REQUEST LETTER

05-012

April 18, 2005

NAME
ADDRESS

The purpose of this letter is to request binding sales and use tax opinion.

Background

CORP is currently a worldwide leader in high-performance, high density, programmable logic devices (PLDs) and associated computer-aided engineering logic development tools. PLDs are semiconductor chips that can be customized and programmed by the customer using software tools that run on personal computers or engineering workstations. CORP develops, manufactures, and sells high-density, microchips, PLDs, related hardware, software and intellectual property cores for use in designing the PLDs. CORP is headquartered in CITY STATE. CORP primary customers are distributors. CORP anticipates future increases in direct sales to manufacturers of consumer electronics and communications devices.

Facts

CORP and customer enter into a contract for CORP to develop a previously un-marketed structured-application-specific-integrated-circuit (ASIC) microchip utilizing customer supplied files on an CORP base array. CORP refers to the processes outlined in this request collectively as "HardCopy". The new device is a combination of the customer's data files (microcircuits) and CORP data files (microcircuits). Customers utilize CORP software tools to design their microcircuits in a computer environment. Customers have the option of incorporating pre-designed "modules" contained in the software tools in their chip design for a one-time royalty fee. The pre-designed modules contain microchip circuitry used to perform common routines such as clock or calculation functions. Software tools are delivered via electronic transmission and may require the use of a dongle or hard token. Dongels or hard tokens are included in the selling price of the software tools when required for tools operation. CORP provides one time non-recurring engineering services (NRE) to merge/graft the customer's electronic design files with the existing CORP base array files in a computer environment. Successful technology pairings are migrated to a standard CORP base array (microchip). A successful project will result in a newly created process as evidenced by a device that is distinctive in nature. The final ASIC device will have unique functions, highly specialized performance characteristics, and satisfy a previously unfilled customer need. The NRE for the design and development is performed in a computer environment. Photo-masks are prepared for the newly created device by a third party manufacturer off shore. The masks remain the property of CORP and reside offshore.

Upon satisfactory development, fabrication, and testing the customer is provided functional prototypes for evaluation and confirmation of successful design. The

prototypes are not intended for functional use or resale. The customer uses the prototypes solely to test and evaluate the design characteristics. Customers communicate approval/acceptance of design concept using the HardCopy Prototype acceptance form.

In general, customers have six (6) months from concept approval date to take delivery of an agreed upon minimum order quantity (MOQ). Subsequent production purchases of approved designs are generally under a separate purchase order. Customers may cancel or reschedule a production order with proper notice. Penalties are charged for untimely cancellations of the NRE contract for cost recovery based on agreed upon terms in the contract. CORP design, development, and production of HardCopy devices is not contractually deemed a "work for hire". CORP does not assign or transfer any intellectual property rights to the customer, other than the right to use the HardCopy devices in customer's target systems.

There is a high degree of uncertainty whether the customer's technology (microcircuits) can be successfully mated with CORP technology and function harmoniously on a standardized base array. The true object of the Hard Copy service is the creation of a new device that meets customers' parameters and requirements, and is reproducible in quantity. Substantially all of the activities performed in the design processes will involve some degree of uncertainty. Intensive and specialized testing is required at each phase of development.

We respectfully request a binding opinion on the proper sales/use tax treatment for the transactions below.

Questions

1. Are charges for HardCopy services to design a new ASIC device subject to sales tax?
2. Are the initial prototypes given at no charge subject to sales or use tax?
   a. If so, what is the measure of tax?
3. Are subsequent sales of prototypes subject to sales or use tax?
   a. If additional prototypes sold are to be used for further testing and evaluation?
   b. If additional prototypes are to be consumed by the customer?
   c. If additional prototypes are to be resold by the customer?
4. Are charges for software tools used by customers to design their micro circuitry in an CORP preferred format subject to sales tax?
   a. If delivered in tangible form (CD/Disk)?
   b. If delivered electronically via email or download?
   c. If delivered intangibly with a tangible dongle or hard token?
5. Are production units sold under the minimum order quantity requirement subject to sales tax?
6. Are cancellation charges associated with early termination of an NRE contract subject to sales or use tax?
   a. If so, what is the measure of tax?

7.   Are cancellation charges associated with early termination of the minimum order quantity requirements for production units subject to sales or use tax?
        a.   If so, what is the measure of tax?
8.   Are the one-time royalty charges for intellectual property cores (prewritten sub-routines/circuitry contained in the software tools) incorporated by customers into the new ASIC microchip subject to tax?

Please do not hesitate to contact me via the email address below, should you have any questions or require additional information.

Sincerely,

NAME
ADDRESS

RESPONSE LETTER

November 29, 2006

NAME
ADDRESS

RE: Sales tax on ASIC devices

Dear NAME,

You have asked the Commission for a private letter ruling regarding the taxability of an application-specific-integrated-circuit (ASIC) device. You provided background and factual information. Based on that information, we understand CORP contracts to develop CORP'S using customer supplied files on an CORP base array. You said the processes involved were referred to as "HardCopy."

You stated this process results in the creation of a new device that is a combination of the customers data files (microcircuits) and CORP data files (microcircuits). Customers may also incorporate pre-designed modules for a one-time royalty fee. These modules contain common routines such as clock or calculation functions.

You said some software tools may be delivered via electronic transmission. This mode of delivery may require a dongle or hard token. Dongles or hard tokens are required to use protected software. They are included in the selling price.

You said CORP provides one time non-recurring engineering (NRE) services to merge/graft the customer's electronic design files. You said successful technology parings are migrated to a standard CORP base array (microchip). A successful project results in a newly created process evidenced by a distinctive device. The final ASIC is a custom device (chip) performing functions unique to the needs of the customer. Photo-masks are prepared off-shore and remain off-shore as the property of CORP.

Following satisfactory development, fabrication, and testing the customer receives functional prototypes for evaluation and confirmation of a successful design. They are not intended for functional use or resale. If the test is successful, the customer uses the HardCopy Prototype acceptance form to communicate approval.

Generally, within six months of the concept approval date, customers take delivery of an agreed upon minimum order quantity (MOQ). Subsequent purchases are generally under a separate purchase order.

Customers may cancel or reschedule a production with proper notice. Untimely cancellations of NRE contracts result in a penalty, as provided in the contract. Under the contract, CORP design, development, and production of HardCopy devices is not deemed a "work for hire." Other than the right to use the HardCopy devices in a customer's target system, all intellectual property rights remain with CORP.

You pointed to a high degree of uncertainty regarding whether the customer's technology could successfully be combined with CORP. You said the true object of the HardCopy service is creating a new device, reproducible in quantity, which meets the customer's needs.

You asked eight questions relating to the proper sales and use tax treatment for various transactions. We will answer them in order.

You asked if HardCopy services to design a new ASIC device are subject to sales tax?

The answer to this question depends on whether the customer pays for tangible personal property. You stated the true object of the transaction is the creation of a new device, or chip. Such a device or chip is tangible personal property.

Utah Code §59-12-102(61)(b) defines purchase price as including: "(i) the seller's cost of the tangible personal property or services sold; (ii) expenses of the seller, including: (A) the cost of materials used; (B) a labor cost; (C) a service cost; (D) interest; (E) a loss; (F)

the cost of transportation to the seller; or (G) a tax imposed on the seller; or (iii) a charge by the seller for any service necessary to complete the sale."

If the customer purchases chips, be they prototypes or production models, the purchase price as defined in §59-12-102(61)(b) would be subject to sales tax.

You said there is significant uncertainty regarding whether the customer's technology can be mated to CORP. If the customer does not purchase chips, the circumstances are analogous to the graphic designer who produces a design not purchased by the customer. Though the customer may be required under the contract to pay for the services of the graphic artist, this cost is not taxable because there is no sale of tangible personal property.

You asked if the initial prototypes given at no charge are subject to sales or use tax, and, if so, what is the measure of tax?

Prototypes provided to the customer for testing are not subject to sales tax, as there has been no sale of tangible personal property. However, once the customer approves or accepts the design concept, it is obligated to purchase a minimum order quantity. It appears the initial prototypes are included in the total cost. Therefore, they would not be taxed separately. The cost of the prototypes would be included in the purchase price as defined in §59-12-102(61)(b).

You asked if subsequent sales of prototypes would be subject to sales tax under three different circumstances.

The first circumstance is the sale of additional prototypes for further testing and evaluation. The sale of the prototypes is the sale of tangible personal property. Subsequent sales of prototypes would be taxable. The amount of sales tax would be determined by the purchase price of the additional prototypes.

The second circumstance is where the prototypes are consumed by the customer. This appears to be a transaction where the customer purchases the prototype as a component used for its own purposes. Therefore, the sale would be taxable.

The third circumstance is where the prototypes are to be resold by the customer. Property acquired for the purpose of resale is not subject to sales tax, provided the purchaser provides a valid sales tax exemption certificate to CORP. CORP should keep the copy with its records of the transaction.

Your fourth question was whether charges for software tools used by customers to design their micro circuitry in an CORP preferred format are subject to sales tax. You listed three methods of delivery: CD or disk; electronically via email or download; and, delivered intangibly with a tangible dongle or hard token.

Generally, the sale, rental, or lease of prewritten software is subject to sales tax, as it is considered tangible personal property. See §59-12-102 (61)(a) and (91) (subsection 92 effective January 1, 2007). This is so regardless of the manner of delivery.

Your letter states CORP provides software tools to the customer for use in designing their microcircuits in a computer environment. As we understand what occurs, the customer pays for the use of pre-written CORP software as part of the design process. The cost of the software is separately stated. It would make no difference if the software is provided via hard token or dongle, CD, or electronic transmission. The transfer of the pre-written software to the customer is the sale of tangible personal property and is subject to sales tax, regardless of whether the process produces a chip that the customer purchases under the contract.

In your fifth question, you asked if production units sold under the minimum order quantity are subject to sales tax. The answer depends on whether the customer has provided CORP with an exemption certificate because the units are for resale. If the purchaser acquires them for its use, the transaction would be taxable. If the customer acquires them for resale and provides a sales tax exemption certificate to CORP, the transaction would be considered an exempt sale.

You asked if cancellation charges associated with early termination of an NRE contract are subject to sales tax. If no tangible personal property has been sold to the customer, no sales or use tax would be due. If tangible personal property has been sold to the customer, the cost of the sale would be the basis of the tax unless the customer returns the tangible personal property for full value to CORP.

You asked if cancellation charges associated with early termination of the minimum order quantity requirements for production units are subject to sales or use tax. We assume that CORP has provided a prototype, and a quantity of chips less than the minimum required by the contract. The basis of the tax would be the price of the chips, if broken out. If not, the basis would be the total contract cost, including cancellation charges.

You asked if the one-time royalty charge for pre-written subroutines/circuitry contained in the software tools is subject to tax. This is analogous to "canned software," and is subject to tax.

Our conclusions are based on the information provided to us. Our response might be different if the facts are other than those upon which our response is based. Should you have further questions, please contact us.

For the Commission,

R. Bruce Johnson
Commissioner

RBJ/SR
05-012