

PRIVATE TAXPAYER RULING LR95-010

October 12, 1995

The following private taxpayer ruling is in response to your letters dated May 23 and August 1, 1995, requesting a ruling on behalf of your client

At issue is the transaction privilege taxability of the transfer of rights, title and interest in computer software programs by ... to its parent corporation, Also addressed is the subsequent licensing of the software back to ... and the subsequent licensing or sales of the software to third parties.

The following is a restatement of the facts as provided by your letters, our telephone conversation on September 12th, and the facsimile transmission reiterating your responses during our telephone conversation which was sent to the department the same day.

Statement of facts:

... is an Arizona corporation engaged in developing and distributing computer software primarily used in the legal industry. Principal software applications include one which enables high volume paper scanning, and a "multimedia trial presentation package" software application which allows users to easily present evidence such as scanned documents, photos, charts and slides during legal trials.

... is a Delaware holding company which does not presently conduct business, but was formed with the intent of owning the rights, title and interests of the software created by ..., which ... would then license back to ... for the purpose of relicensing the software to distributors and end users. It is also probable that ... will license the software to other unrelated parties.

By written agreement, ... will transfer what it calls the "intellectual property" associated with the software to ... , in exchange for licensing rights to the software. As discussed within your letter of May 17, 1995 and defined within the "Intellectual Property Transfer Agreement", "intellectual property" means the ownership and title to the software, including all rights, trademarks, goodwill, patents and patent applications, copyrights and copyright registrations, procedures, processes, and trade secrets associated with the software.

A separate written agreement allows ... to sublicense the software to distributors or end users. The "Intellectual Property Master License Agreement" stipulates that ... may use and sublicense the use of the software after ... approves the sublicense agreement and the rates to be charged the sublicensees. ... agrees to reproduce the appropriate copyright, trademark and/or patent notice on each copy of the software as instructed by In consideration of the

sublicensing rights granted to ..., ... agrees to pay ... a specified amount of the income derived by ... each month.

Issues presented by your ruling request; your position on these issues:

1. Whether the transfer of the "intellectual property" from ... to ... is a taxable sale of tangible personal property.

Your analysis concludes that it is either a nontaxable sale for resale of software and intangible property, or a nontaxable sale of services (related to the creation of custom computer software) and intangible property.

2. Whether income derived from ... 's licensing of the software to ... for the purpose of sublicensing the software to distributors and end users is taxable.

Your analysis concludes that this is a nontaxable sale for resale, since ... is acquiring the software license to relicense the property to others.

3. Whether income derived from the licensing of the software by ... to third parties is a taxable sale of tangible personal property.

Your analysis concludes that this income is subject to the transaction privilege tax under the retail classification unless a statutory exemption is applicable. However, your analysis also supposes that when the software license is transferred to an end user via remote telecommunications, the sale becomes a sale of intangible property which is not subject to the transaction privilege tax under the retail classification.

Applicable statutory provisions and administrative guidance:

Arizona Revised Statutes (A.R.S.) § 42-1310.01 levies the transaction privilege tax on the business of selling tangible personal property at retail.

A.R.S. § 42-1301.16 defines "tangible personal property" as personal property which may be seen, weighed, measured, felt or touched or is in any other manner perceptible to the senses.

A.R.S. § 42-1310.01.P.3 excludes from taxation under the retail classification, sales of tangible

personal property for the purpose of resale in the regular course of business.

A.R.S. § 42-1328 provides that in order to exclude a sale of tangible personal property purchased for the purpose of resale in the ordinary course of business, the seller must receive from the purchaser an (exemption) certificate providing the name, address and signature of the purchaser, a statement that the property was purchased for resale in the ordinary course of business, and the valid license number entitling the purchaser to resell the kind of property which was purchased.

Arizona Administrative Code (A.A.C.) rule R15-5-154 addresses data processing equipment and software, and provides that sales of computer software are taxable.

Discussion:

Arizona imposes a transaction privilege tax which differs from the sales tax imposed by most states. The Arizona transaction privilege (sales) tax is a tax imposed on the privilege of conducting business in the State of Arizona. This tax is levied on the vendor, not the purchaser. The vendor may pass the burden of the tax on to the purchaser; however, the vendor is ultimately liable to Arizona for the tax.

If a company does not have nexus for Arizona transaction privilege tax purposes, Arizona use tax may apply. A.R.S. § 42-1408(A) imposes Arizona's use tax on purchases of tangible personal property from out-of-state retailers. A.R.S. § 42-1411 imposes upon retailers the duty to collect the use tax from Arizona purchasers. A.R.S. § 42-1407 requires retailers selling to Arizona consumers to register with the Department of Revenue for the collection of the use tax.

A.R.S. § 42-1310.01 *Retail classification* levies the transaction privilege tax on the business of selling tangible personal property at retail. A.R.S. § 42-1310.01.P.3 excludes sales of tangible personal property for the purpose of resale in the regular course of business from taxation under this classification. All retail sales of tangible personal property are subject to tax unless specifically exempted by statute. Sales of intangible property are not subject to tax under this classification. The licensing of a computer software program is a sale of tangible personal property which is subject to tax under this classification unless a specific statutory exemption is applicable and has been established through proper documentation in a certificate provided to the seller by the purchaser.

Arizona Transaction Privilege Tax Ruling TPR 93-48 addresses the transaction privilege taxation of computer hardware, software, and related services in depth. The ruling provides that the licensing of computer software is considered a sale of tangible personal property.

... 's initial transfer to ... of the computer software "intellectual property" (as defined above) for a consideration, is considered a taxable sale of tangible personal property. However, since ...

is purchasing the software for the purpose of resale in the ordinary course of business, ... may provide a certificate in accordance with A.R.S. § 42-1328 which establishes this nontaxable status.

... will thereafter be engaged in the business activity of licensing the software to its subsidiary ... and third parties. As stipulated by Arizona Transaction Privilege Tax Ruling TPR 93-48, the provision of a canned computer program through a licensing agreement is considered a taxable retail sale. ... will therefore be subject to tax on Arizona sales/licensing of the software, or licensing the software to Arizona users. However, a certificate provided to ... by the purchaser may establish that the purchase is for the purpose of resale in the ordinary course of business or that another statutory exemption is applicable to the purchase.

Similarly, by licensing computer software to purchasers, ... will be engaged in the business activity of selling tangible personal property. As an Arizona seller, the gross proceeds of sales or gross income derived from this business activity are subject to the transaction privilege tax, unless the purchaser provides a certificate to ... which establishes entitlement to exemption from the tax. Regarding your analysis of the licensing of the software via telecommunications, it matters not that the software is transferred via a method of telecommunications; such sales are subject to tax as a sale of tangible personal property at retail unless a specific exemption is established by the purchaser.

Conclusion and ruling:

The following ruling is given based on the facts presented:

The department rules that the transfer by ... to ... of computer software "intellectual property" as described above, is a nontaxable sale of tangible personal property for the purpose of resale in the ordinary course of business.

The department also rules that the licensing of computer software by ... or ... is a sale of tangible personal property, regardless of the method of transmittal, and is subject to Arizona's transaction privilege tax or use tax unless a specific statutory exemption applies.

The conclusions in this private taxpayer ruling do not extend beyond the facts as presented in your letters of May 17 and August 1, 1995, and your facsimile transmission of September 12, 1995, comprising your request for a private taxpayer ruling.

This response is a private taxpayer ruling and the determination herein is based solely on the facts provided in your request. The determination in this taxpayer ruling is the present position of the department and is valid for a period of four years from the date of issuance except as set out herein. This determination is subject to change should the facts prove to be different on audit. If it is determined that undisclosed facts were substantial or material to the department's

making of an accurate determination, this taxpayer ruling shall be null and void. Further, the determination is subject to future change depending on changes in statutes, administrative rules, case law or notification of a different department position.