



120.0490

STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

450 N STREET, SACRAMENTO, CALIFORNIA  
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)  
(916) 445-6450

MEMBER  
First District

BRAD SHERMAN  
Second District, Los Angeles

ERNEST J. DRONENBURG, JR.  
Third District, San Diego

MATTHEW K. FONG  
Fourth District, Los Angeles

GRAY DAVIS  
*Controller, Sacramento*

May 6, 1993

BURTON W. OLIVER  
*Executive Director*

Ms. A--- DeA---  
Manager  
E--- & Y---  
XX A--- Boulevard  
--- ---, CA XXXXX

Dear Ms. DeA---:

This is in reply to your March 23, 1993 letter regarding the application of sales tax to charges for computer software programs under the following facts you described:

"XYZ Company, our client, develops and licenses to original equipment manufacturers ('OEMS') 'Object' and 'Source' code of XYZ Company's internally developed software. The codes are transferred via diskettes to the OEMs.

"Object code is a series of computer commands which enlists a desired outcome (the program). Source code is the 'blue print' of the Object code which provides a means for manipulating the Object code.

"OBJECT CODE

The Object code is sold to OEMs who in turn transfer the Object code in bundled products to distributors and end users.

"Under the licensing agreement XYZ offers OEMs a non-exclusive, non-transferable, limited license to incorporate XYZ's Object code with other software in order to create a bundled product. Under the terms of the license agreement the OEM may reproduce, or have reproduced, and sub-license XYZ's Object code as incorporated in a bundled product. The Object code may only be incorporated in a bundled product sold by the OEM. OEMs are restricted from selling, licensing, or otherwise transferring XYZ's software as a stand alone product to any person or entity.

"SOURCE CODE

In addition to the Object code, XYZ grants OEMs a non-exclusive, non-transferable, limited license to XYZ's Source code. The Source code is used to create and modify Object code versions in various hardware and software environments. Use of XYZ's Source code allows OEMs to provide support to bundled products sold to end users. The Source code is used only by the OEMs to create the Object code in OEM's software sold in bundled products.

"LICENSE FEES

The OEMs pay license fees for the limited license rights to the Object and Source codes. Typically the arrangement calls for a per-unit object code fee and a one-time source code site license. Billing to OEM's, however, may be structured in the following ways:

"Object Code

Per unit sold by OEM  
Percentage of OEM's sales price (footnote omitted)  
Flat fee

"Source Code

Separate flat fee  
Lump sum (w/Object code)  
No fee (Source code not transferred)"

Given this information, you asked whether the licensing of XYZ's Source code is incidental to the nontaxable licensing of the Object code pursuant to Sales and Use Tax Regulation 1502, subdivision (f)(1)(B) and, if so, whether XYZ's separate billing for the charge for the Object code and the Source code would affect the nontaxability of the charge.

We agree with your conclusion that tax does not apply to the charge for the Source code under the facts you described. The transfer of the Source code is incidental to the transfer of the Object code and is necessary for the OEM to be able to manufacture and distribute the bundled product it creates and distributes. We do not believe that XYZ's separate billing for the Object code and the Source code affects the nontaxable status of the transfer.

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:sr