New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-90(1)S
Sales Tax
December 19, 1989

STATE OF NEW YORK

COMMISSIONER OF TAXATION AND FINANCE

<u>ADVISORY OPINION</u>   <u>PETITION NO. S890324B</u>

On March 24, 1989, a Petition for Advisory Opinion was received from Nomura Securities Inc., 180 Maiden Lane, New York, New York 10038.

The issue raised is whether the certain corporate transfers and sales will be excluded from the definition of retail sale under Section 1101(b) of the Tax Law and thus will not be subject to sales tax under Section 1105(a) of the Tax Law.

Nomura Securities International, Inc, hereinafter referred to as NSI, a Delaware corporation subject to tax under Article 9-A of the New York State Tax Law, is considering restructuring its various operations. NSI currently holds two classes of assets, Group I and Group II assets. Group I assets are principally computer hardware and software comprising NSI's "Tradepro" system. This computer system is still under development and is expected to be used in their securities trading operations. The computer software was originally acquired by NSI as a prewritten program for $2,500,000. Such prewritten program required an analysis of NSI's requirements by the supplier thereof prior to NSI purchasing it. NSI then spent an additional $23,500,000 to have the program customized to its specifications for use in its securities trading operations. This customization is not fully completed; therefore, NSI and U.S. Sub will incur additional programming costs. NSI's ownership of the software is evidenced by a copyright. Group II assets consist of furniture and equipment used in the ordinary course of business. Group I and Group II assets are located in New York.

The Nomura Securities Co., Ltd., hereinafter referred to as NSC, is a corporation formed under the laws of Japan. NSC owns 100% of the stock of NSI. NSC is not engaged in business in New York State. NSC intends to, in transaction 1, form a new United States corporation, hereinafter referred to as USHC, in exchange for 100% of the stock of USHC and contribute the NSI stock to the capital of USHC.

NSI, thereafter, in transaction 2, will distribute to USHC only that portion of Group I assets consisting of computer hardware and operating system and all of Group II assets.

Thereafter, in transaction 3, USHC will form a United States subsidiary, hereinafter referred to as U.S. Sub, and contribute the Group I assets received from NSI to the capital of U.S. Sub solely in exchange for 100% of the common stock of U.S. Sub. NSI will then sell the remaining assets in Group I (i.e., the customized computer software) by transferring the copyright for such assets to U.S. Sub at the fair market value, which at this time is believed to approximate its cost of $26,000,000.

Also being transferred with the copyright are the intangible technological know-how and other proprietary rights in the software (collectively the "Customized Computer Software").

NSI would retain the right and continue to use, in New York, the "Tradepro" system (including any subsequent modifications or improvements) in its trade or business on a fee basis.

Section 526.7 of the New York State sales and use tax regulations defines "Sale, selling or purchase, (a) . . .

(1)	The words sale, selling or purchase mean any transaction in which there is a transfer of title or possession, or both, of tangible personal property for a consideration.

(b). . . The term consideration includes monetary consideration, exchange, barter, the rendering of any service, or any agreement therefor. Monetary consideration includes assumption of liabilities, fees, rentals, royalties or any other charge that a purchaser, lessee or licensee is required to pay."

Section 526.6(d) of the Sales and Use Tax Regulations provides:

(1) The following transfers of property are not retail sales:

*		*		*

(iv) The transfer of property to a corporation upon its organization in consideration for the issuance of stock.

*		*		*

(8)(ii) The transfer of property to a corporation, as a contribution to capital, at a time other then its organization, without the issuance of stock or other consideration, is not a retail sale.

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The tax status of receipts from computer program ("software") sales and services is explained in Department of Taxation and Finance Technical Services Bulletin 1978-1(S), issued February 6, 1978 as follows:

> "Software [means] instructions and routines which, after analysis of the customer's specific data processing requirements, are determined necessary to program the customer's electronic data processing equipment to enable the customer to accomplish specific functions

with his EDP system. To be considered exempt 'software' for purposes of this bulletin, one of the following elements must be present:

A. Preparation or selection of the program for the customer's use requires an analysis of the customer's requirements by the vendor.

<div align="center">or</div>

B. The program requires adaptation, by the vendor, to be used in a specific environment i.e., a particular make and model of computer utilizing a specified output device. For example, a software vendor offers for sale a pre-written sort program which can be used in several computer models. Prior to operation, instructions must be added by the vendor which specify the particular computer model in which the program will be utilized.

The software may be in the form of:

a. <u>Systems programs</u> (except for those instruction codes which are considered tangible personal property in paragraph 1 above) - programs that control the hardware itself and allow it to compile, assemble and process application programs.

b. <u>Application programs</u> - programs that are created to perform business functions or control or monitor processes.

c. <u>Pre-written programs (canned)</u> - programs that are either systems programs or application programs and are not written specifically for one user.

d. <u>Custom programs</u> - programs created specifically for one user.

Software meeting the above criteria, whether placed on cards, tape, disc pack or other machine readable media or entered into a computer directly, is deemed to be intangible personal property for sales tax purposes, and as such its sale is exempt from New York State and local sales and use taxes. Software or programs which do not meet the criteria are subject to tax.

An application of the above rules to the facts as stated by the Petitioner results in the following conclusions:

Transaction 1, will be an exchange of stock for stock which is a transaction that is not a sale as defined in Section 526.7 of the Sales and Use Tax Regulations and thus is not subject to the tax imposed under Section 1105(a) of the Tax Law.

In transaction 2, if the entries on the books of USHC document the acquisition of the assets as a legitimate contribution to capital, such transaction will not be subject to the tax imposed under Section 1105(a) of the Tax Law because the transfer is not a retail sale in accordance with the meaning and intent of Section 526.6(d)(8)(ii) of the Sales and Use Tax Regulations.

Transaction 3, in which USHC upon forming its subsidiary will exchange assets for stock, is a transfer that is not subject to the tax imposed under Section 1105(a) of the Tax Law because it is not a retail sale in accordance with the meaning and intent of Section 526.6(d)(1)(iv) of the Sales and Use Tax Regulations. The sale of the software as described by Petitioner meets the criteria set forth in Technical Services Bureau Bulletin 1978-1(S) and is therefore exempt since it is not a sale of tangible personal property.

DATED: December 19, 1989

s/FRANK J. PUCCIA
Director
Technical Services Bureau

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