

**M e m o r a n d u m****295.0575**

To: San Jose Auditing  
District Principal Auditor

May 17, 1988

From: David H. Levine  
Tax Counsel

ATSS 8-485-5550

Subject: D---, Inc.  
SR -- XX-XXXXXX

This is in response to your memorandum dated April 14, 1988.

In 1986, D--- sold magnetic resonance imaging equipment to N--- - M--- for \$1,000,000 plus royalties (per scan fees) based on the number of patients examined during a 60-month period. D--- reported sales tax on the \$1,000,000 and has been reporting sales tax on the royalties as they have due and payable.

On October 1, 1987, D--- sold its rights to a substantial portion of the royalties to H--- Financial Services. You ask several questions which can be summarized as, "does the sale of royalties affect D--- sales tax liability?"

It does not. D--- sold an intangible right to royalties to H---. Since D--- did not sell tangible personal property to H---, no sales tax liability arises by virtue of that transaction. The relevant sale of tangible personal property is D---' sale of equipment to N--- - M---. D--- has been properly reporting tax on that sale and should continue to report in the same manner. That is, D--- should report as subject to sales tax the royalties owed by N--- - M--- under the 1986 equipment sale contract as those royalties become definite. (BTLG Annot. 295.0570 [1/04/79].) D--- owes sales tax measured by such royalties without regard to D---' transfer of its right to those royalties to a third party.

To answer to your specific questions, no sales tax applies to any amounts received on the sale of the rights to royalties, and H--- should not report sales tax on the amounts of royalties it receives (D--- must report the applicable tax). If you have further questions, feel free to contact me.

DHL:ss