

**STATE BOARD OF EQUALIZATION**

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September 30, 1983

S--- M---
Manager, Financial Analyst
E--- - R---
XXXX --- ---Blvd., Suite XXXX
--- ---, CA XXXXX

Re: P--- C--- Purchase
E--- R--- - Account No. SY -- XX-XXXXXX

Dear Mr. M---:

In your letter to the Board's legal staff dated July 14, you relate the following:

We are currently purchasing a second computer system and Network Software from P--- computer. This computer will be shipped from the P--- factory in ---, Massachusetts, and the title will pass to E--- R--- Corporation at the point of shipment. The computer and software will be shipped to our facility in ---, California, on a temporary basis for a period of 2-5 months, in order to permit our programmers (which are all based in ---, California) to fully integrate our new computer with the one that we already have in place in ---. Since the hardware and software that we are purchasing are both standard products, we will have to integrate the two systems for compatibility. When our programmers have completed their testing and integration of the two systems, we will re-ship the new hardware and software to one of our East Coast offices for permanent installation and use.

Based upon the above facts, please give me a reply as to whether the above transaction represents a taxable event in the state of California with respect to Sales and Use Tax. Please also remember that the end use of this computer will be somewhere outside of California.

I assume that when you state that E--- R--- will integrate the new computer system with your existing system, you mean that you will use the new system to run programs and perform tasks useful to E--- R--- in its business, even if the programs or tasks are duplicated in some other fashion by E--- R---'s existing systems. I also assume that integrating the systems, rather than testing the

new system simply to see if it can communicate with the existing system and to see if it meets your specifications, will consume the majority of E--- R---'s time and effort during the two-to-five month period the property will remain in California.

This situation is governed by the provisions of Sales and Use Tax Regulation 1620, Interstate and Foreign Commerce (copy enclosed for your information), and the provisions of Revenue and Taxation Code section 6009.1. In relevant part, Regulation 1620(b)(3) provides:

PURCHASE FOR USE IN THIS STATE. Property purchased outside of California which is brought into California is regarded as having been purchased for use in this state if the first functional use of the property is in California. When the property is first functionally used outside of California, the property will nevertheless be presumed to have been purchased for use in this state if it is brought into California within 90 days after its purchase, unless the property is used or stored outside of California one-half or more of the time during the six-month period immediately following its entry into this state. ...For purposes of this subparagraph "functional use" means use for the purposes for which the property was designed.

Revenue and Taxation Code section 6009.1 provides, in relevant part:

"Storage" and "use" – exclusion. "Storage" and "use" do not include the keeping retaining or exercising any right or power over tangible personal property for the purpose of subsequently transporting it outside the state for use thereafter solely outside the state, or for the purpose of being processed, fabricated, or manufactured into, attached to or incorporated into, other tangible personal property to be transported outside the state and thereafter used solely outside the state.

Our conclusion is that E--- R---'s purchase of the property is not subject to California sales tax because title will pass in Massachusetts. However, California use tax will apply because E--- R--- will be making the first functional use of the property in California. E--- R--- will not merely be testing the property, or storing or using the property solely for one of the purposes defined by section 6009.1 as excluded from use tax.

We consider that the taxable activity to which California use tax applies is E--- R---'s integration of the computer system, including the hardware and software, into its existing computer system, for compatibility with the existing system. E--- R--- will be making a use in California of the property for a purpose for which the system was designed, namely to run programs and perform tasks related to E--- R---'s business needs.

Because the first functional use of the property is in California, and not out of state, it does not matter whether or not the property is principally used outside of California more than one-half of the time within the first six months after the property enters California. That is, E--- R--- will

owe use tax on the property regardless of whether the period of testing and integration in California lasts as little as two months or as long as five months.

Also, we consider that E--- R---'s integration of the new system with its existing system is not a storage or use of the kind excluded from use tax by section 6009.1. If E--- R--- uses the new system to modify existing programs, write new programs, modify the new software, or in other ways develop processes and procedures to ensure that the two systems will function as a unit in E--- R---'s business operations, these would be examples of the kinds of uses not excluded from use tax under section 6009.1. The integration of the system is an end in itself, necessary for E--- R---'s business purposes, regardless of the property's ultimate permanent location.

Please note that merely testing new equipment for a brief period of time, for example, to see if the equipment meets the specifications of the purchaser, it is not considered to be a functional use of property for which the use tax will be imposed. Business Taxes Law Guide Annotation 570.1180.

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

Very truly yours,

John Abbott
Tax Counsel

JA:ss
Enclosure

cc: Marc M. Laxer
Audit Supervisor