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**STATE BOARD OF EQUALIZATION**

September 21, 1966

Gentlemen:

This is in reply to your letter of September 6, 1966, requesting a ruling as to the application of sales tax to certain process license fees.

You state that ---, is a California corporation organized to license to others, for a fee, the use of a patented process for the coating of contact lenses. The license fees, or royalties, are based upon the number of pairs of lenses coated per month by the licensee. In connection with the use of this process, --- requires the licensee to use certain coating equipment owned and supplied by --- under a separate lease agreement. The equipment is a nonpatented design which was developed for the utilization of the coating process.

It is your position that the license fees paid to --- are not in any way a part of the consideration for the equipment and are, therefore, not subject to sales tax.

It appears, however, based upon the information you have supplied to us, that a licensee must pay the license fees in order to use the equipment for the purpose for which it was intended. In principle, we find very little to distinguish this case from Thys v. Washington, 31 Wn. 2d 739, 199 P.2d 68. The Washington court held that if, upon the sale of an article, further compensation is exacted for the right to use the article for the purpose for which it was intended, both amounts, the sale price and the royalties, are properly subject to sales tax. We conclude, therefore, that in addition to the equipment rental receipts, the process license fees charged by --- are subject to tax.

We have consistently followed this approach in the application of sales tax to royalties under fact situations similar to that presented here. You mention in your letter that our San Diego office has advised another firm that the license fees paid for the coating process would not be subject to tax. We believe that you are referring to the ---, which is owned by --- of the ---. Information received from the San Diego office indicates that the question presented, with regard to the --- Company, concerned only the license fees and no mention was made of a sale or lease of related equipment. The sales tax is applicable only to the sale, lease, etc., of tangible personal property. Since the question related solely to royalties payable for the use of a patented process and did not involve the transfer of tangible personal property, the advice given by our San Diego office was correct and is in no way inconsistent with the conclusion reached above.

Very truly yours,

Richard H. Ochsner  
Associate Tax Counsel

cc: San Jose -District Administrator San Diego -Supervising Tax Auditor (RH)