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May 3, 1993

Mr. R--- J. A---  
Law Offices of  
---, --- & ---  
XXX --- --- ---, Suite XXX  
--- ---, CA XXXXX

Re: T--- P--- S---  
SR -- XX-XXXXXX

Dear Mr. A---:

This is in reply to your February 10, 1993 letter regarding the application of sales tax to charges to and by T--- P--- S---, Inc. (TPS), for the purchase and sale of computer hardware and peripherals under the following facts you provided:

“T--- P--- S--- Inc. (‘TPS’) is a California corporation engaged in a computer consulting business, consisting of the assembly of hardware and peripherals in the creation of custom software. TPS is contemplating a contract to develop and install a system in a foreign country for a foreign entity.

“Some tangible personal property (hardware, peripherals and supplies) will be purchased by TPS for the development of the system and retained by TPS after the completion of the contract. On those items, TPS will pay the applicable sales tax to its vendors or use tax as appropriate. Other items of tangible personal property, which are to become component parts of the system, will be purchased for resale and shipped overseas by TPS after testing and packaging in Los Angeles. It is our understanding that such items are exempt as sales in foreign commerce.

“The taxpayer is requesting the State Board of Equalization’s advice on a separate item of intangible personal property, namely a prototype to serve as a model or a ‘test-bed’ for the larger system which will be assembled and developed in the

foreign country. The prototype will be a 'scale model' of the larger system and will remain in Los Angeles until the completion of the contract overseas. The prototype will be used to perform such tasks as hardware and software integration (during the development phase of the contract) and system problem correction (during the installation, testing and support periods of the contract). On completion of the assembly and development of the system overseas, the prototype will be shipped to the customer via common carrier in foreign commerce.

"Title to the prototype will be maintained by TPS until delivery to the common carrier for shipment."

Given this information, you asked for the taxability of the sale to TPS of the materials used in constructing the prototype and the sale of the prototype itself when it is shipped at the end of the contract.

You note that TPS will purchase for resale the items of tangible personal property which will become components parts of the systems but will test the items in California. Since you have not described the type of testing, we do not provide an opinion as to whether tax may apply to the use of the component parts in California. (Cf. Bus. Taxes Law Guide Annot. 210.0560.)

We disagree with your characterization of the prototype as an "intangible." We believe it clear that the prototype is "tangible personal property" as that term is defined at Revenue and Taxation Code section 6016. Based on the facts you provide, TPS will use the prototype in this state to integrate hardware and software and to correct system problems. That use is a use in California other than for demonstration and display for the purpose of resale. The sale to TPS of the materials and labor to fabricate or assemble the prototype is a retail sale.

TPS' sale of the prototype to the customer is exempt from tax if TPS' sale and shipment of the prototype is made in accordance with Sales and Use Tax Regulation 1620, Interstate and Foreign Commerce, subdivision (a)(3)(B) or (a)(3)(C)2.

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

Mr. R--- J. A---

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May 3, 1993  
515.0725

RLD:sr