New York State Department of Taxation and Finance

Taxpayer Services Division

Technical Services Bureau

TSB-A-98(71)S
Sales Tax
October 9, 1998

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION   PETITION NO. S970625A

On June 25, 1997, the Department of Taxation and Finance received a Petition for Advisory Opinion from Virtual Systems Group, LLC, 6337 Dean Parkway, Ontario, NY 14519.

The issue raised by Petitioner, Virtual Systems Group, LLC, is whether the charges for certain high-end technology services it provides are subject to sales and/or use tax.

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

Petitioner is a professional technical services company which selects computer systems solutions for its customers based on their specific business needs. Petitioner provides insight into computer technology to its customers while focusing on practical business solutions for them. Petitioner specializes in systems integration and provides distributed (multiple) systems life cycle management, i.e., it takes whatever steps are necessary to link computer systems together through the process of design, development, testing, implementation and support. Petitioner may sell and install computer hardware in conjunction with these services. Using key inputs from customers, Petitioner provides project management, consulting and technology planning services for technology implementation, as well as installation, maintenance and end-user training and support in the latest software packages, including MS Office 97, Lotus Notes, CCMail, MS Exchange and NT Client. Petitioner offers all of these services either separately or as part of a total solutions package.

Applicable Law and Regulations

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:

* * *

(5) Sale, selling or purchase. Any transfer of title or possession or both, exchange or barter, rental, lease or license to use or consume (including, with respect to computer software, merely the right to reproduce), conditional or otherwise, in any manner or by any means whatsoever for a consideration . . .

(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 of the Tax Law provides, 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.

* * *

(c) The receipts from every sale, except for resale, of the following services:

* * *

(3) Installing tangible personal property . . . or maintaining, servicing or repairing tangible personal property . . . not held for sale in the regular course of business, whether or not the services are performed directly or by means of coin-operated equipment or by any other means, and whether or not any tangible personal property is transferred in conjunction therewith. . . .

Section 1110(a) of the Tax Law provides, in part:

Except to the extent that property or services have already been or will be subject to the sales tax under this article, there is hereby imposed on every person a use tax for the use within this state on and after June first, nineteen hundred seventy-one except as otherwise exempted under this article, (A) of any tangible personal property purchased at retail . . . (D) of any tangible personal property, however acquired, where not acquired for purposes of resale, upon which any of the services described in paragraphs (2), (3) and (7) of subdivision (c) of section eleven hundred five have been performed . . . and (F) of any computer software written or otherwise created by the user if the user offers software of a similar kind for sale as such or as a component part of other property in the regular course of business.

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.

Section 527.5 of the Sales and Use Tax Regulations provides, in part:

(a) *Imposition*. (1) The tax is imposed on receipts from every sale of the services of installing, maintaining, servicing or repairing tangible personal property . . . .

(2) Installing means setting up tangible personal property or putting it in place for use.

*   *   *

(3) Maintaining, servicing and repairing are terms used to cover all activities that relate to keeping tangible personal property in a condition of fitness, efficiency, readiness or safety or restoring it to such condition.

Technical Services Bureau Memorandum TSB-M-93(3)S, dated March 1, 1993, entitled State and Local Sales and Compensating Use Taxes Imposed on Certain Sales of Computer Software, 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 <u>prewritten computer software</u> and subject to such taxes. . . . <u>The only software that is exempt from sales and use taxes under the new law is software designed and developed to the specifications of a specific purchaser.</u> (Emphasis added)

<u>Prewritten computer software</u> is any computer software that is not designed and developed by the author or other creator to the specifications of a specific purchaser.

The sale of prewritten software includes any transfer of title or possession, any exchange, barter, rental, lease or license to use, including merely the right to reproduce, for consideration....

*   *   *

Prewritten software is subject to tax whether sold as part of a package or separately. Software created by combining two or more prewritten programs or portions of a prewritten program is still prewritten software subject to tax. The medium by which the software is transferred to the purchaser has no effect on the software's taxability. Thus, prewritten software is taxable whether sold, for example, on a disk, tape or by electronic transmission over telephone lines.

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.

*   *   *

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.

*   *   *

<u>Sale of Software Upgrades</u>

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 that specific purchaser would be exempt as custom software.

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Customer Support and Related Services

        . . . charges for customer (user) support or for information services provided by a vendor to a customer, either in person or by some type of telecommunications arrangement (e.g., telephone, modem, facsimile machine, etc.), in the nature of training, consulting, instructing or other diagnostic or troubleshooting services related to prewritten software are exempt from sales and use taxes where the charges are reasonable and separately stated. Charges for the service of installing, repairing, maintaining or servicing prewritten software are also exempt from sales and use taxes where the charges are reasonable and separately stated on the invoice. (Emphasis added) Of course, any charges for the above described services sold in connection with custom software are exempt from tax.

        Programming and systems analysis are also exempt services. However, where these services are rendered in conjunction with the sale of *prewritten* software, the charge for the service is exempt from tax only when the charge for the service is reasonable and separately stated on the invoice or billing statement given to the customer.

Example 2: A computer vendor sells an "off-the-shelf" software program to a customer. The vendor charges additional fees for installing the software, on-site training, and diagnostic and trouble-shooting customer support. The sale of the software is taxable since it is pre-written. However, the charges for installation, on-site training and customer support services are not taxable if reasonable and separately stated on an invoice or billing statement given to the customer.

Software Maintenance Agreements

        If a software maintenance agreement provides for the sale of both taxable elements (e.g., prewritten software upgrades) and nontaxable elements (e.g., training, consulting, diagnostic and troubleshooting support, etc.), the charge for the entire maintenance agreement is 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.

Example 3: A vendor of computer systems sells a maintenance agreement to provide on-site training, repairs, software

upgrades, and customer support by telephone for a customer's computer system (hardware and prewritten software). The portion of the cost of the agreement allocated to prewritten software upgrades and for repair or maintenance of the computer system hardware is taxable. However, the portion of the cost allocated for on-site training, repairs and maintenance of the prewritten software and telephone support is exempt if the cost is reasonable and separately stated in the written agreement and the customer invoice.

Opinion

Petitioner provides professional technical services relating to the selection of computer systems solutions for its customers, focusing on meeting the specific needs of each business. Section 1105(c) of the Tax Law imposes sales tax on certain enumerated services. Petitioner provides consulting, project management, systems management and complete planning services for technology implementation. These services are not among the enumerated services subject to sales or use tax. Therefore, in those instances where Petitioner enters into a contract to perform consulting, project management, systems management or technology planning, or any combination thereof, without the performance of any other service, and provided that they are not performed for a customer in conjunction with the sale of tangible personal property, the receipts from charges for performing these services will not be subject to sales tax (see Salomon & Leitgeb CPA's, LLP, Adv Op Comm T&F, July 23, 1997, TSB-A-97(44)S).

Petitioner specializes in systems integration, taking whatever steps are necessary and requested by each individual customer to link computer systems together in order for them to function effectively as one. Petitioner may sell and install computer hardware as part of systems integration. Sales of computer hardware are taxable under Section 1105(a) of the Tax Law. The services of installing, maintaining, servicing or repairing tangible personal property are taxable under Section 1105(c)(3) of the Tax Law. If Petitioner's systems integration consists of physical connectivity or the sale and installation of computer hardware, its charges for systems integration are subject to the tax imposed under Section 1105 or Section 1110 of the Tax Law (see David Zucker, Adv Op Comm T&F, September 5, 1996, TSB-A-96(53)S; Neuromedical Systems, Inc., Adv Op Comm T&F, June 14, 1993, TSB-A-93(36)S). If systems integration includes Petitioner's selection and sale of additional software, updates, new products or enhancements in order to accomplish the integration of software packages, Petitioner's charges for such systems integration would be treated as charges for the software, for sales tax purposes (see Moore Business Forms, Inc., Adv Op Comm T&F, February 15, 1995, TSB-A-95(6)S). The taxability of receipts from sales of computer software is explained in TSB-M-93(3)S, supra. To the extent that Petitioner merely selects and sells particular pre-written software programs for its customers, or "designs" a personalized computer software package by configuring the proper combination of software modules (some of which are pre-written), Petitioner's receipts from its customers for the sale of such software and of pre-written updates to such software are considered receipts from sales

of tangible personal property and are subject to the taxes imposed by Section 1105 or Section 1110 of the Tax Law. However, Petitioner's receipts from sales of software designed and developed to the specifications of a specific purchaser, including custom modifications, enhancements and updates, would not be subject to tax provided that Petitioner's charges for them are separately stated on an invoice or other statement given to the customer and the charges are reasonable (see <u>Astrogamma Inc.</u>, Adv Op Comm T&F, June 22, 1992, TSB-A-92(50)S; <u>State Tax Resources Group</u>, Adv Op Comm T&F, July 11, 1996, TSB-A-96(44)S).

It is noted that any nontaxable consulting or system engineering services provided by Petitioner in addition to the systems integration will not be subject to tax provided that the charges for the nontaxable services are reasonable and separately billed on the invoice or other document of sale given to the customer (<u>Moore Business Forms, Inc.</u>, <u>supra</u>).

Petitioner also offers the services of software installation, maintenance, training and end-user support for various software packages. The services of installing, maintaining, servicing and repairing tangible personal property (other than installing tangible personal property which when installed constitutes a capital improvement) are taxable under Section 1105(c)(3) of the Tax Law. However, such services are exempt from tax when performed on <u>any</u> computer software, pursuant to Section 1115(o) of the Tax Law. If these services are provided to the customer in conjunction with the sale of tangible personal property, the charge for such services will be taxable, unless Petitioner separately states the charges for the non-taxable services from the charges for the tangible personal property, and the charges are reasonable. Charges for training and customer (user) support related to pre-written or custom software are exempt from sales and use taxes where the charges are reasonable and separately stated on the invoice (see TSB-M-93(3)S, <u>supra</u>). Accordingly, if Petitioner's charges for software installation, maintenance, training and end-user support are reasonable and separately stated on an invoice from the charges for any additional taxable services or tangible personal property Petitioner concurrently sells to its customer, receipts from such charges are not subject to sales or use tax. Contrarily, if the fees charged for nontaxable services performed in conjunction with the performance of a taxable service and/or the sale of taxable tangible personal property are billed to the customer as a lump sum, the entire receipts from the sale are subject to tax (<u>Software Dynamics</u>, <u>supra</u>; <u>David Zucker</u>, <u>supra</u>).

DATED: October 9, 1998   /s/
                                        John W. Bartlett
                                        Deputy Director
                                        Technical Services Bureau

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