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Two States, One Shift: California and Colorado Move To Tax SaaS

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Unlike many other states, California and Colorado have historically excluded software as a service (SaaS) from their definition of tangible personal property, exempting from sales tax most digital transactions.[1] However, in the span of about three weeks this June, both states enacted legislation that pulls SaaS and other remotely accessed, prewritten software into their sales and use tax bases for the first time, in both instances effective January 1, 2027. While future guidance is pending in both states to clarify some of the new provisions, it is already evident that these two statutes will shift the landscape for SaaS providers and customers alike.

California and the Human Services Exemption

On June 29, 2026, California signed Senate Bill 122 into law, which expands the statutory definition of "tangible personal property" to include "digital products," including prewritten computer software transferred electronically or accessed remotely. Historically, California had one of the narrowest sales tax bases in the country, excluding electronically delivered software and cloud transactions. SB 122 largely eliminates that exclusion, subjecting most digital transactions to sales tax beginning January 1, 2027.

Under California's new approach, software prepared to the special order of a single customer remains

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exempt as custom software. Further, California created a "human effort services" exemption for digital products that represent services "primarily involving the application of human effort" originating after a customer request. On its face, this provision excludes transactions involving the sale or purchase of the right to use or access software, including cloud infrastructure, a browser, thin client, or program interface. At its July 2026 implementation workshop, CDTFA framed the human-effort exemption as a "true object" inquiry — namely, an inquiry into whether the customer is accessing software for its function, which would be taxable, or accessing human effort delivered through software, which may remain exempt. CDTFA also acknowledged that it has not yet defined the type or degree of human effort required to meet the exemption. Without further guidance, the scope of this exemption is not clear, although a strict reading of the exemption suggests it may not be available if the customer is accessing or using software at all in connection with a digital service. Thus, we expect there will be a further refinement of this exemption over time.

Since digital products are not tied to a physical location, SB 122 adopts customer-based sourcing rules to determine where a sale is taxed, placing the burden on sellers to collect and maintain accurate customer location data. Notably, while it is possible that the state will issue an MPU form for multistate use prior to the effective date of the statute, California's statute does not currently provide a method for allocating use across multiple states, unlike some other states. Digital products purchased solely for use outside California, or in interstate or foreign commerce, may be exempt, provided a customer furnishes a certificate attesting to out-of-state use.

The law also includes a unique $5 million self-remittance rule: if a single purchaser buys more than $5 million of digital products from one retailer in a year, the retailer is relieved of collection responsibility and the purchaser must self-assess and remit tax directly to CDTFA. It is unclear how this will work in practice, as it would seem to require businesses to separately track this threshold, and they may have to reprogram their sales tax software to address this rule mid-year.

Another area of ambiguity is how “infrastructure as a service” (IaaS) and “platform as a service” (PaaS) offerings will be treated under the new rules. For many companies, determining where the line should be drawn between taxable software and an exempt platform on which customers run their own software is challenging.

Colorado and the Negotiated License Agreement Exemption

Colorado moved just a few weeks earlier, signing House Bill 26-1223 into law on June 4, 2026. Rather than creating a new “digital products” category as California did, Colorado took a more direct route: it repealed the state’s long-standing downloaded software exemption, so that “all software available for repeated sale and license” now qualifies as taxable tangible personal property, regardless of delivery method, whether physical media, downloaded, or remote access. This eliminates the state’s longstanding requirement that software be delivered via physical medium to be subject to sales tax.

In addition to exempting custom software, Colorado’s law has a narrow negotiated license exemption: software governed by a “negotiable license agreement” (one individually bargained and executed by authorized representatives of each party) is exempt. Critically, the statute expressly excludes standard click-through, browse-wrap, and similar non-negotiable agreements from qualifying for that exemption. This may preclude many SaaS businesses from availing themselves of this exemption. However, it is not clear from the statute to what extent an agreement must be negotiable in order to meet the exemption. While the statute does not expressly mention SaaS, Colorado evidently assumed that most SaaS sales would be subject to sales tax, as it included SaaS when projecting revenue impact.

An added complexity in Colorado is the many home-rule municipalities that retain independent authority over their own sales and use tax administration. Thus, state-level changes may not align cleanly with local rules in cities like Denver and Boulder. The shift to taxing remotely accessed software may create new questions about how to source those transactions.

As in California, formal guidance is anticipated, which should help better understand the negotiable license agreement exemption and answer other open questions surrounding this new law. On August 18, 2026, the Colorado Department of Revenue held a workgroup meeting to solicit public input on areas needing regulatory clarification, but did not provide any timeline for when proposed regulations would be issued.

What to Watch For

As we anticipate formal guidance from both states, at this time, there are more questions than answers, especially on the scope and interpretation of the exemptions in each of these laws.

One key question at this stage is whether more nuanced digital services will be wrapped up in these new laws, or whether, like many states, such services will be carved out in future guidance or by examples in regulations. In California, some transactions may fall under the human-effort service exemption, but the definitions are as yet not sufficiently clear to draw such a conclusion. Companies with hybrid product suites, meaning SaaS bundled with implementation, training, or professional services, will need to thoroughly analyze these new provisions to determine where to draw the line. Guidance regarding bundled transactions would be welcome.

Contract drafting also now carries new sales tax stakes, as Colorado's negotiated-license exemption effectively rewards individually bargained enterprise agreements over standard click-through terms. However, many contracts will fall in the grey area in between, and guidance will be needed to assess what level of negotiation is sufficient to meet the exemption. As we await further guidance, however, companies should not just sit back and wait. Treat 2026 as the implementation window: reviewing contract templates, assessing product classifications, and pressure-testing sourcing and billing systems well ahead of the January 1, 2027, effective date in both states.

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[1] Some local jurisdictions have long imposed sales tax on SaaS, despite the state excluding such transactions.
