

New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Taxpayer Guidance Division

TSB-A-07(16)S
Sales Tax
June 22, 2007

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S060313A

On March 13, 2006, the Department of Taxation and Finance received a Petition for Advisory Opinion from Spiritual Compass, LLC, PO Box 12754, Albany, New York 12212-2754. Additional information was provided by Petitioner, Spiritual Compass, LLC, on May 3, 2006.

The issue raised by Petitioner is whether sales tax applies to the sale or license of the following products and services, as described below:

1. Computer hardware and proprietary software.
2. Set-up services.
3. Consulting services.
4. Design services.
5. Editing digitized files.
6. Rights to download audio, video, or music content from Petitioner's online library on a per-download or subscription basis.

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

Petitioner has developed, and offers for sale, software programs and consulting services designed generally for not-for-profit religious organizations to meet the growing challenge of keeping up with emerging trends and opportunities for outreach and marketing. The primary software program licensed by Petitioner is an audio-publishing solution delivered via Hemisphere, Petitioner's proprietary hardware package. Some of Petitioner's customers may be for-profit entities.

The Hemisphere Plug-n-Play hardware and its encoded software enables Petitioner's customers to automatically digitize audio messages and add them to Petitioner's audio library without requiring a customer's staff or volunteers to have special technical expertise. A customer must have an Internet connection from a third-party Internet service provider as well as a sound board (recording device), keyboard, mouse, and monitor or an existing hardware system. Petitioner generally ships the Hemisphere box to a customer with instructions on how the customer should install it. Installation simply requires that the Internet connection be plugged into the Hemisphere box, which is then connected to the customer's hardware. Petitioner

provides training and support on how to use the system's interface. Hemisphere allows a virtual private network to be established between Petitioner and its customers.

Petitioner's proprietary software in Hemisphere provides powerful, easy-to-use tools allowing customers to digitize audio, video, and music content, which is automatically uploaded to Petitioner's online library.

Petitioner maintains ownership of the Hemisphere hardware with its proprietary software and requires that the hardware be returned to Petitioner upon termination of the contract. Thus, Petitioner provides its customers with the use of Hemisphere under a written contract for a pre-determined period of time (e.g., one or two years). In addition, Petitioner's contract requires that Hemisphere remain at the location identified as the shipping address.

Petitioner charges a monthly fee for Hemisphere use as well as a set-up fee which is separately stated when invoiced. The set-up fee is charged for additional programming needed for Petitioner's system to properly interface with the customer's existing hardware and software. Petitioner may also provide customers with other proprietary or third-party publishing and management software for an additional charge.

Once a customer's digitized content is stored in Petitioner's online library, the public can access the online library and purchase the rights to download audio, video, or music content supplied by Petitioner's customers. Such charges may be either on a per-download or subscription basis. Purchasers electing to subscribe to Petitioner's library are permitted to download a specific number of files for a flat monthly charge. Petitioner allows a credit for any subscription fees paid but not used in any specific month to be carried forward.

Petitioner provides various services to assist its customers in promoting and marketing their digitized content. Such services are optional and separately stated on the customer's invoice. Consulting services may be related to marketing, promotional campaigns, program management, public relations, event planning, and placing radio or television advertisements. Petitioner may also consult with customers on Web site design or how to structure digitized content for search engine optimization. Petitioner will also design a customer's Web site upon request.

Petitioner provides graphic design services for the Web or other electronic multi-media activities, as well as for print. The resulting artwork is transmitted electronically to the customer or the customer's designee. Customers have the option to obtain print management services whereby Petitioner will work with a customer's designated printer to ensure that the digitized files meet the printer's specifications. Petitioner does not do any printing or mailing and does not hire the third-party printer.

In addition, Petitioner provides a service to assist customers with special projects by editing the customer's digitized audio, video, or music files into a cohesive presentation.

Petitioner also sells general merchandise such as electronic equipment, clothing, books, etc., to both Petitioner's customers and the public.

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:

* * *

(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. [Emphasis added]

(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. . . .* [Emphasis added]

* * *

(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. . . . 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 a tax on the receipts from every retail sale of tangible personal property, except as otherwise provided.

Section 1105(c) of the Tax Law imposes a tax on, in part:

The receipts from every sale, except for resale, of the following services:

* * *

(2) Producing, fabricating, processing, printing or imprinting tangible personal property, performed for a person who directly or indirectly furnishes the tangible personal property, not purchased by him for resale, upon which services are performed.

Section 1115 of the Tax Law provides, in part:

(a) 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:

* * *

(30) Clothing and footwear for which the receipt or consideration given or contracted to be given is less than one hundred ten dollars per article of clothing, per pair of shoes or other articles of footwear or per item used or consumed to make or repair such clothing and which becomes a physical component part of such clothing.

* * *

(o) 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.

Section 1116(a) of the Tax Law provides, in part:

Except as otherwise provided in this section, any sale or amusement charge by or to any of the following or any use or occupancy by any of the following shall not be subject to the sales and compensating use taxes imposed under this article:

* * *

(4) Any corporation, association, trust, or community chest, fund, foundation, or limited liability company, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary or educational purposes . . . no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation . . . and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office;

Section 1132(c)(1) of the Tax Law provides, in part:

For the purpose of the proper administration of this article and to prevent evasion of the tax hereby imposed, it shall be presumed that all receipts for property or services of any type mentioned in subdivisions (a), (b), (c) and (d) of section eleven hundred five . . . are subject to tax until the contrary is established, and the burden of proving that any receipt . . . is not taxable hereunder shall be upon the person required to collect tax or the customer. Except as provided in subdivision (h) or (k) of this section, unless . . . (ii) the purchaser, not later than ninety days after delivery of the property or the rendition of the service, furnishes to the vendor: any affidavit, statement or additional evidence, documentary or otherwise, which the commissioner may require demonstrating that the purchaser is an exempt organization described in section eleven hundred sixteen, the sale shall be deemed a taxable sale at retail.

Section 525.2 (a) of the Sales and Use Tax Regulations provides, in part:

(2) Except as specifically provided otherwise, the sales tax is a “transactions tax,” with the liability for the tax occurring at the time of the transaction. Generally, a taxed transaction is an act resulting in the receipt of consideration for the transfer of title to or possession of (or both) tangible personal property or for the rendition of an enumerated service. The time or method of payment is generally immaterial, since the tax becomes due at the time of transfer of title to or possession of (or both) the property or the rendition of such service

(3) Except as specifically provided otherwise, the sales tax is a “destination tax.” The point of delivery or point at which possession is transferred by the vendor to the purchaser, or the purchaser's designee, controls both the tax incidence and the tax rate.

Section 529.7(h)(2) of the Sales and Use Tax Regulations provides:

In order to exercise its right to exemption the organization must be the direct purchaser, occupant or patron of record. It must also be the direct payer of record and must furnish its vendors with a properly completed exempt organization certification. *Direct purchaser, occupant or patron* as used in this paragraph includes any agent or employee authorized by the organization to act on its behalf in making such purchases, provided the organization and its agent or employee are both identified on any bill or invoice. An organization is the direct payer of record where direct payment is made by the organization or from its funds directly to the vendor.

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, states, in part:

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. Thus, a payment made by a customer . . . for a license to use, or for the rental or lease of prewritten software is subject to sales or use tax. . . .

Software that was originally designed and developed to the specifications of a specific purchaser (i.e., "custom" software) loses its identity as such and becomes prewritten software, subject to tax, if and when it is sold to someone other than the person for whom it was specifically designed and developed. . . .

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.

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.

Example 1. A software developer creates an accounting system using prewritten software modules for general ledger, accounts receivable, accounts payable, payroll, inventory management, etc. The developer may also sell the modules separately or bundled in other packages. Even though the modules may be modified to the specific requirements of the client's business, the sale of the modules is subject to sales or use tax as prewritten software. An additional charge for modification or "custom" programming by the developer would not be subject to sales or use tax if the developer's charge for the modification is reasonable and is separately stated on the billing statement.

* * *

Customer Support and Related Services

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 to 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.

Example 2: A computer vendor sells an "off-the-shelf" software program to a customer. The vendor charges additional fees for installing the software, on-site training, and diagnostic and trouble-shooting customer support. The sale of the software is taxable since it is prewritten. However, the charges for installation, on-site training and customer support services are not taxable if reasonable and separately stated on an invoice or billing statement given to the customer.

Opinion

Petitioner has developed software programs designed generally for not-for-profit religious organizations. Petitioner's audio-publishing software is delivered via Hemisphere, Petitioner's proprietary hardware/software package. The Hemisphere hardware and Petitioner's proprietary software provide its customers with powerful, easy-to-use tools allowing customers to digitize their audio, video, and music content, which is automatically uploaded to Petitioner's online library.

Petitioner maintains ownership of Hemisphere with its proprietary software and requires that the Hemisphere package be returned to Petitioner upon termination of the contract. The Hemisphere package is delivered to and must be kept at the customer's location. Petitioner charges a monthly fee for the use of the Hemisphere package and a set-up fee that are separately stated when invoiced. The set-up fee covers additional programming needed for Petitioner's system to properly interface with a customer's equipment. Petitioner may also provide customers with other proprietary or third-party publishing and management software and various consulting, design, and editing services for an additional charge.

Petitioner's online library is available to the public where anyone may, for a fee, download audio, video, or music content supplied by Petitioner's customers. Petitioner also sells general merchandise like electronic equipment, clothing, books, etc., to both its customers and the public.

Petitioner's proprietary software, as well as any third-party software provided to customers, is considered to be prewritten computer software since it does not appear that Petitioner has designed this software to the specifications of a specific purchaser for sale only to that purchaser. See section 1101(b)(14) of the Tax Law. Such software is tangible personal property for sales tax purposes. See section 1101(b)(6) of the Tax Law. Thus, the customer's license to use Petitioner's software, whether encoded in the Hemisphere hardware or otherwise provided to the customer, is the license to use prewritten software subject to sales tax when used by customers located within New York State. Petitioner's monthly charges for the use of Petitioner's Hemisphere package are considered to be receipts from the license or rental of tangible personal property and are subject to sales tax. See sections 1101(b)(5) and 1105(a) of the Tax Law.

The point at which possession of tangible personal property is transferred by the vendor to the purchaser, or the purchaser's designee, controls both the tax incidence and the tax rate. See section 525.2(a)(3) of the Sales and Use Tax Regulations. Thus, when Hemisphere is delivered within New York State, the point of delivery (i.e., the shipping address) dictates the tax rate used to compute the appropriate State and local sales tax on the monthly charge. Since the point of delivery determines taxability of a sale, only the charges attributable to customers located in New York State are subject to sales tax. Petitioner's bills of lading or other shipping documents

showing out-of-state delivery of Hemisphere are considered sufficient documentation of the nontaxability of out-of-state sales.

A large number of Petitioner's customers are religious organizations that may be exempt from sales and use tax pursuant to section 1116(a)(4) of the Tax Law. Petitioner is not required to collect tax on sales of taxable tangible personal property and services to organizations that are exempt from sales tax pursuant to section 1116(a)(4) of the Tax Law if the organization is the direct purchaser and payer of record and it furnishes Petitioner a properly completed *Exempt Organization Exempt Purchase Certificate*, Form ST-119.1, within 90 days of the sale. See section 529.7(h)(2) of the Sales and Use Tax Regulations. Acceptance of a properly completed exemption certificate by Petitioner in good faith will satisfy Petitioner's burden of proof regarding the exempt status of the sale. See section 1132(c)(1) of the Tax Law.

Petitioner charges a set-up fee for any additional programming needed for Petitioner's system to properly interface with a customer's existing equipment. Such charges are for customizing software, which is not subject to sales tax when separately stated on a customer's invoice. If the set-up fee includes charges for installation of hardware, the entire set-up fee is subject to sales tax unless the taxable installation fee and nontaxable programming fee are separately stated and reasonable. In addition, any separately stated charges to customers for training and support on how to use Hemisphere are not subject to sales tax. See TSB-M-93(3)S, *supra*.

Petitioner provides consulting services to customers related to marketing, promotional programs, program management, public relations, event planning, placing radio or television advertisements, Web site design, and structuring digitized content for search engine optimization. Such consulting services are optional and separately stated on a customer's invoice. Section 1105(c) of the Tax Law imposes sales tax on certain enumerated services. The consulting services described by Petitioner are not among the enumerated services subject to sales or use tax; therefore, Petitioner's charges for consulting services are not subject to sales tax provided that they are not performed in conjunction with the sale of tangible personal property or other taxable services. See *KPMG LLP*, Adv Op Comm T&F, February 2, 2000, TSB-A-00(7)S; *Virtual Systems Group*, Adv Op Comm T&F, October 9, 1998, TSB-A-98(71)S; *Salomon & Leitgeb CPA's, LLP*, Adv Op Comm T&F, July 23, 1997, TSB-A-97(44)S.

Petitioner also designs a customer's Web site upon request. The Web site development services provided by Petitioner, which involve consulting, designing, and creating Web sites, do not constitute the sale of tangible personal property and are not included among the enumerated services that are subject to New York State and local sales or use tax. See *Liquid Digital Information Systems Inc.*, Adv Op Comm T & F, May 30, 2002, TSB-A-02(7)S; *Alan J. Goldstein/The Computer Studio*, Adv Op Comm T & F, July 31, 2001, TSB-A-01(21)S; *David H. Posmantier*, Adv Op Comm T&F, June 7, 1999, TSB-A-99(31)S. Accordingly, Petitioner's

charges for Web site development are not subject to sales tax provided they are not performed in conjunction with the sale of tangible personal property or taxable services.

Petitioner also offers a graphic design service. The resulting artwork is always transmitted electronically to a customer or a customer's designee. Digitized artwork transmitted electronically is not subject to sales tax provided it is not performed in conjunction with the sale of tangible personal property or taxable services. If such artwork is transmitted by other means, such as tape, disk, CD, etc., such sales may constitute sales of tangible personal property subject to tax. See *Doyle Partners*, Adv Op Comm T&F, December 29, 2006, TSB-A-06(32)S; *Debra Horn Stachura*, Adv Op Comm T&F, November 22, 2004, TSB-A-04(26)S; *Gentile, Wiener, Penta & Co. CPA's PC.*, Adv Op Comm T&F, December 27, 1996, TSB-A-96(91)S.

Customers have the option to purchase print management services. Petitioner will work with a customer's designated printer to ensure that the customer's digitized files, delivered electronically, meet the printer's specifications. Such services are not among the enumerated services subject to New York State and local sales or use tax; therefore, Petitioner's charges for such services are not subject to sales tax provided they are not performed in conjunction with the sale of tangible personal property or taxable services.

Petitioner provides a service to assist customers with special projects by editing digitized audio, video, or music files into a cohesive presentation, which is then delivered electronically to the customer or placed in Petitioner's online library. Section 1105(c)(2) of the Tax Law taxes the services of producing, fabricating, or processing tangible personal property. However, since digitized audio, video, and music files delivered electronically or online are, with the exception of prewritten software, not tangible personal property, charges for the editing services electronically delivered to the customer are not subject to sales tax. See *Universal Music Group*, Adv Op Comm T&F, April 18, 2001, TSB-A-01(15)S; *Martin R. Timm*, Adv Op Comm T&F, September 27, 2005, TSB-A-05(34)S.

Petitioner charges the public a fee to download audio, video, or music content from Petitioner's online library that is populated by Petitioner's customers' content. Charges for music, audio recordings, or artwork delivered electronically for download on customers' computers or other devices are not sales of tangible personal property and are thus not subject to sales tax. See *Debra Horn Stachura, supra*; *Universal Music Group, supra*. Therefore, Petitioner's charges for such electronic transfer of its digital products for download, whether per download or by subscription, are not subject to sales tax provided they are not in conjunction with the sale of tangible personal property or taxable services.

Petitioner also sells general merchandise like electronic equipment, clothing, books, etc. to both its customers and the public. Charges for the sale of tangible personal property are generally subject to sales tax. See section 1105(a) of the Tax Law. However, Petitioner is not required to collect sales tax on sales to organizations exempt under section 1116(a)(4) of the Tax

Law provided Petitioner receives a properly completed *Exempt Organization Exempt Purchase Certificate*, Form ST-119.1, within 90 days of the sale. It should be noted that sales of clothing costing less than \$110 per article of clothing are exempt from State sales tax and may be exempt from local sales tax. See section 1115(a)(30) of the Tax Law and Technical Services Bureau Memorandum entitled *Year-Round Sales and Use Tax Exemption of Clothing, Footwear, and Items Used to Make or Repair Exempt Clothing*, March 29, 2006, TSB-M-06(6)S and *Local Sales and Use Tax Rates On Clothing and Footwear*, Publication 718-C (2/07). When taxable items are delivered within New York State, the point of delivery (i.e., the shipping address) dictates the tax rate used to compute the appropriate State and local sales tax. Since the point of delivery determines taxability of a sale, only the charges attributable to sales delivered in New York State are subject to sales tax.

DATED: June 22, 2007

/s/
Jonathan Pessen
Tax Regulations Specialist IV
Technical Services Division

NOTE: An Advisory Opinion is issued at the request of a person or entity. It is limited to the facts set forth therein and is binding on the Department only with respect to the person or entity to whom it is issued and only if the person or entity fully and accurately describes all relevant facts. An Advisory Opinion is based on the law, regulations, and Department policies in effect as of the date the Opinion is issued or for the specific time period at issue in the Opinion.