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

TSB-A-13(12)S
Sales Tax
April 23, 2013

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

<u>ADVISORY OPINION</u>   <u>PETITION NO. S110913A</u>

The Department of Taxation and Finance received a Petition for Advisory Opinion from Petitioner ██████████. Petitioner asks whether its investment management product ("Product A") is subject to sales and use tax. We conclude the following: (1) Petitioner's receipts from the sale of Product A are not subject to sales and use tax because Product A constitutes a nontaxable service; (2) Petitioner must pay tax on any of the taxable inputs used in providing that service; (3) Petitioner's sales of third-party information services for which it makes a separate charge are taxable, but its purchases of those services would qualify for the resale exclusion.

Facts

Petitioner is a financial services firm that provides investment management and risk management services to clients. Specifically, Petitioner provides Product A, which is a fully integrated enterprise portfolio management support service for financial institutions and other investment managers. The service includes: customized investment analysis and reporting; data control and operations; compliance evaluation and reporting; customized trade management workflow; daily support and ongoing service enhancements; and ancillary services. In general, the contract does not limit how much of each of the components of Product A that Petitioner must perform in any contract year. Moreover, customers use the different components in different proportions without incurring extra charges as a result. For example, two otherwise similarly situated customers—with the same assets under risk management, same number of portfolios, and the same number of employees interfacing with petitioner—would in general incur the same charges even though one requests more dynamic risk analyses reports, while the other requires more compliance coding and re-coding. While many aspects of Product A are customized, Product A always includes the above components, with the only variation being that different clients may opt to access different third-party data sources through Product A, as discussed below.

Product A is a labor-intensive service that requires a significant employee resource commitment from Petitioner. To perform Product A, Petitioner provides between 3 and 15 full-time equivalent personnel for each Product A client, including those types described below. Petitioner provides dedicated support personnel who are responsible for any issues relating to the daily service requests, administrative tasks, and analytic and reporting issues. As part of Product A, Petitioner's highly educated and experienced team of financial and portfolio analysts regularly apply their knowledge and judgment to perform services related to each client's unique portfolios, as described more fully herein. Petitioner utilizes a range of skilled professionals to perform Product A, including: analytics specialists, portfolio analysts, relationship managers,

data integrity specialists, technology and interfacing specialists, product developers, and financial modeling specialists.

a.   *Implementation & Platform*

Product A requires a tremendous amount of information to be transferred on a daily basis between Petitioner and a client, as well as to third parties involved in a client's investment management activities. Petitioner creates a customized platform, which is delivered via a private network through a web interface, for each client as a means to obtain and transfer such information and facilitate a client's business processes. Each client's dedicated, private platform allows the Petitioner and the client to electronically exchange information, including information originating from, and distributed to, third parties involved in the client's investment management activities.

Petitioner purchases, builds, and configures the technological infrastructure—including telecommunications and dedicated databases—to establish and support the client platform, which is then accessed by the client through its own network via a web interface. Petitioner dedicates a team of skilled analytical, implementation, product specialist, and technology employees to implement the electronic platform for each client, which is the foundation for a long-term service relationship between Petitioner and each Product A client. The implementation process is customized and configured based upon the needs of the client and can take upwards of a year to complete. Petitioner charges an implementation fee on a monthly basis during the implementation period that is separate and distinct from Product A's ongoing service fees. The average Product A implementation takes approximately 12 months and has an implementation fee over $1 million. Product A contracts generally include a five year term commitment.

Petitioner generally provides Product A to its clients during business hours from Monday through Friday. During non-business hours each business night, Petitioner's employees perform data quality control, analytical review, report production and exception support, and production support necessary to provide the services discussed above, including reviewing risk analysis reports and performing various administrative tasks.

Product A's platform is maintained on databases and servers owned by Petitioner. The client accesses the platform through a web interface by entering password information. Once on the platform, a client may initiate a trade, review the balances in its portfolios, use third-party financial analysis tools, use the Analytical Calculator, etc.

Petitioner procures and maintains the telecommunication services necessary to connect Petitioner's data centers to client's data centers and to allow the client's employees, through the client's internal network, to connect to the Product platform.

The investment management services, trading platform, and key functionality of Product A are not made separately available for sale as part of any other product.

b.   *Product A: Portfolio Management Workflow Service*

1. Customized Investment Analysis Services

Petitioner provides two types of risk analysis services as part of Product A, daily risk analysis and reporting ("daily risk analysis service") and dynamic ad hoc risk analysis ("Ad Hoc Risk Analysis").

The daily risk analysis service will analyze the client's portfolio and position information as they stand at the conclusion of a day of trading using a previously specified set of analyses and tests. Petitioner has developed proprietary risk models incorporating over 1,500 global risk factors, which Petitioner employs to create customized analyses and reports for each client on a daily basis. Petitioner's employees review each daily analysis, as required by the contract, before providing Petitioner's customized suite of risk reports to each of its clients.

Petitioner's daily risk analysis service computes the performance of each client portfolio to track investment performance and identifies and analyzes risk associated with client portfolio investments. At the end of each month, Petitioner performs a customized analysis of monthly portfolio performance to attribute profits and losses to various factors, including interest rate exposure, credit risk, foreign currency risk, market exposure, etc. Similar to the other reporting services offered within Product A, Petitioner's skilled employees review and perform quality control for each performance attribution report before release to its clients.

Petitioner sells its daily risk analysis service separate from Product A, in which case it collects sales tax on those sales. When sold as a stand-alone offering, the daily risk analysis service requires comparatively minimal implementation and requires only a two to three-year commitment. The daily risk analysis service, when sold alone, generally does not include any holdings-based performance attribution and never includes daily transaction-based performance calculations because Petitioner needs transaction-based data to perform those analyses which it generally does not have when it sells its daily risk analysis service as a stand-alone product. In a limited number of cases, the stand-alone daily risk analysis service may include holdings-based performance attribution, which is generally of more limited utility to the client.

The daily risk analysis service performs a daily, scheduled analysis (i.e., using portfolio positions and balances as they exist at the end of a business day). In contrast, Product A's Ad Hoc Risk Analysis service can use real-time and/or historical portfolio data maintained as part of Product A. Moreover, the Ad Hoc Risk Analysis service also provides a much more sophisticated and resource-intensive level of analysis, as it may involve several analysts performing a stress test analysis using several variables. The Ad Hoc Risk Analysis service analyzes a client's current portfolio investments under various potential scenarios, which can be based on the client's individually provided assumptions. Petitioner's analysts perform basic sensitivity analyses, full scenario analyses, and scenario stress testing analyses. Requests for the Ad Hoc Risk Analysis service are originated by the client and generally necessitate significant interaction between the client and Petitioner's analysts to understand the nature and scope of the

Client's request. Based on those interactions, the analyst or a team of analysts will choose an existing type of analysis that addresses the client's concern or develop a new one. The design of these dynamic risk analyses will depend crucially on the expertise of Petitioner's financial analysts. Petitioner maintains that Product A's exceptional value is derived from its comprehensive and customized dynamic analyses.

2. Data Control and Operations Services

As part of Product A, Petitioner provides a dedicated database for maintaining each client's portfolio information, including positions, transactions, prices, security data, and analytics. This approach is designed to enhance data integrity and significantly reduce operational risk while simultaneously increasing operating leverage and consistency.

Petitioner provides data management support for numerous third-party data sources that are used by its clients, including security indicative data, pricing services, index providers, rating agencies, and other client-specific data sources. As part of the daily support services, Petitioner maintains relationships and interfaces with these third party data providers and quality controls the data each day on behalf of its clients. Petitioner ensures that these interfaces are operational and provides reports to its clients notifying them of data anomalies that may require correction.

Petitioner also maintains each client's portfolio-related data, including each client's unique portfolio structure and investment positions, which only the client can access through Product A. Petitioner maintains trade settlement, broker dealer, and custodian data management for its clients necessary to facilitate a client's order management process from trade execution through post-trade functions, including trade confirmation processing, portfolio compliance, and corporate action processing. Product A also facilitates communication to third parties related to trade activity, including to counterparties, brokers, electronic communications networks, and custodial banks. The trade execution and post-trade operational workflow is supported by real-time reporting on transaction status. Further, Petitioner facilitates a daily reconciliation of a client's positions and cash activity to other third party sources, such as a client's custodial bank.

3. Customized Trade Management Workflow Services

Petitioner supports each client's trade execution process as part of Product A by facilitating trade allocation, order entry, and trade capture. Petitioner also obtains and reports the status of all client investments covered in Product A, including the status of trades routed to or from third party electronic trade execution services (e.g., Bloomberg, Tradeweb, FXall, etc.). Product A clients contract directly with these third party service providers. Petitioner provides an interface between the client and these third parties, but does not contract with them on behalf of Product A clients.

The trade management workflow services integrate each client's portfolios with third party industry tools, which allow clients to manage all of their investments in one place. Petitioner constantly provides interface support and maintenance services with third parties, such

as data providers and a client's custodians, to facilitate access to current data, pricing, and position information. In some cases, the client contracts direct with the seller of the third-party data. In other cases, Petitioner contracts the right to redistribute third party data from the seller of the third-party data, in which case Petitioner acts as a redistributor of the third party data and then generally passes the cost on to the customer.

4.   Compliance Evaluation and Reporting Service

Petitioner provides a comprehensive portfolio compliance evaluation service for Product A clients. Clients provide Petitioner with their unique portfolio and investment restrictions and compliance parameters for each of their portfolios to ensure compliance with each portfolio's trading strategy and related requirements. Petitioner codes each unique compliance rule and maintains them on behalf of each client. The compliance evaluation service is highly personalized; Petitioner adapts the compliance service within Product A as each client's portfolio evolves. Petitioner uses information garnered through the compliance reporting process to consult with clients and recode rules as necessary. Petitioner analyzes each potential trade against predetermined compliance rules before a client can execute a trade. Petitioner provides alerts to a client's compliance officers of any violations of the compliance rules. Petitioner's compliance evaluation service requires designated client personnel to authorize transactions relative to certain compliance levels and exceptions. In addition to pre-trade compliance analysis, Petitioner provides reporting each day on the prior business day's compliance activity on a post-trade basis.

5.   Daily Support and Service Enhancements

Petitioner provides daily support to Product A clients through a robust Solutions Center and relationship management function. Petitioner's Solutions Center provides daily support and training covering administrative requests, analytic requests and questions, training, and business process support. This team supports numerous daily requests unique to each client, which may range from portfolio setup and compliance coding to complex analytical questions. More significant requests and service enhancements are handled by a dedicated team of Petitioner employees who perform a relationship management function.

As a client's needs evolve in response to developments in the capital markets and changes in business processes, Petitioner enhances its models, services, and workflow support to accommodate its clients' needs. These ongoing service enhancements and improvements are included in the Product A fees.

6.   Desktop Analytical Calculator

Petitioner provides a desktop analytical calculator ("Analytical Calculator") within Product A that allows clients to perform interactive options-adjusted and static analyses on the global universe of fixed income securities and derivatives. This Analytical Calculator provides clients with real-time interactive access to analytics used to perform relative value, trading, and

risk analyses. Through this Analytical Calculator, clients can access Petitioner's models and modify assumptions to meet their specific needs. Adjustable factors include structure and prepayment modeling, cash flow generation, and option pricing. The Analytical Calculator is available for sale as a stand-alone offering. When sold as a separate product, the Analytical Calculator does not require any implementation and requires only a one-year term commitment.

> c.   *Petitioner's Web Site's Description of Product A*

Petitioner's website advertises Product A as follows:

> With [Product A], [Petitioner] is unique in its ability to provide a fully integrated enterprise investment solution. [Product A's] investment management platform combines sophisticated risk analytics with portfolio management, trading, and operations tools to support a consistent, efficient and controlled investment process.

> *   *   **

> As a comprehensive platform, [Product A] provides a centralized database for maintaining financial information including positions, transactions, prices, security data and analytics. This approach is designed to eliminate redundant data input, enhance data integrity and significantly reduce operational risk while simultaneously increasing operating leverage and consistency.

> d.   *Product A Fees*

Petitioner charges an annual fee for all of the services included in the Product A service offering discussed above. The minimum fee for Product A is over $1 million per year. The average Product A fee is a multiple of the $1 million per year minimum fee during the five-year term of the client agreement, which increases based on measurable metrics that are indicative of the extent of the client's overall use of the service and overall complexity.

Charges for ancillary services (i.e., the financial calculator and the daily risk analysis service), if purchased as a stand-alone offering, are small compared to Product A fees. The average charges for an Analytical Calculator client or Risk Reporting client are usually less than 10% of the average Product A charge. Petitioner does not charge an implementation fee for either ancillary service.

Analysis

The Tax Law imposes sales tax on retail sales of tangible personal property and certain enumerated services (*see* Tax Law § 1105[a],[b], and [c]). The definition of tangible personal property includes "prewritten computer software" (Tax Law § 1101[b][6]). The sale of prewritten software is taxable if it results in a customer receiving the right to use the software in New York, whether or not the software is actually downloaded in New York (*see*

TSB-A-08(62)S). Among the services made taxable is intrastate telecommunications (*see* Tax Law § 1105[b][1][B]). Another taxable service is the tax on information services, which excludes "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" (Tax Law § 1105[c][1]).

Many of the components of Product A seem to qualify as taxable when viewed separately. For example, Petitioner provides the telecommunication connection between the client's data center and Petitioner's data center, which would appear to be taxable under Tax Law section 1105(b)(1)(B) to the extent that the telecommunication was intra-state in nature. The web interface is built on prewritten software which is then customized to meet the needs of a particular client. The prewritten portion of that software would be taxable as tangible personal property (*see* Tax Law §§ 1101[b][6]; 1105[a]). Also, Product A's financial calculator and daily risk analysis service would appear to qualify as taxable information services (*Matter of DZ Bank,* Tax Appeals Tribunal, May 11, 2009).

Petitioner makes only a single charge for Product A, leaving aside its sales of third-party information services to some customers. Thus, a threshold question here is whether Petitioner should be seen as bundling taxable products with nontaxable products for a single price (*see* Sales Tax Reg. § 527.1[b]) or whether, alternatively, Petitioner should be seen as selling a single, integrated product (*see, e.g., Matter of SSOV '81 Ltd.,* Tax Appeals Tribunal, January 19, 1995). In light of the following circumstances, we think it is appropriate to treat Product A as a single integrated product. First, Product A doesn't come in multiple variants: it always includes the elements described above, with the only variation being the availability of additional third-party information sources. Secondly, customers use the different components in different proportions without incurring extra charges as a result. Thirdly, the different components of Product A are highly synergistic. For example, the value of the dynamic risk analysis service is its timeliness: the client is able to see the risk characteristics of its holdings even as those holdings change minute to minute. Key to Petitioner's ability to deliver this service is that, as part of Product A, Petitioner maintains the databases containing the information about the client's positions, all trades and confirmations of trades are routed through it, and it performs the trade allocations. Moreover, Petitioner's risk analysis services are made more reliable because, as part of Product A, Petitioner performs data integrity control on the third-party data that is incorporated into those risk analyses.

The comprehensive, integrated nature of Product A makes it similar to the "integrated [information technology] management and monitor service," which was held to be nontaxable in TSB-A-10(14)S because it constituted an information technology "operations and management" contract. Here, Product A appears to constitute a nontaxable operations and management contract for investment portfolio managers. This view of Product A is consistent with the way in which Petitioner advertises the service, as discussed above. Petitioner's implementation fee appears to be another way of charging for Product A and therefore it is similarly nontaxable (*see* TSB-A-11[17]S [Petitioner's service for managing e-mail campaigns is found taxable as the sale of prewritten software; its "set-up" fee for implementing that service is also found to be taxable as additional consideration for the e-mail campaign management service]).

Petitioner sometimes purchases third-party information services for individual customers who request them and is subsequently reimbursed by the customers. Since these are not an invariable part of Product A, their taxability is to be determined separate from Product A. In getting reimbursed from its customer, Petitioner is selling the information services and must register as a vendor and collect tax on those sales (*see* Tax Law § 1105[c][1]; Tax Law § 1101[b][3][definition of "receipt"]; *e.g., Stouffer Management Food Service Inc. v. Tully,* 98 Misc.2d 1128, 1130 (1978), *aff'd*, 69 A.D.2d 1023 [a business's reimbursement of costs incurred by a food service company, under contract to operate an in-house restaurant serving employees of the business's client, constituted "sales" that rendered the reimbursed costs taxable]). However, because Petitioner is reselling those third-party information services, it may buy those information services without paying sales tax by providing the vendors with resale certificates (*see* Tax Law § 1132[c][1]; Sales Tax Reg. § 532.4[b][2]).

Consistent with that conclusion, Petitioner's purchases of taxable items that it uses in providing Product A will not qualify for the resale exclusion because those items are not being resold (see Tax Law § 1101[b][4]).

Finally, as discussed, Petitioner's daily risk analysis service and analytical calculator qualify as taxable information services because they involve the transfer of information and do not qualify for the personal or individual exclusion (*see DZ Bank, supra*; TSB-M-10(7)S). Therefore, Petitioner must collect tax on those services when it sells them separately (*see* Tax Law § 1105[c][1]).

DATED: April 23, 2013

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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. The information provided in this document does not cover every situation and is not intended to replace the law or change its meaning.