



CALIFORNIA

Software License's Tax-Exempt Status May Mean Savings

A License of Software Used to Operate Switch Hardware Was Found to be Exempt From Sales Tax as a Technology Transfer Agreement, and Possible Refund Opportunities Exist

The California Court of Appeal in *Nortel Networks, Inc. v. State Board of Equalization*, No B213415, (Cal. Ct. App. , Jan 18, 2011), recently held that certain software sales were not subject to California sales and use tax because they were considered a technology transfer agreement (TTA).

Nortel sold switching equipment and licensed software to customers that enabled them to operate the switching equipment. Nortel provided two separate licensing agreements for the right to use Nortel's software programs in the equipment. First, were prewritten operator workstation programs, data center programs, and switch connection programs. The other was switch specific programs (SSPs) that operate a switch and enable it to process telephone calls. The SSPs consisted of basic code that underwent additional significant processing in order to fully develop the SSPs.

The question before the court was whether sales tax should be imposed on the software that Nortel licensed to operate switching equipment.

The court concluded that the software licensed by Nortel is exempt from sales tax under the technology transfer agreement (TTA) statute (Cal. R&TC sections 6011(c)(10)(D) and 6012(c)(10)(D)) because it is copyrighted; contains patented processes and enable the licensee to copy the software and to make and sell products embodying the patents and copyrights. In addition, the TTA statutes encompass "any" transfer of an interest subject to a patent or copyright which also included the prewritten programs licensed by Nortel.

Therefore, a license of software subject to a copyright or patent that provides the licensee the right to make or sell a product or to use a process would be exempt from California sales/use tax. This case is subject to appeal by the California Board of Equalization.

TPC Observation

The court's broad interpretation of the TTA statutes particularly to the application of prewritten software may create refund opportunities for some taxpayers.




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