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**STATE BOARD OF EQUALIZATION**

October 29, 1993

Dear

This is in response to your letter of October 27, 1993, which was sent to this office by facsimile transmission.

We understand that --- and --- a --- desire to establish a contractual business alliance in which they will jointly provide to business merchants credit card and debit card authorization, processing and payment services and certain other services relating thereto. Currently --- is engaged in the business of providing credit card and debit card authorization, processing and payment services to merchants and --- is engaged in the business of providing merchants a broad range of payment processing services.

Credit card and debit card authorization, processing and payment services is the approval and collection process of a business merchant's credit transaction. Business merchants accepting a credit card or debit card from a customer as a means of payment receive authorization and payment from --- when utilizing this service. --- then accepts responsibility for processing the transaction so the customer eventually gets billed and --- gets reimbursed for the credit extended to the business merchant's customer.

To establish the business alliance, --- will transfer to --- 100% of some assets and a 60% undivided interest in certain other assets of its business. In addition, --- and --- will enter into other arrangements relating to the operation of the business alliance following the transfer of assets. The alliance will be treated as a partnership for federal and state income tax purposes. The parties may also convert the alliance into a formal partnership after the transfer of the assets, although there is no current commitment to do so.

We understand that the "Agreement of Alliance" (the asset transfer agreement) is still being revised. The Agreement will require --- to transfer the following assets, however:

1. A 60% undivided interest in various --- Contracts (where --- and a merchant agree that, --- will provide various debit or credit card-services);
2. A 60% undivided interest in all merchant reserve accounts, letters of credit, bonds, insurance policies, guaranties, cash collateral deposits and other collateral which secures the payments of amounts owed to --- that relate to the --- Contracts;

3. A 60% undivided interest in all leases to merchants of Point of Sale hardware (the card reader machines);
4. A 60% undivided interest in all papers, documents, instruments, customer lists, books, records, files, agreements, books of account and other records relating to the merchant business;
5. A 60% undivided interest in all tangible personal property (excluding all software storage media and related documentation and various items of computer hardware) related to the merchant business and listed in a separate schedule;
6. A 60% undivided interest in all proprietary personal computer based software which is used exclusively or primarily in the merchant business and related manuals and documentation;
7. A 60% undivided interest in various other assets (excluding software storage media and related documentation) to be listed in a separate schedule;
8. All computer software programs used primarily or exclusively in the merchant business, including (i) the proprietary software systems of used by ---, to provide debit card processing services (subject to ---, paying royalties under a related agreement), (ii) the proprietary software systems used by --- in providing communication services to its customers and (iii) the customized or proprietary point of sale applications as set forth in a separate schedule, plus all related manuals and documentation.

The Agreement will also contain a provision similar or identical to the following:

Notwithstanding anything to the contrary set forth in Section 1.02 [the asset transfer provisions], the assets --- shall sell, convey, transfer, assign or deliver to --- shall not include any tangible personal property containing proprietary software source or object code or other intellectual property, or any manuals or documentation related to such software or intellectual property. All software source or object code or other intellectual property contained on tangible personal property, and all manuals and documentation related thereto, shall be transferred electronically via telecommunications lines as detailed in Schedule \_\_\_\_\_.

We understand that the electronic transmission of the software from --- to --- may not occur until several weeks after the closing of the transaction. To transfer the software error free, it will apparently take the parties several weeks to prepare for the electronic transmission and to secure a reliable telecommunications line.

We understand that --- will loan to --- for its review only, a copy of its mainframe system software used in its merchant business operation (the proprietary software described in #8 above). --- will limit its use solely to its evaluation and determination of which software, if any, will be purchased. Upon completion, all software loaned will be returned to --- No copies will be retained and all of the loaned software will be deleted from all --- computer systems.

We understand that in September 1994, --- will transfer title to its IBM Model 4381 computers used in the merchant business. The storage media associated with these computers may contain some of the programming transferred in 1993 under the Alliance Agreement. --- may also ship the computers back to --- in Maryland in September 1994.

We understand that ---, may transfer a 60% undivided interest in the personal computers used in the merchant business. The storage media for these computers will contain only off-the-shelf programming, and will not contain any software proprietary to --- in its merchant business.

The purchase price for the assets consists of cash and the assumption of liabilities. The parties will make an allocation of the purchase price for income tax purposes.

We understand that one of the principle assets being acquired by --- is the proprietary software for --- merchant business. --- and --- intend to transfer this software (and related manuals and documentation) by remote telecommunications from --- location in --- California to a --- location in Maryland.

Based on the foregoing, it is our opinion that:

- a. No sales or use tax will be imposed on the sale of the proprietary software and related manuals and documents under the Agreement of Alliance (i.e., the proprietary software described in #6 and #8 above). Regulation 1502 (f) (1) (D) provides that the sale of a prewritten program is not taxable if transferred by remote telecommunications.
- b. No sales or use tax applies to the items described in #1, #2 and #4.
- c. No sale or use tax applies to the copies of the proprietary software given by --- to --- so that --- could review the technology prior to entering into the Agreement of Alliance.
- d. If California sales or use tax applies to the transfer of the IBM 4381 computers in September 1994, the measure of the tax will not include any value attributable to any proprietary programming contained on the related storage media to the extent that the programming was transferred electronically in late 1993.

e. While we would regard the relationship established by the Agreement of Alliance between --- and --- as a partnership for sales and use tax purposes, the transfer of assets contemplated by the agreement is properly characterized as a retail sale of assets from --- to ---. The Agreement does not contemplate that the assets will be regarded as partnership assets.

Sales or use tax may apply to the transfers of tangible personal property described in #3, #5 and #7. You did not request our opinion as to these items.

Sincerely,

Gary J. Jugum  
Assistant Chief Counsel

GJJ:sr