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July 16, 1993

BURTON W. OLIVER
Executive Director

Mr. R--- D. U---
B---, P--- & H---
--- --- Plaza --- --- Tower
--- ---, CA XXXXX

Re: M--- D--- L---
Sales Tax Opinion
Account No. SR -- XX-XXXXXX

Dear Mr. U---:

This is in response to your letter of July 13, 1993.

M--- D--- L--- (the "Seller") submitted on May 25, 1993 a request for opinion in regard to a very complicated fact pattern. We rendered our opinion on June 4, 1993. We understand that the Seller believes that it is necessary to make certain changes to the transaction described in the original request.

A. Personal Computers.

In the original request, you anticipated transferring all information contained on the Seller's personal computers to the Buyer's storage media electronically. See paragraph 2(g) on old Schedule 2.2. This transfer will be far more time-consuming and expensive than initially believed. As an alternative, you will transfer only proprietary information (largely source code materials) electronically. Items such as canned programs (WordPerfect, Lotus, etc.), and electronic copies of letters, memos and other documents will not be transferred electronically. In addition, the Seller has one of its products (ISIS) residing on a number of PC's, although the PC's contain only the object code version, which cannot be copied to produce a master. This programming will not be transferred electronically as well.

You will make a corresponding pricing adjustment in the contract to reflect the change in the materials transferred electronically pursuant to paragraph 2(g) of old Schedule 2.2. Specifically, the contract price for the transfer of the PC hardware will reflect the value of the information left on the PC's. The price for the WordPerfect, Lotus and other programs will be based upon the Seller's cost of acquiring the licenses to use the canned programs from the licensors. The price for the ISIS object code materials will be based upon the site licensing fees charged by the Seller to a licensee for a similar number of users. A de minimis price will be attributed to the electronic copies of letters, memos and documents.

B. Inventory.

In the original request, you anticipated destroying the inventory of magnetic tapes and floppy disks containing database materials. See paragraph 2(p) of old Schedule 2.2. It appears now that the destruction of inventory could make it difficult or impossible to fill a customer's order in a timely manner. As an alternative, you will keep those materials in inventory, and change the contract to provide that the Buyer can only sell those materials to customers or destroy them. The Buyer will not be permitted to make any other use of the materials.

C. Master Tapes.

In the original request, you anticipated destroying all master magnetic tapes containing source code. See paragraph 2(p) of old Schedule 2.2. You anticipated that the Buyer would produce new master tapes at the California facility. See paragraph 2(q) of old Schedule 2.2.

It appears now that the Buyer would be unable to fill customer orders for a period of time if the master tapes are destroyed and then reproduced as envisioned under paragraphs 2(p) and (q) of old Schedule 2.2. As an alternative, the Seller will ship the master tapes to the Buyer in Oregon, where the Buyer will have the tapes duplicated. The Buyer will return the new duplicates to California. The originals will stay in Oregon and eventually be destroyed there.

The technology transfers contemplated by the parties and addressed in Schedule 2.2 will occur during a weekend. The Seller will ship the master tapes to Oregon on the Monday following the weekend when the technology transfers occur. The Seller will retain title to the master tapes until the Buyer receives the tapes in Oregon.

D. Escrowed Tapes.

After you received our sales tax opinion, you discovered that the Seller has placed certain magnetic tapes in escrow for the benefit of certain major customers. The customers receive the tapes if the Seller goes into bankruptcy.

You intend to modify the contract to provide that the Seller retains title to the tapes in escrow, and that the Buyer assumes the Seller's obligation to submit new tapes containing updated programs. The escrow agent will be instructed to destroy the old tapes after the updated tapes are received.

E. Modification of Earlier Opinion.

The opinions expressed in my Sales Tax Opinion letter dated June 4, 1993 remain valid, except that:

- (i) Sales Tax will apply to the transfer to the Buyer of the personal computers, with the measure of the tax being the fair value allocated to these items by the parties as reflected in a schedule attached to the Asset Purchase Agreement (including the price allocated to any programs remaining on the personal computers when they are transferred);
- (ii) No sales or use tax will apply to the transfer of the inventory of magnetic tapes or floppy disks containing databases, as these items will be sold for resale;
- (iii) No sales or use tax will apply to the transfer of the master magnetic tapes by the Seller to the Buyer in Oregon; use tax will apply to the copies of the tapes that are returned to California without an intervening use elsewhere, with the measure of the use tax being the purchase price of the magnetic tapes which includes the cost of the tapes as well as duplication charges; and,
- (iv) No sales or use tax applies to the tapes in escrow, with the Seller retaining title.

As in your earlier ruling request, you did not request our opinion regarding the possible sales tax treatment relating to the transfer or the possible transfer of automobiles, other vehicles, leasehold improvements, supplies, packaging and wrapping materials, and circuits and mask works. Sales or use tax may apply if the Seller transfers any of these items to the Buyer.

We understand that time is of the essence because the parties intend to take certain steps to begin the transfers described above immediately. Accordingly, we are providing you with a facsimile transmission of this letter, and we are mailing the original today.

Sincerely,

Gary J. Jugum
Assistant Chief Counsel

GJJ:sr