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

TSB-A-09(6)S
Sales Tax
January 30, 2009

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION   PETITION NO. S070920A

On September 20, 2007, the Department of Taxation and Finance received a Petition for Advisory Opinion from Aviation Software, Inc., 400 Rella Blvd, Suite 205, Suffern, NY 1090l. Petitioner, Aviation Software, Inc., provided additional information pertaining to the Petition on March 13, 2008.

The issues raised by Petitioner are:

1. Whether receipts from the sale of licenses for the use of software that has been customized to the specifications of each airline customer are subject to sales and use taxes.

2. Whether receipts from airline customers with locations outside of New York may be allocated by the location of the airports used by the airline customer.

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

Petitioner develops customized software for airlines. The airlines using Petitioner's software transport mail for the United States Postal Service (USPS) and foreign postal authorities.

Airline Software, Inc. (ASI) originally received a request from an airline to develop software. The airline planned to use the software in its operation to carry US mail throughout the Caribbean were the airline to be the successful bidder on a contract with USPS. In order to obtain the contract, USPS required the airline to be electronic data interface (EDI) compliant. ASI requested the USPS EDI specifications, developed a computer software program to meet these specifications, and the airline was awarded the contract with USPS.

After this software was developed, ASI formed a new corporation, Petitioner, in Nevada in April 2004. The software was then transferred as a capital contribution to Petitioner.

This software was used as the basis for the software currently provided by Petitioner to each airline customer. The software is customized by Petitioner for each airline, in order to integrate the software with the airline's computer system and scanning equipment. The resulting software will only be usable by the specific airline customer. For example, airline A can not use the software that has been customized for airline B and vice versa.

The customized software is licensed to various airlines. The licenses are nonexclusive and nontransferable. The customized software is transmitted electronically to Petitioner's airline

customers via a server in New Jersey. The airline customer then transmits the customized software to various locations. Petitioner is not involved in the determination as to where the software is to be utilized.

The customized software is used in the following manner. The airline downloads the software to its computer systems that include scanners. Employees of the airline use the scanners to scan sacks of mail being transported by the airline; the sacks are scanned at the point of departure and at the point of destination. Some of the points of departure and destination are located at airports in New York. The customized software downloaded into the scanners enables the airline to "capture" the bar-code information on labels affixed to the sacks of mail being transported. This information enables the airlines to invoice USPS and foreign postal authorities for the mail being transported by the airline.

Petitioner charges a per kilo/pound amount for scanning the transported mail and providing the documentation in support of the fee charged by an airline to USPS. In the future Petitioner's invoices will indicate the charge for prewritten software and for customized software.

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:

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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.

(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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(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. (Emphasis added)

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 entitled *State and Local Sales and Compensating Use Taxes Imposed on Certain Sales of Computer Software* dated 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. . . .

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 on or after September 1, 1991, for a license to use, or for the rental or lease of prewritten software is subject to sales or use tax

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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.

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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.

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Sale of Software Upgrades

Generally, the sale of a revision or upgrade of prewritten software is subject to tax as the sale of prewritten software. If, however, the software upgrade is designed and developed to the specifications of a specific purchaser, its sale to that specific purchaser would be exempt as custom software.

Opinion

Petitioner develops software specifically for use by airlines transporting mail. Each individual airline customer may have a different computer system and scanning equipment and

Petitioner must customize the software to meet the system and equipment specifications. Petitioner's software originally was developed for a specific airline for use in transporting mail throughout the Caribbean. Subsequently, Petitioner determined there would be a broader market for this software, and the software was then made available for use by other airlines transporting mail in the United States and other foreign countries. Petitioner states that the software created for the airline in the Caribbean was used as the basis for the software currently being marketed throughout the United States and other foreign countries.

Prewritten computer software is included within the definition of tangible personal property, "regardless of the medium by means of which such software is conveyed to the purchaser." Section 1101(b)(6) of the Tax Law. The sale of prewritten computer software is subject to tax as the sale of tangible personal property. See sections 1101(b)(6) and 1105(a) of the Tax Law . *Sale* is defined as "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." Section 1105(b)(5) of the Tax Law . Section 526.7(e) of the Sales and Use Tax Regulation provides generally that "a sale is taxable at the place where the tangible personal property or service is delivered, or the point at which possession is transferred by the vendor to the purchaser or his designee." Section 526.7(e)(4) further provides that, with respect to a "license to use," a transfer of possession has occurred if there is a transfer of actual or constructive possession, or if there has been a transfer of "the right to use, or control or direct the use of, tangible personal property." The location of the code embodying the software is irrelevant, because the software can be used just as effectively by the customer even though the customer never receives the code on a tangible medium or by download. The accessing of Petitioner's software by Petitioner's customers' constitutes a transfer of possession of the software, because the customer gains constructive possession of the software, and gains the "right to use, or control or direct the use of," the software. The transfer of Petitioner's software to its customers in New York is subject to sales tax if the software is prewritten software.

Prewritten software for purposes of section 1101(b)(14) of the Tax Law includes software designed and developed to the specifications of a specific purchaser when it is sold to a person other than such purchaser. Therefore, the portion of Petitioner's software that is used as the basis for the software currently being marketed to various airlines is prewritten software as described in section 1101(b)(14). Prewritten software is subject to sales and use tax under section 1105(a) of the Tax Law as tangible personal property when delivered to purchasers in New York State. See section 1101(b)(6) of the Tax Law.

Though Petitioner is modifying its software, the modifications do not affect the software's overall character as prewritten software. Petitioner's receipts from the sale of its software and any charges to modify such software will be subject to sales and use taxes, unless charges for the prewritten portion and the modifications are reasonable and separately stated on an invoice or other statement given to the purchaser. If reasonable and separately stated, the fees

for modification of the software to the specifications of the individual airline customer will not be subject to sales and use taxes. See sections 1101(b)(6) and 1115(o) of the Tax Law. See also *Software Dynamics, Inc.*, Adv Op Comm., July 23, 1997, TSB-A-97(45)S.

Petitioner's software is downloaded by an airline to its computer systems. The airline then transmits the software to various locations for use in scanning sacks of mail at points of departure and points of destination. The situs of the sale for purposes of determining the proper incidence of tax is the location associated with the license to use (i.e., the location of the customer's employees that use the software). In the present case, if the airport locations and other business locations (e.g., corporate data processing center, accounting department, etc.) where the customer will use the software are located both in and out of New York State, Petitioner should collect tax based on the portion of the receipt attributable to the locations in New York. The portion of Petitioner's receipts from sales of software that are delivered and used by the purchaser outside of New York are not subject to New York State and local sales and use taxes. The determination of the proper local tax rate and jurisdiction is also based on the location associated with the license to use.

Allocating the sale of Petitioner's software based upon the specific airport (and other business locations) where the customer uses the software would appear to be an acceptable basis for allocation of Petitioner's receipts from the sales of licenses for the use of its software. It should be noted that, generally, the determination of whether a proposed method for apportioning receipts from the sale of software as described in this Advisory Opinion is a reasonable method for collection of tax requires consideration of all the facts and circumstances in a particular case. See *KPMG LLP*, Adv Op Comm T&F, January 31, 2003, TSB-A-03(5)S.

DATED: January 30, 2009   /s/
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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.