New York State Department of Taxation and Finance

Taxpayer Services Division
Technical Services Bureau

TSB-A-98(59)S
Sales Tax
September 9, 1998

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION   PETITION NO. S970910A

On September 10, 1997, the Department of Taxation and Finance received a Petition for Advisory Opinion from OMR Systems Corporation, CN 581, Princeton, New Jersey 08542. Petitioner, OMR Systems Corporation, provided additional information pertaining to the Petition on June 11, 1998.

The issue raised by Petitioner is whether fees received from customers in New York State in exchange for Petitioner's Program, Modifications and Support Services are subject to sales and compensating use tax.

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

Petitioner licenses a software computer program module (the "Program") that provides a fully integrated, multi-currency, trade processing system for in-house use by investment and commercial banks, specialty trading companies and investment managers. The Program is a trade processing system that facilitates deal capture and supports back-office activities for most financial products. The Program provides an end-to-end electronic processing environment. This includes trade entry, trade verification, unrealized profit and loss on a market-to-market basis, liquidations, realized profit and loss, deal confirmations, net income processing and automated journal entries for all transactions.

Pursuant to Petitioner's master license and support agreement, Petitioner grants a licensee a nonexclusive, nonassignable and perpetual license of: (i) a Program, (ii) any modifications to this Program that are requested by the licensee (the "Modifications"), and (iii) any updates to this Program (the "Updates"). The license fee for the Program varies, depending upon the average daily transaction processing volume.

A Modification is customized software for which a separate charge is imposed by Petitioner. The fee for a Modification is based upon a specified per-hour fee for each employee assigned to perform the task of designing and programming the Modification according to the business requirement for the requested modification.

The licensee does not pay any fee for Updates, which may include Modifications made for different licensees that are made available to every licensee (i.e., a Modification for one customer can be added as an Update to the Program of another customer at no charge).

Petitioner makes available basic support services which are free of charge during the warranty period (the "Support Services"). These services include a telephone hotline service that allows the licensee to report problems with the functionality and productive use of the Program. These services also include

making the Updates available. Additional Support Services, including on-site support and project management support, are available for a fee.

There is no static Program that a licensee can simply install and use. All licensees require changes and, therefore from a practical perspective, no two licensees license the same Program.

Prior to licensing any Program, Petitioner visits the licensee's location to determine licensee-specific information relating to the licensee's hardware, third party software, specific financial instruments traded, and other licensee-specific requirements. Before the Program is delivered to the licensee, more than 900 system operating switches (SYSOPs) in the Program must be set to customize the Program to operate in accordance with the licensee preferences established in the on-site interview and to function in the licensee's computer environment. Each of the 900+ SYSOPs has a specific number of possible values (settings) that usually range from between two and 20, creating virtually an infinite number of possible combinations. Practically all of the SYSOPs are interrelated, and they all must be set by Petitioner's team of qualified technicians. Petitioner records on tape a copy of the Program that reflects the individualized settings and delivers the tape to the licensee for installation. The Program is not functional without these adjustments.

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:

*   *   *

(4) Retail sale. (i) A sale of tangible personal property to any person for any purpose....

(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....

(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 1105(a) of the Tax Law imposes sales tax on the "receipts from every retail sale of tangible personal property, except as otherwise provided in this article."

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, State and Local Sales and Compensating Use Taxes Imposed on Certain Sales of Computer Software, TSB-M-93(3)S, March 1, 1993, 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.... [C]ertain 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 ... license to use ... for a consideration. Thus, a payment made by a customer ... for a license to use ... prewritten software is subject to sales or use tax....

* * *

Prewritten software is subject to tax whether sold as part of a package or separately....

Prewritten software, even though modified or enhanced to the specifications of a specific purchaser, remains prewritten software subject to tax. However, if a charge for the custom modification or enhancement is reasonable and separately stated on the invoice or billing statement, then the separately stated charge for the custom modification or enhancement is not subject to tax.

* * *

The incidental use of a development language (e.g., COBOL, BASIC, C, etc.) or of libraries of "prewritten" functions or routines in designing and developing a "custom" software program to the specifications of a specific purchaser will not, in and of itself, make the sale of an otherwise custom program taxable. The "custom" program must be examined as a whole to determine whether it is exempt from tax. If the prewritten components of a custom program are sold separately, their sale is subject to tax.

The purchase of a development language or libraries of software routines is subject to sales or use tax if it is used in designing and developing 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.

Thus, charges for customer (user) support or for information services provided by a vendor [t]o a customer, either in person or by some type of telecommunications arrangement (e.g., telephone, modem, facsimile machine, etc.), in the nature of training, consulting, instructing or other diagnostic or troubleshooting

services related to prewritten software are exempt from sales and use taxes where the charges are reasonable and separately stated. Charges for the service of installing, repairing, maintaining or servicing prewritten software are also exempt from sales and use taxes where the charges are reasonable and separately stated on the invoice. Of course, any charges for the above described services sold in connection with custom software are exempt from tax.

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.

*   *   *

If a software maintenance agreement provides for the sale of both taxable elements (e.g., prewritten software upgrades) and nontaxable elements (e.g., training, consulting, diagnostic and troubleshooting support, etc.), the charge for the entire maintenance agreement is subject to tax unless the charge for the nontaxable elements is reasonable and separately stated in the maintenance agreement and separately billed on the invoice or other document of sale given to the purchaser.

Opinion

The license fee received by Petitioner in exchange for its Program is subject to New York State and local sales taxes when the Program is delivered to a customer in this State. The Program, even though subject to Modifications and Updates, constitutes and remains "pre-written computer software" as defined in Section 1101(b)(14) of the Tax Law. Accordingly, these fees are taxable as receipts from the sales (i.e., licenses to use) of tangible personal property under Section 1105(a) of the Tax Law.

Technical Services Bureau Memorandum TSB-M-93(3)S, supra, provides guidance with respect to sales of computer software and related services. This memorandum explains the Department of Taxation and Finance's policy regarding pre-written computer software, including its *de minimis* policy regarding the "incidental" use of development languages and libraries of prewritten functions and routines. (See, TSI International Software Ltd., Adv Op Comm T&F, September 30, 1997, TSB-A-97(59)S.) Petitioner's Program, prior to any Modifications or Updates, is not "incidental" to the overall trade processing systems that Petitioner licenses to its customers and was not designed and developed by Petitioner to the specifications of any one customer. Rather, the basic Program was designed and developed with the foresight and flexibility to accommodate most, if not all, of Petitioner's customers via the setting of any of more than 900 SYSOPs. The fee for the basic Program, therefore, is taxable, except to the extent that a reasonable separately stated charge is made for setting the SYSOPs.

Petitioner's Modifications to the Program do not constitute pre-written computer software and fees charged by Petitioner for these Modifications are not subject to tax provided the fees are reasonable and continue to be separately stated on any invoices or other statements of the price given to the customers. (See, for example, Technical Services Bureau Memorandum TSB-M-93(3)S, supra; TSI, supra; Software Dynamics, Inc., Adv Op Comm T&F, July 23, 1997, TSB-A-97(45)S; State Tax Resources Group, Adv Op Comm T&F, July 11, 1996, TSB-A-96(44)S.)

Updates and Support Services that are provided to customers for no consideration are not subject to sales tax. However, as in the case of Modifications, any fees charged by Petitioner for additional Support Services must be reasonable and separately stated on any invoices or other statements of price given to the customers in order not to be subject to sales tax. Provided, further, if the additional Support Services that are available for a fee include the sale of both taxable elements (e.g., pre-written Updates) and nontaxable elements (e.g., on-site support), the entire fee is subject to tax unless the charges for the nontaxable elements are also reasonable and separately stated. In which case, only the charges for the taxable elements are subject to sales tax. (See, Software Dynamics, Inc., supra; State Tax Resources Group, supra; Moore Business Forms, Inc., Adv Op Comm T&F, February 15, 1995, TSB-A-95(6)S.)

DATED: September 9, 1998   /s/
`   John W. Bartlett
                                         Deputy Director
                                         Technical Services Bureau

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