New York State Department of Taxation and Finance

Office of Tax Policy Analysis

Taxpayer Guidance Division

TSB-A-09(19)S
Sales Tax
May 21, 2009

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION   PETITION NO. S060411C

On April 11, 2006, the Department of Taxation and Finance received a Petition for Advisory Opinion from Jeffrey J. Coren CPA, P.C., 450 Seventh Avenue, Suite 2710, New York, New York 10123.

The issue raised by Petitioner, Jeffrey J. Coren, is whether charges for providing access to an on-line computer software program pursuant to a software license agreement are subject to New York State sales and use tax.

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

Company has developed software that provides each customer with weekly markdown recommendations based upon weekly sales data supplied by the customer. The software and customer related data are stored on Company's server. Company's software collects, analyzes and compiles each customer's data according to the customer's specifications. The data is assembled into reports accessible by or furnished only to the customer.

Via an Internet connection, the customer or its employees can access or download weekly reports and recommendations generated by Company's software. These reports and recommendations assist each customer in managing its clearance of merchandise. The customer may accept, reject, or change the markdown recommendations.

According to Petitioner, customers or their employees cannot access or use the software to manipulate their data stored on Company's server. Customers cannot generate ad hoc reports, test marketing hypotheses, or request additional analysis. Company's software is generally not downloaded by customers and does not reside on customers' computers.

The information being processed and the resulting reports and recommendations are confidential in nature, for the exclusive use of the customer, and are not provided to any other persons.

Company enters into a Master Software License and Services Agreement (Agreement) with customers. Pursuant to the Agreement, customers pay a monthly license fee for the initial term of the license. The license may be renewed for an additional two year term, or renewed for a perpetual term. Customers may be charged additional fees for implementation services required to make Company's software system operational by configuring the software to the customer's business requirements, technical support services, and hosting services which also include technical support.

Petitioner provided a sample Agreement that provides, in part, as follows:

1.1. Delivery of Licensed Software; Grant of License. Subject to the terms and conditions of this Agreement and in consideration for the fees set forth on Exhibit A, [Company] grants to Customer a non-transferable . . . and non-exclusive license to use the Licensed Software . . . "Licensed Software" means the computer programs provided by [Company] to Customer. . . "License" means the license to use the Licensed Software granted to Customer in this Agreement.

1.2. Restrictions. Customer may not itself, or through any parent, subsidiary, affiliate, agent or other third party: (a) sell, lease, rent, display, license, sublicense, operate as a service bureau, or timeshare, the Licensed Software to any third party; . . . [Company] reserves the right to use technical means to verify that Customer's use of the Licensed Software comports with the terms of this Agreement and to terminate any unlicensed use of the Licensed Software.

*   *   *

1.5. Copies. Customer may make one copy of the Licensed Software for installation on a server or other host computer. Customer may make additional copies of the Licensed Software in the normal course of its back-up and archival operations but none of such copies may be used and all of such copies will remain subject to the terms of this Agreement.

EXHIBIT A

1. Licensed Software:

Description of Licensed Software. The Licensed Software is designed to provide Customer with weekly markdown recommendations based upon certain weekly sales data of Customer to assist Customer in managing its clearance of merchandise. Commencing on the Go Live Date . . . on a weekly basis during the Term, Customer will provide [Company] with a data feed indicating units sold by style and price in a format specified by [Company]. The data feed will include, at a minimum, the most recent Customer weekly sales and inventory data. It is initially agreed that Customer will provide such data feed on or before noon on each Sunday and [Company] will utilize such data in conjunction with the Licensed Software to produce new markdown recommendations which will be made available to Customer within the Licensed Software within 24 hours, on or before noon on the immediately following Monday. From time to time the parties may mutually agree upon a revised delivery schedule for Customer's data feed and/or the weekly markdown recommendations.

*   *   *

3. Scope of License: Customer's License to the Licensed Software is limited to Customer's . . . branded stores and . . . branded or co-branded internet "stores" or "sales areas" in existence during the Term, . . .

*   *   *

5. Renewal Options: Customer has the option to continue use of the Licensed Software for a renewal term ("Renewal Term") by selecting . . . one of the options below. In order to exercise one of such options, Customer must provide written notice to [Company] prior to the end of the Initial Term.

(a) Renewal Option A: Two year term following expiration of the Initial Term. The License Fee for Renewal Option A is $50,000 per month, due on the first day of each month of the Renewal Term. . . .

(b) Renewal Option B: Perpetual term. The effective date of Customer's exercise of Renewal Option B may not be prior to end of the first year of the Initial Term. The License Fee for Renewal Option B is $1.2 million. . . .

In order to exercise either Renewal Option set forth above, Customer must elect to either (i) have [Company] continue hosting the Licensed Software for an additional two year period following the Initial Term . . . (ii) host the Licensed Software internally and have [Company] provide Remote Software Management Services for a two year period following the Initial Term . . . or (iii) host the License Software internally, without [Company] providing Remote Software Management Services. . . .

Petitioner also provided a sample Hosting Agreement which provides, in part, as follows:

1.1. Hosting Services. [Company] agrees to provide to Customer services for hosting software licensed to Customer by [Company] (the "Licensed Software") pursuant to the Master Software License and Services Agreement . . . between [Company] and Customer (the "License Agreement"), and for hosting all other software required for the operation of the Licensed Software, as specified in the License Agreement, including software provided to [Company] by Customer . . . The services provided by [Company] hereunder to permit Customer to remotely access and use the Software are referred to as the "Hosting Services".

1.2. Technical Support. As part of the Hosting Services, [Company] will provide the support and maintenance for the connection to the Licensed Software set forth under the Support Levels section of Exhibit A.

Applicable law and regulations

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:

* * *

(5) Sale, selling or purchase. Any transfer of title or possession or both, exchange or barter, rental, lease or license to use or consume (including, with respect to computer software, merely the right to reproduce), conditional or otherwise, in any manner or by any means whatsoever for a consideration, or any agreement therefore, including the rendering of any service, taxable under this article, for a consideration or any agreement therefor.

(6) Tangible personal property. Corporeal personal property of any nature. However, except for purposes of the tax imposed by subdivision (b) of section eleven hundred five, such term shall not include gas, electricity, refrigeration and steam. 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. . . 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(a) of the Tax Law imposes a tax on the receipts from every retail sale of tangible personal property, except as otherwise provided.

Section 1105(c) of the Tax Law imposes sales tax upon receipts from the sales, except sales for resale, of certain enumerated services.

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 entitled *State and Local Sales and Compensating Use Taxes Imposed on Certain Sales of Computer Software* dated March 1, 1993, TSB-M-93(3)S, 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. . .

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. . . .

*   *   *

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. . . .

*   *   *

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.

* * *

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.

* * *

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.

Opinion

Company has developed software that provides each customer with weekly markdown recommendations based upon weekly sales data supplied by the customer. This software assists each customer in managing its clearance of merchandise. The information being processed is provided by the customer, is confidential in nature and is for the exclusive use of the customer. The data and software may reside on a remote server. Company enters into a license agreement (the Agreement) with customers which permits each customer or its employees to remotely access the weekly reports generated by Company's system. The customer has the option to accept, reject or modify the recommended markdowns indicated in the report.

Pursuant to the Agreement, Company is selling a license to use prewritten computer software to customers that is subject to sales tax under section 1105(a) of the Tax Law. *Prewritten computer software* is defined as tangible personal property subject to State and local sales tax, "regardless of the medium by means of which the software is conveyed to a purchaser." Tax Law §1101(b)(6). The sale of prewritten computer software is subject to tax as the sale of tangible personal property. See Tax Law §§1101 (b)(6); 1105(a). *Sale* is defined as "Any transfer of title or possession or both, exchange or barter, rental, lease or license to use or consume (including, with respect to computer software, merely the right to reproduce),

conditional or otherwise, in any manner or by any means whatsoever for a consideration, or any agreement therefor." Tax Law §1101(b)(5). Sales and Use Tax Regulation section 526.7 provides generally that "a sale is taxable at the place where the tangible personal property or service is delivered or the point at which possession is transferred by the vendor to the purchaser or his designee." Regulation section 526.7(e)(4) further provides that a transfer of possession has occurred if there is actual or constructive possession, or if there has been a transfer of "the right to use, or control or direct the use of, tangible personal property." The location of the code embodying the software is irrelevant, because the software can be used just as effectively by the customer even though the customer never receives the code on a tangible medium or by download.

The Agreement provides that the customer is granted a license to use Company's software, and makes numerous references to the customer's use of the software. The Agreement allows the customer to make a copy of the software for installation on a server or other host computer. Upon renewal of the Agreement, the customer may elect to host the software internally. The terms of the Agreement make clear that the customer receives the right to use Company's software. This software is considered to be prewritten software. Accordingly, the monthly license fees charged by Company for its software are subject to sales tax under section 1105(a) of the Tax Law. The situs of the sale for purposes of determining the proper local tax rate and jurisdiction is the location of the customer or its agents or employees who use the software. If the customer's employees who use the software are located both in and out of New York State, Company must collect tax based on the portion of the receipt attributable to the users located in New York. See *KPMG LLP*, Adv Op Comm T & F, January 31, 2003, TSB-A-03(5)S.

Company makes separate charges for implementation services and technical support. Such services appear to involve modifying Company's software to meet a customer's business requirements, and repairing or servicing the software as necessary. Separately stated and reasonable charges for making custom modifications to prewritten software, or for repairing or servicing software are exempt from sales tax. Tax Law, §§ 1101(b)(14) and 1115(o). See TSB-M-93(3)S, *supra*. Therefore, Company's separately stated and reasonable charges for implementation services and technical support are not taxable.

Company charges fees for hosting the software and client data on its server. Such fees are separately stated from the software licensing fees. Hosting services by themselves are not included among the enumerated services that are subject to tax. See *Alan J. Goldstein/The Computer Studio*, Adv Op Comm T&F, December 29, 1997, TSB-A-01(21)S; *CAV CORP d/b/a Stone Soup Multimedia*, Adv Op Comm T&F, December 29, 1997, TSB-A-97(87)S. However, when hosting services are sold in conjunction with prewritten computer software, even though the charges for the hosting services and software are separately stated, if such services and software cannot be separately purchased, the combination of items must be considered as one and, thus, subject to sales tax as a single purchase. See *Penfold v State Tax Commission*,

114 AD 2d 696 [1985]. Accordingly, if a client can only purchase a license to use Company's software in conjunction with hosting services provided by Company, then charges for the hosting services are considered to be an expense of the software license and are subject to sales tax. If Company's hosting services are optional, and Company sells hosting services to persons who do not purchase a license to use Company's software, then in the case of bundled sales Company's charges for hosting services will not be taxable if the charges for software and hosting services are separately stated and reasonable. In a bundled transaction, the separately stated charges for hosting services and software will be considered reasonable if they reflect the charges for these items when sold separately.

DATED: May 21, 2009

/s/
Jonathan Pessen
Director of Advisory Opinions
Office of Counsel

NOTE: An Advisory Opinion is issued at the request of a person or entity. It is limited to the facts set forth therein and is binding on the Department only with respect to the person or entity to whom it is issued and only if the person or entity fully and accurately describes all relevant facts. An Advisory Opinion is based on the law, regulations, and Department policies in effect as of the date the Opinion is issued or for the specific time period at issue in the Opinion.