

New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

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Sales Tax
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State and Local Sales and Compensating Use Taxes
Imposed on Certain Sales of Computer Software

Effective September 1, 1991, State and local sales and compensating use taxes are imposed on the sale or use of prewritten computer software and certain related services.

The effect of this change in the Tax Law is to broaden the types of computer software that are subject to sales and use taxes. Prior to September 1, 1991, "custom" software was exempt from tax as described in Technical Services Bulletin 1978-1(S). However, certain software previously considered "custom" may now be considered prewritten computer software and subject to such taxes. References in the 1978 bulletin to exempt software are largely obsolete and should be disregarded. The only software that is exempt from sales and use taxes under the new law is software designed and developed to the specifications of a specific purchaser.

Prewritten computer software is any computer software that is not designed and developed by the author or other creator to the specifications of a specific purchaser.

The sale of prewritten software includes any transfer of title or possession, any exchange, barter, rental, lease or license to use, including merely the right to reproduce, for consideration. Thus, a payment made by a customer on or after September 1, 1991, for a license to use, or for the rental or lease of prewritten software is subject to sales or use tax. The transfer of public domain software without any charge is not taxable because there is no consideration.

Software that was originally designed and developed to the specifications of a specific purchaser (i.e., "custom" software) loses its identity as such and becomes prewritten software, subject to tax, if and when it is sold to someone other than the person for whom it was specifically designed and developed. (See section "Exemptions from Tax" for certain exceptions.)

Prewritten software is subject to tax whether sold as part of a package or separately. Software created by combining two or more prewritten programs or portions of prewritten programs is still prewritten software subject to tax. The medium by which the software is transferred to the purchaser has no effect on the software's taxability. Thus, prewritten software is taxable whether sold, for example, on a disk, tape or by electronic transmission over telephone lines.

Prewritten software, even though modified or enhanced to the specifications of a specific purchaser, remains prewritten software subject to tax. However, if a charge for the custom modification or enhancement is reasonable and separately stated on the invoice or billing statement, then the separately stated charge for the custom modification or enhancement is not subject to tax.

Example 1. A software developer creates an accounting system using prewritten software modules for general ledger, accounts receivable, accounts payable, payroll, inventory management, etc. The developer may also sell the modules separately or bundled in other packages. Even though the modules may be modified to the specific requirements of the client's business, the sale of the modules is subject to sales or use tax as prewritten software. An additional charge for modification or "custom" programming by the developer would not be subject to sales or use tax if the developer's charge for the modification is reasonable and is separately stated on the billing statement.

The incidental use of a development language (e.g., COBOL, BASIC, C, etc.) or of libraries of "prewritten" functions or routines in designing and developing a "custom" software program to the specifications of a specific purchaser will not, in and of itself, make the sale of an otherwise custom program taxable. The "custom" program must be examined as a whole to determine whether it is exempt from tax. If the prewritten components of a custom program are sold separately, their sale is subject to tax.

The purchase of a development language or libraries of software routines is subject to sales or use tax if it is used in designing and developing custom software. Since custom software does not constitute tangible personal property the development language (or libraries) is not used to produce tangible personal property for sale.

Sale of software Upgrades

Generally, the sale of a revision or upgrade of prewritten software is subject to tax as the sale of prewritten software. If, however, the software upgrade is designed and developed to the specifications of a specific purchaser, its sale to that specific purchaser would be exempt as custom software.

Bulk Sales

When a seller of business assets in bulk, as part of the bulk sale, sells software, such software is subject to tax even if it was deemed to be exempt software when purchased by the seller.

Exemptions from Tax

Customer Support and Related Services

Services taxable under section 1105(c) of the Tax Law are exempt from tax under section 1115(o) of the Tax Law where performed on any computer software. However, where such services to be performed on software are sold in conjunction with the sale of tangible personal property, such as prewritten software, the charge for such services is exempt only if it is reasonable and separately stated on the invoice or billing statement given to the customer.

Thus, charges for customer (user) support or for information services provided by a vendor to a customer, either in person or by some type of telecommunications arrangement (e.g., telephone, modem, facsimile machine, etc.), in the nature of training, consulting, instructing or other diagnostic or troubleshooting services related to prewritten software are exempt from sales and use taxes where the charges are reasonable and separately stated. Charges for the service of installing, repairing, maintaining or servicing prewritten software are also exempt from sales and use taxes where the charges are reasonable and separately stated on the invoice. Of course, any charges for the above described services sold in connection with custom software are exempt from tax.

Programming and systems analysis are also exempt services. However, where these services are rendered in conjunction with the sale of prewritten software, the charge for the service is exempt from tax only when the charge for the service is reasonable and separately stated on the invoice or billing statement given to the customer.

Example 2: A computer vendor sells an "off-the-shelf" software program to a customer. The vendor charges additional fees for installing the software, on-site training, and diagnostic and trouble-shooting customer support. The sale of the software is taxable since it is prewritten. However, the charges for installation, on-site training and customer support services are not taxable if reasonable and separately stated on an invoice or billing statement given to the customer.

Software Maintenance Agreements

If a software maintenance agreement provides for the sale of both taxable elements (e.g., prewritten software upgrades) and nontaxable elements (e.g., training, consulting, diagnostic and troubleshooting support, etc.), the charge for the entire maintenance agreement is subject to tax unless the charge for the nontaxable elements is reasonable and separately stated in the maintenance agreement and separately billed on the invoice or other document of sale given to the purchaser.

Example 3: A vendor of computer systems sells a maintenance agreement to provide on-site training, repairs, software upgrades, and customer support by telephone for a customer's computer system (hardware and prewritten software). The portion of the cost of the agreement allocated to prewritten software upgrades and for repair or maintenance of the computer system hardware is taxable. However, the portion of the cost allocated for on-site training, repairs and maintenance of the prewritten software and telephone support is exempt if the cost is reasonable and separately stated in the written agreement and the customer invoice.

Production/Research and Development

Prewritten computer software used or consumed directly and predominantly in the production of tangible personal property for sale or directly and predominantly in research and development is exempt from tax. The purchaser seeking either of these exemptions must provide the software vendor with a properly completed Exempt Use Certificate (Form ST-121).

Use Tax Exemption

Use tax generally applies to taxable uses of prewritten computer software in the same manner that the use tax applies to uses of other tangible personal property, except that: (1) no use tax is imposed on software used by its author if the author does not offer similar software for sale in the regular course of business, and (2) where software is used by its author and the author does sell the same or similar software in the regular course of business, use tax applies and is computed on the cost of the medium (floppy disk, magnetic tape, etc.) that contains or is used in conjunction with the program.

Transfers of Software To Certain Corporations and Partnerships

Computer software designed and developed by the author or other creator to the specifications of a specific purchaser is exempt from tax under section 1115(a)(28) of the Tax Law when subsequently sold or transferred, directly or indirectly, by the purchaser of the software either

- to a corporation that is a member of an affiliated group of corporations which includes the original purchaser of the software; or

- to a partnership in which the original purchaser of the software and other members of such an affiliated group have at least a 50 percent capital or profits interest.

However, the exemption does not apply if the sale or transfer of the software is part of a plan to avoid or evade the tax. The intragroup transfer exemption also does not apply to prewritten software that is available to be sold to customers in the ordinary course of the seller's business. The term "affiliated group" has the same meaning as it has in section 1504 of the Internal Revenue Code except that references to "at least 80 percent" shall be read as "more than 50 percent" for purposes of this sales tax exemption.

Example 4: The XYZ Corporation purchases software designed and developed specifically for it by a software developer. XYZ corporation is a member of an affiliated group of corporations. Even though the XYZ Corporation purchased the software from the developer, it may, with the developer's permission, transfer the software to another

corporation which is a member of the same affiliated group of corporations. Transfers from XYZ Corporation to the affiliated corporation are exempt from sales and use taxes. However, if the software developer sells the same program directly to any member of the group of affiliated corporations, the transaction is subject to tax because it would now be a sale of prewritten software. Similarly, if XYZ Corporation offered the program for sale to the public in the regular course of its business, then XYZ Corporation's sale to another member of its affiliated group would be subject to tax.

Example 5: Q corporation designs and develops software for sale to the general public, as well as to P Corporation, S Corporation and R Corporation. All four corporations are members of the same affiliated group of corporations. When Q corporation sells prewritten programs to the general public or to other members of its affiliated group, such sales are taxable. When Q Corporation sells a "custom" program to P Corporation, the sale is not subject to tax. But, if the "custom" program is then offered for sale to the general public, any sale of that "custom" program by either Q Corporation or P Corporation to any of the other members of the group or to the public would be subject to tax.

Computer Bulletin Board Systems

Persons who operate a computer system and offer information or software to the general public or to system members/subscribers may be selling taxable services or tangible personal property. Charges by a system operator to persons in New York State for membership or for "on-line" time, for the purpose of exchanging or conveying information or software programs, are subject to sales and use taxes. The appropriate rate of tax is determined by the location where delivery of the service or software to the subscriber or recipient occurs.

The system operator (generally the person whose equipment is used to provide bulletin board system or "on-line" services) is required to register as a vendor and collect the appropriate sales and use taxes on its sales of membership, on-line time, software, etc.

Example 6: The system operator of a commercial on-line computer information service charges a fee to its customers for downloading prewritten software programs and for access to a computer bulletin board which has features on software support and technical advice by computer experts regarding the prewritten software. Charges for the software programs are taxable as the sale of tangible personal property. Charges for access to the software support and technical advice are subject to tax as information services. The manner of delivery to the customer of the software or information services does not affect the taxable status of the transactions.

Some software developers distribute copyrighted software (commonly called "shareware") to computer users for trial use. Copying and sharing of this software among other computer users is encouraged by the developer. If a user wants to receive future upgrades or user support from the developer, the user is required to "register" the software and pay the developer a fee or required "donation."

If a recipient of shareware is located within New York State, any payment for the right to use the shareware or to receive upgrades or support is subject to sales and use taxes.

Example 7: A New York resident is charged an annual membership fee of \$30 by a computer bulletin board system (BBS). When the New York resident "downloads" a shareware program from the system, the creator of the shareware requests a \$75 registration fee or required "donation" for its use. State and local sales taxes are due and payable on the \$30 membership fee and the \$75 shareware payment. The membership fee is taxable as the purchase of an information service and the \$75 cost of the shareware program is taxable because the registration fee or "donation" paid to the creator constitutes consideration paid upon the transfer or possession of prewritten computer software at retail.

Exchanges of public domain software or other copyrighted software that are not offered for sale and for which no fee or charge is made or demanded are not subject to sales or use tax. If a system operator serves merely as a conduit, there is no requirement upon the system operator to collect tax on transfers of free software. However, as previously mentioned, any membership fees for membership in a bulletin board system, and on-line time or access fees (however expressed) are subject to tax, as are any charges or other consideration requested by the system operator in exchange for the transfer of the software.