritten computer programs.

(E) A computer program prepared to the special order of a customer to operate for the first time in connection with a particular basic operating system is a custom computer program even though a different version currently operates in connection with an incompatible basic operating system.

(F) Digital pre-press instruction is a custom computer program under section 6010.9 of the Revenue and Taxation Code, the sale of which is not subject to tax, provided the digital pre-press instruction is prepared to the special order of the purchaser. Digital pre-press instruction shall not, however, be regarded as a custom computer program if it is a "canned" or prewritten computer program which is held or existing for general or repeated sale or lease, even if the digital pre-press instruction was initially developed on a custom basis or for in-house use. The sale of such canned or prewritten digital pre-press instruction in tangible form is a sale of tangible personal property, the retail sale of which is subject to tax.

(g) SERVICE CHARGES. The following activities are service activities. Charges for the performance of such services are nontaxable unless the services are performed as a part of the sale of tangible personal property.

(1) Designing and implementing computer systems (e.g., determining equipment and personnel required and how they will be utilized).

(2) Designing storage and data retrieval systems (e.g., determining what data communications and high-speed input-output terminals are required).

(3) Consulting services (e.g., study of all or part of a data processing system).

(4) Feasibility studies (e.g., studies to determine what benefits would be derived if procedures were automated).

(5) Evaluation of bids (e.g., studies to determine which manufacturer's proposal for computer equipment would be most beneficial).

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(6) Providing technical help, analysts, and programmers, usually on an hourly basis.

(7) Training Services.

(8) Maintenance of equipment. (See Regulation 1546 for application of tax to maintenance contracts.)

(9) Consultation as to use of equipment.

(h) PICK-UP AND DELIVERY CHARGES. If the data processing firm's billing is for nontaxable processing of customer-furnished information, the tax will not apply to pick-up and delivery charges. If pick-up and delivery charges are made in conjunction with the sale of tangible personal property or the processing of customer-furnished tangible personal property, the tax will apply to the pick-up charges. Tax will apply to the delivery charges to the extent specified in Regulation 1628, "Transportation Charges."

(i) RENTAL OF COMPUTERS. A lease includes a contract, by which a person secures for a consideration the use of a computer which is not on his or her premises, if the person or his or her employees, while on the premises where the computer is located operate the computer, or direct and control its operation. A lease does not include a contract whereby a person secures access by means of remote telecommunication to a computer which is not on his or her premises, if the person or his or her employees operate the computer or direct and control its operation by means of remote telecommunication. (See Regulation 1660 for application of tax to leases.)

NOTE: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 995.2, 6006, 6007, 6010, 6010.9, 6011, 6012, 6015, and 6016, Revenue and Taxation Code.

The proposed amendments contained in this document may not be adopted. Any revisions that are adopted may differ from this text.

Bennion, Richard

From: Forman, Amber M [Amber.M.Forman@BOE.CA.GOV]
Sent: Thursday, January 29, 2009 2:34 PM
To: BOE_REGULATIONS@LISTSERV.CAHWNET.GOV
Subject: State Board of Equalization - Announcement of Regulatory Change 1502

The State Board of Equalization proposes to amend regulation section 1502, *Computers, Programs, and Data Processing*. The public hearing on the proposed regulation will be held in Room 121, 450 N Street, Sacramento, CA at 9:30 a.m., or as soon thereafter as the matter may be heard, on Monday, March 16, 2009.

The amendment is proposed to be adopted to clarify the statutory definition of "computer program."

To view the notice of hearing, initial statement of reasons, proposed text, and history click on the following link:

http://www.boe.ca.gov/regs/reg1502.htm

Questions regarding the substance of the proposed amendments to Regulation 1502: Ms. Leila Hellmuth (916) 322-5271, at 450 N Street, Sacramento, CA 95814, e-mail *Leila.Hellmuth@boe.ca.gov* or by mail at State Board of Equalization, Attn: Lisa Andrews, MIC:50, P.O. Box 942879, 450 N Street, Sacramento, CA 94279-0050.

Written comments for the Board's consideration, notices of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed regulatory action should be directed to Rick Bennion, Regulations Coordinator, telephone (916) 445-2130, fax (916) 324-3984, e-mail Richard.Bennion@boe.ca.gov or by mail to: State Board of Equalization, Attn: Rick Bennion, MIC: 80, P.O. Box 942879-0080, Sacramento, CA 94279-0080.

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tion of the information on which the proposal is based may also be obtained upon request. In addition, when completed, the final statement of reasons will be available upon request. Requests should be directed to the contact named herein.

If the regulations adopted by the Department differ from, but are sufficiently related to the action proposed, they will be available to the public for at least 15 days prior to the date of adoption. Any person interested may obtain a copy of said regulations prior to the date of adoption by contacting the agency officer (contact) named herein.

TITLE 18. STATE BOARD OF EQUALIZATION

NOTICE IS HEREBY GIVEN

The State Board of Equalization, pursuant to the authority vested in it by section 15606(a) of the Government Code, proposes to amend Regulation 1502, Computers, Programs, and Data Processing, in Title 18, Division 2, Chapter 4, of the California Code of Regulations, relating to sales and use tax. A public hearing on the proposed regulations will be held in Room 121, 450 N Street, Sacramento, at 9:30 a.m., or as soon thereafter as the matter may be heard, on March 16, 2009. At the hearing, any person interested may present statements or arguments orally or in writing relevant to the proposed regulatory action. The Board will consider written statements or arguments if received by March 16, 2009.

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Current law, Revenue and Taxation Code section 6010.9, provides that "sale" and "purchase," for sales and use tax purposes, generally do not include the design, development, writing, translation, fabrication, lease, or transfer, for a consideration, of title or possession of a custom computer program. The statute includes definitional sections.

Regulation 1502, Computers, Programs, and Data Processing, is proposed to be amended to interpret, implement, and make specific Revenue and Taxation Code section 6010.9. Amendments are proposed to clarify the statutory definition of "computer program." Specifically, the amendments are necessary to clarify that: (1) the definition of "computer program" includes subdivisions such as routines and similar programming building blocks, as described in Revenue and Taxation Code section 6010.9, subdivision (c); and (2) the definition of "computer program" contained in subdivision (c) is consistent and in harmony with the definitional and related explanatory provisions pertaining to "customer computer programs" and "existing prewritten programs" set forth in subdivision (d).

COST TO LOCAL AGENCIES AND SCHOOL DISTRICTS

The State Board of Equalization has determined that the proposed amendments and regulations do not impose a mandate on local agencies or school districts. Further, the Board has determined that the amendments and regulations will result in no direct or indirect cost or savings to any State agency, any costs to local agencies or school districts that are required to be reimbursed under Part 7 (commencing with section 17500) of Division 4 of Title 2 of the Government Code or other non–discretionary costs or savings imposed on local agencies, or cost or savings in federal funding to the State of California.

EFFECT ON BUSINESS

Pursuant to Government Code section 11346.5(a)(8), the Board of Equalization made an initial determination that the adoption of the amendments to Regulation 1502 will have no significant statewide adverse economic impact directly affecting business.

The adoption of the proposed amendment to this regulation will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California.

The amendment to the regulation as proposed will not be detrimental to California businesses in competing with businesses in other states.

The proposed regulations may affect small business.

COST IMPACT ON PRIVATE PERSON OR BUSINESSES

That Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

SIGNIFICANT EFFECT ON HOUSING COSTS

No significant effect.

FEDERAL REGULATIONS

Regulation 1502 and the proposed changes have no comparable federal regulations.

AUTHORITY

Section 7051, Revenue and Taxation Code.

REFERENCE

Section 6010.9, Revenue and Taxation Code.

CONTACT

Questions regarding the substance of the proposed regulation should be directed to Ms. Lisa Andrews (916) 322–5989, at 450 N Street, Sacramento, CA 95814, e–mail Lisa.Andrews@boe.ca.gov or MIC:50, P.O. Box 942879, 450 N Street, Sacramento, CA 94279–0050.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Regulations Coordinator, telephone (916) 445–2130, fax (916) 324–3984, e–mail Richard.Bennion@boe.ca.gov or by mail at State Board of Equalization, Attn: Rick Bennion MIC:81, P.O. Box 942879, 450 N Street, Sacramento, CA 94279–0080.

ALTERNATIVES CONSIDERED

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which this action is proposed, or be as effective and less burdensome to affected private persons than the proposed action.

AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Board has prepared an initial statement of reasons and an underscored version (express terms) of the proposed regulation. Both of these documents and all information on which the proposal is based are available to the public upon request. The Rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed regulation are available on the Internet at the Board's web site http://www.boe.ca.gov.

AVAILABILITY OF FINAL STATEMENT OF REASONS

The final statement of reasons will be made available on the Internet at the Board's web site following its public hearing of the proposed regulation. It is also available for your inspection at 450 N Street, Sacramento, California.

ADDITIONAL COMMENTS

Following the hearing, the State Board of Equalization may in accordance with law adopt the proposed regulation if the text remains substantially the same as described in the text originally made available to the public. If the State Board of Equalization makes modifications which are substantially related to the originally proposed text, the Board will make the modified text, with the changes clearly indicated, available to the public for fifteen days before adoption of the regulation. The text of any modified regulation will be mailed to those interested parties who commented on the proposed regulatory action orally or in writing or who asked to be informed of such changes. The modified regulation will be available to the public from Mr. Bennion. The State Board of Equalization will consider written comments on the modified regulation for fifteen days after the date on which the modified regulation is made available to the public.

TITLE 25. DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT

MEMORANDUM

DATE: January 23, 2009

TO: Interested Parties

FROM: Cathy E. Creswell, Deputy Director
Division of Housing Policy Development

SUBJECT: **Annual Progress Reports — Notice of Comment Period**

NOTICE OF PROPOSED RULEMAKING FOR THE ADOPTION OF HOUSING ELEMENT ANNUAL PROGRESS REPORT REGULATIONS

Notice is hereby given that the Department of Housing and Community Development (Department) proposes to adopt regulations governing the State Housing Element Annual Progress Report. These regulations implement and interpret subdivision (b) of Government

STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
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MICHELLE STEEL
Third District, Rolling Hills Estates

JUDY CHU, Ph.D.
Fourth District, Los Angeles

JOHN CHIANG
State Controller

RAMON J. HIRSIG
Executive Director

January 29, 2009

To Interested Parties:

Notice of Proposed Regulatory Action
by the
State Board of Equalization

Proposed to Adopt Regulation 1502, *Computers, Programs, and Data Processing*

NOTICE IS HEREBY GIVEN

The State Board of Equalization, pursuant to the authority vested in it by section 15606(a) of the Government Code, proposes to amend Regulation 1502, Computers, Programs, and Data Processing, in Title 18, Division 2, Chapter 4, of the California Code of Regulations, relating to sales and use tax. A public hearing on the proposed regulations will be held in Room 121, 450 N Street, Sacramento, at 9:30 a.m., or as soon thereafter as the matter may be heard, on March 16, 2009. At the hearing, any person interested may present statements or arguments orally or in writing relevant to the proposed regulatory action. The Board will consider written statements or arguments if received by March 16, 2009.

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Current law, Revenue and Taxation Code section 6010.9, provides that "sale" and "purchase," for sales and use tax purposes, generally do not include the design, development, writing, translation, fabrication, lease, or transfer, for a consideration, of title or possession of a custom computer program. The statute includes definitional sections.

Regulation 1502, Computers, Programs, and Data Processing, is proposed to be amended to interpret, implement, and make specific Revenue and Taxation Code section 6010.9. Amendments are proposed to clarify the statutory definition of "computer program." Specifically, the amendments are necessary to clarify that: (1) the definition of "computer program" includes subdivisions such as routines and similar programming building blocks, as described in Revenue and Taxation Code section 6010.9, subdivision (c); and (2) the definition of "computer

program" contained in subdivision (c) is consistent and in harmony with the definitional and related explanatory provisions pertaining to "customer computer programs" and "existing prewritten programs" set forth in subdivision (d).

COST TO LOCAL AGENCIES AND SCHOOL DISTRICTS

The State Board of Equalization has determined that the proposed amendments and regulations do not impose a mandate on local agencies or school districts. Further, the Board has determined that the amendments and regulations will result in no direct or indirect cost or savings to any State agency, any costs to local agencies or school districts that are required to be reimbursed under Part 7 (commencing with section 17500) of Division 4 of Title 2 of the Government Code or other non-discretionary costs or savings imposed on local agencies, or cost or savings in federal funding to the State of California.

EFFECT ON BUSINESS

Pursuant to Government Code section 11346.5(a)(8), the Board of Equalization made an initial determination that the adoption of the amendments to Regulation 1502 will have no significant statewide adverse economic impact directly affecting business.

The adoption of the proposed amendment to this regulation will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California.

The amendment to the regulation as proposed will not be detrimental to California businesses in competing with businesses in other states.

The proposed regulations may affect small business.

COST IMPACT ON PRIVATE PERSON OR BUSINESSES

That Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

SIGNIFICANT EFFECT ON HOUSING COSTS

No significant effect.

FEDERAL REGULATIONS

Regulation 1502 and the proposed changes have no comparable federal regulations.

AUTHORITY

Section 7051, Revenue and Taxation Code.

REFERENCE

Section 6010.9 Revenue and Taxation Code.

CONTACT

Questions regarding the substance of the proposed regulation should be directed to Ms. Leila Hellmuth (916) 322-5271, at 450 N Street, Sacramento, CA 95814, e-mail Leila.Hellmuth@boe.ca.gov or MIC:50, P.O. Box 942879, 450 N Street, Sacramento, CA 94279-0050.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Regulations Coordinator, telephone (916) 445-2130, fax (916) 324-3984 , e-mail Richard.Bennion@boe.ca.gov or by mail at State Board of Equalization, Attn: Rick Bennion MIC:81, P.O. Box 942879, 450 N Street, Sacramento, CA 94279-0080.

ALTERNATIVES CONSIDERED

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which this action is proposed, or be as effective and less burdensome to affected private persons than the proposed action.

AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Board has prepared an initial statement of reasons and an underscored version (express terms) of the proposed regulation. Both of these documents and all information on which the proposal is based are available to the public upon request. The Rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed regulation are available on the Internet at the Board's web site http://www.boe.ca.gov.

January 23, 2009

AVAILABILITY OF FINAL STATEMENT OF REASONS

The final statement of reasons will be made available on the Internet at the Board's web site following its public hearing of the proposed regulation. It is also available for your inspection at 450 N Street, Sacramento, California.

ADDITIONAL COMMENTS

Following the hearing, the State Board of Equalization may in accordance with law adopt the proposed regulation if the text remains substantially the same as described in the text originally made available to the public. If the State Board of Equalization makes modifications which are substantially related to the originally proposed text, the Board will make the modified text, with the changes clearly indicated, available to the public for fifteen days before adoption of the regulation. The text of any modified regulation will be mailed to those interested parties who commented on the proposed regulatory action orally or in writing or who asked to be informed of such changes. The modified regulation will be available to the public from Mr. Bennion. The State Board of Equalization will consider written comments on the modified regulation for fifteen days after the date on which the modified regulation is made available to the public.

Sincerely,

Diane G. Olson

Diane G. Olson, Chief
Board Proceedings Division

DGO:reb

Enclosures

INITIAL STATEMENT OF REASONS/PLAIN ENGLISH OVERVIEW/NON-CONTROLLING SUMMARY

REGULATION 1502, COMPUTERS, PROGRAMS, AND DATA PROCESSING

Regulation 1502 interprets and explains the application of sales and use tax to sales of computers and computer programs, as defined. It explains when such sales are subject to sales and use tax and when they are not.

Specific Purpose

The purpose of the proposed amendments is to interpret, implement, and make specific Revenue and Taxation Code section 6010.9. These amendments are necessary to provide guidance to that portion of the public which is affected by this statute.

Factual Basis

Regulation 1502 discusses the application of tax to sales of computers and data processing programs. In part, it provides definitions of various terms used in the statute.

Amendments are proposed to clarify the statutory definition of "computer program." Specifically, the amendments are necessary to: (1) clarify that the definition of a computer program includes "both systems and application programs and subdivisions, such as assemblers, compilers, routines, generators, and utility programs," as described in Revenue and Taxation Code section 6010.9, subdivision (c); and (2) harmonize the definition of "computer program" contained in subdivision (c) with the definitional and related explanatory provisions pertaining to "customer computer programs" and "existing prewritten programs" set forth in subdivision (d).

Revenue and Taxation Code section 6010.9, subdivision (c) and existing Board Sales and Use Tax Regulation 1502 (b) (10) both define "computer program" to mean the "complete plan for the solution of a problem, such as the complete sequence of automatic data-processing equipment instructions necessary to solve a problem and includes both systems and application programs and subdivisions, such as assemblers, compilers, routines, generators, and utility programs."

Statutes and regulations should be interpreted logically and consistently. In particular, statutes and regulations should be interpreted so as to be internally consistent. The phrase "complete plan for the solution of a problem" should be defined broadly enough to encompass all of the different types of "problems" that a program or subdivision of a program, such as an assembler, compiler, routine, generator, or utility program, may be created or used to address or solve. Such software building blocks obviously are created and used to solve numerous and diverse programming problems, even if taken discretely, in and of themselves, they may not be capable of fulfilling a specific purchaser's or user's complete and ultimate software needs. Therefore, the Board has concluded that to narrowly define a computer problem as only one that satisfies the full array of a purchaser's software needs in each and every instance would improperly create an internal conflict within the definitional provisions of the statute and regulation because these provisions expressly include such software building blocks as subdivisions and routines within their definition of "program." The proposed regulatory amendment is intended to clarify the statute and regulation to

statute and regulation to preclude such an impermissibly narrow interpretation, and prevent an internally self-contradictory construction of the definitional provisions set forth in Revenue and Taxation Code section 6010.9.

Revenue and Taxation Code section 6010.9, subdivision (d), provides that "custom computer program" means "a computer program prepared to the special order of the customer and includes those services represented by separately stated charges for modifications to an existing prewritten program which are prepared to the special order of the customer. The term does not include a 'canned' or prewritten computer program which is held or existing for general or repeated sale or lease, even if the prewritten or 'canned' program was initially developed on a custom basis or for in-house use. Modification to an existing prewritten program to meet the customer's needs is custom computer programming only to the extent of the modification."

Statutory provisions should be interpreted to be consistent and in harmony with related provisions. With respect to the above statutory language, if an existing prewritten program does not "meet the customer's needs" and, thus, needs custom "modification," then it cannot be said to be capable of fulfilling that customer's complete and ultimate software needs. Nevertheless, the statute expressly and explicitly deems such prewritten software requiring modification and customization to be a "program." Thus, it is obvious that the Legislature did not mean to exclude prewritten software that did not fully satisfy each and every need of a customer from the definition of computer program.

Therefore, to define a computer program as only one that satisfies the full array of the customer's software needs in each and every instance, without the need for the slightest amount of customization or data input, would improperly create a conflict with the express provisions of section 6010.9, subdivisions (c) and (d), which address the sales and use tax consequences of defining a program as either custom or prewritten (or "canned"). Nevertheless, a number of taxpayers have contended that a prewritten computer program, even one that contains millions of lines of compiled software code, does not qualify as a "computer program" under Revenue and Taxation Code section 6010.9, if it needs the slightest quantum of customization, or data or parameter input, before installation and operation. The Board has concluded that the instant amendment is necessary to clarify that such contention is both erroneous and incompatible with California law.

Pursuant to Government Code section 11346.5(a)(8), the Board of Equalization finds that the adoption of the proposed amendments will not have a significant adverse economic impact on private businesses or persons. The amendments are proposed to interpret, implement, and make specific the authorizing statutes in the context covered by the regulation for greater ease of understanding. These changes will clarify the interpretation or administration of the sales and use tax laws. Therefore, the Board has determined that these changes will not have a significant adverse economic impact on private businesses or persons.

Regulation 1502. Computers, Programs, and Data Processing.

(a) IN GENERAL. "Automatic data processing services" are those rendered in performing all or part of a series of data processing operations through an interacting assembly of procedures, processes, methods, personnel, and computers.

Automatic data processing services may be provided by manufacturers of computers, data processing centers, systems designers, consultants, software companies, etc. In addition, there are banks and other businesses which own or lease computers and use them primarily for their own purposes but occasionally provide services to others. Businesses rendering automatic data processing services will be referred to herein as "data processing firms."

(b) DEFINITIONS OF TERMS.

(1) APPLICATION. The specific job performance by an automatic data processing installation. For example, data processing for a payroll may be referred to as a payroll application.

(2) CODING. The list, in computer code, of the successive computer instructions representing successive computer operations for solving a specific problem.

(3) COMPUTER. A computer is an electronic device (including word processing equipment and testing equipment) or combination of components, which is programmable and which includes a processor (central processing unit or microprocessor), internal memory, and input and output connections. Manufacturing equipment which incorporates a computer is a computer for purposes of this regulation. However, the term does not include manufacturing equipment which operates under the control of mechanical or electronic accessories, the attachment of the equipment of which is required for the machine to operate. An electronic device otherwise qualifying as a computer remains a computer even though it may be used for information processing, data acquisition, process control, or for the control of manufacturing machinery or equipment.

(4) CUSTOM COMPUTER PROGRAM AND PROGRAMMING. A computer program prepared to the special order of the customer. A program prepared to the special order of the customer qualifies as a custom program even though it may incorporate preexisting routines, utilities, or similar program components. It includes those services represented by separately stated charges for modifications to an existing prewritten program which are prepared to the special order of the customer.

(5) DATA ENTRY (INCLUDING ENCODING). Recording information in or on storage media by punching holes or inserting magnetic bits to represent letters, digits, and special characters.

(6) DIGITAL PRE-PRESS INSTRUCTION. The creation of original information in electronic form by combining more than one computer program into specific instructions or information necessary to prepare and link files for electronic transmission for output, within the printing industry, to film, plate, or direct to press, which is then transferred on electronic media such as tape or compact disc.

(7) INPUT. The information or data transferred, or to be transferred, from storage media into the internal storage of the computer.

(8) OUTPUT. The information transferred from the internal storage of the computer to storage media or tabulated listing.

(9) PREWRITTEN PROGRAM. A program held or existing for general or repeated sale or lease. The term also includes a program developed for in-house use which is subsequently offered for sale or lease as a product.

(10) PROGRAM. "Program" is the complete plan for the solution of a problem, i.e., the complete sequence of automatic data processing equipment instructions necessary to solve a problem, and includes both systems and application programs and subdivisions thereof. "Subdivision" includes, without limitation, assemblers, compilers, generators, procedures, functions, routines, and utility programs. "Problem" means

and includes any problem that may be addressed or resolved by a program or subdivision; and the "problem" addressed need not constitute the full array of a purchaser's or user's problems, requirements, and desired features. "Problem" further includes, without limitation, any problem associated with: information processing; the manipulation or storage of data; the input or output of data; the transfer of data or programs, including subdivisions; the translation of programs, including subdivisions, into machine code; defining procedures, functions, or routines; executing programs or subdivisions that may be invoked within a program; and the control of equipment, mechanisms, or special purpose hardware.~~The complete plan for the solution of a problem, i.e., the complete sequence of automatic data processing equipment instructions necessary to solve a problem; includes both systems and application programs and subdivisions such as assemblers, compilers, routines, generators, and utility programs.~~

(11) PROOF LISTING. A tabulated listing of input.

(12) SOURCE DOCUMENTS. A document supplied by a customer of a data processing firm from which basic data are extracted (e.g., sales invoice).

(13) STORAGE MEDIA. Includes hard disks, floppy disks, diskettes, magnetic tape, cards, paper tape, drums and other devices upon which information is recorded.

(c) BASIC APPLICATIONS OF TAX.

(1) The transfer of title, for a consideration, of tangible personal property, including property on which or into which information has been recorded or incorporated, is a sale subject to tax.

(2) Charges for producing, fabricating, processing, printing, imprinting, or otherwise physically altering, modifying or treating consumer-furnished tangible personal property (cards, tapes, disks, etc.), including charges for recording or otherwise incorporating information on or into such tangible personal property, are generally subject to tax.

(3) A transfer for a consideration of the title or possession of tangible personal property which has been produced, fabricated, or printed to the special order of the customer, including property on which or into which information has been recorded or incorporated, is generally a sale subject to tax. However, if the contract is for the service of researching and developing original information for a customer, tax does not apply to the charges for the service. The tangible personal property used to transmit the original information is merely incidental to the service.

(4) Charges for the transfer of computer-generated output are subject to tax where the true object of the contract is the output and not the services rendered in producing the output. Examples include artwork, graphics, and designs. However, the transfer by the seller of the original information created by digital pre-press instruction is not subject to tax if the original information is a custom computer program as explained in subdivision (f)(2)(F).

(5) Charges for processing customer-furnished information (sales data, payroll data, etc.) are generally not subject to tax. (For explanation and specific application of tax, see subdivision (d).)

(6) Leases of tangible personal property may be subject to tax under certain conditions. (See Regulation 1660 for application of tax to leases.)

(7) Charges made for the use of a computer, on a time-sharing basis, where access to the computer is by means of remote telecommunication are not subject to tax. (See subdivision (i).)

(8) Generally data processing firms are consumers of all tangible personal property, including cards and forms, which they use in providing nontaxable services unless a separate charge is made to customers for the materials, in which case tax applies to the charge made for the materials.

(d) MANIPULATION OF CUSTOMER-FURNISHED INFORMATION AS SALE OR SERVICE.

(1) GENERAL. Generally tax applies to the conversion of customer-furnished data from one physical form of recordation to another physical form of recordation. However, if the contract is for the service of

The proposed amendments contained in this document may not be adopted. Any revisions that are adopted may differ from this text.

developing original information from customer-furnished data, tax does not apply to the charges for the service. The tangible personal property used to transmit the original information is merely incidental to the service.

(2) DATA ENTRY AND VERIFICATION. This covers situations where a data processing firm's agreement provides only for data entry, data verification, and proof listing of data, or any combination of these operations. It does not include contracts under which these services are performed as steps in processing of customer-furnished information as discussed under subdivision (d)(5).

Agreements providing solely for data entry and verification, or data entry, providing a proof list and/or verifying of data are regarded as contracts for the fabrication of storage media and sales of proof lists. Charges therefore are taxable, whether the storage media are furnished by the customer or by the data processing firm.

Tax also applies to charges for the imprinting of characters on a document to be used as the input medium in an optical character recognition system. The tax application is the same regardless of which type of storage media is used in the operation.

(3) ADDRESSING (INCLUDING LABELS) FOR MAILING. Where the data processing firm addresses, through the use of its computer or otherwise, material to be mailed, with names and addresses furnished by the customer or maintained by the data processing firm for the customer, tax does not apply to the charge for addressing. Similarly, where the data processing firm prepares, through the use of its computer or otherwise, labels to be affixed to material to be mailed, with names and addresses furnished by the customer or maintained by the data processing firm for the customer, tax does not apply to the charge for producing the labels, whether or not the data processing firm itself affixes the labels to the material to be mailed. (For the sale of mailing list by the proprietor of such list, as a sale of tangible personal property or as a nontaxable addressing, see Regulation 1504 "Mailing Services.")

(4) MICROFILMING AND PHOTORECORDING. Tax applies to charges for microfilming or photo recording except, as provided in subdivision (d)(5), where the microfilming or photo recording is done under a contract for the processing of customer-furnished information. Tax applies to a contract where data on magnetic tape are converted into combinations of alphanumeric printing, curve plotting and/or line drawings, and put on microfilm or photo recording paper.

(5) PROCESSING OF CUSTOMER-FURNISHED INFORMATION.

(A) "Processing of customer-furnished information" means the developing of original information from data furnished by the customer. Examples of automatic data processing processes which result in original information are summarizing, computing, extracting, sorting, and sequencing. Such processes also include the updating of a continuous file of information maintained by the customer with the data processing firm.

(B) "Processing of customer-furnished information" does not include: (1) an agreement providing solely for the reformatting of data or for the preparation of a proof listing or the performance of an edit routine or other pre-processing, (2) the using of a computer as a mere printing instrument, as in the preparation of personalized computer-printed letters, (3) the mere converting of data from one medium to another, (4) an agreement under which a person undertakes to prepare artwork, drawings, illustrations, or other graphic material unless the provisions of subdivision (f)(2)(F) apply regarding digital pre-press instruction and custom computer programs. Additionally, graphic material furnished incidentally to the performance of a service is not subject to tax. For example, graphics furnished in connection with the performance of architectural, engineering, accounting, or similar professional services are not subject to tax. With respect to typography, clip art combined with text on the same page is considered composed type as explained in Regulation 1541.

(C) Contracts for the processing of customer-furnished information usually provide that the data processing firm will receive the customer's source documents, record data on storage media, make necessary corrections, process the information, and then record and transfer the output to the customer.

The proposed amendments contained in this document may not be adopted. Any revisions that are adopted may differ from this text.

Where a data processing firm enters into a contract for the processing of customer-furnished information, the transfer of the original information to the customer is considered to be the rendering of a service. Except as described in subdivisions (c)(8) and (d)(5)(E), tax does not apply to the charges made under contracts providing for the transfer of the original information whether the original information is transferred on storage media, microfilm, microfiche, photo recording paper, input media for an optical character recognition system, punched cards, preprinted forms, or tabulated listing. The breakdown of the total charge into separate charges for each operation involved in processing the customer-furnished information will not change the application of tax.

(D) The furnishing of computer programs and data by the customer for processing under direction and control of the data processing firm will not alter the application of tax, notwithstanding that charges are based on computer time.

(E) Taxable Items. Where a data processing firm has entered into a contract which is regarded as a service contract under subdivision (d)(5)(C) and the data processing firm, pursuant to the contract, transfers to its customer tangible property other than property containing the original information, such as: duplicate copies of storage media; inventory control cards for use by the customer; membership cards for distribution by the customer; labels (other than address labels); microfiche duplicates; or similar items for use, tax applies to the charges made for such items. If no separate charge is made, tax applies to that portion of the charge made by the data processing firm which the cost of the additional computer time (if any), cost of materials, and labor cost to produce the items bear to the total job cost.

(F) Additional Copies. When additional copies of records, reports, tabulation, etc., are provided, tax applies to the charges made for the additional copies. "Additional copies" are all copies (other than carbon copies), whether the copies are prepared by rerunning the same program, by using multiple simultaneous printers, by looping a program such that the program is run continuously, by using different programs to produce the same output product, or by other means. Where additional copies are prepared the tax will be measured by the charge made by the data processing firm to the customer. If no separate charge is made for the additional copies, tax applies to that portion of the gross receipts which the cost of the additional computer time (if any), the cost of materials and labor cost to produce the additional copies bear to the total job cost. Charges for copies produced by means of photocopying, multi-lithing, or by other means are subject to tax.

(e) TRAINING SERVICES AND MATERIALS. Data processing firms provide a number of training services, such as data entry and verification, programming, and specialized training in systems design.

(1) Charges for training services are nontaxable, except as provided in subdivision (g) where the training services are provided as part of the sale of tangible personal property. The data processing firm is the consumer of tangible personal property which is used in training others, or provided to trainees without a separate charge as a part of the training services.

(2) Tax applies to charges for training materials, including books, furnished to trainees for a charge separate from the charge for training services.

(3) Where a person sells tangible personal property, such as computers or programs, and provides training materials to the customer without making an additional charge for the training materials, this is a sale of the training materials. The selling price of the training materials is considered to be included in the sales price of the tangible personal property.

(f) COMPUTER PROGRAMS.

(1) PREWRITTEN (CANNED) PROGRAMS. Prewritten programs may be transferred to the customer in the form of storage media or by listing the program instructions on coding sheets. In some cases they are usable as written; however, in other cases it is necessary that the program be modified, adapted, and tested to meet the customer's particular needs. Tax applies to the sale or lease of the storage media or coding sheets on which or into which such prewritten (canned) programs have been recorded, coded, or punched.

The proposed amendments contained in this document may not be adopted. Any revisions that are adopted may differ from this text.

(A) Tax applies whether title to the storage media on which the program is recorded, coded, or punched passes to the customer, or the program is recorded, coded, or punched on storage media furnished by the customer. The temporary transfer of possession of a program, for a consideration, for the purpose of direct use or to be recorded or punched by the customer, or by the lessor on the customer's premises, is a lease of tangible personal property. The tax applies unless the property is leased in substantially the same form as acquired by the lessor and the lessor has paid sales tax reimbursement or use tax with respect to the property.

(B) Tax applies to the entire amount charged to the customer. Where the consideration consists of license fees, all license fees, including site licensing and other end users fees, are includable in the measure of tax. Tax does not apply, however, to license fees or royalty payments that are made for the right to reproduce or copy a program to which a federal copyright attaches in order for the program to be published and distributed for a consideration to third parties, even if a tangible copy of the program is transferred concurrently with the granting of such right. Any storage media used to transmit the program is merely incidental.

(C) 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, that is, if the purchaser must purchase the maintenance contract in order to purchase or lease a prewritten computer program, then the charges for the maintenance contract are taxable as part of the sale or lease of the prewritten program. Tax applies to any charge for consultation services provided in connection with a maintenance contract except as provided below.

For reporting periods commencing on or after January 1, 2003, if the purchase of the maintenance contract is optional with the purchaser, that is, if the purchaser may purchase the prewritten software without also purchasing the maintenance contract, and there is a single lump sum charge for the maintenance contract, 50 percent of the lump sum charge for the maintenance contract is for the sale of tangible personal property and tax applies to that amount; the remaining 50 percent of the lump sum charge is nontaxable charges for repair.

If no tangible personal property whatsoever is transferred to the customer during the period of the maintenance contract, tax does not apply to any portion of the charge. Tax does not apply to a separately stated charge for consultation services if the purchaser is not required to purchase those services in order to purchase or lease any tangible personal property, such as a prewritten computer program or a maintenance contract.

(D) The sale or lease of a prewritten program is not a taxable transaction if the program is transferred by remote telecommunications from the seller's place of business, to or through the purchaser's computer, and the purchaser does not obtain possession of any tangible personal property, such as storage media, in the transaction. Likewise, the sale of a prewritten program is not a taxable transaction if the program is installed by the seller on the customer's computer except when the seller transfers title to or possession of storage media or installation of the program is a part of the sale of the computer.

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 purchaser for no additional charge. If a separate charge is made for the documentation or manuals, then tax applies to the separate charge.

(E) The transfer of a prewritten program on storage media is not a sale for resale when the storage media, or an exact copy, will be used to produce additional copies of the program. Charges for testing a prewritten program on the purchaser's computer to insure that such a program operates as required are installation charges and are nontaxable.

The proposed amendments contained in this document may not be adopted. Any revisions that are adopted may differ from this text.

(2) CUSTOM PROGRAMS

(A) Tax does not apply to the sale or lease of a custom computer program, other than a basic operational program, regardless of the form in which the program is transferred. Nor does the tax apply to the transfer of a custom program, or custom programming services performed, in connection with the sale or lease of computer equipment, whether or not the charges for the custom program or programming are separately stated.

(B) However, charges for custom modifications to prewritten programs are nontaxable only if the charges for the modifications are separately stated. Otherwise, the charges are taxable as part of the sale of the prewritten program.

When the charges for modification of a prewritten program are not separately stated, tax applies to the entire charge made to the customer for the modified program unless the modification is so significant that the new program qualifies as a custom program. If the prewritten program was previously marketed, the new program will qualify as a custom program, if the price of the prewritten program was 50 percent or less of the price of the new program. If the prewritten program was not previously marketed, the new program will qualify as a custom program if the charge made to the customer for custom programming services, as evidenced in the records of the seller, is more than 50 percent of the contract price to the customer.

(C) Charges for any written documentation or manuals designed to facilitate the use of a custom computer program by the customer are nontaxable, whether separately stated or not. The vendor of the custom computer program is the consumer of the written documentation or manuals, or of any tangible personal property used by the vendor in producing the written documentation or manuals.

(D) A custom computer program includes a program prepared to the special order of a customer who will use the program to produce and sell or lease copies of the program, and the charge for such custom computer program is not subject to tax. Sales or leases of the copies, however, are taxable as sales of prewritten computer programs.

(E) A computer program prepared to the special order of a customer to operate for the first time in connection with a particular basic operating system is a custom computer program even though a different version currently operates in connection with an incompatible basic operating system.

(F) Digital pre-press instruction is a custom computer program under section 6010.9 of the Revenue and Taxation Code, the sale of which is not subject to tax, provided the digital pre-press instruction is prepared to the special order of the purchaser. Digital pre-press instruction shall not, however, be regarded as a custom computer program if it is a "canned" or prewritten computer program which is held or existing for general or repeated sale or lease, even if the digital pre-press instruction was initially developed on a custom basis or for in-house use. The sale of such canned or prewritten digital pre-press instruction in tangible form is a sale of tangible personal property, the retail sale of which is subject to tax.

(g) SERVICE CHARGES. The following activities are service activities. Charges for the performance of such services are nontaxable unless the services are performed as a part of the sale of tangible personal property.

(1) Designing and implementing computer systems (e.g., determining equipment and personnel required and how they will be utilized).

(2) Designing storage and data retrieval systems (e.g., determining what data communications and high-speed input-output terminals are required).

(3) Consulting services (e.g., study of all or part of a data processing system).

(4) Feasibility studies (e.g., studies to determine what benefits would be derived if procedures were automated).

(5) Evaluation of bids (e.g., studies to determine which manufacturer's proposal for computer equipment would be most beneficial).

The proposed amendments contained in this document may not be adopted. Any revisions that are adopted may differ from this text.

(6) Providing technical help, analysts, and programmers, usually on an hourly basis.

(7) Training Services.

(8) Maintenance of equipment. (See Regulation 1546 for application of tax to maintenance contracts.)

(9) Consultation as to use of equipment.

(h) PICK-UP AND DELIVERY CHARGES. If the data processing firm's billing is for nontaxable processing of customer-furnished information, the tax will not apply to pick-up and delivery charges. If pick-up and delivery charges are made in conjunction with the sale of tangible personal property or the processing of customer-furnished tangible personal property, the tax will apply to the pick-up charges. Tax will apply to the delivery charges to the extent specified in Regulation 1628, "Transportation Charges."

(i) RENTAL OF COMPUTERS. A lease includes a contract, by which a person secures for a consideration the use of a computer which is not on his or her premises, if the person or his or her employees, while on the premises where the computer is located operate the computer, or direct and control its operation. A lease does not include a contract whereby a person secures access by means of remote telecommunication to a computer which is not on his or her premises, if the person or his or her employees operate the computer or direct and control its operation by means of remote telecommunication. (See Regulation 1660 for application of tax to leases.)

NOTE: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 995.2, 6006, 6007, 6010, 6010.9, 6011, 6012, 6015, and 6016, Revenue and Taxation Code.

The proposed amendments contained in this document may not be adopted. Any revisions that are adopted may differ from this text.

Regulation History

Type of Regulation: Sales and Use Tax

Regulation: 1502

Title: 1502, Computers, Programs, and Data Processing

Preparation: John Waid
Legal Contact: Brad Heller

Staff request for authorization to publish a proposed amendment to Regulation 1502, *Computers, Programs, and Data Processing.*

History of Proposed Regulation:

December 17, 2008 Chief Counsel Matters, Board Authorized Publication (vote 5-0)

Sponsor: NA
Support: NA
Oppose: NA

Statement of Compliance

The State Board of Equalization, in process of adopting Sales and Use Tax Regulation 1502, Computers, Programs, and Data Processing, did comply with the provision of Government Code section 11346.4(a)(1) through (4). A notice to interested parties was mailed on January 29, 2009, 46 days prior to the public hearing.

April 2, 2009

Richard Bennion
Regulations Coordinator
State Board of Equalization

BEFORE THE CALIFORNIA STATE BOARD OF EQUALIZATION

450 N Street, Room 121

Sacramento, California

REPORTER'S TRANSCRIPT

MARCH 16, 2009

ITEM F1

PUBLIC HEARING

Reported by: Beverly D. Toms

No. CSR 1662

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2 P R E S E N T

3

4 For the Board of Equalization: Betty Yee
Chair

5

Judy Chu
6 Vice-Chair

7 Bill Leonard
Member

8

Michelle Steel
9 Member

10 Marcy Jo Mandel
Appearing for John
11 Chiang, State Controller
(per Government Code
12 Section 7.9)

13 Diane Olson
Chief, Board
14 Proceedings Division

15

Board of Equalization
16 Staff: Robert Lambert

17 Bradley Heller

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4 Sacramento, California
5 March 16, 2009
6 ---oOO---
7 MS. OLSON: Our next -- next matter is Public
8 Hearing on Sales and Use Tax Regulation 1502, Computers,
9 Programs and Data Processing.
10 MS. YEE: Okay.
11 MR. LAMBERT: Good afternoon, Madam Chairwoman
12 and Members of the Board. We're here requesting the
13 Board's adoption of Regulation 1502 as published and
14 provided to you.
15 MS. YEE: Okay.
16 Okay.
17 MR. LAMBERT: I don't know if anyone's signed
18 in to -- as a public speaker.
19 MS. YEE: No, we do not have any public
20 speakers on this item.
21 Any questions or comments, Members?
22 MR. LEONARD: Move.
23 DR. CHU: Second.
24 MS. YEE: Motion by Mr. Leonard, second by Dr.
25 Chu.
26 Without objection, that motion carries.
27 MR. LAMBERT: Thank you.
28 MS. YEE: Thank you.

---oOo---

1 REPORTER'SCERTIFICATE

2

3 State of California)

4) ss

5 County of Sacramento)

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7 I, BEVERLY D. TOMS, Hearing Reporter for the

8 California State Board of Equalization certify that on

9 March 16, 2009 I recorded verbatim, in shorthand, to the

10 best of my ability, the proceedings in the

11 above-entitled hearing; that I transcribed the shorthand

12 writing into typewriting; and that the preceding 3 pages

13 constitute a complete and accurate transcription of the

14 shorthand writing.

15

16 Dated: March 29, 2009.

17

18

19

20 BEVERLY D. TOMS

21 Hearing Reporter

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23

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2009 MINUTES OF THE STATE BOARD OF EQUALIZATION

Monday, March 16, 2009

[C] SALES AND USE TAX APPEALS HEARINGS

C1 Sandisk Corporation, 208950, 225448, 312943 (GH)
10-1-99 to 3-31-00, $158,327.97 Tax
4-1-00 to 12-31-01, $456,221.06 Tax
10-1-99 to 12-31-01, $614,549.03 Claim for Refund
For Petitioner: Richard B. Taylor, CPA
Phuong Nguyen, CPA
Robert Hirt, Representative
Mary Mendes, Representative
For Sales and Use Tax Department: Scott Lambert, Hearing Representative
Contribution Disclosures pursuant to Government Code section 15626: None were disclosed.
Issue: Whether petitioner has established that adjustments are warranted to the measure of inventory withdrawals subject to use tax.
Action: Upon motion of Ms. Yee, seconded by Ms. Mandel and unanimously carried, Ms. Yee, Dr. Chu, Mr. Leonard, Ms. Steel and Ms. Mandel voting yes, the Board ordered staff to review the additional documentation presented today and bring back to a hearing.

C2 Shirley Everett-Dicko and Donald Ray White, 342570 (CH)
10-1-02 to 9-30-05, $2,133.17 Tax, $3,940.43 Negligence Penalty
For Petitioner: Deborah Bell, CPA
For Sales and Use Tax Department: Scott Lambert, Hearing Representative
Contribution Disclosures pursuant to Government Code section 15626: None were disclosed.
Issues: Whether an additional reduction to unreported taxable sales is warranted to account for days that the business was allegedly closed.
Whether petitioner was negligent.
Whether a portion of the interest that has accrued should be relieved.
Action: Upon motion of Ms. Yee, seconded by Mr. Leonard and unanimously carried, Ms. Yee, Dr. Chu, Mr. Leonard, Ms. Steel and Ms. Mandel voting yes, the Board postponed the matter to the May 27-29, 2009 meeting.

PUBLIC HEARINGS

F1 Proposed Amendments to Sales and Use Tax Regulation 1502, *Computers, Programs, and Data Processing*

Robert Lambert, Assistant Chief Counsel, Legal Affairs Division, Legal Department, (was available to answer questions **OR** made introductory remarks) regarding the proposed amendments to clarify the definition of a computer program (Exhibit 3.6).

Speakers: Speakers were invited to address the Board, but there were none.

STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
450 N STREET, SACRAMENTO, CALIFORNIA
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BETTY T. YEE
First District, San Francisco

BILL LEONARD
Second District, Ontario/Sacramento

MICHELLE STEEL
Third District, Rolling Hills Estates

JUDY CHU, Ph.D.
Fourth District, Los Angeles

JOHN CHIANG
State Controller

RAMON J. HIRSIG
Executive Director

January 29, 2009

To Interested Parties:

Notice of Proposed Regulatory Action
by the
State Board of Equalization

Proposed to Adopt Regulation 1502, *Computers, Programs, and Data Processing*

NOTICE IS HEREBY GIVEN

The State Board of Equalization, pursuant to the authority vested in it by section 15606(a) of the Government Code, proposes to amend Regulation 1502, Computers, Programs, and Data Processing, in Title 18, Division 2, Chapter 4, of the California Code of Regulations, relating to sales and use tax. A public hearing on the proposed regulations will be held in Room 121, 450 N Street, Sacramento, at 9:30 a.m., or as soon thereafter as the matter may be heard, on March 16, 2009. At the hearing, any person interested may present statements or arguments orally or in writing relevant to the proposed regulatory action. The Board will consider written statements or arguments if received by March 16, 2009.

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Current law, Revenue and Taxation Code section 6010.9, provides that "sale" and "purchase," for sales and use tax purposes, generally do not include the design, development, writing, translation, fabrication, lease, or transfer, for a consideration, of title or possession of a custom computer program. The statute includes definitional sections.

Regulation 1502, Computers, Programs, and Data Processing, is proposed to be amended to interpret, implement, and make specific Revenue and Taxation Code section 6010.9. Amendments are proposed to clarify the statutory definition of "computer program." Specifically, the amendments are necessary to clarify that: (1) the definition of "computer program" includes subdivisions such as routines and similar programming building blocks, as described in Revenue and Taxation Code section 6010.9, subdivision (c); and (2) the definition of "computer

program" contained in subdivision (c) is consistent and in harmony with the definitional and related explanatory provisions pertaining to "customer computer programs" and "existing prewritten programs" set forth in subdivision (d).

COST TO LOCAL AGENCIES AND SCHOOL DISTRICTS

The State Board of Equalization has determined that the proposed amendments and regulations do not impose a mandate on local agencies or school districts. Further, the Board has determined that the amendments and regulations will result in no direct or indirect cost or savings to any State agency, any costs to local agencies or school districts that are required to be reimbursed under Part 7 (commencing with section 17500) of Division 4 of Title 2 of the Government Code or other non-discretionary costs or savings imposed on local agencies, or cost or savings in federal funding to the State of California.

EFFECT ON BUSINESS

Pursuant to Government Code section 11346.5(a)(8), the Board of Equalization made an initial determination that the adoption of the amendments to Regulation 1502 will have no significant statewide adverse economic impact directly affecting business.

The adoption of the proposed amendment to this regulation will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California.

The amendment to the regulation as proposed will not be detrimental to California businesses in competing with businesses in other states.

The proposed regulations may affect small business.

COST IMPACT ON PRIVATE PERSON OR BUSINESSES

That Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

SIGNIFICANT EFFECT ON HOUSING COSTS

No significant effect.

FEDERAL REGULATIONS

Regulation 1502 and the proposed changes have no comparable federal regulations.

AUTHORITY

Section 7051, Revenue and Taxation Code.

REFERENCE

Section 6010.9 Revenue and Taxation Code.

CONTACT

Questions regarding the substance of the proposed regulation should be directed to Ms. Leila Hellmuth (916) 322-5271, at 450 N Street, Sacramento, CA 95814, e-mail Leila.Hellmuth@boe.ca.gov or MIC:50, P.O. Box 942879, 450 N Street, Sacramento, CA 94279-0050.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Regulations Coordinator, telephone (916) 445-2130, fax (916) 324-3984 , e-mail Richard.Bennion@boe.ca.gov or by mail at State Board of Equalization, Attn: Rick Bennion MIC:81, P.O. Box 942879, 450 N Street, Sacramento, CA 94279-0080.

ALTERNATIVES CONSIDERED

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which this action is proposed, or be as effective and less burdensome to affected private persons than the proposed action.

AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION.

The Board has prepared an initial statement of reasons and an underscored version (express terms) of the proposed regulation. Both of these documents and all information on which the proposal is based are available to the public upon request. The Rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed regulation are available on the Internet at the Board's web site http://www.boe.ca.gov.

January 23, 2009

AVAILABILITY OF FINAL STATEMENT OF REASONS

The final statement of reasons will be made available on the Internet at the Board's web site following its public hearing of the proposed regulation. It is also available for your inspection at 450 N Street, Sacramento, California.

ADDITIONAL COMMENTS

Following the hearing, the State Board of Equalization may in accordance with law adopt the proposed regulation if the text remains substantially the same as described in the text originally made available to the public. If the State Board of Equalization makes modifications which are substantially related to the originally proposed text, the Board will make the modified text, with the changes clearly indicated, available to the public for fifteen days before adoption of the regulation. The text of any modified regulation will be mailed to those interested parties who commented on the proposed regulatory action orally or in writing or who asked to be informed of such changes. The modified regulation will be available to the public from Mr. Bennion. The State Board of Equalization will consider written comments on the modified regulation for fifteen days after the date on which the modified regulation is made available to the public.

Sincerely,

Diane G. Olson

Diane G. Olson, Chief
Board Proceedings Division

DGO:reb

Enclosures

INITIAL STATEMENT OF REASONS/PLAIN ENGLISH OVERVIEW/NON-CONTROLLING SUMMARY

REGULATION 1502, COMPUTERS, PROGRAMS, AND DATA PROCESSING

Regulation 1502 interprets and explains the application of sales and use tax to sales of computers and computer programs, as defined. It explains when such sales are subject to sales and use tax and when they are not.

Specific Purpose

The purpose of the proposed amendments is to interpret, implement, and make specific Revenue and Taxation Code section 6010.9. These amendments are necessary to provide guidance to that portion of the public which is affected by this statute.

Factual Basis

Regulation 1502 discusses the application of tax to sales of computers and data processing programs. In part, it provides definitions of various terms used in the statute.

Amendments are proposed to clarify the statutory definition of "computer program." Specifically, the amendments are necessary to: (1) clarify that the definition of a computer program includes "both systems and application programs and subdivisions, such as assemblers, compilers, routines, generators, and utility programs," as described in Revenue and Taxation Code section 6010.9, subdivision (c); and (2) harmonize the definition of "computer program" contained in subdivision (c) with the definitional and related explanatory provisions pertaining to "customer computer programs" and "existing prewritten programs" set forth in subdivision (d).

Revenue and Taxation Code section 6010.9, subdivision (c) and existing Board Sales and Use Tax Regulation 1502 (b) (10) both define "computer program" to mean the "complete plan for the solution of a problem, such as the complete sequence of automatic data-processing equipment instructions necessary to solve a problem and includes both systems and application programs and subdivisions, such as assemblers, compilers, routines, generators, and utility programs."

Statutes and regulations should be interpreted logically and consistently. In particular, statutes and regulations should be interpreted so as to be internally consistent. The phrase "complete plan for the solution of a problem" should be defined broadly enough to encompass all of the different types of "problems" that a program or subdivision of a program, such as an assembler, compiler, routine, generator, or utility program, may be created or used to address or solve. Such software building blocks obviously are created and used to solve numerous and diverse programming problems, even if taken discretely, in and of themselves, they may not be capable of fulfilling a specific purchaser's or user's complete and ultimate software needs. Therefore, the Board has concluded that to narrowly define a computer problem as only one that satisfies the full array of a purchaser's software needs in each and every instance would improperly create an internal conflict within the definitional provisions of the statute and regulation because these provisions expressly include such software building blocks as subdivisions and routines within their definition of "program." The proposed regulatory amendment is intended to clarify the statute and regulation to

statute and regulation to preclude such an impermissibly narrow interpretation, and prevent an internally self-contradictory construction of the definitional provisions set forth in Revenue and Taxation Code section 6010.9.

Revenue and Taxation Code section 6010.9, subdivision (d), provides that "custom computer program" means "a computer program prepared to the special order of the customer and includes those services represented by separately stated charges for modifications to an existing prewritten program which are prepared to the special order of the customer. The term does not include a 'canned' or prewritten computer program which is held or existing for general or repeated sale or lease, even if the prewritten or 'canned' program was initially developed on a custom basis or for in-house use. Modification to an existing prewritten program to meet the customer's needs is custom computer programming only to the extent of the modification."

Statutory provisions should be interpreted to be consistent and in harmony with related provisions. With respect to the above statutory language, if an existing prewritten program does not "meet the customer's needs" and, thus, needs custom "modification," then it cannot be said to be capable of fulfilling that customer's complete and ultimate software needs. Nevertheless, the statute expressly and explicitly deems such prewritten software requiring modification and customization to be a "program." Thus, it is obvious that the Legislature did not mean to exclude prewritten software that did not fully satisfy each and every need of a customer from the definition of computer program.

Therefore, to define a computer program as only one that satisfies the full array of the customer's software needs in each and every instance, without the need for the slightest amount of customization or data input, would improperly create a conflict with the express provisions of section 6010.9, subdivisions (c) and (d), which address the sales and use tax consequences of defining a program as either custom or prewritten (or "canned"). Nevertheless, a number of taxpayers have contended that a prewritten computer program, even one that contains millions of lines of compiled software code, does not qualify as a "computer program" under Revenue and Taxation Code section 6010.9, if it needs the slightest quantum of customization, or data or parameter input, before installation and operation. The Board has concluded that the instant amendment is necessary to clarify that such contention is both erroneous and incompatible with California law.

Pursuant to Government Code section 11346.5(a)(8), the Board of Equalization finds that the adoption of the proposed amendments will not have a significant adverse economic impact on private businesses or persons. The amendments are proposed to interpret, implement, and make specific the authorizing statutes in the context covered by the regulation for greater ease of understanding. These changes will clarify the interpretation or administration of the sales and use tax laws. Therefore, the Board has determined that these changes will not have a significant adverse economic impact on private businesses or persons.

Regulation 1502. Computers, Programs, and Data Processing.

(a) IN GENERAL. "Automatic data processing services" are those rendered in performing all or part of a series of data processing operations through an interacting assembly of procedures, processes, methods, personnel, and computers.

Automatic data processing services may be provided by manufacturers of computers, data processing centers, systems designers, consultants, software companies, etc. In addition, there are banks and other businesses which own or lease computers and use them primarily for their own purposes but occasionally provide services to others. Businesses rendering automatic data processing services will be referred to herein as "data processing firms."

(b) DEFINITIONS OF TERMS.

(1) APPLICATION. The specific job performance by an automatic data processing installation. For example, data processing for a payroll may be referred to as a payroll application.

(2) CODING. The list, in computer code, of the successive computer instructions representing successive computer operations for solving a specific problem.

(3) COMPUTER. A computer is an electronic device (including word processing equipment and testing equipment) or combination of components, which is programmable and which includes a processor (central processing unit or microprocessor), internal memory, and input and output connections. Manufacturing equipment which incorporates a computer is a computer for purposes of this regulation. However, the term does not include manufacturing equipment which operates under the control of mechanical or electronic accessories, the attachment of the equipment of which is required for the machine to operate. An electronic device otherwise qualifying as a computer remains a computer even though it may be used for information processing, data acquisition, process control, or for the control of manufacturing machinery or equipment.

(4) CUSTOM COMPUTER PROGRAM AND PROGRAMMING. A computer program prepared to the special order of the customer. A program prepared to the special order of the customer qualifies as a custom program even though it may incorporate preexisting routines, utilities, or similar program components. It includes those services represented by separately stated charges for modifications to an existing prewritten program which are prepared to the special order of the customer.

(5) DATA ENTRY (INCLUDING ENCODING). Recording information in or on storage media by punching holes or inserting magnetic bits to represent letters, digits, and special characters.

(6) DIGITAL PRE-PRESS INSTRUCTION. The creation of original information in electronic form by combining more than one computer program into specific instructions or information necessary to prepare and link files for electronic transmission for output, within the printing industry, to film, plate, or direct to press, which is then transferred on electronic media such as tape or compact disc.

(7) INPUT. The information or data transferred, or to be transferred, from storage media into the internal storage of the computer.

(8) OUTPUT. The information transferred from the internal storage of the computer to storage media or tabulated listing.

(9) PREWRITTEN PROGRAM. A program held or existing for general or repeated sale or lease. The term also includes a program developed for in-house use which is subsequently offered for sale or lease as a product.

(10) PROGRAM. "Program" is the complete plan for the solution of a problem, i.e., the complete sequence of automatic data processing equipment instructions necessary to solve a problem, and includes both systems and application programs and subdivisions thereof. "Subdivision" includes, without limitation, assemblers, compilers, generators, procedures, functions, routines, and utility programs. "Problem" means

and includes any problem that may be addressed or resolved by a program or subdivision; and the "problem" addressed need not constitute the full array of a purchaser's or user's problems, requirements, and desired features. "Problem" further includes, without limitation, any problem associated with: information processing; the manipulation or storage of data; the input or output of data; the transfer of data or programs, including subdivisions; the translation of programs, including subdivisions, into machine code; defining procedures, functions, or routines; executing programs or subdivisions that may be invoked within a program; and the control of equipment, mechanisms, or special purpose hardware.~~The complete plan for the solution of a problem, i.e., the complete sequence of automatic data processing equipment instructions necessary to solve a problem; includes both systems and application programs and subdivisions such as assemblers, compilers, routines, generators, and utility programs.~~

(11) PROOF LISTING. A tabulated listing of input.

(12) SOURCE DOCUMENTS. A document supplied by a customer of a data processing firm from which basic data are extracted (e.g., sales invoice).

(13) STORAGE MEDIA. Includes hard disks, floppy disks, diskettes, magnetic tape, cards, paper tape, drums and other devices upon which information is recorded.

(c) BASIC APPLICATIONS OF TAX.

(1) The transfer of title, for a consideration, of tangible personal property, including property on which or into which information has been recorded or incorporated, is a sale subject to tax.

(2) Charges for producing, fabricating, processing, printing, imprinting, or otherwise physically altering, modifying or treating consumer-furnished tangible personal property (cards, tapes, disks, etc.), including charges for recording or otherwise incorporating information on or into such tangible personal property, are generally subject to tax.

(3) A transfer for a consideration of the title or possession of tangible personal property which has been produced, fabricated, or printed to the special order of the customer, including property on which or into which information has been recorded or incorporated, is generally a sale subject to tax. However, if the contract is for the service of researching and developing original information for a customer, tax does not apply to the charges for the service. The tangible personal property used to transmit the original information is merely incidental to the service.

(4) Charges for the transfer of computer-generated output are subject to tax where the true object of the contract is the output and not the services rendered in producing the output. Examples include artwork, graphics, and designs. However, the transfer by the seller of the original information created by digital pre-press instruction is not subject to tax if the original information is a custom computer program as explained in subdivision (f)(2)(F).

(5) Charges for processing customer-furnished information (sales data, payroll data, etc.) are generally not subject to tax. (For explanation and specific application of tax, see subdivision (d).)

(6) Leases of tangible personal property may be subject to tax under certain conditions. (See Regulation 1660 for application of tax to leases.)

(7) Charges made for the use of a computer, on a time-sharing basis, where access to the computer is by means of remote telecommunication are not subject to tax. (See subdivision (i).)

(8) Generally data processing firms are consumers of all tangible personal property, including cards and forms, which they use in providing nontaxable services unless a separate charge is made to customers for the materials, in which case tax applies to the charge made for the materials.

(d) MANIPULATION OF CUSTOMER-FURNISHED INFORMATION AS SALE OR SERVICE.

(1) GENERAL. Generally tax applies to the conversion of customer-furnished data from one physical form of recordation to another physical form of recordation. However, if the contract is for the service of

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developing original information from customer-furnished data, tax does not apply to the charges for the service. The tangible personal property used to transmit the original information is merely incidental to the service.

(2) DATA ENTRY AND VERIFICATION. This covers situations where a data processing firm's agreement provides only for data entry, data verification, and proof listing of data, or any combination of these operations. It does not include contracts under which these services are performed as steps in processing of customer-furnished information as discussed under subdivision (d)(5).

Agreements providing solely for data entry and verification, or data entry, providing a proof list and/or verifying of data are regarded as contracts for the fabrication of storage media and sales of proof lists. Charges therefore are taxable, whether the storage media are furnished by the customer or by the data processing firm.

Tax also applies to charges for the imprinting of characters on a document to be used as the input medium in an optical character recognition system. The tax application is the same regardless of which type of storage media is used in the operation.

(3) ADDRESSING (INCLUDING LABELS) FOR MAILING. Where the data processing firm addresses, through the use of its computer or otherwise, material to be mailed, with names and addresses furnished by the customer or maintained by the data processing firm for the customer, tax does not apply to the charge for addressing. Similarly, where the data processing firm prepares, through the use of its computer or otherwise, labels to be affixed to material to be mailed, with names and addresses furnished by the customer or maintained by the data processing firm for the customer, tax does not apply to the charge for producing the labels, whether or not the data processing firm itself affixes the labels to the material to be mailed. (For the sale of mailing list by the proprietor of such list, as a sale of tangible personal property or as a nontaxable addressing, see Regulation 1504 "Mailing Services.")

(4) MICROFILMING AND PHOTORECORDING. *Tax applies to charges for microfilming or photo* recording except, as provided in subdivision (d)(5), where the microfilming or photo recording is done under a contract for the processing of customer-furnished information. Tax applies to a contract where data on magnetic tape are converted into combinations of alphanumeric printing, curve plotting and/or line drawings, and put on microfilm or photo recording paper.

(5) PROCESSING OF CUSTOMER-FURNISHED INFORMATION.

(A) "Processing of customer-furnished information" means the developing of original information from data furnished by the customer. Examples of automatic data processing processes which result in original information are summarizing, computing, extracting, sorting, and sequencing. Such processes also include the updating of a continuous file of information maintained by the customer with the data processing firm.

(B) "Processing of customer-furnished information" does not include: (1) an agreement providing solely for the reformatting of data or for the preparation of a proof listing or the performance of an edit routine or other pre-processing, (2) the using of a computer as a mere printing instrument, as in the preparation of personalized computer-printed letters, (3) the mere converting of data from one medium to another, (4) an agreement under which a person undertakes to prepare artwork, drawings, illustrations, or other graphic material unless the provisions of subdivision (f)(2)(F) apply regarding digital pre-press instruction and custom computer programs. Additionally, graphic material furnished incidentally to the performance of a service is not subject to tax. For example, graphics furnished in connection with the performance of architectural, engineering, accounting, or similar professional services are not subject to tax. With respect to typography, clip art combined with text on the same page is considered composed type as explained in Regulation 1541.

(C) Contracts for the processing of customer-furnished information usually provide that the data processing firm will receive the customer's source documents, record data on storage media, make necessary corrections, process the information, and then record and transfer the output to the customer.

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Where a data processing firm enters into a contract for the processing of customer-furnished information, the transfer of the original information to the customer is considered to be the rendering of a service. Except as described in subdivisions (c)(8) and (d)(5)(E), tax does not apply to the charges made under contracts providing for the transfer of the original information whether the original information is transferred on storage media, microfilm, microfiche, photo recording paper, input media for an optical character recognition system, punched cards, preprinted forms, or tabulated listing. The breakdown of the total charge into separate charges for each operation involved in processing the customer-furnished information will not change the application of tax.

(D) The furnishing of computer programs and data by the customer for processing under direction and control of the data processing firm will not alter the application of tax, notwithstanding that charges are based on computer time.

(E) Taxable Items. Where a data processing firm has entered into a contract which is regarded as a service contract under subdivision (d)(5)(C) and the data processing firm, pursuant to the contract, transfers to its customer tangible property other than property containing the original information, such as: duplicate copies of storage media; inventory control cards for use by the customer; membership cards for distribution by the customer; labels (other than address labels); microfiche duplicates; or similar items for use, tax applies to the charges made for such items. If no separate charge is made, tax applies to that portion of the charge made by the data processing firm which the cost of the additional computer time (if any), cost of materials, and labor cost to produce the items bear to the total job cost.

(F) Additional Copies. When additional copies of records, reports, tabulation, etc., are provided, tax applies to the charges made for the additional copies. "Additional copies" are all copies (other than carbon copies), whether the copies are prepared by rerunning the same program, by using multiple simultaneous printers, by looping a program such that the program is run continuously, by using different programs to produce the same output product, or by other means. Where additional copies are prepared the tax will be measured by the charge made by the data processing firm to the customer. If no separate charge is made for the additional copies, tax applies to that portion of the gross receipts which the cost of the additional computer time (if any), the cost of materials and labor cost to produce the additional copies bear to the total job cost. Charges for copies produced by means of photocopying, multi-lithing, or by other means are subject to tax.

(e) TRAINING SERVICES AND MATERIALS. Data processing firms provide a number of training services, such as data entry and verification, programming, and specialized training in systems design.

(1) Charges for training services are nontaxable, except as provided in subdivision (g) where the training services are provided as part of the sale of tangible personal property. The data processing firm is the consumer of tangible personal property which is used in training others, or provided to trainees without a separate charge as a part of the training services.

(2) Tax applies to charges for training materials, including books, furnished to trainees for a charge separate from the charge for training services.

(3) Where a person sells tangible personal property, such as computers or programs, and provides training materials to the customer without making an additional charge for the training materials, this is a sale of the training materials. The selling price of the training materials is considered to be included in the sales price of the tangible personal property.

(f) COMPUTER PROGRAMS.

(1) PREWRITTEN (CANNED) PROGRAMS. Prewritten programs may be transferred to the customer in the form of storage media or by listing the program instructions on coding sheets. In some cases they are usable as written; however, in other cases it is necessary that the program be modified, adapted, and tested to meet the customer's particular needs. Tax applies to the sale or lease of the storage media or coding sheets on which or into which such prewritten (canned) programs have been recorded, coded, or punched.

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(A) Tax applies whether title to the storage media on which the program is recorded, coded, or punched passes to the customer, or the program is recorded, coded, or punched on storage media furnished by the customer. The temporary transfer of possession of a program, for a consideration, for the purpose of direct use or to be recorded or punched by the customer, or by the lessor on the customer's premises, is a lease of tangible personal property. The tax applies unless the property is leased in substantially the same form as acquired by the lessor and the lessor has paid sales tax reimbursement or use tax with respect to the property.

(B) Tax applies to the entire amount charged to the customer. Where the consideration consists of license fees, all license fees, including site licensing and other end users fees, are includable in the measure of tax. Tax does not apply, however, to license fees or royalty payments that are made for the right to reproduce or copy a program to which a federal copyright attaches in order for the program to be published and distributed for a consideration to third parties, even if a tangible copy of the program is transferred concurrently with the granting of such right. Any storage media used to transmit the program is merely incidental.

(C) 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, that is, if the purchaser must purchase the maintenance contract in order to purchase or lease a prewritten computer program, then the charges for the maintenance contract are taxable as part of the sale or lease of the prewritten program. Tax applies to any charge for consultation services provided in connection with a maintenance contract except as provided below.

For reporting periods commencing on or after January 1, 2003, if the purchase of the maintenance contract is optional with the purchaser, that is, if the purchaser may purchase the prewritten software without also purchasing the maintenance contract, and there is a single lump sum charge for the maintenance contract, 50 percent of the lump sum charge for the maintenance contract is for the sale of tangible personal property and tax applies to that amount; the remaining 50 percent of the lump sum charge is nontaxable charges for repair.

If no tangible personal property whatsoever is transferred to the customer during the period of the maintenance contract, tax does not apply to any portion of the charge. Tax does not apply to a separately stated charge for consultation services if the purchaser is not required to purchase those services in order to purchase or lease any tangible personal property, such as a prewritten computer program or a maintenance contract.

(D) The sale or lease of a prewritten program is not a taxable transaction if the program is transferred by remote telecommunications from the seller's place of business, to or through the purchaser's computer, and the purchaser does not obtain possession of any tangible personal property, such as storage media, in the transaction. Likewise, the sale of a prewritten program is not a taxable transaction if the program is installed by the seller on the customer's computer except when the seller transfers title to or possession of storage media or installation of the program is a part of the sale of the computer.

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 purchaser for no additional charge. If a separate charge is made for the documentation or manuals, then tax applies to the separate charge.

(E) The transfer of a prewritten program on storage media is not a sale for resale when the storage media, or an exact copy, will be used to produce additional copies of the program. Charges for testing a prewritten program on the purchaser's computer to insure that such a program operates as required are installation charges and are nontaxable.

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(2) CUSTOM PROGRAMS

(A) Tax does not apply to the sale or lease of a custom computer program, other than a basic operational program, regardless of the form in which the program is transferred. Nor does the tax apply to the transfer of a custom program, or custom programming services performed, in connection with the sale or lease of computer equipment, whether or not the charges for the custom program or programming are separately stated.

(B) However, charges for custom modifications to prewritten programs are nontaxable only if the charges for the modifications are separately stated. Otherwise, the charges are taxable as part of the sale of the prewritten program.

When the charges for modification of a prewritten program are not separately stated, tax applies to the entire charge made to the customer for the modified program unless the modification is so significant that the new program qualifies as a custom program. If the prewritten program was previously marketed, the new program will qualify as a custom program, if the price of the prewritten program was 50 percent or less of the price of the new program. If the prewritten program was not previously marketed, the new program will qualify as a custom program if the charge made to the customer for custom programming services, as evidenced in the records of the seller, is more than 50 percent of the contract price to the customer.

(C) Charges for any written documentation or manuals designed to facilitate the use of a custom computer program by the customer are nontaxable, whether separately stated or not. The vendor of the custom computer program is the consumer of the written documentation or manuals, or of any tangible personal property used by the vendor in producing the written documentation or manuals.

(D) A custom computer program includes a program prepared to the special order of a customer who will use the program to produce and sell or lease copies of the program, and the charge for such custom computer program is not subject to tax. Sales or leases of the copies, however, are taxable as sales of prewritten computer programs.

(E) A computer program prepared to the special order of a customer to operate for the first time in connection with a particular basic operating system is a custom computer program even though a different version currently operates in connection with an incompatible basic operating system.

(F) Digital pre-press instruction is a custom computer program under section 6010.9 of the Revenue and Taxation Code, the sale of which is not subject to tax, provided the digital pre-press instruction is prepared to the special order of the purchaser. Digital pre-press instruction shall not, however, be regarded as a custom computer program if it is a "canned" or prewritten computer program which is held or existing for general or repeated sale or lease, even if the digital pre-press instruction was initially developed on a custom basis or for in-house use. The sale of such canned or prewritten digital pre-press instruction in tangible form is a sale of tangible personal property, the retail sale of which is subject to tax.

(g) SERVICE CHARGES. The following activities are service activities. Charges for the performance of such services are nontaxable unless the services are performed as a part of the sale of tangible personal property.

(1) Designing and implementing computer systems (e.g., determining equipment and personnel required and how they will be utilized).

(2) Designing storage and data retrieval systems (e.g., determining what data communications and high-speed input-output terminals are required).

(3) Consulting services (e.g., study of all or part of a data processing system).

(4) Feasibility studies (e.g., studies to determine what benefits would be derived if procedures were automated).

(5) Evaluation of bids (e.g., studies to determine which manufacturer's proposal for computer equipment would be most beneficial).

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(6) Providing technical help, analysts, and programmers, usually on an hourly basis.

(7) Training Services.

(8) Maintenance of equipment. (See Regulation 1546 for application of tax to maintenance contracts.)

(9) Consultation as to use of equipment.

(h) PICK-UP AND DELIVERY CHARGES. If the data processing firm's billing is for nontaxable processing of customer-furnished information, the tax will not apply to pick-up and delivery charges. If pick-up and delivery charges are made in conjunction with the sale of tangible personal property or the processing of customer-furnished tangible personal property, the tax will apply to the pick-up charges. Tax will apply to the delivery charges to the extent specified in Regulation 1628, "Transportation Charges."

(i) RENTAL OF COMPUTERS. A lease includes a contract, by which a person secures for a consideration the use of a computer which is not on his or her premises, if the person or his or her employees, while on the premises where the computer is located operate the computer, or direct and control its operation. A lease does not include a contract whereby a person secures access by means of remote telecommunication to a computer which is not on his or her premises, if the person or his or her employees operate the computer or direct and control its operation by means of remote telecommunication. (See Regulation 1660 for application of tax to leases.)

NOTE: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 995.2, 6006, 6007, 6010, 6010.9, 6011, 6012, 6015, and 6016, Revenue and Taxation Code.

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Regulation History

Type of Regulation: Sales and Use Tax

Regulation: 1502

Title: 1502, Computers, Programs, and Data Processing

Preparation: John Waid
Legal Contact: Brad Heller

Staff request for authorization to publish a proposed amendment to Regulation 1502, *Computers, Programs, and Data Processing.*

History of Proposed Regulation:

March 16, 2009	Public hearing
March 9, 2009	45-day public comment period ends
January 23, 2009	OAL publication date; 45-day public comment period begins; IP mailing
January 13, 2009	Notice to OAL
December 17, 2008	Chief Counsel Matters, Board Authorized Publication (vote 5-0)

Sponsor:	NA
Support:	NA
Oppose:	NA