STATE OF CALIFORNIA **330.2135**

STATE BOARD OF EQUALIZATION

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December 5, 1995

Mr. R--- J--- H---
S---, M---, R--- & H---
--- Floor
XXX --- ---
--- ---, California XXXXX-XXXX

Re: Unidentified Taxpayer

Dear Mr. H---:

Your September 27, 1995 letter to Staff Counsel Sharon Jarvis was referred to me for a response. You ask how tax applies to the transfer of information and a data base to your client's customers.

You state:

> "A corporation ('T---') owns a data base of information regarding titles to real property located in [name] County, California. The data base is updated daily by the addition of information from documents to be recorded the next day with the County Recorder of [name] County. The data base, commonly referred to as a 'title plant', is then made available to title insurance companies and underwritten title companies who use the title plant to search title and insure title to [name] County real property.
>
> "Currently, the title plant consists of computerized indices, microfilm copies of recorded documents, paper copies of recorded documents, and paper or microfilm copies of maps and other miscellaneous documents. T--- currently provides title information to customers for fees based on usage. To the extent T--- delivers any tangible property, it pays a sales tax.

> "T--- proposes to enter into agreements with clients to grant immediate access to the title plant and, potentially, to transfer copies of the title plant. A typical agreement would provide that (i) the customer would have immediate access to the title plant for a period of five years, (ii) the customer would make monthly payments proportional to the customer's actual use of the title plant during the preceding month, and (iii) the customer could obtain a copy of the title plant at the end of five years by electronic data transmission, digitized optical images or in any other intangible or tangible form then utilized by T--- upon payment of a nominal sum in excess of $100."

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

Discussion

> "1. Would the agreement be characterized as a service agreement, a lease or sale for sales and use tax purposes?"

California imposes a sales tax on a retailer's gross receipts from the retail sale of tangible personal property inside this state unless the sale is specifically exempt from taxation by statute. (Rev. & Tax. Code § 6051.) Where sales tax does not apply, use tax is imposed on the sales price of property purchased from a retailer for the storage, use or other consumption in California. (Rev. & Tax. Code §§ 6201, 6401.) Gross receipts or sales price include all amounts received with respect to the sale, with no deduction for the cost of the materials, service, or expenses of the retailer passed on to the purchaser, unless there is a specific statutory exclusion. (Rev. & Tax. Code §§ 6011, 6012.)

A lease of tangible personal property in California is a continuing sale and purchase unless the lessor leases it in substantially the same form as acquired and has made a timely election to pay California sales tax reimbursement or use tax measured by the lessor's purchase price of the property. (Rev. & Tax. Code §§ 6006(g)(5), 6006.1, 6010(e)(5), 6010.1, Reg. 1660(c)(2).[1/]) When the lease is a continuing sale and purchase because either or both of the foregoing conditions are not satisfied, the lease is subject to use tax measured by rentals payable. (Reg. 1660(c)(1).) The lessee owes the tax and the lessor is required to collect it from the lessee and pay it to this Board. (Rev. & Tax. Code §§ 6202, 6203, 6204; Reg. 1660(c).)

[1/] A copy of Regulation 1660 is enclosed for your review.

We understand that T--- accumulates title information to real property on computer storage media (e.g., tape drives, floppy disks, etc.), microfilm and paper in order to create a "title plant" for access and use by its customers. We assume for purposes of this opinion that the information contained in the title plant is not in substantially the same form as acquired by T--- (e.g., T--- takes paper copies of title information obtained from the [name] Recorder's office and converts them to a microfilm format). We further assume that T---'s customers (and not T---) use this property at a single physical location in the course of performing on-site title searches and related title-information activities. We also understand that T---'s customers have an option to obtain a copy of T---'s title plant at the end of T---'s proposed five year access agreement with that customer. Based on these facts and assumptions, the initial question is whether T---'s proposed transaction constitutes a sale (or continuing sale) of tangible personal property or instead is the providing of a non-taxable service.

Regulation 1501 provides that persons engaged in the business of rendering services are consumers, not retailers, of the tangible personal property they transfer incidentally to the performance of a service. The distinction between the sale of tangible personal property and the transfer of such property incidental to the providing of a service is set forth as follows:

> "The basic distinction in determining whether a particular transaction involves a sale of tangible personal property or the transfer of tangible personal property incidental to the performance of a service is one of the true object of the contract; that is, is the real object sought by the buyer the service per se or the property produced by the service ...." (Reg. 1501.)

In this case, T---'s customers (not T---) are performing title research and related activities using information contained in a tangible form at T---'s title plant located at a single physical location. T--- is not providing its customers with title research or reports completed to the specification or order of its customers. Under these facts, the true object of T---'s contract with its customers is the providing of tangible personal property (and not a service) in the form of the title plant for use by its customers. The remaining issue is whether T--- is selling or leasing its title plant to its customers.

A lease of tangible personal property contemplates a temporary transfer of possession and use of the property to another who agrees to return the property at a future time. (See Civ. Code § 1925; see also 42 Cal.Jur.3d, Leases of Personal Property, § 1, p. 510.) A lease includes rental, hire and license. (Rev. & Tax. Code § 6006.3.) In this case, T--- is providing its customers with access to its real estate data base comprised of tangible personal property that is identical to that of the [name] County Recorder's office. T---'s customers are therefore obtaining temporary possession of tangible personal property (i.e., the title plant) for the purpose of conducting on-site title searches and related activities. Under these facts, T--- is leasing tangible personal property for a fixed term to its customers. Since the title plant is not leased in substantially the same form as acquired by T---, tax applies to the rentals payable from the title plant unless T---'s lease is considered as a sale under a security agreement (outright sale).

You state that T---'s customers will pay monthly amounts based on the amount of usage of the title plant and that these customers will have an option to purchase a copy of the title plant at the end of the five year agreement for an amount in excess of $100. Our understanding is that this option is to purchase a copy of the title plant the customer previously used during the lease period, and is not an option to purchase the actual title plant previously leased by that customer. Since the customer obtains property other than the actual leased property, the sale at inception rules explained in subdivision (a)(2)(A) of Regulation 1660 do not apply. Instead, T--- would be regarded as making a sale of a copy of the title plant to its customers for the purchase price in excess of $100. This means that T--- is leasing the title plant to its customers and must collect tax on the rentals payable. When a lessee subsequently exercises its option to purchase a copy of the title plant, T--- owes sales tax on this sale measured by the gross receipts (i.e., the option price) from that sale. T--- must report and pay tax on that sale for the quarter in which the sale occurs (i.e., when title to the copy of the title plant occurs or when possession of the copy is transferred to T---'s lessee).

> "2. Will any sales tax be due if the copy of the title plant is delivered by electronic data transmission or digitized optical images and not in any tangible form?"

Tax will not apply where T---'s transfer of the title plant to a customer is by remote telecommunications from its computer and the customer does not obtain possession of *any* tangible personal property, such as storage media or paper, in the transaction. (See Reg. 1502(f)(1)(D).)

> "3. If the transaction is characterized as a sale, will the sales tax be due and payable at the end of the fifth year?"

If the transaction were characterized as a sale at inception, tax would be due with the timely return filed for the reporting period in which the sale occurs, which would be when possession is first transferred to the "lessee." (See Reg. 1641(c).) However, as explained above, the sale at inception rules are not applicable since the customer never obtains title to the property it leased.

> "4. If the sales tax is payable earlier than the end of the fifth year, how will it be computed, as the total 'purchase price' will be unknown until the end of the fifth year, because the monthly payments will vary?"

Please see our responses above.

We hope this answers your questions. If you have any further questions, please write again.

Sincerely,

Warren L. Astleford
Staff Counsel

WLA:rz

Enclosure - Reg. 1660

cc: --- District Administrator - (--)