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April 6, 1994

Mr. E--- T---  
E--- T--- & Associates  
XXXX ---, Suite XXX  
---, CA XXXXX

Dear Mr. T---:

This is in reply to your February 7, 1994 letter regarding the application of use tax to the cost of computers and computer components withdrawn from inventory solely for the purpose of demonstrating their performance level.

You explained that, once the performance levels, or benchmarks, are established, the computers are returned to inventory and held for sale in the regular course of business. You provided the following additional information:

- "1. Industry standard performance measurements are used by all of the major computer systems manufacturers to demonstrate that their products perform at competitive levels. The only purpose of a benchmark is to provide a common yardstick with which to compare performances. Benchmarks provide a mechanism for customers to compare products on a consistent basis and reduces the need for the manufacturer to perform demonstrations at customer sites. The ability of a manufacturer to furnish performance numbers is critical to the success of their field sales force. Comparative performance ratings furnish empirical data that can provide the sales force a competitive advantage.
- "2. Benchmarks are developed by councils such as the Standard Performance Evaluation Corporation (SPEC) and the Transaction Processing Performance Council (TPC). There are multiple ways a computer manufacturer can demonstrate performance. The most commonly used methods are the Industry Standard Performance Demonstration,

Customized Industry Standard Performance Demonstration, and Custom Customer Performance Demonstration.

- 2.1 Industry Standard Performance Demonstration. Typically, a very large system is configured in a testing laboratory. The laboratory is used exclusively for testing. No research and development is performed in the laboratory. Demonstrations are run to demonstrate performance levels Only. Several measures of performance are required. Demonstrations can take to up six months to complete. The configuration in the lab will change on a regular basis as new options become available. All components of the system configuration must be available on a manufacturer's price list within 12 months of the manufacturer's filing of demonstration data with a performance council.
  - 2.2 Customized Industry Standard Performance Demonstration. A system is configured in the lab that is similar to a specific customer's system requirements. Industry standard performance demonstrations are conducted on the system at no cost to a potential customer.
  - 2.3 Custom Customer Performance Demonstration. A system is configured in the lab that is identical to a customer's requirements. The customer's application software and data are used to run performance specific tests that demonstrate the machine's performance level. This type of demonstration is done for large prospective customers and is not funded by the customer.
- "3. Demonstrations are conducted by manufacturers and the results are submitted to the councils for review. The results are published and made available to the public.
- "4. Components used in the demonstrations are withdrawn from inventory, used exclusively to establish performance standards, then returned to inventory for sale. The components are neither capitalized or expensed for either financial statement or federal income tax purposes."

If a purchaser who gives a resale certificate or purchases property for the purpose of reselling it makes any storage or use of the property other than retention, demonstration, or display while holding it for sale in the regular course of business, the storage or use is taxable as of the time the property is first so stored or used. (Rev. & Tax Code Sections 6094, 6244.)

We believe that benchmark testing performed under the facts you described is a demonstration of the property by the purchaser while holding it for sale in the regular course of business. Accordingly, we believe that the benchmark testing is not a taxable use of the property.

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

RLD:plh  
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cc: --- District Administrator - --