



**STATE BOARD OF EQUALIZATION**

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Executive Director

June 25, 1997

Mr. R--- J. F---  
--- & ---  
XXXX --- --- Highway, Suite XXX  
---, California XXXXX-XXXX

Re: Unidentified Taxpayer

Dear Mr. F---:

This is in response to your May 15, 1997 letter regarding the application of tax on your unidentified client's manufacturing operations.

You state:

“Our client is a high technology manufacturer of semiconductor devices. From time to time they require printed circuit boards to be used in their business. They purchase:

- “1. single boards to test newly developed chip designs;
- “2. burn-in boards (many) used to cycle products in quality assurance to confirm that the devices will handle the load, cycling, temperature, etc., resultant from normal use;
- “3. probe cards (boards with electrical probe pins positioned in the shape of the device) and various boards to test the circuit before assembly into a finished product;
- “4. product boards, used by the sales force, to demonstrate the design characteristics of a given device.

“ . . .

“In conjunction with the purchase of these boards, our client purchases other related services whose taxability is not so clear.

“I. Board Manufacturing Design Charges

“When our client designs a new device, it is necessary to purchase custom boards for that device. All of the boards identified above might be required during the life cycle of such a product. Board manufacturers identify charges for designing boards separately on their invoices. These charges are for the creation of digitized custom designs of the boards. These digital files eventually are used to create the board circuitry (an electronic file used to drive a machine that builds the board). Often these designs are sent to our client as files delivered via modem. In some cases, the electronic file is sent via modem and an accompanying disk or tape containing the same data is sent separately as a historical record. Sometime a schematic or photoplot is provided to the customer as a reference document. Once received, the designs are used by our client to simulate the testing of the new device prior to creating the actual board. When both parties agree that the board(s) will work properly, the manufacturer produces the board(s).”

You ask a series of questions based on the above facts. For purposes of clarity, we have separately responded to each of your questions below.

“Question 1A: Is the original board design work taxable if the file containing the board design is transmitted via modem for design verification?”

California imposes sales tax on a retailer's gross receipts from the retail sale of tangible personal property in this state unless the sale is specifically exempt from taxation by statute. (Rev. & Tax. Code § 6051.) This tax is imposed on the retailer who may collect reimbursement from its customer if the contract of sale so provides. (Civ. Code § 1656.1.) When sales tax does not apply, use tax is imposed on the sales price of property purchased from a retailer for the storage, use, or other consumption in California. (Rev. & Tax. Code §§ 6201, 6401.) A retailer engaged in business inside this state is required to collect this tax from its customers and remit it to the Board. (Rev. & Tax. Code §§ 6202, 6203.)

We understand from your letter that the file containing the board design is a prewritten (canned) program that is modified<sup>1</sup> by the manufacturer for transmission to your client. Regulation 1502(f)(1)(D) provides that tax does not apply to the sale or lease of a computer program that is transferred by remote telecommunications (e.g., modem or e-mail) where the purchaser does not obtain possession of any tangible personal property such as storage media in the transaction. This means that tax does not apply to the gross receipts or sales price from the

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<sup>1</sup> We assume that these modifications do not rise to the level to convert the prewritten program to a custom program within the meaning of Regulation 1502(f)(2)(B).

manufacturer's transfer of its circuit board design to your client if the circuit board manufacturer only transfers its board design by computer modem and does not provide your client with any tangible personal property.

“Question 2: Is the answer to question 1 the same if the electronic file is accompanied by magnetic media as a historical record without a separate charge for the magnetic media?”

The transfer of a prewritten (canned) computer program is subject to tax where it is transferred in the form of storage media or other tangible personal property whether or not the program was previously transferred by remote telecommunications. (Reg. 1502(f)(1); (f)(1)(D).) Regulation 1501.1(b)(5) provides that tax does not apply to the transfer of pattern generation tapes, wafer probe tapes, final test tapes, schematic diagrams for a probe board, and schematic diagrams for the final test load board where the transfer of these items is for archival or other informational purposes not involving a functional use.

We assume from the words “original board design” that this design is not a final test tape or schematic diagram for the final test load board. We also understand that the original board design is functionally used by your client to test and revise the design whether or not your client keeps a copy of the original design for historical purposes. Under these facts, tax applies to the entire charge for the transfer of the original board design when a tangible copy is transferred to your client. Tax applies to the entire charge whether or not the vendor's invoice contains a separate charge for the electronic transmission and a separate charge for the tangible copy.

“Question 2A: Is the answer to question 1 the same if the electronic file is accompanied by magnetic media as an historical record with a separate charge for the magnetic media?”

Please see our response to question two above.

“Question 3: Is the answer to question 1 the same if the schematic is sent to the buyer without a separate charge for the schematic?”

Please see our response to question two above.

“Question 3A: Is the answer to question 1 the same if the schematic is sent to the buyer with a separate charge for the schematic?”

Please see our response to question two above.

You provide the following background for your remaining questions:

“The manufacturer is given approval to create the designated board(s) The charges for the design work may be separately stated on the manufacturer’s invoice. Often there are charges for non-recurring engineering (NRE), the cost of modifying the digitized file to be used to drive the manufacturer’s machinery. This NRE is really a form of tooling that may or may not become the property of the customer. Often there are separate charges for testing the board.

“Question 4: Is the NRE charge taxable if title to the design file is vested in the customer?”

You state that the NRE is really a form of tooling. Regulation 1501.1(b)(5) provides that production tooling, including a mask to be used in production, is a custom-made item. Tax applies to the entire gross receipts from the transfer of that property or that portion of the contract related to the manufacture of the tooling pursuant to a phased contract. (*Id.*)

“Question 5: Is the NRE charge taxable if title to the design file is not vested in the customer?”

We understand that the board manufacturer makes a separate charge for tooling to its customer but that the customer never receives title to, or possession of, the tooling. We also understand that the separate charge for tooling represents a cost of the manufacturer in building the circuit board. Under these facts, we regard the tooling charge as part of the manufacturer’s cost of manufacturing the board which it passes on to its customer. Tax applies to the charges for manufacturing this board whether they are separately stated (e.g., a charge for the board and “tooling”) or billed as a single lump sum.

“Question 6: Is the charge for testing the board taxable?”

Taxable gross receipts or sales price include all amounts received with respect to a sale, with no deduction for the cost of materials, service or expense of the retailer passed on to the customer unless there is a specific statutory exclusion. (Rev. & Tax. Code §§ 6011, 6012.) We understand that the manufacturer’s testing of the boards is a part of its manufacturing process in order to sell or lease its board to its customers. Under these facts, tax applies to its charges for testing whether or not these charges are separately stated on the manufacturer’s invoice to your client.

Mr. R--- J. F---

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June 25, 1997  
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We hope this answers your questions. If you have any further questions, please write again.

Sincerely,

Warren L. Astleford  
Senior Tax Counsel

WLA/cmm

cc: San Francisco District Administrator (BH)