New York State Department of Taxation and Finance

**Taxpayer Services Division
Technical Services Bureau**

TSB-A-88(5)S
Sales Tax
December 16, 1987

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

<u>ADVISORY OPINION</u>   <u>PETITION NO. S870624A</u>

On June 24, 1987, a Petition for Advisory Opinion was received from Cognos Corporation, 2 Corporate Place 1-95, Peabody, MA 01960.

The issues raised are whether the sale of a license to use prepackaged (canned) computer software and the receipts from service contracts supporting such software are subject to New York State and local sales taxes.

The software, either owned by or licensed to the Petitioner, is provided to its customers on magnetic encoded tape for use by data processing professionals in commercial data management applications. A brochure appended to the Petition describes the software (called "Powerhouse") as a Development Center Fourth Generation Language designed to increase the efficiency of Hewlett-Packard's HP3000 software environment.

Petitioner and its licensors retain exclusive ownership of the software which is available to customers for evaluation, lease or 20 year license periods. Each copy of the software is licensed for use only on the computer system designated thereon by model, serial number and location. Transfer from the licensed system to an alternate system requires the consent of the Petitioner.

Software support services ("Support") are included under a lease and, for a 30 day warranty period commencing on delivery, under a license to use the software. Various levels of Support may be purchased for renewable one year terms beginning after the warranty period. During a support term, the customer is entitled to telephone advice to ensure operation of the software in accordance with its documentation. The customer will also receive, on magnetic tape, any program enhancements and updated manuals released in that term.

Section 1105(a) of the Tax Law imposes a tax on the receipts from every retail sale of tangible personal property. Section 1105(c)(3) taxes installation, maintenance and repair of such property. Sale, as defined in Section 1101(b)(5), includes any rental, lease or license to use tangible personal property. For sales tax application, computers and peripheral devices commonly described as "hardware" are considered tangible personal property.

The tax status of receipts from computer program ("software".) sales and services is explained in Department of Taxation and Finance Technical Services Bulletin 1978-1(S), issued February 6, 1978:

Software [means] instructions and routines which, after analysis of the customer's specific data processing requirements, are determined necessary to program the customer's electronic data processing equipment to enable the customer to accomplish specific functions with his EDP system. To be considered exempt 'software' for purposes of this bulletin, one of the following elements must be present:

A.   Preparation or selection of the program for the customer's use requires an analysis of the customer's requirements by the vendor.

<div align="center">or</div>

B.   The program requires adaptation, by the vendor, to be used in a specific environment i.e., a particular make and model of computer utilizing a specified output device. For example, a software vendor offers for sale a pre-written sort program which can be used in several computer models. Prior to operation, instructions must be added by the vendor which specify the particular computer model in which the program will be utilized.

The software may be in the form of:

a.   Systems programs (except for those instruction codes which are considered tangible personal property in paragraph 1 above) - programs that control the hardware itself and allow it to compile, assemble and process application programs.

b.   Application programs - programs that are created to perform business functions or control or monitor processes.

c.   Pre-written programs (canned) - programs that are either systems programs or application programs and are not written specifically for one user.

d.   Custom programs - programs created specifically for one user.

Software meeting the above criteria, whether placed on cards, tape, disc pack or other machine readable media or entered into a computer directly, is deemed to be intangible personal property for sales tax purposes, and as such its sale is exempt from New York State and local sales and use taxes. Software or programs which do not meet the criteria are subject to tax.

<div align="center">*   *   *</div>

[Example] E. A software supplier manufactures prepackaged programs for use with home television games or other personal computer equipment. The programs are marketed through retail stores, and the programs are fully usable by customers without modifications. In selecting or preparing the program, the supplier does not perform a detailed analysis of the customer's requirements. The program is viewed as tangible personal property for sales tax purposes.

The software here at issue is not retail merchandise as described in the example, it is not sold in stores and it is not readily transferable from one computer to another. Initial trouble shooting and support service is included in the lease charge or license fee. Although the programs are pre-adapted for use mainly on Hewlett Packard, Digital Equipment or Data General computers, Petitioner's representatives analyze the customer's hardware configuration and application needs and test program performance on the designated computer model by running a demonstration tape.

The software therefore qualifies for exemption as the type of prewritten application program outlined in paragraph A. and c. above, which is considered intangible personal property. The exemption extends to instruction manuals for the program.

Services involving software modification and problem solving after its installation, accordingly, are exempt from tax because they are rendered in connection with intangible property. See Technical Services Bulletin, 1978-1(S), para. 3.

Consequently, Petitioner's receipts from leasing or licensing the software at issue and from charges for software support services are not subject to State or local sales or use taxes.

However, Petitioner as the provider of these nontaxable sales and services is deemed the ultimate consumer of all tangible personal property necessary for the production of the exempt software and manuals including property eventually transferred to the customer. Thus, Petitioners purchases of equipment, utilities, material and supplies are taxable.

Petitioner states it has filed a request for refund of taxes collected from its customers on charges for exempt software and support services.

Section 1139(a) of the Tax Law provides that the Commissioner of Taxation and Finance shall refund or credit any tax, penalty or interest erroneously, illegally or unconstitutionally paid.

It should be noted, however, that any tax Petitioner has erroneously collected and remitted must be repaid to the customer before the Commissioner of Taxation and Finance may grant a refund or credit of such monies to the Petitioner. 20 NYCRR 534.2(c)(1).

DATED: December 16, 1987   s/FRANK J. PUCCIA
                                            Director
                                            Technical Services Bureau

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