

M e m o r a n d u m**120.0101.250**

To: Mr. Gene Shaffer, Senior Tax Auditor
San Jose Audit

April 22, 1988

From: John Abbott
Tax Counsel

Subject: P---, Inc. SR -- XX-XXXXXX
C---, Inc. SY -- XX-XXXXXX
Sale of assets – copyrights and prewritten programs

In your January 27, 1988 memorandum to Legal, you write:

“A current audit of P---, Inc., SR -- XX-XXXXXX, disclosed the following transaction. An interpretation of the revised Regulation 1502 is needed in order to clear this transaction

“On May 2, 1985, P--- sold an entire Division (A--- Division) to C---, Inc. P--- is engaged in the business of selling canned software programs to their customers. The A--- Division was sold for over \$7 million.

“Two master software programs called [B] and [C] were transferred in the sales. [C] was booked at \$300,000, and [B] was booked at \$2,550,000 in C---’s records. These items were accounted for as assets on C---’s balance sheet.

“C--- obtained title along with distribution rights (right to copy) for these programs. As part of the agreement C--- has granted P--- a site license agreement for internal use of these programs.

“QUESTION – Does title of these master programs acquired, trigger the sales tax or does the ‘right to copy’ make the sale exempt per revised Regulation 1502?”

The Asset Purchase Agreement you enclosed is dated May 2, 1985, between P---, Inc., (P---) and S--- A---, Inc., now C---, Inc.

As relevant to your inquiry, the Asset Purchase Agreement between P--- and C--- provides in section 1.A.(3) on page two that P--- transferred its copyright interests in its computer programs to C---. Schedule L of the agreement also specifically transfers the copyrights of P--- to [C] and [B] (in addition to other computer programs), and states that these copyrights have not been registered by P---. Also, as part of section 1.A.(e), C--- granted back to P--- a license to copy and sublicense [B] for use only in the mechanical segment of the printed circuit board market. This license back is repeated in a software license agreement between the parties included as a part of the Asset Purchase Agreement. In addition, under section 2.B of this software license agreement, C--- licensed back to P--- a right to use the [B] program source code for P---'s internal use only.

Opinion

Our opinion is that under Regulation 1502(f)(1)(B), the transfer of the copyright interests in these programs in the Asset Purchase Agreement is nontaxable. P--- transferred the copyright interest in these programs to C--- so that C--- could publish and distribute copies of the programs for consideration to third parties, and the transfer of the copyrights is not limited to copying the programs for Sander's own internal use. In this situation, the amounts C--- paid for these copyrighted programs were not for side licensing or other end user fees amounts, which would have been includable in the measure of tax under Regulation 1502(f)(1)(B).

Although P--- acquired from C--- a license under section 2.B of the software license agreement to use the source code for the [B] program for internal use of P--- only, this is also nontaxable because there was no transfer of tangible personal property from C--- to P---. Instead, P--- merely retained certain rights to the [B] program when it transferred the program to C---.

JA:jb