**New York State Department of Taxation and Finance**
**Office of Tax Policy Analysis**
**Technical Services Division**

TSB-A-02(7)S
Sales Tax
May 30, 2002

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

<u>ADVISORY OPINION</u>          <u>PETITION NO. S991221A</u>

On, December 21, 1999, the Department of Taxation and Finance received a Petition for Advisory Opinion from Liquid Digital Information Systems Inc., 180 Varick Street 12th floor, New York, New York 10014.

The issue raised by Petitioner, Liquid Digital Information Systems Inc., is whether any of its services described below involving (A) Web site development, design, implementation and maintenance, or (B) Web site consulting, is subject to sales and use tax.

Petitioner submits the following facts as the basis for this Advisory Opinion.

Petitioner is a full service new media company providing technology solutions for corporate clients. Petitioner will design, produce, implement, and maintain interactive media solutions, including commercial and corporate Web sites, intranets, kiosks, online advertising, and e-commerce and network-based software applications. Web sites may be furnished to clients in the form of a CD-ROM.

Prior to the design phase, Petitioner will learn about its client's business; what the market is, how the client got started, and where it hopes to go in the future. Petitioner will try to understand specifically what the client hopes to accomplish by using interactive media to enhance its marketing and sales efforts. Once Petitioner has reached an understanding of a client's goals, Petitioner suggests particular solutions based on the scope of the project and starts designing those solutions.

The design phase of a project involves conceiving the actual structure of a Web site, intranet, etc., to determine how many parts it is going to have, how a user will move from one part to another, what kind of content it will have, and what it will look like. Before moving to the production stage of a project, Petitioner estimates the scope of the work necessary to make the design a reality. This outline details software and staff needs, as well as time and budgetary limits.

During the production stage, programmers code software and applications. Designers format the look and feel of a Web site, including how it will be navigated and how a user will interact with it. As work progresses, the project is tested to make sure it is functioning as planned.

Implementation can be as simple as posting a banner ad on a Web site or as complicated as setting up an e-commerce Web site that allows for products to be purchased on-line. E-commerce involves on-line credit card transactions and requires customers to fill out forms. Each piece of data on a form may be stored in a different data base.

Maintenance agreements vary from project to project. Petitioner sometimes provides ongoing service to clients after the project is completed, such as updating portions of a Web site, or adding a new element to a database system when needed.

**Applicable Law**

Section 1101(b) of the Tax Law provides, in part:

When used in this article for the purposes of the taxes imposed by subdivisions (a), (b), (c) and (d) of section eleven hundred five and by section eleven hundred ten, the following terms shall mean:

\* \* \*

(6) Tangible personal property. Corporeal personal property of any nature. . . . Such term shall also include pre-written computer software, whether sold as part of a package, as a separate component, or otherwise, and regardless of the medium by means of which such software is conveyed to a purchaser. . . .

\* \* \*

(14) Pre-written computer software. Computer software (including pre-written upgrades thereof) which is not software designed and developed by the author or other creator to the specifications of a specific purchaser. The combining of two or more pre-written computer software programs or pre-written portions thereof does not cause the combination to be other than pre-written computer software. Pre-written software also includes software designed and developed by the author or other creator to the specifications of a specific purchaser when it is sold to a person other than such purchaser. Where a person modifies or enhances computer software of which such person is not the author or creator, such person shall be deemed to be the author or creator only of such person's modifications or enhancements. Pre-written software or a pre-written portion thereof that is modified or enhanced to any degree, where such modification or enhancement is designed and developed to the specifications of a specific purchaser, remains pre-written software; provided however, that where there is a reasonable, separately stated charge or an invoice or other statement of the price given to the purchaser for such modification or enhancement, such modification or enhancement shall not constitute pre-written computer software.

Section 1105 of the Tax Law provides, in part:

On and after June first, nineteen hundred seventy-one, there is hereby imposed and there shall be paid a tax of four percent upon:

(a) The receipts from every retail sale of tangible personal property, except as otherwise provided in this article.

\*            \*            \*

(c) The receipts from every sale, except for resale, of the following services:

\*            \*            \*

(3) Installing tangible personal property . . . or maintaining, servicing or repairing tangible personal property . . . not held for sale in the regular course of business . . . whether or not any tangible personal property is transferred in conjunction therewith . . . .

\*            \*            \*

(5) Maintaining, servicing or repairing real property, property or land, as such terms are defined in the real property tax law, whether the services are performed in or outside of a building . . . .

Section 1115(o) of the Tax Law provides:

Services otherwise taxable under subdivision (c) of section eleven hundred five or under section eleven hundred ten shall be exempt from tax under this article where performed on computer software of any nature; provided, however, that where such services are provided to a customer in conjunction with the sale of tangible personal property any charge for such services shall be exempt only when such charge is reasonable and separately stated on an invoice or other statement of the price given to the purchaser.

Technical Services Bureau Memorandum, TSB-M-93(3)S, March 1, 1993, pertaining to the taxability of computer software and certain related services provides, in part:

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. . . . certain software previously

considered "custom" may now be considered *prewritten computer software* and subject to such taxes. . . .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.

\*          \*          \*

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. . . .

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.

\*          \*          \*

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.

\*          \*          \*

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.

## **Opinion**

The Web site development services provided by Petitioner to its clients, which involve consulting, designing, and the actual creation of Web sites, do not constitute the sale of tangible personal property and are not included among the enumerated services that are subject to New York State and local sales and compensating use taxes. See Alan J. Goldstein/The Computer Studio, Adv Op Comm T & F, July 31, 2001, TSB-A-01(21)S. This is so, regardless of whether the Web sites are created for purposes of advertising or promotion, Internet commerce, intranets or other communications and support functions (see David H. Posmantier, Adv Op Comm T&F, June 7, 1999, TSB-A-99(31)S; K2 Design Incorporated, Adv Op Comm T&F, July 23, 1997, TSB-A-97(43)S; Pat Rolland, Adv Op Comm T&F, July 23, 1997, TSB-A-97(41)S; Ski Soft, Inc., d/b/a Ski Areas of New York Internet Publishing Services, Adv Op Comm T&F, June 25, 1997, TSB-A-97(35)S). Accordingly, Petitioner's charges to its clients for such services are not subject to sales or compensating use tax. Petitioner's charges for Web site development are not taxable whether the Web site is uploaded electronically to the World Wide Web or delivered to a client in the form of a CD-ROM or other media. When a client purchases Web site development from Petitioner and receives the Web site in the form of a CD-ROM or other media, the transfer of the medium such as a disk or tape to the client as an incident to the Web site development is not subject to tax under Section 1105(a) of the Tax Law. See EMCON, Adv Op Comm T&F, December 16, 1996, TSB-A-96(79)S respecting the transfer of items as an incident to nontaxable engineering services.

Petitioner's purchase of pre-written software for use in performing its Web site development services is subject to tax under Section 1105(a) of the Tax Law as a purchase at retail of tangible personal property. See Section 1101(b)(6) of the Tax Law. The purchase by Petitioner of custom software designed and developed to Petitioner's specifications is not taxable. Pre-written software, even though modified or enhanced to the specifications of a specific purchaser, remains pre-written software subject to tax. However, if a charge for the customization or enhancement is reasonable and separately stated on the invoice or billing statement, then the separately stated charge for the customization or enhancement is not subject to tax. See TSB-M-93(3)S, supra.

Petitioner's use in its Web site development service of software that it develops in-house is not subject to compensating use tax if similar software is not offered for sale by Petitioner in the

regular course of business. If Petitioner offers similar software for sale in the regular course of business, then Petitioner's use of the software would be subject to tax based on the cost of the medium that contains or is used in conjunction with the program. See TSB-M-93(3)S, supra.

It is noted that Web site maintenance services generally are not subject to sales tax. See Salomon & Leitgeb CPA's, LLP, Adv Op Comm T&F, July 23, 1997, TSB-A-97(44)S. If a nontaxable service, however, is performed in conjunction with the sale of tangible personal property, the entire receipts from the sale are subject to tax unless the charges for the service and tangible personal property are separately stated and reasonable, and the service and property may be separately purchased. See Salomon & Leitgeb CPA's, LLP, supra. Section 1105(c) of the Tax Law imposes tax on the services of maintaining, servicing or repairing tangible personal property or real property. Maintenance services performed by Petitioner on computer hardware or kiosks, therefore, are subject to sales tax unless otherwise exempt.

DATED: May 30, 2002

/s/
Jonathan Pessen
Tax Regulations Specialist IV
Technical Services Division

NOTE:     The opinions expressed in Advisory Opinions are
          limited to the facts set forth therein.