

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

TSB-A-97(45)S
Sales Tax

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S970214A

On February 14, 1997, the Department of Taxation and Finance received a Petition for Advisory Opinion from Software Dynamics, Inc., 9400 Topanga Canyon Boulevard, Suite 200, Chatsworth, CA 91311. Petitioner, Software Dynamics, Inc., provided additional information pertaining to the Petition on April 28, 1997.

The issue raised by Petitioner is whether its computer software development activities constitute custom programming.

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

Petitioner develops, licenses and supports software for banks and financial institutions. This software allows microcomputers on the bank platform or tellers' windows to interface with the bank's mainframe computer, linking the institution's unique mainframe computer system into PC-based bank platform and teller lines. The software is described as "platform Plus" or "teller Plus" depending on whether the software will be used on the platform or at the teller's window. Because each bank has differing requirements (both hardware and presentation), the software is not licensed in an "off the shelf" form. It is not offered to the public in general as it requires significant programming to customize it to each client's unique system configuration and needs.

The software programs are created from start to finish for each customer's particular needs. To write these unique software programs, Petitioner uses some pre-written subroutines within the unique software specifications of its clients. For example, a program may contain a standard "Print" routine, but the rest of the program would be unique. These prewritten functions or routines are not programs but do become part of the custom programs that are written for each specific customer. None of these routines will work or perform any function on their own, nor can they be separately sold. They require a mainframe interface and "hooks" which, by necessity, are specific to each customer.

A customer is required to pay an annual license fee in order to continue to use the software. There is also an optional maintenance fee, which allows the user to receive customer support and updates.

Applicable Law and Regulations

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.

Sections 1101(b)(6) and 1101(b)(14) of the Tax Law were amended and added, respectively, by Chapter 166, Laws of 1991, effective September 1, 1991.

Section 1101(b) of the Tax Law states, 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:

* * *

(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 1105(c) of the Tax Law imposes tax on the receipts from every sale, except for resale, of certain enumerated services.

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, TSB-M-93(3)S, March 1, 1993, pertaining to the taxability of computer software and certain related services 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 software, even though modified or enhanced to the specifications of a specific purchaser, remains prewritten software subject to tax. However, if a charge for the custom modification or enhancement is reasonable and separately stated on the invoice or billing statement, then the separately stated charge for the custom modification or enhancement is not subject to tax.

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.

The incidental use of a development language (e.g., COBOL, BASIC, C, etc.) or of libraries of "prewritten" functions or routines in designing and developing a "custom" software program to the specifications of a specific purchaser will not, in and of itself, make the sale of an otherwise custom program taxable. The "custom" program must be examined as a whole to determine whether it is exempt from tax. If the prewritten components of a custom program are sold separately, their sale is subject to tax.

Opinion

Petitioner writes software which is not retail merchandise, is not sold in stores to the general public, and is not readily transferable from one computer to another. Each program is written separately for each customer and is tailored to the specific requirements of the end user.

In this case, Petitioner contends that the software it sells does not fall within the definition of pre-written software as described in Tax Law Section 1101(b)(14) because the pre-written subroutines it uses in software development meet the criteria for "incidental use" described in TSB-M-93(3)S, supra. Petitioner states that it uses some pre-written subroutines within the unique software specifications of each customer. The use of these routines, if they are simply pre-written lines of code, e.g., a "Print" routine, would not turn Petitioner's software program into a pre-written program, provided they are used only incidentally in the design and development of the custom program (see TSB-M-93(3)S, supra). Under these circumstances, the sale of Petitioner's software would not be subject to sales tax.

However, if Petitioner is merely selecting and enhancing a particular pre-written program for each customer, or is designing a personalized computer program by configuring the proper combination of software modules (some of which are pre-written), the modifications would not affect the software's overall character as pre-written software. Accordingly, Petitioner's receipts from the sale of its software and any charges to modify such software would be subject to sales and use taxes, unless charges for the pre-written portion and the modifications are separately stated on an invoice or other statement given to the purchaser. If separately stated, the modifications would not constitute pre-written computer software and these fees would not be subject to sales tax (see State Tax Resources Group, Adv Op Comm T&F, July 11, 1996, TSB-A-96(44)S).

Moreover, pursuant to Section 1115(o) of the Tax Law, the entire charge for services performed under a software maintenance agreement which provides for the sale of both taxable elements (e.g., pre-written software upgrades) and nontaxable elements (e.g., training, consulting, diagnostic and troubleshooting support) is subject to tax, unless the charge for the nontaxable elements is reasonable and separately stated in the agreement and separately billed to the purchaser (see Arthur Andersen and Co., Adv Op Comm T&F, November 8, 1991, TSB-A-91(70)S and State Tax Resources Group, supra).

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It is not within the scope of this Advisory Opinion, based on the information submitted, to determine questions of fact such as whether the pre-written subroutines Petitioner uses are in each case merely incidental to its development of custom software.

DATED: July 23, 1997

/s/
John W. Bartlett
Deputy Director
Technical Services Bureau

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