



# Understanding California's Sales and Use Tax

Concepts and Clarification for Procurement

—

April 21, 2025

# Meet your Presenters

## **Brian Phillips**

Senior Managing Director | KPMG LLP  
[bpphillips@kpmg.com](mailto:bpphillips@kpmg.com) – (858) 750-7294

## **Nicholas Thomas**

Manager | KPMG LLP  
[nathomas@kpmg.com](mailto:nathomas@kpmg.com) – (213) 955-8469



# Objective

In this presentation, we will explore challenges faced by CSU campuses from a sales & use tax perspective. We will share insights and best practices designed to improve your sales and use tax functions and decision making.

**Disclaimer:**

The following information is not intended to be “written advice concerning one or more Federal tax matters” subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

## Part 1

## Part 2

# Agenda

## **Taxation of Specific Transactions**

Evaluating, leases, and exemptions on purchases

1.1 – Use Tax

1.2 – Shipping and Delivery

1.3 – Leases and Rentals

## **Additional Topics for Discussion**

Tax treatment of Software and purchases for Manufacturing and Research & Development

# Part 1

# Taxation of Specific Transactions

Taxation of (1.1) use tax transactions (1.2) shipping and delivery, and (1.3) leases and rentals,



# 1.1

## Use Tax

# Accruing and Paying Use Tax in California

## Sales Tax vs. Use Tax

The general rules for determining when sales tax applies are described in subdivision (a) of Sales and Use Tax Regulation 1620. When the retailer ships the property into California from a point outside this state, sales tax applies only if two requirements are satisfied: ***(1) there must be “local participation” in the transaction by an office or other place of business of the retailer in California; and (2) the sale (title transfer) must occur in this state.***

## Purchases from Out-of-State Vendors

In general, a business must accrue and pay California use tax on purchases from out-of-state retailers if the following conditions are met:

- The out-of-state retailer does not collect California sales or use tax, and
- The item is subject to tax within the state of California

## Purchases from California Vendors

- Purchases from California vendors who have not collected the appropriate sales tax on tangible personal property delivered within the state do not require a use tax accrual on the state and local tax portion of the rate. See next slide for responsibility of district tax portion.
- This is because it is the California vendor's responsibility for collecting and remitting “sales tax” on sales made to California customers.

# District Tax – Who is responsible?

## District Tax

As a purchaser, you are generally required to report and pay district use tax on the purchase price of tangible personal property when:

- You make the first taxable use of the property in a district.
- You purchased the property without district tax or at a lesser rate of district tax than is imposed in the district of use.
- The retailer has no obligation to collect and report the tax. (i.e. lacks nexus in the district)

**Example:** If the consumer buys merchandise in a location and pays district tax of 0.50 percent and then first uses it in another location where the district tax rate is 1.00 percent, they are liable for the district use tax of 1.00 percent. The consumer is allowed a credit for the 0.50 percent district tax paid but owes the additional 0.50 percent district tax due in the location where the property was first used.

**Example:** A university purchases laboratory equipment from a vendor who does not charge district tax. The equipment is shipped to the university's campus in District A, where the district tax rate is 1.00 percent. Since the vendor did not collect district tax, the university is responsible for accruing and paying the 1.00 percent district use tax based on the location where the equipment is first used.



1.2

# Shipping & Delivery

# Shipping and Delivering Fees

In California, **sales tax typically does not apply** to shipping and delivery charges when you meet the following requirements:

- You ship directly to the purchaser by common carrier, contract carrier, or US Mail;
- Your invoice clearly lists delivery, shipping, freight, or postage as a separate charge;
- The charge is not greater than your actual cost for delivery to customer – any markup on delivery charges may be subject to tax.
  - While shipping and delivery charges may not be taxable, handling charges are taxable in California.
- The property delivered is subject to an exemption (resale, food products, etc.)

Shipping and delivery charges **are taxable** in California when:

- There are no accurate records to show the actual cost of delivery from the sale or purchase of a product
- The delivery charges are included within the unit price of the taxable purchased/sold item
- Shipping and delivery is not separately stated
- Delivery is FOB-destination and delivered through the seller's vehicles
- Freight-in charges passed onto customers within the cost of the item sold or purchased

For further reference: [CDTFA Publication 100](#)



1.3

## California Lease & Rental Agreements

# California Leases of Tangible Personal Property – University as Purchaser/Lessee

## Operating Lease (Transfer of Possession)

- Leases of tangible personal property are considered a “sale” and subject to tax
- Lessee does not gain ownership of the asset, but a purchase option is allowed to exist
- Lease agreements outline terms, payment schedules, maintenance responsibilities, and renewal options
- **Lease payments are subject to use tax**
- Certain exemptions could apply for interstate or manufacturing

## Capital Lease (Conditional Sale)

- Lease-like structure where the lessee is legally required to make payments for a fixed term
- Lessee gains ownership at the end of the term or has a purchase option at the end of the lease term for the lesser of \$100 or 1% of the contract price
- **The full contract price will be subject to sales tax unless the lessor maintains records to separately state sales price of TPP, interest, and other charges made in the contract.**
- If an option to terminate due to insufficient funds exists, Lessee is still liable for the full sales tax of the contract

*For further reference: [CDTFA Regulation 1660](#)*

# California Leases (continued)

- If sales tax is paid at the property's purchase, the lessor can opt **not to collect sales tax on lease payments** since the tax was already paid on the property's cost
- If the location of the product is moved, and taxes are being collected on lease stream, the new district and county tax rate will apply to the lease streams effective the date it has been moved
- If the lessee observes that the lease payments are not being taxed by the lessor, the lessee should consult with the lessor to determine whether the lessor has elected to pay the tax on cost. This would indicate that the transaction is not considered a continuing sale and use tax would not need to be accrued.
- If lessor provides tangible personal property included with an operator (i.e. crane operator), the transaction is not a lease of tangible personal property – but a service transaction.
- If the lessee relocates the product and the lessor has chosen to pay tax based on cost, the lessee should consult with the lessor to identify any differences in tax rates at the new location and accrue the difference.

*For further reference: [CDTFA Publication 46](#)*

# Part 2

# Additional Topics for Discussion

**Tax treatment of Software and purchases for  
Manufacturing and Research & Development**

# Downloaded Software and Software-as-a-Service (SaaS)

## Software-as-a-Service (SaaS)

- Provides internet-based access to software applications via a web browser
- **California does not tax the sale or purchase of SaaS**
- Generally taxed at full based on the bill-to location of invoice if ship-to does not exist
- Maintenance or service agreements are generally not taxable if the sale of the SaaS is not taxable
- **Note:** *If remote users outside of California access the SaaS via login and the state taxes SaaS, there may be a use tax obligation in that state.*

## Downloaded Software

- Installed directly on local devices or servers and is accessed only from the installation device
- **California does not tax the sale or purchase of electronic delivered software** unless if delivered on a tangible medium, such as a CD or flash drive
- Generally taxed at the location of where the software was installed onto a device or server
- If software was purchased through a tangible medium, subsequent electronic updates would be taxable at 50%
- **Note:** *Downloaded software is generally taxable in states other than California when it is canned, while custom-written software is typically not taxable.*

# Manufacturing / Research & Development Exemption

California offers a sales tax exemption of 3.9375% from the state-level sales tax for Manufacturing (MFG) and Research & Development (R&D). Exemptions are not automatically granted. To qualify for the exemption, you must provide vendors with the appropriate documentation stating you are making a qualified purchase.

## Qualifications:

### 1. Qualified Person

- Must derive or expend 50% or more of revenue or expenses in a qualifying line of business.

### 2. Qualified Property

- Machinery and equipment, including component parts and operating structures like belts and shafts
- Devices to operate/control machinery, such as computers and software, including repair/replacement parts with a useful life of one or more years for state income tax purposes.

### 3. Qualified Use

- Tangible personal property which is used primarily (50% or more of the time) in Manufacturing, Research and Development or generating, producing, storing, or distributing electric power.

*Please see [Regulation 1525.4](#) for more information.*

# Thank You!

**We welcome your questions and feedback.**



In preparing this advice, we considered tax authorities that are subject to change, retroactively, prospectively, or both, and any such changes could affect the conclusions stated herein. This advice is based on the completeness and accuracy of any one or more of the facts, assumptions, and client representations on which we relied, relating to the matters to which this advice is addressed. Unless separately agreed in writing, we will not update our advice for subsequent changes or modifications to the law, regulations, or to the judicial and administrative interpretations thereof, nor to take into account your correcting, updating, or providing new or additional facts or information you supplied or any assumptions on which we relied in preparing our advice.

In various sections of this document, for ease of understanding and as a stylistic matter, we may use language (such as “will” or “should”) that might suggest that we have come to a particular level of comfort or conclusion as to a particular issue. We hereby advise you that such language is not intended to state a level of comfort upon which you should rely.

You (and your employees, representatives, or agents) may disclose to any and all persons, without limitation, the tax treatment or tax structure, or both, of any transaction described in the associated materials we provide to you, including, but not limited to, any tax opinions, memoranda, or other tax analyses contained in those materials.

The advice or other information in this document was prepared for the sole benefit of KPMG’s client and may not be relied upon by any other person or organization. KPMG accepts no responsibility or liability in respect of this document to any person or organization other than KPMG’s client.

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

**Learn about us:**



**[kpmg.com](https://kpmg.com)**

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

© 2025 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.