

**STATE BOARD OF EQUALIZATION**

(916) 445-3723

September 26, 1991

Mr. M--- T---
--- --- & Co.
--- --- ---, Suite XXXX
--- --- ---
--- ---, CA XXXXX

Dear Mr. T---:

This is in reply to your letter of September 23, 1991. You have sought our opinion as to application of the California Sales and Use Tax Law to the S--- A--- C--- P--- (SACP) offered by the O--- Corporation (O---)

You have furnished us with a draft of the SACP Agreement. Under this Agreement, O--- undertakes to provide to original equipment manufacturers computer software for sublicensing by the manufacturer for use by end users on the manufacturer's computer hardware.

The Agreement is extensive and complex, but basically it is a software licensing agreement. We are in agreement with your analysis that tax does not apply to the following specified fees:

- “1. Initial Participation Fee (2.1) - - ZZ acquires the right to participation in the SACP and receives the rights and benefits of the SACP.
2. Annual Participation Fee (2.2) - - ZZ agrees to pay O--- a nonrefundable annual fee for the rights received in No. 1 above.
3. Royalty Fees (4.1) - - O--- shall pay ZZ a royalty fee (commission) for each sublicense issued by ZZ. The fee will be based on an applicable fee schedule.
4. Sublicense Fees (4.2) - - For each program sublicense granted by ZZ, ZZ shall pay O--- a fee (royalty) based on an applicable price list. The fee shall be calculated effective the date the program is shipped, or if no shipment is required, when the sublicense is invoiced.

5. Technical Support Fees (4.3) - - Optional product support offered by O--- to ZZ's sublicensees. ZZ will pay O--- this fee.

6. Porting Fees (6.1.A) - - At ZZ's election, O--- will be responsible for porting the updates of specific programs. Porting fees for parts of the programs shall be payable to O--- annually in arrears.

7. Certification Service Fees (6.1.E) - - Fees paid by ZZ to O--- to have O--- provide certification approval for additional hardware compatible platforms running O--- products."

There are fees which are subject to tax, however. Paragraph 3.3.A of the Agreement provides that "O--- may agree to provide ZZ with a Porting Kit for the Programs as provided in Section 6.1." The Porting Kit must be returned to O---. Section 3.3.E. O--- retains title to the Porting Kit. Section 3.4. Section 6.1.D provides that "At ZZ's election, and on payment to O--- of mutually acceptable fees, O--- will send ZZ a Porting Kit for the applicable Programs and ZZ will be responsible for porting the Programs to the Additional Hardware." Payment of fees, if any, under Section 6.1.D are taxable. Transactions under this paragraph are neither charges for custom programming nor charges for transfer of licensing rights to preexisting programs but are charges to end users for the use of preexisting programs.

Additionally, Section 6.4.B of the Agreement provides as follows:

"O--- will provide ZZ or ZZ Sublicensees contracting directly with O---, with the following technical support services upon ZZ's payment of the Technical Support Fees mentioned in Paragraph 4.2 above, or the Sublicensees payment of applicable end-user support fees:

- (1) Telephone consultation, assistance, and advice to ZZ with respect to technical questions which are raised by Sublicensees and which its own technical staff is unable to answer; and
- (2) Correction to errors reported in the Current Release of the Program as such corrections become available; and
- (3) Updates as they become available.

ZZ and O--- will each appoint a specific staff member to serve as technical contact for the purposes of this Agreement, with one additional person as a backup. Nothing in this Agreement shall obligate O--- to update the Programs or to correct all Program errors."

Charges to sublicensees for product support services are taxable. Tax applies to charges made by O--- to sublicensees, where the sublicensees have contracted directly with O---. Charges made by ZZ to sublicensees for product support services are taxable, where ZZ has contracted directly with the sublicensees. The technical support fee referred to as nontaxable above (Section 4.3) is a fee charged by O--- to ZZ in instances of this latter type, where O--- functions essentially as a subcontractor to ZZ.

Very truly yours,

Gary J. Jugum
Assistant Chief Counsel

GJJ:sr