

Nortel Software Case

Written by Yacoob

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On January 18th, 2011, the Superior Court of Los Angeles 2nd Appellate District issued its decisions in the *Nortel Networks, Inc. v. State Board of Equalization*. In summary, the decision ruled that **most sales of prewritten software are subject to a copyright or patent , meeting the definition of a Technology Transfer Agreement (TTA) and are exempt from CA sales and use tax**

. The Judge ruled against the BOE's Regulation where they attempted to exclude prewritten software from the definition of a TTA' s saying that such an interpretation is not supported by the original statute as written by the Legislator. The BOE attempted to take this case up to the Supreme Court of California, but on April 27

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2011, that request was denied.

Therefore this case has been closed and settled in the California Court System in favor of Nortel.

This *Nortel* case has huge implications for the taxation of prewritten software in California. The BOE has always taken the position that all sales of prewritten software are subject to the sales tax. However, the BOE must now review every software license on a case-by-case basis to determine whether the software is subject to a patent or copyright and exempt under the TTA exemption.

Customers who have paid California sales or use tax on purchases or licenses of prewritten software should work with vendors to file claims for refund, immediately to maximize refund periods and also take a proactive stand under the laws as they are currently written. Even though this

Nortel

case is now completed in the courts, we expect that the BOE, the California Legislature and Governor to continue to fight the TTA exemption to prewritten software.

At a minimum, we expect that the BOE will set high standards for documentation and support for taxpayers to establish that their software is subject to a patent or copyright.

Also, based on another high profile case, it has been our experience that the laws could be changed limiting your options in the future.

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Accordingly, we are recommending that our clients file protective claims to hold open the maximum periods while the dust settles. We spoke with the BOE Refund Section and they indicated that they plan to hold these claims in abeyance until a final decision is reached. As background, a claim for refund must be specific to the area of overpayment and be filed within 3 years of the due date of the return. Previous claims we filed did not have any language that directly included TTA's as an area of overpayment. So a new claim with TTA as the basis is required. No support is required with the claim, it is one page.

We are available to discuss if you would like or let us know and we will send the claim for your review.