STATE OF CALIFORNIA

BOARD OF EQUALIZATION

120.0110

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law N--- D--- C---, INC. Petitioner	))))))))	DECISION AND RECOMMENDATION OF HEARING OFFICER Account No. SS OH XX XXXXXX

The above entitled matter came on regularly for hearing on Wednesday, August 22, 1979, in Van Nuys, California. James E. Mahler, Hearing Officer.

Appearing for Petitioner: None

Appearing for H---
M--- H--- Mr. R--- A. S---
Director of Communications

Mr. H--- G---
Business Consultant

Appearing for the Board: Mr. Guy Zimmerman
Auditor

PROTEST

Petitioner protests a determination of sales and use tax deficiency for the period April 1, 1975 through December 31, 1977. The protested taxes are measured by:

	State, Local and County
Program "license fees" and "program changes relating to prewritten programs for use with the VITAL System at H--- M--- H---	$241,980

CONTENTIONS

1. The so-called "license fees" were in fact subscription fees and were not charges for using the programs.

2. The charges for "program changes" are exempt because programs are intangible.

SUMMARY

Petitioner is a Texas corporation which markets a computerized record-keeping system known as the VITAL system to [customers]. During the period in question its only California customer was H--- M--- H--- (H---).

In July 1975 H--- purchased the hardware for the VITAL system from petitioner's exclusive distributor, H--- I--- S--- [HIS]. It also leased the programs for the system from [HIS]. The charge for the program lease, which was termed a "license fee", was $300,000. H--- paid tax reimbursement to [HIS] measured by the total charge for the hardware and the program lease.

H--- also agreed to pay petitioner an additional "license fee" of $3,000 per month. According to H---, this fee was for "the privilege of participating in a consortium of other hospitals for the development of computer programs and modifications." Improvements in the VITAL system's programs are continuously being developed by petitioner and by users of the system, and payment of the monthly "license fee" insured that H--- would be notified of all such improvements.

The contract between petitioner and H--- provides that in consideration for the monthly "license fee", petitioner will furnish the improvements and modifications to H--- "on a machine readable copy medium, along with instructions for loading." However, H--- states that in fact the "license fee" only entitled it to receive notice of the improvements. If H--- chose to have the improvements incorporated onto its programs, which it had no obligation to do, it had to pay petitioner an additional fee for program modification.

When petitioner decided to have particular improvements incorporated into its programs, it sent blank computer tapes to petitioner's offices in Texas. Petitioner had a subcontractor record the entire improved program on the tapes and then returned the tapes to H---. Apparently H--- retained tapes of the old programs in its files.

During the audit period petitioner charged H--- a total of $93,009 for the monthly "licensing fees". It also charged $148,971 for program modifications. The audit determined that these charges are subject to tax.

ANALYSIS AND CONCLUSIONS

Revenue and Taxation Code Section 6006(b) provides that the term "sale" includes the fabrication or processing of customer furnished tangible personal property for a consideration. In addition, subdivision (c)(2) of Regulation 1502 provides that tax applies to charges for fabricating or processing customer-furnished tangible personal property, such as cards or tapes, "including charges for recording or otherwise incorporating information on or into such tangible personal property." In this case, petitioner charged H--- $148,971 to record improved programs on tapes furnished by H---. Under the statute and regulation, such recording is regarded as a sale of tangible personal property. Therefore, tax applies to the $148,971.

The $93,009 monthly "license fees" are also subject to tax. Revenue and Taxation Code Sections 6011 and 6012 provides that the measure of tax includes "the total amount for which tangible personal property is sold…." H--- paid the monthly "license fee" in order to obtain notice of improvements and to obtain an option to purchase the improvements. Although H--- was not obligated to buy the improvements, it was entitled to do so only if it paid the monthly "license fees". Since payment of the "license fee" was a prerequisite to purchasing the improvements, the "license fees" are a part of the total selling price of the improvements and therefore are subject to tax. (See Peterson Tractor Company v. State Board of Equalization, 199 Cal.App.2d 662.)

Recommendation

It is recommended that the petition be denied and the account redetermined without adjustment.

_____ 11/5/79

James E. Mahler, Hearing Officer Date