

CAUSE NO. D-1-GN-15-001662

CALAVISTA, L.P.	§	IN THE DISTRICT COURT OF
Plaintiff	§	
	§	
	§	
v.	§	
	§	TRAVIS COUNTY, TEXAS
GLENN HEGAR,	§	
COMPTROLLER OF PUBLIC	§	
ACCOUNTS OF THE STATE OF TEXAS;	§	
AND KEN PAXTON, ATTORNEY	§	126TH JUDICIAL DISTRICT
GENERAL OF THE STATE OF TEXAS,	§	
Defendants	§	

PLAINTIFF’S MOTION FOR SUMMARY JUDGMENT

Calavista, L.P., (“Calavista”), moves for summary judgment pursuant to Texas Rule of Civil Procedure 166a. The granting of this motion will conclude this litigation and render the remaining claims moot. In support thereof, Plaintiff shows the following:

EXECUTIVE SUMMARY

Calavista is entitled to summary judgment holding that the charges for services stated in this motion are not subject to Texas sales and use tax because there are no genuine issues of material fact and Calavista has proven, through its summary judgment evidence and the Comptroller’s concessions, that it is entitled to judgment as a matter of law. Thus, Calavista seeks an order granting its motion for summary judgment and awarding (1) a refund of \$158,161.67 in sales tax, plus the corresponding penalty and interest assessed by the Comptroller, which Calavista paid under protest and (2) statutory interest on this refund as provided in Texas Tax Code § 112.060.

SUMMARY JUDGMENT STANDARD

A traditional motion for summary judgment is properly granted when there are no genuine issues of material fact to be decided and the movant is entitled to judgment as a matter

of law. Tex. R. Civ. P. 166a(c); *Amedisys, Inc. v. Kingwood Home Health Care, LLC*, 437 S.W.3d 507, 511 (Tex. 2013); *Thomas v. Graham Mortg. Corp.*, 408 S.W.3d 581, 588 (Tex. App.—Austin 2013, pet. denied).

EXHIBITS

Pursuant to Texas Rule of Civil Procedure 166a(d), notice is hereby given of Calavista's intent to use the following exhibits as summary judgment proof. These exhibits include discovery products that are not on file with the clerk. True and correct copies of the exhibits are attached hereto and incorporated herein by reference.

- Exhibit 1: Affidavit of Lawrence Waugh
- Exhibit 2: Defendants' Amended RFD Response
- Exhibit 3: Defendants' Amended Interrogatory Responses
- Exhibit 4: Notification of Audit Results
- Exhibit 5: Audit Exam 1 & 2
- Exhibit 6: Affidavit of Danielle Ahlrich

BACKGROUND

Calavista offers a variety of products and services to technology companies located throughout the United States. *See Exhibit 1* at 1-2. Calavista provides software development services, computer program modification services where Calavista did not sell the underlying program, consulting services, and software quality assurance testing services. *Id.*

Calavista provided software development services for Aware, Fluid, Latilla, OnRamp, Raffleshowcase, TMT, and Volusion. *See Exhibit 1* at 2. Specifically, Calavista created new computer programs for Aware, Fluid, Latilla, Raffleshowcase, and Volusion and retained no right to license or sell the computer programs. *Id.* Calavista also modified existing computer

programs for TMT and OnRamp Access. Neither TMT nor OnRamp Access acquired or purchased the underlying computer programs from Calavista. *See Exhibit 1* at 3. For all of these clients, Calavista's contracts assigned all rights to the computer programs that Calavista created or modified to the clients. Calavista retained no right to sell or license the computer programs. *See Exhibit 1* at 2-3. Calavista only retained its rights to its "Underlying Calavista Technology," which consists of Calavista's general knowledge, experience, and internal tools, including a computer program called DevEdge. *Id.* DevEdge functions similar to a spell-check tool for software coding because it runs tests to ensure that the programmer's coding produces the intended result. *Id.* DevEdge is analogous to a mechanic's wrench rather than a component of the car. *Id.* "Underlying Calavista Technology" – DevEdge included – does not become a part of the computer program created or modified by Calavista for a client. *Id.*

During the audit period, Calavista also provided consulting services to Electronic Arts and Optimal Electronics. *See Exhibit 1* at 3. Calavista gathered proprietary information from these clients regarding their software development processes, analyzed the processes, and provided its professional opinions for improving them. *Id.* Calavista provided its opinions to these consulting clients through reports and presentations. *Id.* Calavista has no legal right to sell the proprietary information gathered or the reports or presentations prepared to a third-party. *Id.* Calavista did not create any computer programs for, modify any computer programs for, sell any computer programs to, or otherwise provide or sell taxable items to Electronic Arts and Optimal Electronics. *See Exhibit 1* at 3-4.

Finally, Calavista performed quality assurance testing services to Oracle by testing the functionality of computer programs that Oracle owned. *See Exhibit 1* at 4. Calavista did not

create any computer programs for, modify any computer programs for, sell any computer programs to, or otherwise provide or sell taxable items to Oracle. *Id.*

The Comptroller subsequently audited Calavista and erroneously assessed tax, penalties, and interest on charges for software development services, services to modify existing computer programs not originally sold to the clients by Calavista, consulting services, and quality assurance testing services. *See Exhibits 4 and 5.* However, on March 10, 2016, the Comptroller filed amended discovery responses conceding that the above-referenced transactions are not taxable and identifying a few transactions as taxable. *See Exhibits 2 and 3.* As a result of these concessions, Calavista amended its petition to remove the contested items and files this motion for summary judgment on the transactions conceded by Defendants.

ARGUMENT

I. Calavista’s Software Development Services Are Not Taxable.

Software development services are services performed to develop or create a computer program, and they are not subject to the Texas sales and use tax. Texas Tax Code § 151.0101(a) lists the services that are taxable. Software development services are not on the list. In fact, the statute expressly states that taxable services do not include software development services performed to “develop” or “create” software. *See* Tex. Tax Code § 151.0101(a)(5)(D). Comptroller Rule 3.308(b)(4) recognizes this taxability rule and states: “Charges to create a program . . . are not taxable.” 34 Tex. Admin. Code § 3.308(b)(4). In addition, the Comptroller has stated charges for creating a computer program for a specific client where the exclusive rights to the computer program are transferred to the client are not taxable. *See* Texas Comptroller STAR Document No. 200007501L.

The software development services that Calavista provided to Aware, Fluid, Latilla, Raffleshowcase, and Volusion are not subject to the Texas sales and use tax because Calavista created computer programs specifically for each of these clients, transferred exclusive rights to them, and retained no right to license or sell the computer programs. *See Exhibit 1* at 2.

Moreover, the Comptroller has conceded that these customer transactions are not subject to the Texas sales tax in its discovery responses. *See Exhibits 2* and *3*. On March 10, 2016, the Comptroller's amended his Response to Plaintiff's Request for Disclosure regarding the Comptroller's legal theories and factual bases to state, in relevant part:

"The Audit Period encompassed by this suit is October 1, 2006 through June 31, 2010. Defendants concede that, for this Audit Period only, the contracts and invoices produced by Plaintiff in discovery demonstrate that the majority of the transactions at issue are not subject to tax. This concession by Defendants entitles Plaintiff to a refund of approximately 97% of the amount in tax, penalties, and interest it paid under protest.

However, a small portion of the remaining transactions at issue are simply sales of tangible personal property, which are subject to sales and use tax. See documents produced by Plaintiff in discovery bates-stamped 'P00164-P00165' and P00275-P00280'. Consequently, Plaintiff is not entitled to a refund of the remaining 3%, approximately, in tax, penalties and interest it paid under protest. . . ."

Exhibit 2. Additionally, Calavista served the following interrogatories:

Interrogatory No. 1: If you contend that Calavista did not perform contract programming services for clients during the Audit Period, please state the basis for your contention.

Interrogatory No. 2: If you contend that Calavista retained a right to license or sell software created or modified for its clients during the Audit Period, please state the basis for your contention.

Interrogatory No. 5: If you contend that DevEdge is a component of the software that Calavista provides to its customers, please state the basis for your contention.

Exhibit 3 at 2, 4. And, on March, 20, 2016, the Comptroller amended his response to each to state, in relevant part, the following:

“Response: . . . Subject to and without waiving the foregoing objections, the Comptroller concedes that, for the Audit Period only (October 1, 2006 through June 31, 2010), the contracts and invoices produced by Plaintiff in discovery demonstrate that the majority of the transactions at issue are not subject to tax. This concession by the Comptroller entitles Plaintiff to a refund of approximately 97% of the amount in tax, penalties, and interest it paid under protest.

However, a small portion of the remaining transactions at issue are simply sales of tangible personal property, which are subject to sales and use tax. See documents produced by Plaintiff in discovery bates-stamped “P00164-P00165 and P00275-P00280. Consequently, Plaintiff is not entitled to a refund of the remaining 3%, approximately, in tax, penalties and interest it paid under protest. . . .”

Exhibit 3 at 2-4.

P00164-P00165 and P00275-P00280 are Calavista’s invoices for client transactions for which Calavista no longer seeks a refund of tax, penalty, and interest through this motion. *See Exhibit 1* at 4-5. Calavista has amended its petition to withdraw its claim for the recovery of the sales tax assessed on these invoices. For the reasons set forth above, Calavista is entitled to summary judgment that the charges for software development services that it provided to Aware, Fluid, Latilla, Raffleshowcase, and Volusion are not subject to the Texas sales and use tax.

II. Calavista’s Services to Modify Existing Computer Programs Not Sold by Calavista Are Not Taxable.

The charges for services performed to modify existing computer programs not sold by the person performing the modification are not subject to the Texas sales and use tax. Texas Tax Code § 151.0101(a) lists the services that are taxable, and the statute specifically excludes from this list the charges for “the repair, maintenance, creation, and restoration of a computer program, including its development and modification, not sold by the person performing the

repair, maintenance, creation, or restoration service.” Tex. Tax Code Ann. § 151.0101(a)(5)(D). Additionally, Comptroller Rule 3.308(b)(4) states that “Charges to . . . modify an existing program not sold by the person doing the modification are not taxable.” 34 Tex. Admin. Code § 3.308(b)(4). Accordingly, the Comptroller has privately ruled that charges for modifying a computer program not sold by the person providing the modification are not subject to the Texas sales and use tax. *See* Texas Comptroller STAR Document No. 200007501L.

The charges for the services that Calavista provided to TMT and OnRamp Access are not subject to the Texas sales and use tax because Calavista modified existing computer programs not sold by Calavista for each of these clients. *See* **Exhibit 1** at 2-3.

The Comptroller has conceded that these customer transactions are not subject to the Texas sales tax in its discovery responses. *See* **Exhibits 2** and **3**. On March 10, 2016, the Comptroller’s amended his Response to Plaintiff’s Request for Disclosure regarding the Comptroller’s legal theories and factual bases to state, in relevant part:

“The Audit Period encompassed by this suit is October 1, 2006 through June 31, 2010. Defendants concede that, for this Audit Period only, the contracts and invoices produced by Plaintiff in discovery demonstrate that the majority of the transactions at issue are not subject to tax. This concession by Defendants entitles Plaintiff to a refund of approximately 97% of the amount in tax, penalties, and interest it paid under protest. . . .”

Exhibit 2. Additionally, Calavista served the following interrogatories:

Interrogatory No. 1: If you contend that Calavista did not perform contract programming services for clients during the Audit Period, please state the basis for your contention.

Interrogatory No. 2: If you contend that Calavista retained a right to license or sell software created or modified for its clients during the Audit Period, please state the basis for your contention.

Interrogatory No. 5: If you contend that DevEdge is a component of the software that Calavista provides to its customers, please state the basis for your contention.

Exhibit 3 at 2, 4. And, on March, 20, 2016, the Comptroller amended his response to each to state, in relevant part, the following:

Response: . . . Subject to and without waiving the foregoing objections, the Comptroller concedes that, for the Audit Period only (October 1, 2006 through June 31, 2010), the contracts and invoices produced by Plaintiff in discovery demonstrate that the majority of the transactions at issue are not subject to tax. This concession by the Comptroller entitles Plaintiff to a refund of approximately 97% of the amount in tax, penalties, and interest it paid under protest. . . .”

Exhibit 3 at 2-4.

For the reasons stated above, Calavista is entitled to summary judgment that the charges for the computer program modification services that it provided to TMT and OnRamp Access are not subject to the Texas sales and use tax.

III. Calavista’s Consulting Services Are Not Taxable.

Consulting services are not listed as a taxable service under Texas Tax Code § 151.0101(a). Further, Comptroller Rule 3.342(a)(5)(A) states that “[t]he sale of information that is gathered or compiled on behalf of a particular client is not subject to tax if the information is of a proprietary nature to that client and may not be sold to others by the person who gathered or compiled the information.” 34 Tex. Admin. Code § 3.342(a)(5)(A). The Comptroller has issued rulings stating that consulting services are not taxable when not connected to the sale of taxable items. See Texas Comptroller STAR Document No. 9904412L (“Unrelated consulting services which are the expert or professional opinions of the consultant are not taxable when they are separately stated and not connected in any way to the sale of a taxable item.”).

Calavista obtained and analyzed proprietary information from Electronic Arts and Optimal Electronics for the purpose of issuing a report that discussed Calavista's professional opinion about how to improve each company's software development processes. *See Exhibit 1* at 3. The reports that Calavista prepared for these clients are proprietary to them. *Id.* Calavista may not resell or otherwise use this information. *Id.* Additionally, Calavista did not provide its consulting services in connection with the sale of a taxable item. *See Exhibit 1* at 3-4. Calavista only provided software consulting services. It did not sell any taxable items, including computer programs, to these clients, nor did it provide any taxable services to them. *Id.*

Moreover, the Comptroller has conceded that these customer transactions are not subject to the Texas sales and use tax through its Amended Response to Plaintiff's Request for Disclosure. *See Exhibit 2.* Additionally, the Comptroller served the following amended interrogatory response, which states, in relevant part:

Interrogatory No. 6: If you contend that Calavista provided anything other than nontaxable consulting services to Electronic Arts, please state the basis for your contention.

Response: . . . Subject to and without waiving the foregoing objections, the Comptroller concedes that, for the Audit Period only (October 1, 2006 through June 31, 2010), the contracts and invoices produced by Plaintiff in discovery demonstrate that its transactions with Electronic Arts are not subject to tax."

Exhibit 3 at 4.

For the reasons set forth above, Calavista is entitled to summary judgment that the charges for the consulting services that it provided to Electronic Arts and Optimal Electronics are not subject to the Texas sales and use tax.

IV. Calavista's Quality Assurance Testing Services Are Not Taxable.

The list of taxable services provided under Texas Tax Code § 151.0101(a) does not include quality assurance testing services. The Comptroller has recognized that charges for quality assurance testing are not subject to the Texas sales and use tax. *See* Texas Comptroller STAR Document No. 9011L1058F12 (destructive testing of computer chips not taxable); Texas Comptroller STAR Document No. 9202L1158A01 (identifying various testing services as non-taxable).

Calavista provided quality assurance testing services to Oracle by testing the functionality of computer programs that Oracle owned. *See Exhibit 1* at 4. Calavista did not create any computer programs for, sell any computer programs to, or otherwise provide or sell taxable items to Oracle. *Id.*

In addition, the Comptroller has conceded that Calavista's quality assurance testing services are not subject to the Texas sales and use tax through its Amended Response to Plaintiff's Request for Disclosure. *See Exhibit 2.*

For the reasons set forth above, Calavista is entitled to summary judgment that the charges for the quality assurance testing services that it provided to Oracle are not subject to the Texas sales and use tax.

CONCLUSION AND PRAYER

Calavista is entitled to summary judgment holding that the charges for services stated in this motion are not subject to the Texas sales and use tax. Calavista has established through its summary judgment motion and proof (including the Comptroller's concessions) that there are no genuine issues of material fact and Calavista is entitled to judgment as a matter of law.

For these reasons, Calavista prays that, after a hearing, this Court grant its motion for summary judgment and award Calavista a refund of \$158,161.67 in sales tax, plus the corresponding penalty and interest assessed by the Comptroller, which Calavista paid under protest, as well as statutory interest on this refund as provided in Texas Tax Code § 112.060. Calavista further prays that this Court grant any other relief to which Calavista is entitled at law or in equity.

Respectfully submitted,

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By /s/ Danielle V. Ahlrich

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ATTORNEYS FOR PLAINTIFF, CALAVISTA, L.P.

CERTIFICATE OF CONFERENCE AND NOTICE OF HEARING

Per Travis County District Court Local Rule 2.2, the parties have agreed as to the date and time for the hearing on Calavista's Motion for Summary Judgment. The hearing is set for Wednesday, April 13, 2016, at 2:00 p.m. for a total of 1.5 hours.

/s/ Danielle V. Ahlrich

Danielle V. Ahlrich

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of Plaintiff's Motion for Summary Judgment has been electronically served upon Defendants' Counsel, Quinn T. Ryan, Attorney-In-Charge, Office of the Attorney General, Tax Division, P.O. Box 12548, Austin, Texas 78711-2548, on this 22nd day of March, 2016.

/s/ Danielle V. Ahlrich

Danielle V. Ahlrich