M e m o r a n d u m

To: San Diego – District Principal Auditor   Date: November 13, 1984

From: Headquarters – Legal
John Abbott

Subject: Custom programming – sale of computer equipment

In your September 11, 1984 memorandum to Gary Jugum, you write:

> As we discussed on September 6, we are confronted with a situation where custom programming is furnished along with computer equipment in a lump-sum contract. A separately stated charge for custom programming is not made on the invoice.
>
> Should an allowance for custom programming be made in the audit or should the custom programming be considered as services provided in conjunction with a retail sale?

Our opinion is that charges for custom programming are not subject to tax in this case even where the charges are included in the sale of computer equipment without a separate statement or itemization of the programming charges. Therefore, we suggest that you make a reasonable allowance for these charges in your audit.

We believe this result is required by Revenue and Taxation Code section 6010.9, which excludes custom computer programs from tax, and the legislative finding (section 4, Chapter 1274, Statutes 1982, which accompanied the addition of section 6010.9) that:

> sales and service of custom computer programs…are service transactions not subject to sales or use taxes under any existing state law. The use of any storage media in the transfer of custom computer programs is only incidental to the true object of the transaction, which is the performance of a service….

Since custom programs are excluded from tax, it follows that custom programming must also be excluded, in view of the legistlative finding that the storage media on which the custom programs are recorded do not affect the characterization of the transaction as the performance of a service.

Please note, however, that this result only applies in a situation such as this, where (I assume) the vendor is not transferring a prewritten or canned program to the customer, together with custom modifications to that program. If the custom programming consists of modifications to a canned program, then section 6010.9(d) does not require that the charges for the modifications be separately stated.

Under the facts you have presented, we believe that the intent of section 6010.9 has the effect of invalidating that part of Regulation 1502(k) which provides that programming services are taxable when those services are provided on a mandatory basis as an inseparable part of the sale of automatic data processing equipment.

JA:ss