STATE OF CALIFORNIA

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September 12, 1996

Mr. J--- B. C---
--- & --- LLP
XXX --- ---, Suite XXX
---, CA XXXXX

Dear Mr. C---:

This is in reply to your March 29, 1996 letter regarding the application of sales and use tax to your client's sales of CD ROMs and charges for access to a database under the following facts you provided:

Sales of CD ROMs

> "Our client ('The Company'), a corporation, has its headquarters in California. It purchases hardware and develops software programs for sale to consumers. It also maintains a database of technical information that it markets on CD ROM. The CD ROM is marketed through distributors and directly to consumers. The database is also marketed to customers by direct on-line computer access. The database is maintained at The Company's location in California.
>
> "The Company is registered with California for sales and use tax purposes. It [pays] tax on the sales of computer hardware, canned software and CD ROM to consumers. Sales of the CD ROM to distributors are sales for resale. Resale certificates are taken to support the distributor sales as [nontaxable].
>
> "The CD ROM contains information covering several different applications. Usually, limited access to the data on the CD ROM is sold to the consumer by the

> distributors. The consumer is required to contact our client to obtain a code to access the information on the CD ROM. When the consumer contacts The Company to obtain the access code, the consumer is told of the additional information that could be made available for an additional charge. If the customer is interested, The Company will provide additional access codes for a fee. The Company does not transfer tangible personal property to the customer. The information is already on the CD ROM and is made accessible by the provision of the additional access code(s)."

Given this information, you asked whether tax applies to the charge made by your client to the consumer.

It is our opinion that the charge made by the Company to the consumer is subject to sales tax, whether the charge is made to a customer who purchased the CD ROM directly from the Company or to a customer who purchased the CD ROM from a distributor. It is our view that the consumer is the owner of the CD ROM, and the amount paid to the Company is a payment related to the right to use the property. The consumer may have agreed, as a matter of contract, that it would make a limited use of the property only, at the time the CD ROM is purchased. No doubt this agreement is enforceable between the Company, on the one hand, and the consumer on the other hand. Yet there would be nothing to prevent the consumer from selling or giving the CD ROM to a third party. The third party would be entitled to full use of the property, as owner of the property without regard to the contractual agreement which may have existed between the consumer and the Company. To the extent that the new owner of the tangible personal property might desire the access code, the new owner would be able to use the property fully. See SBE Business Taxes Law Guide Annotation 295.0560.

Your client cannot create a new form of ownership of tangible personal property. Your client is neither a tenant-in-common nor joint tenant with respect to the CD ROM ownership by the consumer. Anyone who owns the property has the right to use the property, except to the extent they may have agreed contractually to limit their use. This is a matter of contract law, not property law. It is likely, of course, that any third person who may come into possession of the CD ROM would not be able to access the additional information without the code.

It could be argued that in the situation where the CD ROM has been purchased from an independent distributor, that the distributor who made the retail sale should be liable for the additional tax. For purposes of efficient administration of the Sales and Use Tax Law, and consistent with the contractual restriction that flows from the Company through the distributor to the consumer, it is our view that the proper taxpayer is the Company.

This is like a situation where a vehicle is sold by a dealer with the restriction that the purchaser may not use the vehicle on an interstate highway, without payment of an additional fee

to the manufacturer. The additional payment would be taxable, because it is a payment for nothing other than ownership of the property. The payment terminates the contractual restriction, but does not enlarge the consumer's property interest.

Charges for Database Access

> "The Company maintains a comprehensive data base of technical information for a specific industry at its California location. It allows on-line access to the database for a fee. The charge is based on the time the customer uses the database and the information obtained. the customer may make repeated uses of the database, with a charge for each use. Again, tangible personal property is not transferred by The Company to its customer. The customer electronically accesses the database from a remote computer terminal."

Given this information, you asked whether the charge for electronically accessing the Company's database is subject to California sales or use tax.

We assume this transaction is in no way related to the one to which your previous question related. We also assume that there is no transfer of tangible personal property involved in the transaction. In that case, we believe neither sales tax nor use tax applies to the Company's charge to customers for on-line access to the Company's database.

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

Yours very truly,

Ronald L. Dick
Senior Tax Counsel

RLD:sr

cc: Sacramento District Administrator - KH