



## **California Courts Confirm No Sales Tax on Computer Software Licensing**

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A California Appellate Court recently confirmed that certain licensed software is not subject to sales and use tax in California, despite the State Board of Equalization's attempts to tax such sales. [Nortel Network Inc. v. State Board of Equalization](#), (Cal., Apr. 27, 2011).

Nortel Networks Inc. manufactured and sold telephone switching equipments to Pacific Bell Telephone Company. It also sold prewritten or "canned" software programs as well as switch-specific software programs used to operate such equipments to Pacific Bell. The State Board of Equalization (BOE) wanted to collect sales tax for both the hardware sales (which is indisputably taxable "tangible personal property") and the software sales, which are generally exempt from sales tax under California Technology Transfer Agreement (TTA) statutes. California taxpayers are entitled to tax exemptions for a TTA or "**any** agreement under which a person who holds a patent or copyright interest assigns or licenses to another person the right to make and sell a product or to use a process that is subject to the patent or copyright interest." ([Rev. & Tax. Code, §§ 6011\(c\)\(10\)\(D\)](#), emphasis added.) The BOE, however, does not exempt taxation on "an agreement for the transfer of prewritten software." ([BOE, Reg. 1507\(a\)\(1\)](#)) Based on this exemption of an exemption, BOE denied Nortel's claim for a full tax refund.

Nortel appealed the decision, and the California Court of Appeal for the Second District found the TTA statutes to be broadly encompassing licenses with intellectual property interests. It struck down the BOE's interpretation for prewritten software, holding that "the Board cannot exclude prewritten software that is subject to a copyright or patent, thereby creating an exception that the Legislature did not see fit to make." As the licensed software at issue here was copyrighted, contained patented processes, and enables the licensee to copy the software and to make and sell products embodying the patents and copyright, the BOE's attempt to limit the scope of the TTA was an invalid exercise of the BOE's regulatory power, the court held. The Court ordered the BOE to refund to Nortel \$29.7 million in sales tax Nortel paid on the licensed software, as well as \$13.4 million in interest. The California Supreme Court recently denied BOE's petition to review the appellate court's decision.

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