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**STATE BOARD OF EQUALIZATION**

916-445-6493

September 18, 1989

Customer computer programs – basic operational programs

Dear [X]:

In your July 1, 1989 letter to Mr. James Delaney, Chief Counsel, you raise two questions about the application of the Sales and Use Tax Law to customer computer programs. Your first question is as follows:

Question

“Regarding Regulation 1502 Section (2) Custom Programs (A).

“We need clarification concerning the Board of Equalization’s interpretation of the words in line one and two, ‘other than a basic operational program.’

“Which of the following does this tax exemption (No sales tax applies) pertain to:

“Operating system, i.e., MS-DOS, APPLETALK, OS/2, UNIX and utility programs?”

Answer. Revenue and Taxation Code Section 6010.9 provides an exclusion from sales and use tax for certain custom computer programs and custom modifications to prewritten programs. However, Section 6010.9 specifically excludes from the definition of a custom computer program, a basic operational program as defined in Revenue and Taxation Code Section 995.2. That section defines the term basic operational program to mean, among other things, a computer program which is fundamental and necessary to the functioning of a computer. By contrast, applications programs are not basic operational programs. Rather than quote section 995.2 in its entirety because of its length, I have enclosed a copy of the section for your information. Under section 995.2, MS-DOS, OS/2, and UNIX are basic operational programs. APPLETALK may or may not be a basic operational program, depending on whether it is an integral part of Apple Computer’s operating system software. Whether any particular utility program is or is not a basic operational program would depend upon whether it meets the section 995.2 definition.

The effect of Section 6010.9, as interpreted by Sales and Use Tax Regulation 1502(f)(2)(A), is that if you develop custom modifications to a basic operational program, sales or use tax applies to your charges if you transfer the modifications on tangible storage media to

your customer. Also, if you develop an entirely new custom computer program which is a basic operational program, sales or use tax will likewise apply to your charges if you transfer tangible storage media to your customer.

Question

“What about software modules used in a custom program, written once, but re-used over and over again with very small modifications with each subsequent custom program.

“For example such modules as:

- Basic file I/O management
- Screen management
- File import-export management
- File backup and recovery
- Report Writing
- Print management
- Data Entry management
- Graphics Management

“Although each of the above would not be sold as an individually as a piece of prewritten software, it would however be resold again and again as one part of a larger custom software package.

“Are these modules then taxable on each sale of custom software that contain these modules, thus result in listing them as separate line items on an invoice with sales tax applied? If so, how do you arrive at a price that is acceptable to the Board of Equalization? What if each time the modules are used they contain minor changes to accommodate one of our customer? How would that be taxed?”

Answer. Assuming that the custom program in which the software modules are used is not a basic operational program as described in section 995.2, and also assuming that each software module which is reused does not itself constitute a complete computer program, then our opinion is that if you write a program to the special order of a customer and incorporate into that program software modules which have already been written, sales or use tax will not apply to your charges for the custom program. This is because a computer program is defined by Revenue and Taxation Code 6010.9(c) to mean “the complete plan for a solution of a problem.” If a software module is not itself capable of being used as a complete computer program, but must be combined with other modules, then its incorporation into a program does not affect the determination of whether that program is a custom program or a prewritten program.

[X]

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Thus, you are not liable for sales or use tax on your use of software modules when you develop custom computer programs. You need not list the modules separately on an invoice. Nor does the tax treatment change if the modules themselves contain custom programming to accommodate a customer.

Please feel free to contact me if you have any further questions or comments about this letter.

Sincerely,

John Abbott  
Senior Tax Counsel

JA:jb