Avalara

CALIFORNIA SALES TAX COMPLIANCE GUIDE

California SB 122: Software tax readiness checklist — Is your business ready?



WHAT IS CALIFORNIA SB 122?

Effective January 1, 2027, California Senate Bill 122 extends sales and use tax to prewritten computer software and SaaS.

WHO DOES IT IMPACT?

- Software and SaaS vendors selling to California customers
- Corporate software buyers using tools in California
- Dual-impact tech companies with California employees, offices, or facilities (AR and AP exposure)

WHY IT MATTERS

Businesses that buy and sell software may be obligated to collect, file, and remit sales and/or use tax.

$500,000 economic nexus: Software counts toward California sales threshold.

$5M liability shift: High-volume spend may shift tax liability to buyers via direct pay permits.

CHECKLIST FOR SOFTWARE SELLERS

California sales and use tax applies to electronically transferred and remotely accessed prewritten software starting January 1, 2027.

Use these steps to evaluate sell-side exposure:

☐ 1. Assess product taxability.

Determine whether your software, digital subscriptions, or SaaS offerings qualify as taxable prewritten computer software under SB 122.

Solution: **Avalara Tax Research** provides fast, plain-language answers on tax rules, rates, and exemptions so your team makes confident classification decisions.

☐ 2. Evaluate your California nexus.

Review physical nexus and economic nexus criteria to determine registration and filing requirements:

- Physical nexus: Offices, remote employees, contractors, inventory, or property located in California
- Economic nexus: Over $500,000 in total sales delivered into California in the current or previous calendar year (including prewritten software and SaaS starting January 1, 2027).

Solution: Avalara's **free sales tax risk assessment** calculates where you have sales tax obligations.

☐ 3. Register with the CDTFA.

Register with the California Department of Tax and Fee Administration (CDTFA) if you're required to collect California tax and do not hold a permit. Applications can be submitted up to 90 days before obligations begin.

Solution: **Avalara License Management** centralizes state registrations and renewals.

☐ 4. Verify customer address data.

Confirm your billing systems capture your customers' billing address data to meet CDTFA sourcing rules.

Solution: **Avalara AvaTax** provides rooftop accuracy across 12,000+ U.S. sales and use tax jurisdictions.

☐ 5. Automate tax calculation and reporting.

Automate tax compliance into your billing, CRM, and ERP systems to offload the complexity of managing local district tax rates and periodic return filings.

Solution: **Avalara AvaTax** connects calculation, exemption tracking, and return remittance.

☐ 6. Monitor sales volume for $5M shift.

Sellers may be relieved from collecting sales tax when aggregate digital sales to a single purchaser exceed $5 million in a year. Once that threshold is met, tax liability may shift to the buyer.

Solution: **Avalara Exemption Certificate Management** (ECM) collects and validates direct pay certificates in real time.

CHECKLIST FOR SOFTWARE BUYERS

California sales and use tax applies to many software tools and cloud services purchased for use in California starting January 1, 2027.

Use these steps to evaluate buy-side costs:

☐ 1. Assess software purchase taxability.

Review purchase contracts, SaaS subscriptions, and billing statements to determine which purchases will become subject to sales or use tax under SB 122.

Solution: **Avalara Tax Research** delivers instant clarity on taxable versus exempt products and services.

☐ 2. Identify vendors and budget for increases.

Software supplier invoices will soon include California tax, increasing software costs by 7.25% to 10.75%+. Update IT budgets and establish automated invoice review.

Solution: **Avalara AvaTax for Accounts Payable** continuously reviews purchase line items.

☐ 3. Establish multistate and mixed-use allocation.

Identify locations for all employees accessing software licenses. Software used exclusively outside California is exempt with valid documentation. Establish consistent allocation methods for distributed teams and provide the right exemption certificates to your vendors.

Solution: **Avalara Vendor Exemption Management** streamlines creating exemption certificates and submitting them to vendors.

☐ 4. Monitor purchases for $5M liability shift.

When annual software purchases from a single vendor exceed $5 million, tax liability may shift from the vendor to you. Unless you're granted a waiver, you must obtain a CDTFA direct pay permit and self-assess use tax.

Solution: **Avalara AvaTax for Accounts Payable** monitors spend thresholds and direct pay compliance.

☐ 5. Automate use tax reporting in Accounts Payable.

To avoid unexpected liability, make sure to self-assess and remit use tax when vendors fail to charge or undercollect sales tax.

Solution: **Avalara AvaTax for Accounts Payable** automates verification, flags billing errors, and accrues use tax.

Learn more about the California software tax in our on-demand webinar.

Join a State and Local Tax Partner at Bennett Thrasher and Avalara tax specialists for a 60-minute practical breakdown of SB 122 rules, compliance challenges, and automated system readiness.

Watch now

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