



STATE BOARD OF EQUALIZATION

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Executive Director

March 17, 1997

Ms. C--- M. M---
C--- A--- I---, Inc.
--- --- Plaza
---, NY XXXXX-XXXX

Re: SC ---B XX-XXXXXX

Dear Ms. M---:

This is in response to your letter of February 4, 1997 in which you inquired about the application of sales tax on amounts received in settlement of a dispute over use of computer software.

Your company, C--- A--- (CA), is in the business of designing, developing, marketing, and supporting computer software products which are compatible with most computer systems. According to your letter, CA sold software to the [T] of the C--- S--- U--- ([T]) and entered into a contract with them restricting the use of the software to their individual central processing unit (CPU). There was a dispute as to whether the [T] had used the software programs in an unauthorized manner. While the [T] contended that the software was not used in an unauthorized manner, a settlement was reached whereby the [T] agreed to pay \$250,000.00 in settlement of the dispute. CA added \$20,625.00 in sales tax on its invoice for the settlement. The [T] contend that sales tax should not apply because the "settlement fee" is a non-taxable transaction. You have written to seek clarification as to whether sales tax applies to the amount received in settlement from the [T].

Sales and Use Tax Regulation 1502(f)(1) explains that tax applies to the sale or lease of tangible personal property such as software onto which prewritten computer programs have been recorded, coded, or punched. Subparagraph (B) of this section further explains that tax applies to the entire amount charged to the customer, including license fees associated with the transfer of the software.

Questions regarding the application of sales and use tax on software license transfer fees have been previously addressed in Business Taxes law Guide (BTLG) Sales and Use Tax Annotations. In Annotations 120.0552 (1/6/92) and 120.0540 (7/18/95) the Board of Equalization's legal staff has taken the position that additional license fees charged by a software provider to expand the use of the software or to transfer the license to additional equipment is subject to tax.

While the [T] maintain that they did not use the software in any manner other than that authorized under the license, nonetheless the dispute arises over the charges for the purchase of software and the license fees. The settlement fee was paid in order to settle the dispute over amounts owed attributable to the acquisition of the software and the accompanying license fees. Accordingly, the proceeds from the settlement constitute gross receipts attributable to the sale of the software to the [T] and, as such, are taxable. If you have any further questions please feel free to contact this office again.

Sincerely,

Patricia Hart Jorgensen
Senior Tax Counsel

PHJ:cl

cc: Out-of-State District Administrator