



Revenue Ruling No. 08-009
July 3, 2008

Sales Tax Treatment of Licensing Fees Paid to the Manufacturers and Distributors of Electronic Video Bingo Devices

The purpose of this Revenue Ruling is to clarify the sales tax treatment of agreements for the licensing of software, which operates electronic video bingo devices.

Issue One

Whether the licensing of software pursuant to an Agreement between a Manufacturer of electronic video bingo devices and a Distributor is the lease of tangible personal property and subject to taxation.

Facts

Manufacturer is in the business of developing software and manufacturing gaming systems for electronic video devices for the bingo industry in Louisiana. The Manufacturer entered into an agreement with a Distributor appointing it as its exclusive distributor of the electronic video bingo devices for an assigned territory. Distributor was granted a non-transferable, non-assignable license allowing it to market, distribute, and sublicense the electronic video bingo devices and software. However, the Manufacturer retained all of its ownership rights to the software including the intellectual property rights and all proprietary rights. The Distributor is not allowed to reverse engineer or to copy the software, except in certain circumstances, and then the copy must contain the Manufacturer's trademark. The grant of the right to sublicense does not give the Distributor any rights in or to the software operating the electronic video bingo devices. The Distributor cannot assign, transfer, or sublicense the devices or software without the prior consent of the Manufacturer.

The Manufacturer provided the Distributor with the initial product training for proper installation, maintenance, and operation of the electronic video bingo devices and software. The Distributor may order replacement parts from the Manufacturer's discounted published price list. To maintain its exclusive appointment, Distributor is required to order or pay for an agreed upon number of electronic video bingo devices. If Distributor fails to do so, then the Manufacturer has the right to then make the Distributor's appointment nonexclusive.

The Distributor must pay the Manufacturer a daily license fee for each electronic video bingo device sold by it during the term of the agreement. The license fee is charged by the Manufacturer to defray the costs of periodic software enhancements and maintenance, and it will make additional new products available at times. The license fee is due and payable for each day that the device is operational and available for play to the public. The license fee is usually paid to the Manufacturer at the end of each calendar quarter or other time interval. The Distributor is allowed to deduct from the daily license fee a preset service fee per machine. This service fee is allowed to the Distributor in consideration for collection of the licensing fee from its customers and to defray, reimburse, and compensate Distributor for its administrative and office personnel expenses related to collection.

The Agreement between the parties may be terminated in the event either one violates or fails to comply with the conditions. Upon termination of the agreement, the rights and licenses granted to the Distributor are terminated. The Distributor must cease all use of the software and return

any copies of software, documentation, products, and confidential information to the Manufacturer.

Analysis

A “lease or rental” is defined in Louisiana Revised Statute 47:301(7)(a) as “the leasing or rental of tangible personal property and the possession thereof by the lessee or renter, for consideration without transfer of the title of such property.” In this situation, the Distributor has purchased electronic video bingo devices from the Manufacturer and has been granted a license to use software but not title thereto.

Computer software is tangible personal property. La. R.S. 47:301(16)(a) defines “tangible personal property” in part as “personal property which may be seen, weighed, measured, felt or touched, or is in any other manner perceptible to the senses.” Computer software is defined as a set of statements, data, or instructions to be used directly or indirectly in a computer in order to bring about a certain result. Computer software includes all types of software including operational, applicational, utilities, compilers, and all other forms. La. R.S. 47:301(22). Computer software is recognized as being in one of two groups, “canned” or “custom.” “Custom” computer software means software which requires preparation, creation, adaptation or modification by the vendor in order to be used in a specific work environment or to perform a specific function for the user. La. R.S. 47:301(23). Canned computer software is pre-written or “off the shelf” software.

The bingo computer software was pre-written by the Manufacturer for installation in its electronic video bingo devices. The electronic video bingo devices and software are not destined for an ultimate end user for use in a specific environment, as the electronic video bingo devices are sold and the software sublicensed to any number of customers. Therefore, this software fits the definition of canned computer software. The Manufacturer may have several Distributors selling similar electronic video bingo devices in the same sales territory. In some instances, a Distributor may be given the exclusive right to sell devices in an assigned territory based upon a certain number of devices that it has paid for or ordered. However, this does not mean that the software contained in the devices was created for the Distributor, who has been assigned the exclusive territory. Furthermore, a Distributor is usually granted the right to purchase, sell, re-sell and lease the electronic video bingo devices.

The Distributor must pay a licensing fee to the Manufacturer every calendar quarter or after another set interval of time. Distributor already has title to the electric video bingo devices but does not have title to the software. The software is a necessary and integral part of the operation of the electric video bingo devices. The sale of the electric video bingo device by the Manufacturer cannot be separated from the right to use the device for its designated function. The Department has already issued a ruling for a similar set of facts in Revenue Ruling No. 06-014, in which a manufacturer sold an eye surgical machine to a group of physicians but retained its intellectual property rights to the technology necessary to the operation of the machine. The surgeons had to pay fees to the manufacturer for the use of the patented procedures necessary for operation. The fees paid for the use of the eye surgery machine were treated as a taxable lease transaction. Similar to the physician’s loss of the use of the technology necessary to operate the eye surgery machine, the Distributor must cease use of the computer software and return all copies of the software to the Manufacturer upon termination of the agreement.

This transaction between the Manufacturer and the Distributor is distinguishable from a computer software maintenance contract. In Revenue Ruling 04-001, computer software

maintenance agreements were described as releases to fix problems (“bug fixes”) with the original software purchased, software upgrades provided either without charge or via payment of periodic fees to software developers, or consultation support to licensees to address user-specific problems. Typically, a purchaser buys computer software, which has a license for the current version of the software. Later, the purchaser may choose to upgrade the software for an additional charge. If the purchaser chooses not to upgrade the software, then the purchaser is still able to use the outdated version of the licensed software. In this matter, however, a Distributor who does not pay licensing fees will lose the right to use the electronic video bingo software. Control of the electronic video bingo software reverts back to the Manufacturer, who owns the license. Since title does not pass, the Distributor is leasing the electronic video bingo software.

Issue Two

Whether licensing of software for use in an electronic video bingo device by a Charitable Gaming Company from the Distributor is taxable as the lease of tangible personal property.

Facts

A charitable gaming company (“Gaming Company”) purchased electronic video bingo devices from a Distributor. As part of the agreement between the two parties, the Gaming Company was granted a non-transferable, non-assignable sublicense by the Distributor. As part of the agreement between the device Manufacturer and the Distributor, the Distributor may sublicense the software. The Manufacturer retains ownership of all intellectual property rights in the electronic video bingo devices, the software, data or information developed by it. The Gaming Company takes title to the purchased electronic video bingo machines but not the software.

The Gaming Company must pay the Distributor a daily fee for the sublicense for each device. The sublicense fees are due beginning in the first month in which the devices are operational and available for the public to play. The Gaming Company must pay the sublicense fee monthly. If the sublicense fees are paid late, then past due fees and interest accrue on the unpaid balance. If the Gaming Company falls more than 30 days past due in paying the sublicense fees, then the Manufacturer, Distributor, or a representative of either will disable the software in the electronic video bingo devices.

Analysis

As evaluated in the first scenario, the electronic video bingo software is canned software. The electronic video bingo software is the same in the second scenario. The software contained within the electronic video bingo devices is an item of tangible personal property. Title to the software does not pass to the Gaming Company. Monthly payments of the sublicense fee to the Distributor are mandatory for the continued use of the software operating the electronic video bingo devices.

The Distributor leases the software from the Manufacturer and then re-leases it to the Gaming Company by sublicensing it. Re-rentals, re-leases, and subleases are considered taxable leases or rentals. In *Central Marine Service, Inc., v. Collector of Revenue*, 162 So. 2d 81 (La. App. 4 Cir. 1964), the taxpayer rented barges to its customers, who in turn subleased the barges to the ultimate users within the state. The Court found that the lease and sublease were both taxable and held that the act of subleasing was an exercise of any right over tangible personal property. The sublicense of the electronic video bingo software by the Distributor to the Gaming Company, which in turn pays monthly licensing fees to the Distributor, is the lease of tangible personal property for consideration without the transfer of title. The Distributor exercised its right of

control of the software by sublicensing it to the Gaming Company. The Gaming Company is exercising the right of control of the software by providing the electronic video bingo devices for customers to play. If the Gaming Company fails to make its monthly payments of the sublicense fee, then it loses the right to use the electronic video bingo software. Therefore, the transaction between the Distributor and the Gaming Company is a sublease or re-rental, which is a taxable transaction, and lease tax is due thereon.

Ruling

In Issue One, the payment of licensing fees by the Distributor to the Manufacturer for the right to use the software contained in an electronic video bingo device is the lease of tangible personal property that is subject to the four percent state lease tax. The Distributor purchases the electronic video bingo devices and contracts with the Manufacturer for a license for the right to use the software. The Distributor does not receive ownership to the software, because the Manufacturer retains its ownership rights to the software.

In Issue Two, Gaming Company purchases electronic video bingo devices from the Distributor. By agreement with the Manufacturer, the Distributor is allowed to sublicense the right to use the software. The Distributor sublicenses its right to use the electronic video bingo software to the Gaming Company. In return, the Gaming Company pays the Distributor a monthly license fee. The transaction between the Gaming Company and Distributor is a sublease of tangible personal property and subject to the state lease tax in the amount of four percent.

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