

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S130529B

The Department of Taxation and Finance received a Petition for Advisory Opinion from [REDACTED]. Petitioner asks whether a variety of charges to Petitioner's franchisees located in the state of New York are subject to sales and compensating use tax, including: (1) faxes per page; (2) online order charges; (3) shipping; (4) loyalty hosting; (5) IT support for hardware and software; (6) IT set up for hardware and software; (7) hardware; (8) hardware used to receive an internet connection; (9) franchise fees; (10) marketing fees; and (11) royalty fees.

We conclude that charges associated with faxes, online order charges, initial software installation and loyalty rewards hosting are not subject to sales tax. However, charges associated with miscellaneous hardware, hardware to support an internet connection, initial hardware installation and ongoing IT support are all subject to sales tax. Charges associated with shipping are subject to sales tax if the item being shipped is being sold in a taxable transaction. Charges associated with franchise fees and royalty fees are not subject to sales tax. Charges for marketing fees are subject to sales tax because they include tangible personal property and nontaxable services for a single charge.

Facts

Petitioner is a corporation located in another state that sells franchises of its restaurant throughout the United States. Petitioner has franchised locations in the State of New York and often charges its franchisees for a variety of costs associated with operating the restaurants. Petitioner wants to know which of these charges are subject to sales and compensating use tax.

Petitioner provides hosting for the loyalty rewards program to franchisees, and each franchisee is charged a set rate per restaurant to utilize this service. The loyalty rewards program allows customers to obtain a rewards card and then collect points for purchases towards future free meals. The rewards program also comes with additional perks, such as coupons and free offers for a customer's birthday. The hosting charge includes only the tracking of customer purchases, information, and the maintenance of points; the actual loyalty cards and hardware are sold separately to the franchisee.

Petitioner self-hosts a website that allows customers to find locations, view menus and place orders. Petitioner purchases a service from a third-party vendor to process the orders through the website, and each franchisee is charged a set rate per restaurant to utilize this service. This service primarily covers the maintenance required to ensure the ordering system runs

smoothly and to process payments, but it may include the updating of the website itself. However, any programming done to update the website would be personalized to Petitioner's restaurant. In addition to online orders, Petitioner offers the ability for customers to fax in an order, which is generally used for larger catering orders. According to Petitioner's website, customers have the ability to print out an order form, fill it in, and then fax the order form to the location of their choice. These faxes are transmitted via the Internet by a third party vendor. The fax company charges Petitioner 17 cents per page for all faxes, and Petitioner then sends a bill to each franchisee for the faxes used by the franchisee's individual restaurant(s).

In addition to these services, Petitioner bills franchisees for a variety of hardware and software maintenance, as well as for the hardware itself. Upon establishing a new restaurant location, Petitioner charges franchisees a one-time fee for a hardware device that allows the restaurant to receive and maintain an Internet connection. Petitioner also charges franchisees for miscellaneous hardware needed to repair any of a franchisee's restaurant's existing hardware. These items are purchased directly from the vendor by Petitioner in bulk, who pays sales tax on the initial transaction, and these items are then shipped to Petitioner's warehouse outside of the state of New York. When these items are needed by a franchisee, Petitioner subsequently passes on to the franchisee the cost of the item, shipping and sales tax paid by the Petitioner.

Petitioner charges each franchisee a one-time fee for hardware and software installation for each restaurant. The software installation and hardware installation are not charged separately. Following this initial charge, Petitioner charges each franchisee a set rate per period for any hardware and software maintenance that might be needed. This fee is a flat rate regardless of use and is not itemized by the type of support provided.

Petitioner also charges each franchisee a franchise fee, marketing fee and royalty fee. Franchise fees cover a variety of items including training, access to Petitioner's manuals and recipes, and use of Petitioner's trademarks. Royalty fees provide franchisees with similar items such as continued training and manual updates. Marketing fees cover the cost of advertising and promotions to build the brand, research and development for menu innovation, food photography and point-of-purchase materials, such as counter cards and decals.

Finally, whenever Petitioner ships an item to a franchisee or restaurant via common carrier, Petitioner charges the franchisee to cover the cost of the shipping. The items shipped vary, but could include, for example, miscellaneous hardware needed for repairs.

Analysis

Petitioner has not provided us with sufficient information to conclude whether it is required to collect New York sales tax. However, to the extent that it is so required, sales tax would apply to Petitioner's charges to its franchisees as discussed below.

Petitioner charges its franchisees a set rate per period for the cost of hosting its loyalty rewards program. This charge covers the collection and tracking of information, which is a

service. Under Tax Law § 1105(c)(1), the service of “collecting, compiling or analyzing information of any kind or nature and furnishing reports thereof” is a taxable service, unless the information is “personal or individual in nature” and “may not be substantially incorporated in reports furnished to other persons.” However, the fact that one element of a service is an information service does not mean that the service as a whole is taxable as an information service. *See* TSB-M-10(7)S. The hosting of the loyalty rewards program includes managing and maintaining the points system, accruing and debiting points based on coupons, and other perks; this is broader than the compiling and provision of information described in Tax Law § 1105(c)(1). Therefore, the charges associated with the loyalty rewards points are for an unenumerated service and would be exempt from sales tax.

Petitioner hosts a website that allows customers to place online orders. Petitioner pays a third-party vendor to maintain the order portion of the website, and then seeks reimbursement from each franchisee. The charge collected from each franchisee does not include the website or the hosting of the website, but only technical support for the website. Tax Law § 1115(o) exempts from sales tax services otherwise taxable under Tax Law § 1105(c) or § 1110 (e.g., installation, maintenance, etc.) where performed on computer software of any nature. However, where services to software are provided to a customer in conjunction with the sale of tangible personal property, the charge for these services is exempt only when it is reasonable and separately stated on an invoice or other statement of the price given to the customer. Tax Law § 1115(o). Petitioner charges the franchisees for the third-party vendor’s maintenance of its website, which includes software upgrades. These upgrades by themselves may qualify as prewritten software. *See* TSB-M-93(3)(S). If the fee charged by the Petitioner covers both services and prewritten software provided by the third-party vendor, the entire fee is subject to sales tax. *See* TSB-A-96(27)S. However, these upgrades would be considered custom software if they are specific to Petitioner’s restaurants and are created solely for this use, and, if so, would also be exempt from sales tax. *See* Tax Law § 1101(b)(6),(14).

Petitioner charges their franchisees a fee of 17 cents per page for faxes received from customers for orders. Petitioner does not provide the means of transmitting the faxes. These are charges that are a reimbursement for expenses incurred by Petitioner that are not subject to sales tax.

Petitioner charges a set price to each store for a hardware device used to receive an Internet connection. Furthermore, Petitioner charges its franchisees miscellaneous hardware charges as needed to replace or repair existing hardware. All of these charges constitute sales of tangible personal property and are therefore subject to sales tax. *See* Tax Law § 1105(a). The entire charge to a franchisee would be included in the “receipt” under Tax Law § 1101(b)(3), including any markup to cover shipping charges or sales tax paid by Petitioner, if these costs were also passed on to a franchisee.

Petitioner charges a franchisee a flat rate for hardware and software installation whenever a franchisee opens a new restaurant. Tax Law § 1105(c)(3) imposes sales tax on the service of installing tangible personal property. Hardware is tangible personal property; therefore, the fee

for hardware installation is a taxable service. Because Petitioner's software installation charge is not stated separately from the hardware installation charge, the entire charge is taxable as one receipt.

After the initial installation, Petitioner charges its franchisees a set rate per period to cover IT support. This charge includes the maintenance of software and hardware for fax machines, printers, terminals, back office computers and related software. Tax Law § 1105(c)(3) imposes a tax on "maintaining, servicing, or repairing tangible personal property." Therefore, any charges associated with the maintenance of hardware are subject to sales tax. Because Petitioner combines the charges for software maintenance with the charges for hardware maintenance, the entire charge is taxable.

The application of sales tax to franchise fees, royalty fees and marketing fees depends on what items and services are covered by these fees. Here, the franchise and royalty fees cover primarily non-taxable intangibles, such as the right to use Petitioner's trademarks and training programs. Although these fees include limited tangible personal property, such as operations manuals, these tangible objects are only incidental to the intangible rights conveyed. Therefore, under the circumstances, the franchise and royalty fees are not subject to sales tax.

On the other hand, the marketing fees include both non-taxable services, such as advertising services, and point-of-purchase materials, such as counter cards and decals, which are tangible personal property subject to sales tax under Tax Law § 1105(a). Unlike the tangible personal property included in the franchise and royalty fees, the point-of-purchase materials included in the marketing fees provide a tangible visual element to the marketing of Petitioner's restaurants and brand, and are not an insignificant element of the marketing fees. Because the marketing fees are not itemized and include taxable tangible personal property, the entire fee is subject to sales tax as one receipt.

To the extent that Petitioner's purchases occur in New York, purchases of tangible personal property and services intended exclusively for resale would be exempt from sales tax as long as the Petitioner is registered for sales tax purposes and timely furnishes the vendor with a properly completed resale certificate. This would allow Petitioner to avoid paying sales tax on its original purchase of tangible personal property and taxable services. However, regardless of the Petitioner's payment of sales tax on the original transaction, the resale of taxable personal property and taxable services to a franchisee located in New York is a taxable transaction under Tax Law § 1105(a) as a retail sale of tangible personal property and taxable services. To the extent that Petitioner's purchases for resale to its franchisees occur outside of New York, it should consult the state in which the purchase occurred for information with respect to a resale exemption.

Petitioner charges its franchisees the cost of shipping a variety of items via common carrier to franchisees or restaurants. The applicability of sales tax to shipping charges depends on the item(s) being shipped. Tax Law § 1105(a) imposes sales tax on "receipts" from sales of tangible personal property. Tax Law § 1101(b)(3) defines "receipt" to include any shipping

