New York State Department of Taxation and Finance

Taxpayer Services Division
Technical Services Bureau

TSB-A-96 (44)S
Sales Tax
July 11, 1996

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

<u>ADVISORY OPINION</u>   <u>PETITION NO. S950925A</u>

On September 25, 1995, the Department of Taxation and Finance received a Petition for Advisory Opinion from State Tax Resources Group, 18006 Skypark Circle, Suite 106, Irvine, California 92714. Petitioner, State Tax Resources Group, provided the last of additional information pertaining to the Petition on March 7, 1996.

The issues raised by Petitioner are whether receipts from its client's data manipulation service and software licenses are subject to New York State sales and compensating use taxes.

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

<u>Data manipulation</u>: Petitioner's client (Company ABC) receives databases from its clients on some form of magnetic media, usually tapes. The databases contain information about their customers. Company ABC reformats and updates these databases using current information supplied to its clients by their customers. Generally, the databases are converted into a form that can be utilized by Company ABC's software. However, Company ABC also performs this data manipulation service for clients that do not purchase its software. The type and amount of information contained in each database varies based upon the specifications of Company ABC's client.

The purpose of this data manipulation is to organize the clients' own data resources in a form that is suitable for marketing analysis. The element most critical to the integrity of the marketing information database is the accuracy of household matching. Accuracy, in turn, depends on the quality of the name and address matching algorithms that bring account records together to form the household unit.

In preparation for matching, each name and address record is standardized to the same set of rules. For example, "6th Street" and "Sixth Street" become "6th St." Sophisticated pattern recognition tables are used to cull out legal phrases and descriptors which often appear in a name line. Tables are also used to differentiate between retail and commercial accounts. These methods increase the opportunities for matching records with different address structures and standards.

Next, the records are matched by last name and address to form households. Unlike companies that use "match codes," Company ABC's unique matching routines compare all characters in the name and address to create a matching score. This allows records with missing, extra or transposed characters to match if the combination of scores does not drop below a predetermined confidence level.

Every household is assigned a unique identification code when it first appears on the file. This code remains constant from Update to Update as long as the name or address does not change.

As a standard feature, the five digit zip codes and census tract codes are verified or added to each address record. Zip coding is performed using the most recent files from the U.S. Postal Service and other proprietary zip code files. Accurate zip codes facilitate accurate household matching and are necessary for appending census tract codes. In some cases, Company ABC may append additional fields to its clients' data. Usually this additional data is some form of demographic information or purchasing history.

Software: Company ABC also provides its clients with software that is used to create various forms of output from the reformatted databases. The software provided to each of Company ABC's clients is virtually identical. The software need not be significantly modified to be usable by new clients.

Company ABC separately states the fees it charges clients for its data manipulation service and its software. Generally, Company ABC grants clients one-year, nontransferable, nonexclusive licenses to use its software. Licensing fees are billed in advance and related processing fees or expenses are billed as incurred.

Applicable Law and Regulations

Section ll01(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 therefor, 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 .... 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. The combining of two or more pre-written computer software programs or pre-written portions thereof does not cause the combination to be other than pre-written computer software. Pre-written software also includes software designed and developed by the author or other creator to the specifications of a specific purchaser when it is sold to a person other than such 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 l105(a) of the Tax Law imposes sales tax on, "[t]he receipts from every retail sale of tangible personal property, except as otherwise provided in this article."

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

Section ll15(a) of the Tax Law provides in part:

Receipts from the following shall be exempt from the tax on retail sales imposed under subdivision (a) of section eleven hundred five and the compensating use tax imposed under section eleven hundred ten:

*   *   *

(28) Computer software designed and developed by the author or creator to the specifications of a specific purchaser which is transferred directly or indirectly to a corporation which is a member of an affiliated group of corporations within the meaning of subparagraph six of paragraph (b) of subdivision seventeen of section two hundred eight of this chapter except for clauses (ii) and (iii) of such subparagraph that includes such purchaser, or to a partnership in which such purchaser and other members of such affiliated group have at least a fifty percent capital or profits interest (but only if the transfer is not in pursuance of a plan having as its principal purpose the avoidance or evasion of tax under this article),

but in no case including computer software which is pre-written, as defined in paragraph six of subdivision (b) of section eleven hundred one of this article and available to be sold to customers in the ordinary course of the seller's business.

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.

Opinion

Company ABC organizes and updates its clients' pertinent input files into accurate and useful information that is suitable for marketing analysis. In some cases, Company ABC also incorporates data from external sources. This data manipulation service is not one of the enumerated services subject to tax under Section 1105 of the Tax Law. Thus, Company ABC's separately stated fees for the sale of its data manipulation service are not subject to New York State and local sales and use taxes.

Company ABC's licenses to use its software are sales of tangible personal property, the fees from which are subject to tax pursuant to Section 1105(a) of the Tax Law. This software is virtually identical for every client and falls within the definition of "pre-written computer software" found in Section 1101(b)(14) of the Tax Law. Since there is no indication that Company ABC's clients are corporations or partnerships described in Section 1115(a)(28) of the Tax Law, it would appear that the sales are not exempt from tax under this section of the law. Although Company ABC modifies its software (albeit not significantly) in accordance with a specific client's specifications, the modifications do not affect the software's character as pre-written computer software and consequently as tangible personal property. However, if Company ABC provides its clients with reasonable, separately stated fees or invoices or other statements of the fees for modifications designed and developed for the individual clients, the modifications would not constitute pre-written computer software and these separately stated fees would not be subject to sales tax. See, Matter of Astrogamma, Adv Op Comm T&F, June 22, 1992, TSB-A-92(50)S; Matter of Carucci & Co., Adv Op Comm T&F, March 19, 1992, TSB-A-92(26)S; Matter of Garpac Corporation, Adv Op Comm T&F, February 6, 1992, TSB-A-92(8)S; State and Local Sales and Compensating Use Taxes Imposed on Certain Sales of Computer Software, Technical Services Bureau Memorandum, March 1, 1993, TSB-M-93(3)S.

Similarly, if a license agreement provides for the sale of taxable elements (for example, the pre-written computer software and pre-written upgrades) in conjunction with nontaxable elements, the entire fee for the agreement would be subject to sales tax, unless the fees for the nontaxable

elements are reasonable and separately stated on the invoice or other statement of fees given to the client. Nontaxable elements would include Section 1105(c) services that are exempt from tax in accordance with Section 1115(o) of the Tax Law, such as installing, maintaining, servicing or repairing the software, and services that are not enumerated in Section 1105(c) of the Tax Law, such as training or consultation. See, Matter of Moore Business Forms, Adv Op Comm T&F, February 15, 1995, TSB-A-95(6)S.

DATED: July 11, 1996

/s/
John W. Bartlett
Deputy Director
Technical Services Bureau

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