

New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

TSB-A-05(40)S
Sales Tax
October 26, 2005

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S050124A

On January 24, 2005, the Department of Taxation and Finance received a Petition for Advisory Opinion from Connected Corporation, 100 Pennsylvania Avenue, Framingham, MA 01701.

The issues raised by Petitioner, Connected Corporation, are:

- 1) Whether the New York State sales and use taxes apply to its subscription service, which provides customer access to a data backup and recovery system at Petitioner's off-site data center.
- 2) Whether the New York State sales and use taxes apply to software provided by Petitioner to customers as described below.

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

Petitioner has two lines of business, described as follows. Most of Petitioner's customers subscribe to Petitioner's Connected DataProtector service in order to ensure the safe storage of data in the event that subscribers' original data is lost or stolen. All data is stored at data centers operated by Petitioner and located in Massachusetts.

Subscribers use the service for data backup and recovery either because they do not own data storage equipment or because they choose to have a third party service provider operate and manage the data; in effect outsourcing the data storage work to Petitioner's data centers. These subscribers access Petitioner's data centers solely so that subscribers may archive data in Petitioner's data centers. Petitioner ensures that received data cannot be altered, a critically important feature for companies subject to governmental or other recordkeeping requirements. All of the services are provided at the data centers and relate to ensuring that an accurate copy of the data is maintained and easily available if a subscriber's computer is damaged, lost or stolen.

DataProtector software is sent to each subscriber. This software is placed on the subscribers' computers solely to connect the subscribers' computer to Petitioner's data centers in Massachusetts. The software can only be used in conjunction with Petitioner's data centers, and the software has no commercial value to subscribers on a stand-alone basis. The software provides no functionality and does not expand any functionality of the subscribers' computers. The software does not save data on the computers or otherwise improve the features, speed or operation of the subscribers' computers. The sole purpose of the software is to establish a link between the subscribers' computers and Petitioner's data centers, allowing subscribers to backup their data onto the servers at Petitioner's data centers. Without purchasing the license and

appropriate associated server software, subscribers are unable to perform these same backup and retrieval processes in their own offices. No customer would purchase or license the software Petitioner provides for use by customers subscribing to Petitioner's backup and storage services unless the customer were receiving the services provided by Petitioner.

A subscriber who disconnects from Petitioner's data center has its DataProtector software disabled so it is not able to use the software with third party technologies or data center equipment. Thus, there is no possibility of the subscriber using the DataProtector software at its own location without Petitioner's knowledge.

Petitioner's second line of business is the licensing to larger customers a version of DataProtector software that customers can use on their own data backup equipment without entering into subscription service agreements. If these customers are located in New York State, Petitioner collects sales tax from the customer and remits the tax to the state of New York. This version of DataProtector software contains server software and configuration information in addition to the DataProtector software provided to customers which only enter into subscription services agreements (subscribers).

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, other than (A) for resale as such or as a physical component part of tangible personal property....

* * *

(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 therefore, including the rendering of any service, taxable under this article, for a consideration or any agreement therefore.

(6) Tangible personal property. Corporeal personal property of any nature. However, except for purposes of the tax imposed by subdivision (b) of section eleven

hundred five, such term shall not include gas, electricity, refrigeration and steam. 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....

(7) Use. The exercise of any right or power over tangible personal property or over any of the services which are subject to tax under section eleven hundred ten of this article or pursuant to the authority of article twenty-nine of this chapter, by the purchaser thereof, and includes, but is not limited to, the receiving, storage or any keeping or retention for any length of time, withdrawal from storage, any installation, any affixation to real or personal property, or any consumption of such property or of any such service subject to tax under such section eleven hundred ten or pursuant to the authority of such article twenty-nine....

* * *

(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 of the Tax Law provides, in part:

Imposition of sales tax On and after June first, nineteen hundred seventy-one, there is hereby imposed and there shall be paid a tax . . . upon:

(a) The receipts from every retail sale of tangible personal property, except as otherwise provided in this article.

* * *

(c) The receipts from very sale, except for resale, of the following services:

(1) The furnishing of information by printed, mimeographed or multigraphed matter or by duplicating written or printed matter in any other manner, including the services of collecting, compiling or analyzing information of any nature and furnishing reports thereof to other persons, but excluding the furnishing of information which is personal or individual in nature and which is not or may not be substantially incorporated in reports furnished to other persons....

* * *

(4) Storing all tangible personal property not held for sale in the regular course of business and the rental of safe deposit boxes or similar space.

Section 1110 of the Tax Law provides, in part:

(a) 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 on and after June first, nineteen hundred seventy-one except as otherwise exempted under this article, (A) of any tangible personal property purchased at retail, (B) of any tangible personal property (other than computer software used by the author or other creator) manufactured, processed or assembled by the user, (i) if items of the same kind of tangible personal property are offered for sale by him in the regular course of business...(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,...

* * *

(g) For purposes of clause (F) of subdivision (a) of this section, the tax shall be at the rate of four percent of the consideration given or contracted to be given for the tangible personal property which constitutes the blank medium, such as disks or tapes, used in conjunction with the software, or for the use of such property, and the mere storage, keeping, retention or withdrawal from storage of computer software described in such clause (F) by its author or other creator shall not be deemed a taxable use by such person.

Technical Services Bureau Memorandum, entitled *State and Local Sales and Compensating Use Taxes Imposed on Certain Sales of Computer Software*, March 1, 1993, TSB-M-93(3)S, 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 . . . certain software previously considered “custom” may now be considered *prewritten computer software* and subject to such taxes The only software that is exempt from sales and use taxes under the new law is software designed and developed to the specifications of a specific purchaser.

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 transfer of title or possession, any exchange, barter, rental, lease or license to use, including merely the right to reproduce, for consideration

* * *

Prewritten software is subject to tax whether sold as part of a package or separately. Software created by combining two or more prewritten programs or portions of prewritten programs is still prewritten software subject to tax. The medium by which the software is transferred to the purchaser has no effect on the software’s taxability. Thus, prewritten software is taxable whether sold, for example, on a disk, tape or by electronic transmission over telephone lines.

* * *

Use Tax Exemption

Use tax generally applies to taxable uses of prewritten computer software in the same manner that the use tax applies to uses of other tangible personal property, except that: (1) no use tax is imposed on software used by its author if the author does not offer similar software for sale in the regular course of business, and (2) where software is used by its author and the author does sell the same or similar software in the regular course of business, use tax applies and is computed on the cost of the medium (floppy disk, magnetic tape, etc.) that contains or is used in conjunction with the program.

Opinion

Issue 1

Petitioner’s subscribers pay a subscription fee for access to Petitioner’s service which ensures accurate backup and safe storage of their data. Petitioner provides the data backup and

recovery system at its data centers located in Massachusetts. Petitioner provides subscribers with a portion of its proprietary DataProtector software for installation on the subscribers' computers. The DataProtector software connects the subscribers' computers to Petitioner's data centers. Petitioner assures subscribers that an accurate copy of their data will be maintained and that the data will be readily available from the data centers. The software provided to subscribers does not permit or enable the subscribers' computers to perform these same backup and retrieval processes on the subscribers' equipment in its own offices without purchasing from Petitioner a license and the appropriate additional associated server software. When a subscriber cancels its subscription service, the DataProtector software provided by Petitioner for use in such service is disabled.

Petitioner's subscribers pay Petitioner a subscription fee to obtain access to data backup, storage and recovery services. The primary function of Petitioner's subscription service is to provide its subscribers with a backup of their data. The subscribers' data is transmitted from the subscribers' computers to Petitioner's server. The information is then stored on Petitioner's server until such time as a subscriber needs the information, at which point the data is accessed and transmitted from Petitioner's server to the subscriber. Petitioner is receiving a fee for securing and storing the subscriber's information and for transmitting it back to the subscriber when needed. A subscriber does not receive any new information from Petitioner but rather receives a copy of its original data. Petitioner's service, therefore, is not considered the sale of information services pursuant to section 1105(c)(1) of the Tax Law. See *Immediate Medical Records, Inc.*, Adv op Comm T&F, January 31, 1992, TSB-A-92(7)S.

One of the elements of the services that Petitioner provides is storage of data. Section 1105(c)(4) of the Tax Law imposes tax on the storage of tangible personal property. Since the data which is being stored is not tangible personal property, the charge for such storage is not subject to tax. See *Immediate Medical Records, Inc.*, *supra*. In addition, the data is not stored in a facility located in New York.

Although subscriber data is stored on Petitioner's equipment in the data center, Petitioner operates the equipment, and maintains dominion and control of the equipment. Thus, charges for subscriptions to Petitioner's data backup and storage service are not considered receipts from the rental of equipment by Petitioner subject to sales tax under section 1105(a) of the Tax Law. Further, as discussed in Issue 2 below, Petitioner's use of DataProtector software to provide data backup and storage service does not constitute a sale of such software for purposes of section 1105(a).

Therefore, the charges for Petitioner's data backup and storage services are not subject to sales tax. These services are not included among the enumerated taxable services under section 1105(c) of the Tax Law.

Issue 2

Petitioner's service is provided through the use of Petitioner's software and data center equipment. The software which is installed on the subscribers' computers is used solely to allow the subscribers' computers to transmit data to the data center servers. This software serves no other purpose and is disabled if a subscriber discontinues the backup and retrieval service. Petitioner is using this software in providing its backup and retrieval services to subscribers, rather than making a sale or license of this software for purposes of Article 28 of the Tax Law. Petitioner appears to sell similar software in the normal course of business since the connecting software provided to subscribers to the backup and retrieval service appears to be included within the software package sold to persons purchasing DataProtector software for use in their own backup and recovery equipment and systems. Therefore, Petitioner's use of the DataProtector software to provide its services to subscribing customers in New York State is subject to the use tax imposed under section 1110(a) of the Tax Law. The use tax is computed on the cost of the medium (floppy disk, magnetic tape, etc.) that contains or is used in conjunction with the software. See section 1110(g) of the Tax Law; and TSB-M-93(3)S, *supra*.

Lastly, it is noted that Petitioner also makes available for sale to its larger customers a version of DataProtector software for use on the customer's own data backup equipment. The DataProtector software sold or licensed to these customers contains server software and configuration information that is not contained in the version of DataProtector software provided to subscribers. The licensed software allows customers to backup, secure, store and recover data from the customer's own data backup servers, and contains software facilitating the customer's transfer of data from its computers to the servers where the customer will backup and store the data. Petitioner's licenses of such software to customers located in New York constitute sales of prewritten software subject to sales and compensating use tax. See sections 1105(a) and 1110(a) of the Tax Law; and TSB-M-93(3)S, *supra*.

DATED: October 26, 2005

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