

New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-89(13)S
Sales Tax
June 7, 1989

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S890213B

On February 13, 1989, a Petition for Advisory Opinion was received from Computer Language Research, Inc., 2395 Midway Road, Carrollton, Texas 75006.

The Petitioner raises two issues. First, do Petitioner's computer products qualify as custom software exempt from New York State and local sales and use taxes. Secondly, if custom software is exempt from sales tax, is the annual renewal of the license for such software similarly exempt from tax.

Petitioner provides mainframe and microcomputer-based tax processing to accounting firms, corporations, partnerships and banks under the trade name Fast-Tax. Petitioner also develops and markets Electronic Form Systems for sale to forms-intensive businesses.

Petitioner has recently developed and is currently selling in-house tax processing systems which encompass both software and hardware. In most cases, the price for a software license is separately stated. The license fee initially entitles the customer to receive the software and updates for a given tax year. It is renewable annually for an additional fee.

The following are examples of Petitioner's assessment and installation procedures:

1. Petitioner's Tax Compliance Systems (TCS) and related software (marketed under the trade name "System 5") is used by the corporate client to process its corporate tax returns and related information on a microcomputer(s) located in the client's office. Petitioner's sales and technical support personnel generally make four to seven calls on a prospective client. The complexity of corporate tax compliance with federal, state, and local jurisdictions requires Petitioner to gather a considerable amount of specific information about the client (corporate status, number of subsidiaries, filing frequency, etc.) in order to have a clear understanding of the client's compliance needs. In addition, Petitioner must analyze the functions and operation of the client's tax compliance department. Using this information, Petitioner can configure the proper combinations of software modules to meet the client's compliance and operational needs. Additionally, Petitioner's support personnel must frequently modify the systems to achieve compatibility with the client's existing hardware and software.
2. Tax Processing Systems (TPS) software is used to process tax returns on mainframe computers located at the corporate client's location. This software includes installation materials consisting of: (1) the TPS software magnetic tape, (2) installation Job Control Language (JCL) and (3) technical and user manuals. When a client orders the on-line option,

additional tapes and manuals are sent. The client's data processing department is required to customize the installation JCL by modifying many system parameters. These parameters determine the client's specific data processing standards and operating system requirements. Once the basic TPS system is installed, the tax department may further customize the software by changing the forms logic. Part of the TPS agreement includes an implementation session whereby Petitioner's technical support group personnel are at the client's site to determine specific client requirements prior to delivery of the TPS system tape.

Technical Services Bureau Bulletin 1978-1 defines software as:

"Instructions and routines (programs) which, after an 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.

or

- 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. System 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. The person selling exempt software is required to pay the applicable sales or use tax on any tangible personal property transferred to the customer in connection with the exempt service. In addition, the hardware, utility services and supplies used to develop the exempt software are not eligible for any sales tax exemptions. Taxpayer Services Bureau Bulletin, 1978-1(S).

Accordingly, as the computer programs (software) developed by Petitioner require an analysis of the customer's requirements and modification of the actual program for use by such customer, such programs are considered to be intangible personal property and therefore are not subject to New York State and local sales and use taxes. Moreover, as intangible personal property, its sale, including licenses to use and renewals of licenses to use, is not subject to New York State and local sales and use taxes provided that the charge for such software is separately stated in Petitioner's invoices to its customers. Should Petitioner charge a single amount representing charges for taxable hardware and software, the entire charge is subject to tax.

DATED: June 7, 1989

s/FRANK J. PUCCIA
Director
Technical Services Bureau

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