

**M e m o r a n d u m****120.0100**

To: Los Angeles – Dist. Prin. Aud. (JTQ)

Date: March 20, 1968

From: Tax Counsel (GAT)

Your memo of May 3, 1967 to Headquarters – Principal Auditor, concerning the operations of “W” has been referred to the undersigned for reply.

The specific question raised in the memo was whether the operations of “W” in processing business data for “S” constitute taxable fabrication or processing of tangible personal property or whether such operations constitute a nontaxable service.

It is our understanding that “S” entered into an oral agreement with “W”, pursuant to which “W” agreed to process “S”’s business data with the use of “W”’s electronic data processing equipment and to produce therefrom print outs of

1. general ledger detail,
2. accounts payable,
3. accounts receivable,
4. work in process,
5. general ledger trial balance,
6. customer contracts,
7. sales reports, and
8. miscellaneous control listings.

Pursuant to the agreement, “S” made duplicate copies of its sales invoices, purchase invoices, journal entries and other business records and sent these duplicates to “W”. When “W” received these copies, it transferred the data to cards by keypunch and then fed the cards into its electronic data processing equipment and produced the aforementioned print outs.

Recently a conference was held at Headquarters concerning the establishment of guidelines for determining the application of sales tax with respect to the operations of computer service centers, data processing centers, or other business enterprises which may process data or engage in operations involving electronic data processing equipment.

It was agreed that when a computer service or data processing center enters into a contract with a client to process data by the use of a computer program, or through an electrical accounting machine using a wired plugboard program, the contract should properly be characterized as a service contract. Thus, if such a contract provides that the computer service or data processing center is to receive source documents from its client, keypunch data from such documents into cards, verify data, make corrections, feed punched cards into the computer and produce tab runs, billings, etc., the total charge is not subject to tax, notwithstanding the fact that each step is separately itemized and a separate charge made therefore.

It was further agreed that where a computer service or data processing center enters into a contract with a client pursuant to which the center agrees solely to keypunch or keypunch and verify data from source documents to cards, such contact is one calling for the fabrication and sale of tangible personal property. Accordingly, charges for such work constitute taxable gross receipts. Likewise, where they agree solely to reproduce punched cards, or to produce print outs in the form of printed labels, or to produce multiple copies of reports, their receipts from such operations constitute taxable gross receipts.

Applying the foregoing guidelines to the operations performed by “W” for “S”, it appears to us that, in processing “S”’s data through its computer and producing the aforementioned print outs, “W” is utilizing a computer program or wired plugboard to process “S”’s data and produce reports. Accordingly, it is our opinion that “W”’s receipts from such operations do not constitute taxable gross receipts.

GAT:smk [lb]

Now see Reg. 1502, enacted subsequent to this letter. SPJ 12/17/04.
---