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September 11, 1992

Mr. R--- M. R---
---, ---, --- & ---
--- --- --- Square
--- ---, CA XXXXX

<div align="center">

E--- Corporation
SR -- XX-XXXXXX

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Dear Mr. R---:

This is in reply to your July 9, 1992 letter regarding the application of sales tax to charges by E--- Corporation (E---) for the L--- Application Programming Interface for DOS (L--- API).

You explained that E--- is in the business of developing, licensing, and manufacturing hardware and software products and technology for distributed communications and control which allow systems (whether in a home, a building, or a factory) to operate on an interactive basis. One of the key elements of this approach is a Neuron chip embedded control at a remote point (such as a light switch or thermostat) and which allows distributed information flow and control. A system utilizing E--- products is often referred to as a local operating network. The L--- API is a set of software libraries for the programming language. Customers who create application programs to run on an IBM-type personal computer incorporate portions of the libraries into their programs.

The L--- API is delivered on a set of disks which contain inexecutable object code and does not function as an application program by itself. It is solely a set of libraries which third party developers incorporate into executable application programs. There is nothing in the L--- API which is used in, or assists in, the creation of another program; (that is, it does not do any compilation or linking nor does it have any functions which help a programmer in the actual creation of another program).

A developer might want to create a program, for example, to monitor the operations of a network, such as the heating or lighting system in a building. To create that particular application program, the developer would use a compiler (such as those sold by Borland or Microsoft). The application program would be written in the programming language and would contain various calls within that program to the L--- API. The compiler compiles the program and links selected portions of the L--- API code into the overall application program. In creating the ultimate application program, the E--- code is not changed but merely incorporated as part of the overall application.

A software developer enters into a written license agreement with E--- governing the developer's rights relative to the L--- API. The developer has no right to resell the L--- API libraries as received from E---. A developer only has the right to resell an application program which has incorporated portions of the L--- API code. In some instances, a developer will create an application for its own internal use rather than for resale, in which case they have the right to use the L--- API code only as incorporated in their application.

We agree with your conclusion that transfers of the L--- API by E--- are nontaxable pursuant to Sales and Use Tax Regulation 1502, Computers, Programs, and Data Processing, subdivision (f)(l)(B) where the licensee acquires the software for incorporation into applications which are published and distributed for a charge. The application developer is developing a program in which a portion of the L--- API is imbedded. The purpose of the transfer is to allow the licensee to publish and distribute the software even though the licensee only has the right to publish and distribute executable application programs which contain the E--- libraries rather than the unmodified inexecutable object code. Any storage media used to transmit the programs to the licensee are incidental to the nontaxable transfer.

When E--- licenses a L--- API to a licensee to create an application program for the licensee's own functional use, the charge is subject to tax.

You asked us to provide you with practical guidance as to the appropriate documentation E--- should retain for audit purposes. You asked whether a signed statement from the developer indicating that the L--- API is being licensed for publication and distribution or whether it is being licensed for use is sufficient to establish the purpose of the transfer. You asked whether such a statement could be incorporated into or attached to the signed license between E--- and the developer.

Yes, we believe that such a statement would be evidence of the type of transfer. However, if the licensee were to provide a statement to E--- indicating that the use of the program is for publication and distribution but were to make use of the program which renders the original transfer by E--- subject to tax, the Board would look to E--- for payment of such tax. E--- should then seek any reimbursement from its customer. This is not a situation where an Exemption Certificate would relieve the seller from liability for the sales tax. (Cf. Rev. & Tax.

Code § 6421, which limits such use of Exemption Certificates to sales qualifying as exempt under Chapter 4 of the Sales and Use Tax Law.)

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

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