

**STATE BOARD OF EQUALIZATION**

1020 N STREET, SACRAMENTO, CALIFORNIA  
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)  
(916) 445-6450

WILLIAM M. BENNETT  
First District, Kentfield

BRAD SHERMAN  
Second District, Los Angeles

ERNEST J. DRONENBURG, JR.  
Third District, San Diego

MATTHEW K. FONG  
Fourth District, Los Angeles

GRAY DAVIS  
*Controller, Sacramento*

BURTON W. OLIVER  
*Executive Director*

August 31, 1992

Ms. L--- F---  
Sr. Accountant  
F--- B--- C--- S---  
XXXX --- Avenue  
---, CA XXXXX

SY -- XX-XXXXXX

Dear Ms. F---:

This is in reply to your June 2, 1992 letter regarding the application of sales tax to a charge to F--- B--- C--- S--- (FBCS) for a software license. You included what appears to be a January 21, 1992 F--- internal memorandum which provided the following facts:

"We are planning to contract the development of a software product from A---, International. This product includes a communication board which requires driver software. The board's manufacturer does not offer a version of the driver software which will run under OS/2, as required for our product. A--- will purchase an unlimited source code license for the UNIX version of the driver software for F--- from the manufacturer, modify the driver source code to run under OS/2, and deliver the original and modified source to us at project completion. FBCS will sell the product built from code prepared by A--- along with the modified source.

"The license will cost us \$18,000...."

You are apparently familiar with the application of tax to the various charges except for the charge for the unlimited source code license.

Based on the facts you provided, it appears that the charge is a charge for the use of a prewritten program; that is, the UNIX version of the driver software. Sales and Use Tax Regulation 1502, Computers, Programs, and Data Processing, provides at subdivision (f)(1):

"Prewritten programs may be transferred to the customer in the form of storage media or by listing the program instructions on coding sheets. In some cases they are usable as written; however, in other cases it is necessary that the program be

modified, adapted, and tested to meet the customer's particular needs. Tax applies to the sale or lease of the storage media or coding sheets on which or into which such prewritten (canned) programs have been recorded, coded, or punched.

"(A) Tax applies whether title to the storage media on which the program is recorded, coded, or punched passes to the customer, or the program is recorded, coded or punched on storage media furnished by the customer. The temporary transfer of possession of a program, for a consideration, for the purpose of direct use or to be recorded or punched by the customer, or by the lessor on the customer's premises, is a lease of tangible personal property. The tax applies unless the property is leased in substantially the same form as acquired by the lessor and the lessor has paid sales tax reimbursement or use tax with respect to the property.

"(B) Tax applies to the entire amount charged to the customer. Where the consideration consists of license fees, all license fees, including site licensing and other end users fees, are includable in the measure of tax. Tax does not apply, however, to license fees or royalty payments that are made for the right to reproduce or copy a program to which a federal copyright attaches in order for the program to be published and distributed for a consideration to third parties, even if a tangible copy of the program is transferred concurrently with the granting of such right. Any storage media used to transmit the program is merely incidental."

We assume that "F---" and FBCS are the same entity. We also assume from the facts you present that A--- merely acts as an agent on behalf of FBCS in acquiring the program from the manufacturer. In such case, the relevant transaction is the transfer of the program from the manufacturer to FBCS.

Tax does not apply to the amount paid by FBCS to the manufacturer for the transfer of the program to FBCS if the transfer is to provide FBCS the right to reproduce and copy a program to which a federal copyright attaches in order for FBCS to publish and distribute the program regardless that FBCS has A--- modify the program to be compatible with FBCS's application.

We hope this answers your questions; however, if you need further information, feel free to write again.

Very truly yours,

Ronald L. Dick  
Senior Tax Counsel