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

TSB-A-93 (15)S
Sales Tax
February 26, 1993

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. S920610A

On June 10, 1992 a Petition for Advisory Opinion was received from Nomura Automation Management, Inc., 2 World Financial Center, Building B, New York, NY 10281-1198.

The issue raised by Petitioner, Nomura Automation Management, Inc., is whether the computer software which has been licensed non-exclusively for use by Petitioner is subject to the imposition of sales tax.

Petitioner is in the business of providing customized financial data processing services through the use of its "Tradepro" computer system. "Tradepro" is a back office system which handles numerous functions related to the processing of customer and firm trades. These functions include recording transactions and maintaining trade positions and account balances. In addition, "Tradepro" supports the firms' regulatory and compliance reporting requirements to various external agencies such as the Securities and Exchange Commission, the New York Stock Exchange and the Internal Revenue Service.

Petitioner is currently in the process of obtaining a nonexclusive license from George Davidsohn & Son, Inc., hereinafter "Davidsohn", a corporation organized and existing under the laws of the State of New York and having its principal place of business in New York. The license is for Petitioner to utilize software which Davidsohn is in the process of developing and which will be marketed under the names Autocage and Autobank Pledge (hereinafter collectively called "the software") when it is developed. Petitioner has agreed to be a beta test site for the software, once fully developed, as its initial user.

The software was approximately 60% complete upon execution of the licensing agreement. At that time, and until it is fully developed the software is not of any utility. Davidsohn will complete the programming of the software within approximately six months of the execution date of the agreement, after which time Petitioner will initiate an acceptance test of the software. It is only after this process that the software will be fully developed, and be able to be used for its intended purpose. Once fully developed, Davidsohn will market the completed software to other companies.

Petitioner will incorporate the software upon completion in its already existing "Tradepro" system. It will utilize the software in an effort to further computerize its securities settlement process. The system will add the following automated functionality to the security settlement processes currently utilized by Petitioner: 1) The software will allow for multi-company processing. 2) Updates to the system database are to be made on a real-time basis; and 3) Many of the current manual processes will be automated, and additional functionality for collateral financing will be added.

Petitioner has also retained the right to license the software (once fully developed) to other companies, but only as a part of the basic securities back office software package which Petitioner currently uses. Davidsohn will be entitled to a fee from Petitioner for any license of software entered into pursuant to the Davidsohn agreement.

Section 1105 of the Tax Law states, in part:

> Imposition of sales tax ..... there is hereby imposed and there shall be paid a tax of four percent upon:
>
> (a) The receipts from every retail sale of tangible personal property, except as otherwise provided in this article.

Section 1101 of the Tax Law states, in part;

> Definitions. - -
>
> (b) 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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> (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.
>
> (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.

Section 1115 of the Tax Law states, in part

> Exemptions from sales and use taxes. -- (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:
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> (28) Computer software designed and developed by the author or creator to the specifications of a specific purchaser which is transferred directly or indirectly to a corporation which is a member of an affiliated group of corporations within the meaning of subparagraph six of paragraph (b) of subdivision seventeen of section two hundred eight of this chapter except for clauses (ii) and (iii) of such subparagraph that includes such purchaser, or to partnership in which such purchaser and other members of such affiliated group have at least a fifty percent capital or profits interest (but only if the transfer is not in pursuance of a plan having as its principal purpose the avoidance or evasion of tax under this article), but in no case including computer software which is pre-written, as defined in paragraph six of subdivision (b) of section eleven hundred one of this article and available to be sold to customers in the ordinary course of the seller's business.
>
> (o) Services otherwise taxable under subdivision (c) of section eleven hundred five or under section eleven hundred ten shall be exempt from the 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 or 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.

In the instant matter, the software developed by Davidsohn was approximately 60% complete at the time of execution of the licensing agreement between Petitioner and Davidsohn.

Section 1101(b)(14) of the Tax Law defines prewritten computer software, in part, to be "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." Accordingly, the portion of the software (approximately 60%) which had been developed by Davidsohn prior to the licensing agreement between Petitioner and Davidsohn is considered to be prewritten software and the receipts attributable to the sale of the prewritten software are subject to the tax imposed under Section l105(a) of the Tax Law.

The receipts attributable to the sale of the portion of software which Davidsohn developed subsequent to the licensing agreement between Petitioner and Davidsohn will not be subject to the tax imposed under Section 1105(a) provided that such portion of the software was designed and developed to Petitioner's specifications.

The exemption from sales tax provided under Section 1115(a)(28) of the Tax Law will not apply to the instant transaction. The exemption will apply to any subsequent transaction where Petitioner transfers the software licensed from Davidsohn to a corporation that is a member of an affiliated group of corporations which includes Petitioner or to a partnership in which Petitioner and other members of such an affiliated group have at least a 50 percent capital or profits interest. However, the exemption will not apply to any receipts attributable to the prewritten portion of the software as discussed above, nor if the sale or transfer of the software is part of a plan to avoid or evade the tax.

Receipts from charges for the maintenance of the software will be exempt from sales tax under the provisions of Section 1115(0) of the Tax Law. However, it is noted that where a software maintenance agreement provides for the sale of both taxable elements (prewritten software upgrades) and nontaxable elements (training, consulting, diagnostic and trouble shooting support, etc.) the charge for the entire maintenance agreement will be subject to tax unless the charge for the nontaxable elements is reasonable and separately stated in the maintenance agreement and separately billed on the invoice or other document of sale given to the purchaser.

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 the specific purchaser will be exempt as a sale of custom software.

DATED: February 26, 1993

/s/
PAUL B. COBURN
Deputy Director
Taxpayer Services Division

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