In your May 15, 1987 memo to Legal, you write:

“Taxpayer is engaged in the business of scoring tests for schools and school districts. The taxpayer also provides computer services and software to the school districts (O---). The service includes demographic information and questions about whether or not to close schools.

“Exhibits 1A, 1B, & 1C raise questions concerning the taxability of the O--- system. Exhibit 1D regards the sale of ‘C--- scoring software.’”

Below, I have quoted the questions you raise, followed by our responses.

“1) In Exhibit 1A, there appear to be many consulting services involved, and the main purpose of the contract may be to prepare for the testing services to come. This came early in the evolution of E.D.S. as a business entity and the school districts didn’t have computers at this time. The personal property (maps, directories, etc), may have been more like reports of the consulting, rather than the function of the contract. The taxpayer is taking the position that this was a form of consulting service.

“In Exhibit 1A, Section 9, there is a clause which transfers title of the computer program. The taxpayer contends that this program was a custom program developed for this particular job. This type of program became the basis for the O--- system discussed in the later Exhibits. My inclination is that there was no ‘canned’ software in Exhibit 1A, and that there should be no taxable measure.”
Answer. Exhibit 1A is a 1982 contract between E--- and its client, [name] High School District. We agree that Exhibit 1A is a nontaxable contract for consulting and data processing services. Part of Exhibit 1A is Schedule A, “EDS Services and Products,” which provides that E--- will provide the school district with several items. These items include: student assignment simulation reports utilizing the O--- software system; a district map of planning areas; computer files necessary to run O---; telephone and on site consulting; population maps and color transparencies; and a parent and student school satisfaction study report.

Although, as you note, Section 9 of the contract contains a general contract clause that “the computer programs specified for development under the terms and conditions of this contract become the property of the client upon completion of this contract,” there is no indication in this contract, including Schedule A, that E--- either sold or licensed to its client any computer program at all. In Schedule A, the computer files which E--- is to prepare will be used by E--- with the O--- software on another computer, not the client’s computer. Our view is that the true object of this contract was the provision of services, and E--- is the consumer of the tangible property used to transfer to the client the information sought in the reports and the maps.

“2) Exhibit 1B is a later contract which seems to have ‘canned’ computer software. It came during the period when the schools began to get their own computers. Attached you will find a copy of the current O--- brochure. This may give you a little better grasp of what exactly O--- is. Again, in Exhibits 1B, Section 9, title on the software passes to the school districts. In the license agreement attached to Exhibit 1B, there are four pages of Exhibit A, which describe the O--- software. Exhibit C in the license agreement shows tax on Item 3 only. There is no tax noted on Items 1 & 2.”

Answer. Exhibit 1B is a contract dated June 1, 1984 between E--- and the client, [name] School District. Schedule A of that contract generally calls for the same type of consulting services as in Exhibit 1A. In addition, it also calls for E--- to provide the client computer tapes containing data produced from the information provided by the client in Schedule B of that contract. Our view is that this is nontaxable processing of customer-furnished information under Regulation 1502(d)(5), even though the data is provided by E--- in machine readable form. Although not yet adopted by the Board, proposed amendments to Regulation 1502(d)(5)(C), heard by the Board on May 5, 1987, reflect the staff’s view that this is a nontaxable transaction.

The license agreement which is a part of the Exhibit 1B contract describes the O--- computer program which will be transferred to the client. Exhibit C attached to the license agreement describes the following E--- tasks:
As you note, sales tax was only charged to the client on task number 3. Our view is that tax applies to the entire charge by E--- to its client under the license agreement, except for charges which can be identified as for software installation. The other charges are, as you note, mandatory services provided with the sale of the software and taxable under Regulation 1502(k). However, the Board has recently decided that software installation must be treated as other installation charges are treated, namely as nontaxable under Revenue and Taxation Code Sections 6011(c)(3) and 6012(c)(3). There is no requirement that the installation charges be separately stated to the client, but the taxpayer does have the burden of identifying the exempt installation charges in its records.

“3) In Exhibit 1C, on Schedule C & D, Section 4, the use of the O--- system appears to be transferred through the use of a modem.

“In Exhibit 1C, on Schedule A, Section 2, there is a statement that, ‘E--- will make available the O--- system software and the [name] School District database for inter-active use from the school district premises through a telephone dial-up to a computer located in [city]. The computer referred to above is actually the taxpayer’s service bureau.

“Does Regulation 1502(c)(6) and 1502(j)(2) render this a non-taxable transaction?”

Answer. Exhibit 1C is a contract dated July 24, 1985 between E--- and the client, [name] High School District. We agree that this is a nontaxable contract for services only, and does not call for the transfer of tangible property except as incidental to the services provided. The client will use the E--- computer program through a modem, and the computer files prepared by E--- under Schedule A of Exhibit 1C constitute nontaxable processing of customer-furnished information under proposed Regulation 1502(d)(5)(C).

“4. Exhibit 1D is for the sale of C--- scoring software. The taxpayer is taking the position that the training and installation are a service and should be non-taxable.

“In discussion, the taxpayer has stated that the training and installation are a mandatory part of the purchase price of the software. Does Regulation 1502(k) make them taxable.?”
Answer. Exhibit 1D is a part of a contract between E--- and the [name 2] School District, dated May 32, 1984. In this contract, E--- has charged tax on the itemized software costs, but has not charged tax on training and installation charges. Our answer is the same as our answer to question 2 above. The training charges are subject to tax as services which are part of the sale of the software under Regulation 1502(k), but is entitled to exclude from tax its identifiable charges for installation under Sections 6011(c)(3) and 6012(c)(3).

JA:jb