

EXEMPTION FOR SOFTWARE FROM SALES TAX

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Under a recent California Court of Appeal Decision software licensed by Nortel to PacBell was held to be exempt from sales tax. While the software was prewritten (canned) the copyrighted software included a process subject to patent rights.

In Nortel, the court partly overturned Sales Tax Rule 1507, a regulation issued by the Board of Equalization, which stated that sales and/or use tax applies to the transfer of all prewritten (canned) software. Rule 1507 overlooked that that Revenue and Taxation Code Sections 6012(c)(10)(d) and 6012(c)(10)(d) excluded from taxation any transfer where the holder of a patent or copyright interest assigns or licenses to another person a right to either (i) make or sell a product or (ii) to use a process (subject to the aforesaid patent or copyright). Nortel Networks, Inc. v. BOE (January 18, 2011)

Possible Refund Opportunity

This decision may have refund opportunities in addition to opportunities for those selling certain software to no longer charge sales tax. Keep in mind that the Board will likely interpret the statute narrowly and will probably assert that sales taxes applies to off-the-shelf purchased software at retail stores.

Example:

Joe Preparer purchases for himself a 2011 TurboTax return software from Big Box Computer Store. The Board's position will probably be that the software should continue to be subject to sales tax as it was probably purchased for the taxpayer's self and family. If Joe Preparer, however, buys a professional license directly from TurboTax, then if the program holds a copyright or patent (it probably does), it should not be subject to sales tax.

Accordingly, for clients who purchase software directly from and for professional use to provide sales of products and services, e.g., tax/accounting software for accountants, and similar software for lawyers and engineers, a refund of previously paid sales taxes has a few hurdles to go through. However, except for self-assessed use taxes, a refund should not be expected even for qualified software, unless the retailer will cooperate. If a retailer will cooperate, the statute of limitations on requesting refunds is three years. Also, the retailer must request the refund on behalf of the customer. The customer who paid sales tax historically has not been allowed to seek the refund.