

TAXPAYER-FRIENDLY CALIFORNIA COURT RULING

NEW OPPORTUNITY FOR COMPANIES WITH EQUIPMENT PURCHASES (> \$1M ANNUALLY) TO OBTAIN SIGNIFICANT SALES & USE TAX REFUNDS.

TAKE ACTION NOW AND FILE YOUR REFUND CLAIMS BEFORE QUARTERLY STATUTE OF LIMITATIONS EXPIRE AND AVAILABILITY OF REFUNDS EXPIRE.



A recent taxpayer-friendly California court ruling provides an opportunity for companies with equipment purchases (> \$1m annually) to obtain significant sales & use tax refunds on past equipment purchases and significantly reduce sales tax costs on future purchases.¹ The refund opportunity could provide a refund of over 50% of the original sales/use tax paid on equipment purchases/leases over the last three years. Consider a company with \$15M of qualifying equipment purchases/leases during the three-year lookback period. Their sales/use tax refund could be over \$500,000.

Examples of Qualifying Equipment

Qualifying equipment purchases/leases include ANY assets which depend upon embedded technology and software to operate including but not limited to:

- Medical equipment (MRI, CT Scanners, CAT Scanners, PET Scanners, X-Ray, Ultrasound, Surgical equipment, etc.);
- Data center equipment (servers, routers, switches, data storage systems, security systems, advanced power and monitoring systems, advanced cooling systems, etc.);
- Energy equipment (solar, battery storage, generation, smart grid technology, etc.), and
- Industrial equipment used to automate manufacturing and distribution facilities.

Background

An obscure California sales tax exemption, designed to allow companies to sell intellectual property (e.g. manufacturing designs) delivered on tangible media (e.g. discs, drawings), exempt from tax was found to have much wider application than was originally intended.

The Court's interpretation of the **Technology Transfer Agreement ("TTA")** exemption expands the scope to include any purchase of tangible personal property that utilizes either patented processes or copyrighted intellectual property, including software. This is relevant to all companies that purchase or lease expensive equipment with patented software and/or embedded patented processes.

What is particularly attractive about the TTA exemption is that only the value of the tangible personal property is taxable. The value of software, copyrighted and/or patented processes is exempt from tax. This means a potential majority of the purchase price of high-tech equipment should be exempt from tax.

¹ *Lucent Technologies, Inc. v. State Board of Equalization* (2015) 241 Cal.App.4th 19

In addition to reducing sales taxes on future equipment purchases, the Court's decision is retroactive making it possible to recoup excess sales tax paid on equipment purchases in prior years. The opportunity to recover tax is at least three years, but is more likely to be six and could even include periods back into the early 2000's.

Refund Process

It is critically important to file a refund claim with the California State Board of Equalization ("SBE") to avoid the statute of limitations closing on any prior periods. It is also important to assess your facts to know whether you should handle your claim through audit or whether it is likely to be handled in SBE settlement. Separating your low risk and high risk claims may allow you to obtain a refund more quickly. Having a California SBE audit specialist will help put you in the best position to maximize your refund.

To identify qualifying purchases, you should first review a comprehensive fixed asset/lease report and corresponding invoices. After identifying qualifying purchases, leases (operating and capital leases), and vendors, you will need to determine if you have the authority to file a refund claim or if you need to have the vendor file the refund claim on your behalf. This decision hinges on who the tax is imposed on. California imposes use tax on the customer, but sales tax is imposed on the vendor and collected from the customer as sales tax reimbursement. You will need to evaluate your purchases and leases to know which should be handled directly with the SBE as a refund claim and which purchases should be requested through your vendors.

The difficult and potentially time-consuming part of the refund process is collecting pricing information and any supporting documentation from a vendor. Vendors will be reluctant to provide confidential information to assist companies with valuing the tangible personal property and related exempt intangibles. Having a firm that specializes in valuation of a company's assets will avoid the vendor related difficulties and delays, as well as ensure the value of intangibles is accurately determined, which will most likely result in the greatest level of refund.

Think, LLP specializes in valuation of a company's assets for tax refund purposes. Our expertise ensures erroneous over-paid taxes are refunded and taxes on future purchase/leases are eliminated/reduced.

Prospective Equipment Savings Method

Vendors selling technology based equipment such as medical devices, robotic equipment and software have not yet changed their billing practices, meaning you will need to take immediate action to reduce your tax cost on new purchases. You can lock in the tax savings if your vendor agrees to use an approved safe harbor invoicing method. For example, if invoiced correctly, a pending \$5M technology asset purchase could net \$200K-\$450K of savings. A good starting point will be to understand the upcoming capital spending budget and identify those purchases and/or leases that qualify.

Conclusion

There is an opportunity to recover sales taxes paid on prior software and technology asset purchases. To avoid having the statute of limitations close on any prior periods, it is important to file a refund claim with the SBE for use taxes and request refunds directly from your vendors for sales taxes. Looking forward, there is an opportunity to reduce prospective taxes by working with your vendors to take advantage of a safe harbor invoicing method which could substantially reduce the sales tax cost on new assets.



THINK LLP provides comprehensive tax services and has been working with the California State Board of Equalization and the industry to assist with the tax changes described in this article.

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