

New York State Department of Taxation and Finance
Office of Counsel
Advisory Opinion Unit

TSB-A-10(50)S
SalesTax
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STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S100406B

Petitioner ██████████ asks whether its merchandise return authorization service and discount coupon service are subject to New York State and local sales and use taxes.

We conclude that Petitioner's merchandise return authorization service is an information service that is subject to the sales taxes imposed by section 1105(c)(1) of the Tax Law. Petitioner's discount coupon service is neither the sale of tangible personal property nor the sale of a service subject to sales tax imposed by section 1105 of the Tax Law.

Facts

Petitioner is an out-of-state corporation that has no permanent employees or offices in New York State. However, Petitioner's employees enter the State to visit potential and existing customers.

Petitioner's customers are primarily retail merchants. Approximately ninety-five percent (95%) of Petitioner's revenue is derived from the provision of merchandise return authorization service ("Authorization Service") to merchants. Petitioner's remaining revenue is derived from an add-on service that generates merchant coupons ("Discount Coupon Service") for customers making returns to a merchant. A merchant purchases Petitioner's Authorization Service to assist it in determining whether the merchant will accept merchandise returns from one of the merchant's customers.

Refused returns generally fall into two categories: (1) returns that break the retailer's return policy (such as a return without a receipt or a return after the allowed return period) and (2) returns under circumstances that indicate fraud or abuse. Examples of return fraud and abuse problems are described on Petitioner's Webpage to include:

- Wardrobing or renting - Buying merchandise for short-term use with intent to return, such as video cameras for weddings, big-screen TVs for a Super Bowl game, or a dress for a special occasion;
- Employee fraud - Returning goods stolen by employees or with their help for full retail price;
- Receipt fraud - Using falsified, stolen, or reused receipts to return merchandise;
- Returning stolen merchandise - Shoplifting with intent to return for full retail price;
- Price switching - Putting lower priced tags on merchandise with intent to return for full retail price;
- Price arbitrage - Buying differently priced, similar-looking items and returning the cheaper one as the expensive item.

Petitioner's Webpage explains that its Authorization Service is designed to identify those consumers whose behaviors mimic return fraud or abuse. Without this system, retailers are forced to create stricter policies such as "no receipt, no return," or raise prices for consumers to offset the losses

incurred from fraudulent returns. The Authorization Service assists merchants to expedite the handling of returns and reduces the probability of merchandise return fraud. A merchant uses Petitioner's Authorization Service when a customer attempts to make a merchandise return to that merchant. To use the service, the merchant must swipe its customer's driver's license or state ID card through a device on merchant's point-of-sale ("POS") system and transmit the information electronically to Petitioner's data center in California. Petitioner's servers process the information and electronically transmit an Authorization Decision back to the merchant about whether to accept or reject the merchandise return.

The types of information provided by a merchant to Petitioner include the information on the face of an ID card, such as the identification number, the customer's name, address, date of birth, and expiration date. Certain additional information is necessarily supplied, such as the time of day or night of the transaction, the address of the merchant's store where the transaction is occurring, and the type of merchant. The data is transmitted to Petitioner's host server which issues an Authorization Decision to approve the return or exchange, similar to a credit card or check verification.

Upon receipt of the information provided by the merchant, Petitioner performs a two-step analysis at its data center in California. First, the return data described above is run through Petitioner's proprietary, self-created and updated "activity database," which was created by Petitioner and contains all return data that Petitioner has amassed for that specific merchant. Any historical data that appears linked to the customer's return data (such as the driver's license number) is identified for any positive or negative indications.

The data gleaned from the foregoing process is then run through Petitioner's "risk scoring system." The risk scoring system consists of a highly proprietary and sophisticated computer model created by Petitioner. Petitioner considers its models and algorithms to be trade secrets and does not share them with anyone. These models perform a risk analysis applying intricate, complex, confidential and proprietary statistical models, algorithmic processes and other risk assessment tools to the return data and any historical return data to predict the risk to a merchant of a customer's fraudulent or abusive merchandise return. After analyzing the information, Petitioner formulates a recommendation about whether a return should be accepted or declined and provides its recommendation in the form of an Authorization Decision to the merchant.

In general, the Authorization Decision provided by Petitioner to a merchant pertains only to the single return transaction of one customer. Even though the same process is applied to different merchants concerning return transactions by the same person (e.g., a customer goes to one merchant to make a return and then goes to a different merchant to make another return), this does not guarantee the same recommendation will be made because risk parameters specific to the customer and each individual merchant will vary. In other words, Petitioner designs and integrates the Authorization Service based on each merchant's individual return processes and desired risk levels. Petitioner charges its customers a separate fee for professional consulting services associated with the initial set-up and integration support services. The fee for the Authorization Service is billed separately on a per-store basis.

However, Petitioner's Authorization Service also includes a "shared data" feature. If electing to participate in the shared data feature, merchants are able to obtain a recommendation about a return transaction based on data from multiple merchants' return activity experience. Using the Authorization Service's shared data feature, a merchant could leverage the additional data collected from other merchants' experiences to approve or deny customer transactions. A smaller merchant might obtain an advantage by using a large nationwide merchant's return experiences.

Petitioner uses third-party statistical model software in the development of its proprietary program. Petitioner's Authorization Service contract with its merchants provides that the software installed on merchants' POS equipment or otherwise at merchant locations is to facilitate the merchant's access to and use of Petitioner's services. Likewise, Petitioner's contract with respect to its provision of Discount Coupon Service permits the merchants to access Petitioner's remote software to facilitate use of the Discount Coupon Service.

The result of each Authorization Service transaction performed by Petitioner for any merchant is added to Petitioner's in-house activity database. The database is continually updated with new information, which may impact any future merchandise return authorization analyses. The Authorization Decision is not binding on a merchant.

In addition to its return Authorization Service, Petitioner offers a Discount Coupon Service that generates merchant coupons to customers making returns to the merchant. The merchant coupon program is a proprietary, patented service that promotes increased sales after legitimate return or exchange transactions. Coupons are printed directly on the merchant's return receipts. The coupon program drives incremental sales by using statistical modeling, simulation techniques, and predictive analytics. Petitioner maintains the Discount Coupon Service software on its servers, and makes all changes that may be requested by the merchant. Merchants cannot make any changes to the software settings. Petitioner receives payment for the Discount Coupon Service in the form of commissions based on the number of coupons used rather than the number of coupons distributed.

When using the return Authorization or Discount Coupon Services, merchants transmit and receive information from Petitioner in one of two ways: (i) VeriFone terminals or (ii) the merchant's POS system. The terminal or POS system is used to transmit the merchandise return authorization information to Petitioner and receive the Authorization Decisions, discount coupons, or both. For some merchants, Petitioner may provide countertop VeriFone terminals for the merchant to use during a brief pilot period. Petitioner does not make a separate charge to the merchant for the temporary use of the terminals. Rather, the terminals remain the property of Petitioner and must be returned to Petitioner at the termination of the initial pilot period (ranging from 30 to 90-days). If a merchant executes an agreement for Authorization or Discount Coupon Services beyond the pilot period, the merchant may purchase the necessary terminals from third-party vendors. Alternatively, a merchant may access the services directly from its own POS system. In either case, merchants access the services by dial-up phone service, over the Internet (through the merchant's Internet Service Provider), or over dedicated lines. Other than the countertop terminal provided to certain merchants during the pilot period, Petitioner does not provide its customers with any equipment or telecommunication services.

The structure of the customer fee varies depending on the service. For example, the fee for the Authorization Service is generally based upon the number of stores using the service. The number of transactions processed does not affect the amount charged to the merchant. In contrast, the fee for the Discount Coupon Service is based on an agreed-upon percentage of all net sales proceeds from transactions in which the coupon is redeemed. If the merchant's customers do not use the coupons generated, Petitioner receives no fee for this service. The fee for each service is shown as a separate line item on Petitioner's billing invoice.

Petitioner asks the following questions:

1. Is the Authorization Service subject to State and local sales or use taxes?

2. Is the Discount Coupon Service subject to State and local sales or use taxes?

3. If the Authorization Service is found to be a taxable information service, would it be considered a risk management analysis service, for which tax must be collected beginning on September 1, 2010?

Analysis

Petitioner's Authorization Service is an information service subject to tax under section 1105(c)(1) of the Tax Law. New York State and local sales and use taxes are imposed on the sale of tangible personal property and certain enumerated services. See Tax Law § 1105. Under section 1105(c)(1) of the Tax Law, sales tax is imposed on the receipts from sales, other than sales for resale, of 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 kind or 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. Petitioner's Authorization Service is an information service, because it compiles information about return behavior and provides a recommendation based on that information to its customers.

Information derived from common sources or data repositories does not come within the scope of the statutory exclusion for information that is "personal or individual." See *Matter of ADP Automotive Claims Service Inc. v Tax Appeals Tribunal*, 188 AD2d, leave to appeal denied 82 NY2d 655; *Rich Products Corporation v Chu*, 132 AD2d 175 (3d Dept 1987) *lv denied* 72 NY2d 802; *Towne-Oller & Assoc. v State Tax Comm*, 120 AD2d 873(3d Dept 1986); *Alan/Anthony, Inc.*, Adv Op Comm T&F, June 19, 1992, TSB-A-92(51)S. Information generated from a common database is not personal or individual, regardless of whether reports, screens, or displays of the information are customized to meet the specific needs of a customer. Moreover, the Authorization Decision provided to one merchant may incorporate shared data of transactions occurring at other merchants. Because the Authorization Decision may be based on shared data about transactions with other merchants, Petitioner's Authorization Service also fails to satisfy the criteria that the information may not be incorporated in report furnished to other persons. See Tax Law § 1105(c)(1).

Beginning on September 1, 2010, the sale of a service the primary function of which is to provide risk management analysis reports is the sale of a taxable information service. See *Sales and Compensating Use Tax Treatment of Certain Information Services*, TSB-M-10(7)S. A service that relies on statistical models and historical data to generate a report analyzing and forecasting the risk associated with various aspects of a client's business is an example of the type of risk management analysis report that is a taxable information service. See *Matter of DZ Bank*, Tax Appeals Tribunal, DTA No. 821251 (May 11, 2009). Petitioner's Authorization Service relies on historical data and statistical models to predict the risk of fraud and abuse associated with accepting merchandise returns. This service is similar to the risk management analysis services described in TSB-M-10(7)S. Accordingly, Petitioner's Authorization Service described above is subject to tax beginning on September 1, 2010. See TSB-M-10(7)S, *Sales and Compensating Use Tax Treatment of Certain Information Services*.

We further conclude that Petitioner's Discount Coupon Service is not subject to sales and use taxes. Sales tax is imposed on the service of printing or imprinting tangible personal property performed for a person who directly or indirectly furnishes the tangible personal property upon which such services are performed. See Tax Law § 1105(c)(2). Under Petitioner's Discount Coupon Service, a coupon for

use by the customer in making purchases from the merchant is printed on the customer's receipt relating to its merchandise return transaction. It appears that the printing is performed on the merchant's POS register paper tapes using the merchant's POS equipment. It does not appear that Petitioner is selling the merchant printed coupons that might be considered taxable tangible personal property. Likewise, it does not appear that Petitioner is selling a printing service to the merchant. Petitioner does not contract to print any set amount of coupons and is not compensated based upon the number of printed coupons that may be generated. Under Petitioner's Discount Coupon Service, as described above, Petitioner is designing, developing, and implementing a marketing and advertising service. This service is not included in the enumerated services subject to tax under section 1105(c) of the Tax Law.

"Tangible personal property" includes prewritten computer software "regardless of the medium by means of which such software is conveyed to a purchaser." Tax Law § 1101(b)(6). "Prewritten computer software" is software (including prewritten upgrades thereof) that is not designed to the specifications of a specific purchaser. *See* Tax Law § 1101(b)(14). The information Petitioner provided (including sample contracts with its customers) indicates that software is not sold to or licensed to the merchants. Although in some instances the software may be installed or used on a merchant's POS equipment (and with respect to the Discount Coupon Service some software may be necessary in order to direct the actual printing of the coupon on the merchant's POS equipment), it does not appear that the merchants obtain constructive possession or the right to use, control, or direct the use of the software. *See* Sales and Use Tax Regulations §526.7(e)(4). Accordingly, we conclude Petitioner is not selling software to its customers. Rather, Petitioner is the user and consumer of its software in the provision of both its Discount Coupon Service and Authorization Service to merchants. Petitioner must pay sales or use tax on its purchase or use of the software within New York State.

Under Petitioner's pilot programs, as described by Petitioner and set forth in its contracts, it appears that Petitioner is the user and consumer of the equipment provided to merchants for use during the pilot periods for Petitioner's services. Petitioner retains title to the equipment. Petitioner makes no separate charge for such equipment during the pilot period. Thus, we conclude that Petitioner is not selling this equipment, but is using the equipment to provide its services. Accordingly, Petitioner must pay sales or use tax on its purchase or use of the equipment within New York State.

The sales tax is a "destination tax." The point of delivery for sales of property or services controls both the tax incidence and the tax rate. *See* 20NYCRR 525.2(a)(3); N-90-20. Petitioner's charges to a merchant for the Authorization Service it provides are generally based upon the number of merchant locations which use the service. Petitioner may allocate its receipts from the sales of this service between the number of a merchant's locations within New York and those locations outside New York where the merchant's use of the service has been authorized. *See KPMG, LLP*, TSB-A-03(5)S.

DATED: October 14, 2010

/s/

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Deputy Commissioner and Counsel

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