

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

TSB-A-03(5)S
Sales Tax
January 31, 2003

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S010614A

On June 14, 2001, the Department of Taxation and Finance received a Petition for Advisory Opinion from KPMG LLP, 150 John F. Kennedy Parkway, Short Hills, NJ 07078. Petitioner, KPMG LLP, provided additional information pertaining to the Petition on April 16, 2002.

The issue raised by Petitioner is, for purposes of determining the applicability of New York State and local sales and use taxes, what method of allocation and what documentation should an online provider of Internet services use and maintain as proof of out-of-state delivery of its taxable services delivered via electronic means to in-state and out-of-state locations where the services are billed to a New York address.

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

XYZ Inc. ("XYZ"), a Delaware corporation with its principal place of business located outside New York in State X, is a provider of online integrated database services to the financial community both nationally and internationally. Multiple large-scale databases are combined into two mainframe information systems, neither of which is located in New York.

XYZ's databases are accessible from customers' personal computers ("workstations") using passwords provided by XYZ. XYZ provides its customers with proprietary software which allows the subscribers' workstations to access XYZ's mainframe. This software is provided free of charge when a customer subscribes to one or more of its services. Once connected to the system, the subscriber receives real-time updates via on-line transmissions. These services are delivered to the customer through modem connections or through XYZ's wide-area-network ("WAN"). If delivered through the WAN, XYZ installs a router at the customer's location free of charge. XYZ pays for all communication costs associated with the transmissions.

Subscribers to XYZ's data service have access to the processing power of XYZ's mainframes rather than having to store data at their limited facilities. In order to provide access to the system, XYZ assigns passwords to its customers based on the number of users. Subsequently, XYZ's customers distribute these passwords to employees located throughout the United States.

XYZ charges a set monthly fee for its data service. Such fee is based solely on the number of passwords XYZ assigns to its customer, and is not dependent on the amount of time the customer's employees spend accessing XYZ's databases or on the type of information they access. XYZ has the ability to track the databases accessed by their customers but not (1) the information obtained or reports generated, (2) time spent online, or (3) the location of the employees logging on

and off its system. XYZ issues bills to its customers based on the number of passwords assigned, and thus has no need to track such usage.

XYZ's business practice, which does not individually track any particular user, does not account for the fact that access to its data service originates from various workstations throughout the United States. In order for XYZ to determine the taxable base on which to apply sales or compensating use tax, i.e., taxable services delivered (accessed by customers) in New York, Petitioner proposes that XYZ have its customers with a New York billing address complete Form ST-121, *Exempt Use Certificate*, and attach certain documentation ("the Statement"), based on the following methodology:

In the Statement, XYZ will indicate the total number of passwords issued to each customer. Each customer must determine the percentage of passwords issued to employees that utilize the service in New York versus those employees that utilize the service outside New York. XYZ will regularly update the Statement to reflect the change in the number of passwords issued to each customer. This process will allow XYZ to properly charge sales or use tax on those sales that occur in New York.

In this Petition, Petitioner seeks to establish that for services billed to a New York address XYZ's good faith acceptance of such *Exempt Use Certificate* and Statement should be acknowledged by the Department of Taxation and Finance as sufficient documentation supporting the percentage of its exempt sales and the correct application and collection of New York sales or use tax.

Applicable Law and Regulations

Section 1132(c)(1) of the Tax Law provides, in part:

For the purpose of the proper administration of this article and to prevent evasion of the tax hereby imposed, it shall be presumed that all receipts for property or services of any type mentioned in subdivisions (a), (b), (c) and (d) of section eleven hundred five . . . are subject to tax until the contrary is established, and the burden of proving that any receipt . . . is not taxable hereunder shall be upon the person required to collect tax or the customer.

Section 1133(a) of the Tax Law provides:

Except as otherwise provided in section eleven hundred thirty-seven, every person required to collect any tax imposed by this article shall be personally liable for the tax imposed, collected or required to be collected under this article. Any such person shall have the same right in respect to collecting the tax from his customer or in respect to nonpayment of the tax by the customer as if the tax were a part of the

purchase price of the property or service, amusement charge or rent, as the case may be, and payable at the same time; provided, however, that the tax commission shall be joined as a party in any action or proceeding brought to collect the tax.

Section 1142 of the Tax Law provides, in part:

In addition to the powers granted to the tax commission in this article, it is hereby authorized and empowered:

* * *

(4) To prescribe methods for determining the amount of receipts, amusement charges, dues or rents and for determining which of them are taxable and which are nontaxable. . . .

Section 525.2(a) of the Sales and Use Tax Regulations provides, in part:

* * *

(2) . . . the sales tax is a “transactions tax,” with the liability for the tax occurring at the time of the transaction. Generally, a taxed transaction is an act resulting in the receipt of consideration for the . . . rendition of an enumerated service. The time or method of payment is generally immaterial, since the tax becomes due at the time of . . . the rendition of such service. . . .

(3) . . . the sales tax is a “destination tax.” The point of delivery or point at which possession is transferred by the vendor to the purchaser, or the purchaser’s designee, controls both the tax incidence and the tax rate.

Section 532.4 of the Sales and Use Tax Regulations provides, in part:

(a) *General.* (1) It is presumed that all receipts for property or service of any type mentioned in subdivisions (a), (b), (c) and (d) of section 1105 of the Tax Law . . . are subject to tax until the contrary is established.

* * *

(b) *Burden of proof.* (1) The burden of proving that any receipt . . . is not taxable shall be upon the person required to collect the tax and the customer.

* * *

(c) *Use of exemption certificates.* (1) To enable purchasers entitled to an exemption from the sales and compensating use tax to avail themselves of the exemption and for administrative purposes, the Department of Taxation and Finance provides various exemption certificates. . . . (Emphasis added)

* * *

(e) *Exempt use certificate.* (1) An exempt use certificate is used to claim exemption from State and local sales tax on purchases of tangible personal property or services to be used for an exempt purpose. (Emphasis added)

Section 533.2 of the Sales and Use Tax Regulations provides, in part:

(a) *General.* (1) For the proper administration of the Sales and Use Tax Law and to prevent evasion of the sales tax, it is statutorily presumed that all receipts from sales and purchases of property or services of any type mentioned in subdivisions (a) through (d) of section 1105 of the Tax Law . . . are subject to the tax until the contrary is established. The burden of proving that any receipt . . . is not taxable is on the vendor or the customer. To satisfy his burden of proof, a vendor must maintain records sufficient to verify all transactions.

* * *

(b)(3) The seller must maintain records which substantiate points of delivery if delivery was made at a place other than his place of business. Such documents should include receipts from parcel delivery services, common carriers, unregulated truckers, the United States Postal Service, foreign freight forwarders, and logs from company vehicles. Such documents must be referenced to specific sales transactions.

Opinion

XYZ is a provider of online integrated database services both nationally and internationally. XYZ combines multiple large-scale databases into a single mainframe information system accessible from its customers' personal computers using passwords provided by XYZ. For purposes of this Petition, it is assumed that the services XYZ sells are subject to sales tax pursuant to Section 1105(c)(1) or 1105(c)(9)(i) of the Tax Law. Petitioner seeks to establish that for services billed to a New York address XYZ's good faith acceptance of such *Exempt Use Certificate* and Statement should be acknowledged by the Department of Taxation and Finance as sufficient documentation supporting the percentage of its exempt sales and the correct application and collection of New York sales or use tax.

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Since the point of delivery determines taxability, only receipts attributable to the customers of XYZ who receive the information from XYZ in New York State are subject to the imposition of sales tax. See Section 525.2(a)(3) of the Sales and Use Tax Regulations. When the information is delivered by electronic means to customers both within and without New York, sales tax should be allocated between the two. See Paul R. Comeau, Adv Op Comm T&F, August 20, 1990, TSB-A-90(43)S.

To avail itself of a specific statutory exemption or exclusion from sales or compensating use tax to which it is entitled, a purchaser may issue a properly completed exemption document to a seller. See Sections 532.4(c) and (e) of the Sales and Use Tax Regulations. Since XYZ is not providing a service specifically exempted or excluded by the Tax Law, the ST-121, *Exempt Use Certificate*, is not the appropriate document for its customers to use for New York State sales and use tax purposes. Petitioner's proposal for XYZ to accept an *Exempt Use Certificate* and attached Statement from its customers in order to determine taxable New York sales is not a valid methodology.

That portion of XYZ's receipts from sales which are delivered to and consumed by the purchaser outside of New York is not subject to New York State and local sales and use taxes. Usually in such circumstances, the seller's bills of lading or other shipping documents showing the out of state delivery of the goods and services are considered sufficient documentation of the nontaxability of the sales. However, in the case of the electronic delivery of a service, it is more difficult to ascertain where the service is delivered. Here, since XYZ's customers access the service by the use of the passwords supplied by XYZ, XYZ is able to identify which customer has consumed its product. But, the passwords do not allow XYZ to necessarily know the location from which the service was accessed or at which location the service was received by the customer. However, XYZ, as a person required to collect tax (when not in possession of a timely and properly completed resale or exemption certificate from its customer), is liable for the appropriate amount of tax required to be collected. See Section 1133(a) of the Tax Law.

Under the above circumstances, a letter from XYZ's customers regarding the business locations or other appropriate situs of the employees to whom XYZ's customers will provide the passwords needed to access XYZ's service is relevant evidence in regard to the question of how XYZ should allocate its receipts from the sale of its information service between in-state and out-of-state sales. How much weight should be given to such a letter depends in part on the amount of the detail in the letter. A mere statement or estimate in the letter by a customer who has purchased a given number of passwords for XYZ's service that, for example, 10% of the passwords are in New York and 90% are out-of-state, would not be considered sufficient documentation of out-of-state delivery or sufficient information for collection of local sales taxes in New York. On the other hand, a letter by a customer stating that a specific number of passwords are assigned by the customer to its sales office staff at, for example, 110 State Street, Albany, NY, an additional number of passwords to its headquarters at 1740 Broadway, New York, NY, and similarly a specified number of passwords to sales offices in Akron, OH, and Memphis, TN, would form an acceptable basis for

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XYZ to allocate its sales relating to such passwords between New York sales and out-of-state-sales, absent a showing of fraud or knowledge on the part of XYZ that the contents of the letter are untrue. Such a letter must be signed by the customer (or the appropriate employee or officer thereof), and contain a statement by the customer specifying the total number of employees for whom it has purchased passwords and listing, by location, where those employees are stationed, including the street address for any New York locations. Such letter should acknowledge that it is being furnished for the purpose of allowing XYZ to determine the appropriate amount of New York State and local sales and use taxes due.

If XYZ's customer furnishes XYZ with a letter which does not contain the required information, XYZ, as a person required to collect tax, should collect tax on the full amount of receipts from the sale of its services to the customer. XYZ must keep the letters furnished by its customers as part of XYZ's sales tax records, and be able to associate each letter with related sales, for at least three years after the date of the last sale to which the letter relates. The customer is required to update the letter if there is a change in the number of passwords that are assigned to employees stationed in New York or the total number of passwords. In order to continue to rely on the letter, XYZ should regularly review with its customer the information contained in the letter to insure that the information is still accurate.

It should be noted that, generally, the determination of whether a proposed method for apportioning receipts from the sale of online services of the kind described in this Advisory Opinion between in-state and out-of-state sales is a reasonable method for collection of tax requires consideration of all the facts and circumstances in a particular case.

DATED: January 31, 2003

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