

STATE OF CALIFORNIA  
BOARD OF EQUALIZATION

120.3055

In the Matter of the Petition  
for Redetermination Under the  
Sales and Use Tax Law of:

[X]

Petitioner

DECISION AND RECOMMENDATION

The preliminary hearing on the above taxpayer's petition for redetermination was held on January 16, 1985, in Culver City, California.

Hearing Officer: James E. Mahler

Appearing for Petitioner: [X]

Appearing for the  
Department of Business Taxes: Marc Laxer  
District Principal Auditor

Protested Item

The protested tax liability for this period February 8, 1980, through June 30, 1983, is measure by:

<u>Item</u>	<u>State, Local and County</u>
B. Fabrication labor in connection with the conversion of customer-furnished data not reported.	\$117,402

Taxpayer's Contentions

1. Petitioner's custom conversions are nontaxable services and are not taxable sales.
2. Petitioner's custom conversions constitute nontaxable customer computer programs.

## Summary

Under the current state of computer technology, computer systems manufactured by different companies usually use different programming codes. When a user acquires new equipment, therefore, its old programs must be translated into the new codes.

Petitioner performs such translations for its customers, primarily for word processing systems. Two types of materials require translation: application programs which tell the word processing machine how and when to perform certain functions, such as starting new paragraphs; and file records or data, such as the texts of form letters or contracts. The translation requires additions and deletions of codes and some reformatting of the file records, but otherwise involves no compilation or manipulation of the data.

Petitioner receives the old programs from its customers on magnetic tapes or disks. It records the translated programs onto tapes or disks furnished by the customer, but it is not clear whether these are the same disks on which the old programs were recorded.

According to testimony at the preliminary hearing, during the audit period the translation required substantial expertise and technical skill by petitioner's employees. On that basis, petitioner argues that the translation was a service and not a sale. Recently, however, petitioner has acquired a computer system which can do the translation mechanically, and petitioner believes that mechanical translation would be taxable.

## Analysis and Conclusions

Revenue and Taxation Code Section 6010.9 provides that the terms "sale" and "purchase" do not include the "translation of a custom computer program, other than a basic operational program. Subdivision (d) of that Section further provides: "Modification to an existing prewritten program to meet the customer's needs is custom computer programming only to the extent of the modification." The term "computer program" is defined in subdivision (c) to mean:

...the complete plan for the solution of a problem, such as the complete sequence of automatic data-processing equipment instructions necessary to solve a problem and includes both systems and application programs and subdivisions, such as assemblers, compilers, routines, generators, and utility programs.

A portion of petitioner's business involves the translation of application programs. Even if these programs are prewritten and not custom programs, the translation is a "modification" within the meaning of Section 6010.9, and is therefore not a taxable sale or purchase, regardless of whether it is done mechanically or by human translators.

The rest of petitioner's business involves the translation of file records or data. Such materials are not "programs" as defined in Section 6010.9, and the translation does not qualify for exemption under that section. The question is whether the translation may qualify for exemption as a service.

Sales and Use Tax Regulation 1501 provides that the test for distinguishing taxable sales from exempt services is “the true object of the contract; that is, is the real object sought by the buyer the service per se or the property produced by the service.” In this case, petitioner’s customers desire the property produced by the translation services, namely, tapes or disks on which the translated materials are recorded, and do not desire the translation services per se. Accordingly, the translation of file records and data is not an exempt service and is subject to tax, regardless of whether it is done mechanically or by human translators. (See also Sales and Use Tax Reg. 1502, subd. (d)(1).)

Recommendation

Reaudit to delete charges for translating application programs from the measure of tax. Necessary adjustments are to be initialed by [X].

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James E. Mahler, Hearing Officer

9/25/85  
Date