

Technology Transfer Agreements and California's Sales Tax

LEGISLATIVE ANALYST'S OFFICE

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Hon. Sebastian Ridley-Thomas, Chair





California's Sales Tax

- Sales and Use Tax (SUT) Plays Major Role in California's Tax System.*** The SUT has two parts: a sales tax on goods sold by California retailers, and a use tax on goods purchased from other retailers. The SUT is the second-largest revenue source for the state's General Fund, and it is a significant source of revenue for many local governments as well. In 2014-15, the SUT raised \$51 billion for California's state and local governments, including \$24 billion for the state's General Fund.

- State Board of Equalization (BOE) Has Key SUT Responsibilities.*** BOE is headed by a five-member board, with four members directly elected by district, and the fifth—the State Controller—elected on a statewide basis. BOE administers the SUT program, promulgates SUT regulations, and adjudicates SUT disputes and appeals.



Which Transactions Are Subject to SUT?



SUT Levied on Retail Sales of Tangible Personal Property.

- Personal property is movable from one place to another. Real property—land and things that are attached to land, like buildings—is not subject to SUT.
- Tangible property “may be seen, weighed, measured, felt, or touched, or . . . is in any other manner perceptible to the senses” (Revenue and Tax Code 6016).



Many Sales Have Both Tangible and Intangible

Components. The basic definition of the SUT base leaves considerable room for interpretation, particularly for sales that combine tangible property with intangible property or services. Over the years, the Legislature, BOE, and the courts have attempted to clarify the applicability of SUT in numerous scenarios, such as:

- Sales of tangible goods valued primarily for their intangible attributes, such as written materials.
- Sales of electronic devices sold in conjunction with telecommunications services.
- Sales of custom software.

SUT Law Changed in Early 1990s

- BOE Ruled Intel Did Not Owe SUT on Intellectual Property.** Intel Corporation had sold various types of property to other businesses, including some sales that combined tangible goods (such as written materials and tapes) with licenses to use patented and copyrighted information. BOE staff initially determined that Intel owed SUT on the total value of these sales contracts, but Intel appealed. The Board then ruled in favor of Intel, concluding that SUT applied “only to the value attributable to the tangible elements” and not to the value attributable to the licenses.

- 1993 Law Addressed SUT on Certain Sales.** One year after BOE’s ruling on the Intel appeal, the Legislature passed a law addressing the applicability of SUT to “technology transfer agreements” (TTA)—a type of transaction similar to the Intel sales described above. The interpretation of this statute was the central issue in the recent *Lucent* case.

California's TTA Law

- ☑ ***SUT Does Not Apply to Intangible Property Sold in a TTA.*** To be a TTA, a sale must meet these conditions:
 - The seller holds a patent or copyright interest.
 - The seller assigns or licenses “the right to make and sell a product or to use a process” to the buyer.
 - This right is subject to the patent or copyright interest held by the seller.

- ☑ ***SUT Applies to Tangible Property Sold in a TTA.*** The law lays out three ways to determine the amount of tax due on the tangible property:
 - A separately stated “reasonable” price.
 - The price at which it was sold, leased, or offered to third parties.
 - 200 percent of the cost of materials and labor used to make it.

- ☑ ***TTA Not Limited to “Technology” as Commonly Understood.*** For example, in *Preston v. BOE* (2001), the California Supreme Court ruled that the TTA law applied to copyrighted artwork.