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

TSB-A-98(17)S
Sales Tax
TSB-A-98(4)C
Corporation Tax

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. Z960325B

On March 25, 1996, a Petition for Advisory Opinion was received from Electronic Transmission Corporation, 5025 Arapaho Road, Suite 515, Dallas, Texas 75248.

The issues raised by Petitioner, Electronic Transmission Corporation, are:

(1) When Petitioner acquires customers located in New York, will it be subject to New York franchise tax? If Petitioner is subject to tax, how should the sales listed below be apportioned to New York?

(2) What is the sales and use tax status of the following items as it relates to Cases 1, 2 and 3 described below:

(A) Items billed (invoiced) to customers by Petitioner:

(1) Claims conversion fee (Cases 1 and 2 only)

(2) One-way transaction fee (Case 3 only)

(3) Clearinghouse fee (Case 3 only)

(4) Archival fee

(B) Items not billed (invoiced) to customers by Petitioner:

(1) Computer software - Will any use tax be applicable for the computer software located in New York?

(2) Computer hardware - Will any use tax be applicable to the rental fees charged to Petitioner by the owner of the computer hardware and scanners located in New York? If yes, can Petitioner pass the tax along to the customer and identify the use tax on its sales invoice?

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

Petitioner is qualified to do business in Texas and has 20 to 25 employees. It is primarily engaged in "the electronic receipt and transmittal of claims" on behalf of its customers (self-insured/self administered business entities). Petitioner does not have an office or any employees in New York. Petitioner does not have any customers located in New York. Petitioner plans to send employees into New York to install computer software and train customer employees in the future.

Petitioner moves claims electronically between providers of health care (medical providers, preferred provider organizations (PPOs), and third party administrators (TPAs)) and its customers, the payors of the claims (self-insured/self administered business entities). Petitioner owns and has developed the software programs it uses to conduct its activities. For each customer with which it has an agreement, Petitioner looks at its original software program to see if it needs to be modified for that particular customer's needs. If so, it is modified for that customer.

An example of Petitioner's activities is the following: Petitioner has an agreement with its customer, a company that has a self-administering health insurance program. When an employee of the company requires medical attention, the employee would get medical treatment from a health care provider and then either the employee or the health care provider fills out an insurance claim form that is submitted to the employer for payment. The employer electronically sends the claim to Petitioner for processing. Petitioner checks to see if the claim is reasonable, complete and valid. (The tolerances for these checks are set by the employer.) Petitioner then electronically sends information back to the employer as to whether the claim is (or should) be rejected, or whether it is a valid claim and should be paid. The employer then issues the check to either the employee or the health care provider.

The following description of three potential cases illustrates the paperless claim flow and possible pricing structures.

Case 1. Petitioner will supply a computer software interface program to be installed at the customer's corporate headquarters in New York. However, the customer's branches and retail stores are located in various states. All of the insurance claim forms will be sent to the corporate headquarters in New York for processing.

Along with this program, Petitioner may provide a scanner to be utilized in scanning the claim form into a personal computer at the customer's New York location. The data would be edited at the customer's location and then transmitted electronically to Petitioner's computer located in Texas. Petitioner would change the file format but would not make any decisions regarding the information contained on the claim. The data would be processed and transmitted electronically to its customer, the payor of the claim. The customer of Petitioner would be located in New York. The customer's branches may be located anywhere in the United States.

Case 2. This case is similar to Case 1 except that the customer's branches and retail locations electronically send the insurance claim forms directly to Petitioner's location in Dallas, Texas for further processing. The claims are not handled by the customer's corporate location in New York.

After receipt of the claim by Petitioner, the claim is processed in the same manner as in Case 1.

Case 3. This case differs from the other cases in that the claims are not scanned into the computer at the corporate headquarters located in New York. The claims are filed electronically by the Petitioner's customer using a local clearinghouse. The claims are sent electronically from various states through the existing electronic claim networks (i.e. NEIC, Envoy, BCBS and others) to Petitioner's location in Dallas, Texas. Petitioner processes the claim and transmits the claim electronically to its customer, the payor of the claim.

A **claims conversion fee** is applicable to Cases 1 and 2. This is a fee charged to the customer for scanning the health care claim form and creating an electronic image which is stored on the customer's computer. The image is then transmitted to Petitioner and finally back to the customer, the payor of the claim. Petitioner would invoice its customer for this service on a per claim basis. This fee includes data analysis and reporting.

A **one-way transaction fee** is applicable to Case 3. This is a fee charged to the customer for transmitting the claim from Petitioner to the customer, the payor of the claim.

A **clearinghouse fee** is applicable to Case 3. This is a fee charged to the customer for transmitting claims from the customer, through the local clearinghouse to Petitioner. Petitioner reprices the claim and transmits the claim to the customer, the payor of the claim. This fee includes data analysis and reporting.

An **archival fee** is applicable to Cases 1, 2 and 3. This is a fee charged to the customer for converting the claim from an electronic image to a CD. The CD is sent to the customer located in New York.

Petitioner will install and furnish the computer software to its customers located in New York but will not charge a license fee or maintenance fee. The charges are included in the fees listed above. The software and source code will be owned by Petitioner.

Petitioner will lease computer hardware from vendors. Petitioner states that the equipment will be leased exempt from Texas sales tax. However, Texas has ruled that the processing of insurance claims is taxable in Texas. Petitioner will accept delivery of the equipment in Texas. Subsequently, Petitioner will ship the equipment to customers located in various states.

Although Petitioner may furnish computer hardware and scanners to its customers located in New York State, the sales invoice will not list a charge for this equipment. The charges are included in the fees listed above.

Applicable Franchise Tax Law and Regulations

With respect to Issue 1, section 209.1 of Article 9-A of the Tax Law imposes an annual business corporation franchise tax on every foreign corporation, unless specifically exempt, for the privilege of doing business, or of employing capital, or of owning or leasing property in New York State in a corporate or organized capacity, or of maintaining an office in New York State.

Section 1-3.2(b) of the Business Corporation Franchise Tax Regulations ("Article 9-A Regulations") provides that:

> (1) The term doing business is used in a comprehensive sense and includes all activities which occupy the time or labor of people for profit. Regardless of the nature of its activities, every corporation organized for profit and carrying out any of the purposes of its organization is deemed to be doing business for the purposes of the tax. In determining whether a corporation is doing business, it is immaterial whether its activities actually result in a profit or a loss.
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> (2) Whether a corporation is doing business in New York State is determined by the facts in each case. Consideration is given to such factors as:
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> (i) the nature, continuity, frequency, and regularity of the activities of the corporation in New York State;
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> (ii) the purposes for which the corporation was organized;
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> (iii) the location of its offices and other places of business;
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> (iv) the employment in New York State of agents, officers and employees; and
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> (v) the location of the actual seat of management or control of the corporation.
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> Section 1-3.2(c) of the Article 9-A Regulations provides that:
>
> [t]he term employing capital is used in a comprehensive sense. Any of a large variety of uses, which may overlap other activities, may give rise to taxable status. In general, the use of assets in maintaining or aiding the corporate enterprise or activity in New York State will make the corporation subject to tax. Employing capital includes such activities as:

(1) maintaining stockpiles of raw materials or inventories; or

(2) owning materials and equipment assembled for construction.

Section 1-3.2(d) of the Article 9-A Regulations provides that:

> [t]he owning or leasing of real or personal property within New York State constitutes an activity which subjects a foreign corporation to tax. Property owned by or held for the taxpayer in New York State, whether or not used in the taxpayer's business, is sufficient to make the corporation subject to tax. Property held, stored or warehoused in New York State creates taxable status. Property held as a nominee for the benefit of others creates taxable status. Also, consigning property to New York State may create taxable status if the consignor retains title to the consigned property.

With respect to the allocation of Petitioner's receipts, section 4-4.1 of the Article 9-A Regulations provides that:

> (a) The percentage of the taxpayer's business receipts allocable to New York State is determined by:
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> (1) ascertaining the taxpayer's business receipts within New York State during the period covered by the report; and
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> (2) dividing the sum of the New York State business receipts by the taxpayer's total business receipts within and without New York State during such period.
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> For purposes of this section, the term "business receipts" means gross income received in the regular course of the taxpayer's business, provided such receipts are includible in the computation of the taxpayer's entire net income for the taxable year.
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> (b) All business receipts for the period covered by the report ... must be taken into account. The following business receipts are allocable to New York State:
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> (1) 100 percent of receipts from sales of tangible personal property where shipments are made to points within New York State;
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> (2) 100 percent of receipts from services performed in New York State;
>
> (3) 100 percent of rentals from property situated in New York State;

(4) 100 percent of royalties from the use of patents or copyrights in New York State; and

(5) all other business receipts earned in New York State.

(c) If a taxpayer receives a lump sum in payment for services and also for materials or other property, the sum received must be apportioned on a reasonable basis. That part apportioned to services performed is includible in receipts from services performed, and that part apportioned to materials or other property is includible in receipts from sales. Full details must be submitted with the taxpayer's report.

Opinion - Corporation Franchise Tax

It has been held that, where a foreign corporation did not have an office or assets located in New York and no employees were based in New York, the corporation was doing business in New York when it sent employees into New York to install automated management systems sold to movie theatres by connecting the hardware, loading the software, testing the system and training the customers to use the system. It was not exempt pursuant to Public Law 86-272. Theatron Data Systems, Inc., Adv Op Comm T&F, April 16, 1990, TSB-A-90(10)C.

Also, a foreign corporation was held to be doing business in New York when its employees taught software development seminars conducted in New York, even though the corporation did not employ capital or own or lease property in New York and did not maintain an office in New York. Project Technology, Inc., Adv Op Comm T&F, November 6, 1989, TSB-A-89(13)C.

Where a foreign corporation's only presence in New York was the temporary placement of its employees in New York, to provide clerical and technical services using the client's equipment and supplies at the client's facilities under the client's supervision, the corporation was held to be doing business in New York. Quantum Resources Corporation, Adv Op Comm T&F, January 18, 1991, TSB-A-91(2)C.

In this case, Petitioner does not have an office in New York or any employees based in New York. However, Petitioner plans to send employees into New York to install computer software and train customer employees. Petitioner will own the computer software it installs. Also, Petitioner will lease computer hardware that it will furnish to its customers located in New York. Petitioner will also furnish its customers with scanners to be utilized in scanning claim forms into personal computers.

Accordingly, when Petitioner furnishes its customers with computer hardware and software in New York, Petitioner will own and lease tangible personal property in New York pursuant to section 209.1 of the Tax Law and section 1-3.2(d) of the Article 9-A Regulations. In addition, giving due consideration to the factors set forth in section 1-3.2(b)(2) of the Article 9-A Regulations and the cases cited above, especially Theatron, supra, Petitioner's employees'

activities in New York of installing the computer software and hardware and training its customers' employees constitute "doing business" within the meaning of section 209.1 of the Tax Law.

Pursuant to section 209.1 of the Tax Law, Petitioner will be subject to the franchise tax imposed under Article 9-A of the Tax Law for the taxable years that it owns and leases personal property in New York State or is doing business in New York State. It appears from the facts presented that when Petitioner acquires customers located in New York it will be subject to tax under Article 9-A of the Tax Law because it will have tangible personal property located in New York and its employees will come into New York to install the tangible personal property and train its customers for its use.

With respect to the allocation of receipts, section 4-4.3 of the Article 9-A Regulations provides that the receipts from services performed in New York State are allocable to New York State. All receipts from the services are allocated to New York State, whether the services were performed by employees, agents or subcontractors of the taxpayer, or by any other persons. It is immaterial where the receipts are payable or where they are actually received.

Section 4-4.4 of the Article 9-A Regulations provides that the receipts from the rental of personal property situated in New York State are allocated to New York State. Receipts of rentals by the taxpayer include all amounts received by the taxpayer for the use of or occupation of property, whether or not such property is owned by the taxpayer.

In this case, Petitioner may furnish computer hardware, software and scanners to its customers, but these items are not billed to the customers. The charges for their use are included in the fees that Petitioner charges its customers. Therefore, Petitioner's receipts from the activities described above are from services performed for its customers in processing health care insurance claims and the rental of personal property. Thus, the fees constitute lump sum payments pursuant to section 4-4.1(c) of the Article 9-A Regulations.

The fees Petitioner receives are for the services performed for its customers as well as a charge for the computer hardware, software and scanners situated at the customer's locations. These receipts will constitute lump sum payments pursuant to section 4-4.1(c) of the Article 9-A Regulations and are apportioned on a reasonable basis with full details submitted with the report. The services performed by Petitioner's employees include the processing of the claims and the installation of the computer hardware, software and scanners and the training of customers employees for their use. It appears from the facts presented that the processing of the claims will not be performed in New York State. However, when Petitioner's employees come into New York to install the computer hardware, software and scanners or to train customer employees for their use, those employees will be performing services in New York State. Therefore, pursuant to section 4-4.3 of the Article 9-A Regulations, the portion of the lump sum payment from Petitioner's customers that is attributable to the services provided by Petitioner's employees is allocable to New York State to the extent services are provided in New York State. Pursuant to section 4-4.4 of the

Article 9-A Regulations, the portion of the lump sum payment from Petitioner's customers that represents the charges for the tangible property (hardware, software and scanners) is apportioned to New York to the extent that the property is located in New York State.

Applicable Sales and Use Tax 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:
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> * * *
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> (4) Retail sale. (i) A sale of tangible personal property to any person for any purpose, other than (A) for resale ...
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> (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.
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> (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 ....
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> (8) Vendor. (i) The term "vendor" includes:
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> (A) A person making sales of tangible personal property or services, the receipts from which are taxed by this article;
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> (B) A person maintaining a place of business in the state and making sales, whether at such place of business or elsewhere, to persons within the state of tangible personal property or services, the use of which is taxed by this article;
>
> (C) A person who solicits business either:
>
> (I) by employees, independent contractors, agents or other representatives; or ...
>
> (14) Pre-written computer software. Computer software (including prewritten 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 prewritten 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.

The Department of Taxation and Finance issued Bulletin No. 1978-1(S) on February 6, 1978, which discusses the application of sales tax to receipts from sales of computer programs as follows:

Software - 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. 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....

Section 1105(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. Services which are not specifically described in the statute are not subject to sales tax.

Section 1110(a) of the Tax Law provides in Part:

Except to the extent that property or services have already been or will be subject to the sales tax under this article, there is hereby imposed on every person a use tax for the use within this state ... (B) of any tangible personal property (other than computer software used by the author or other creator) manufactured, processed or assembled by the user, ... (F) of any computer software written or otherwise created by the user if the user offers software of a similar kind for sale as such or as a component part of other property in the regular course of business.

Opinion - Sales and Use Tax

With respect to Issue 2(A) of the Petition:

(1) Claims conversion fees charged by Petitioner with respect to Cases 1 & 2 as noted above do not fall within the specified services subject to tax under section 1105(c) of the Tax Law and are outside the scope of the tax and thus are not subject to sales or use tax.

(2) & (3) Petitioner's one-way transaction fees and clearinghouse fees charged to customers in Case 3, also represent charges for services that do not fall within the specified services subject to tax under section 1105(c) of the Tax Law and are outside the scope of the tax and thus are not subject to sales or use tax.

(4) Archival fees charged by the Petitioner to the customer in Cases 1,2 and 3, for converting an electronic image to a CD and sending the CD to the customer located in New York represents the sale of tangible personal property and will be subject to sales and use taxes. (Matter of Finserv Computer Corporation v. Tully 94 AD2d 197, affd 61 NY2d 947)

Petitioner also notes that the claims conversion fee and the clearinghouse fee include data analysis and reporting. However, such analysis and reporting are not the primary functions of the Petitioner. Petitioner's primary business function is the electronic movement of health insurance claim forms between providers of health care (medical providers, preferred provider organizations (PPOs), and third party administrators (TPAs)) and its customers, the payors of the claims. Petitioner's data processing service, including the limited data analysis and reporting function, is not one of the specified services subject to tax under Section 1105(c) of the Tax Law and thus is not subject to sales or use.

With respect to Issue 2(B) of the Petition:

(1) Petitioner owns and has developed the software programs it uses to conduct its business activities. For each customer with which Petitioner has an agreement, Petitioner looks at the original software program to see if modifications of the software program for any particular customer will be needed. If so, the software is modified for that customer. Petitioner’s use in New York State of computer software in connection with Petitioner's services to its customers, as described above, will not be subject to use tax, provided Petitioner designs and develops the software and does not offer similar software for sale as such, or as a component part of other property, in the regular course of business. See Section 1110(a)(F) of the Tax Law. Petitioner's use of software in the manner described above will be subject to use tax if Petitioner does offer for sale similar software in the regular course of business. The use tax in such case will be based on the consideration paid by Petitioner for the disks, tapes or other tangible personal property, used as the blank medium that contains or is used in conjunction with the software. See Section 1110(g) of the Tax Law.

If Petitioner does not design and develop its own computer software, but purchases the software from another person, Petitioner's use of software located in New York State will be subject to use tax based upon Petitioner's cost of the software where such software is pre-written computer software. If, however, the software purchased by Petitioner is designed or developed by the author or creator to Petitioner's specifications, such software is considered to be intangible personal property and not subject to the sales or compensating use tax. Where the software is pre-written software that is modified or enhanced to meet Petitioner's specifications, such software is entirely subject to sales and use tax unless there is a reasonable, separately stated charge on an invoice or other statement of the price given to the Petitioner for such modification or enhancement. If Petitioner is charged a reasonable, separately stated charge on its invoice for the custom programming, only the charges for the pre-written portion of the program will subject to sales and use taxes. (Garpac Corporation, Adv Op Comm of T&F, February 6, 1992, TSB-A-92(8)S.)

(2) Petitioner's use of hardware and scanners purchased out of state and subsequently located in New York State will be subject to use tax under section 1110 of the Tax Law based upon the cost of such hardware and scanners to Petitioner. The use tax is an expense Petitioner may choose to absorb or pass on to the customer by increasing its charges for the services provided. Since, in either instance, the use tax represents a cost of doing business, Petitioner may build such cost into the charges to its customers, but may not separately state the charges as tax on such invoice.

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

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