

New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

TSB-A-03(19)S
Sales Tax
May 8, 2003

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S020212A

On February 12, 2002, the Department of Taxation and Finance received a Petition for Advisory Opinion from Doubleclick, Inc., 450 W. 33rd Street, 16th floor, Tax Dept. Attn: Eric Ruff, New York, NY 10001. Petitioner, Doubleclick, Inc., provided additional information pertaining to the Petition on March 25, 2002.

The issue raised by Petitioner is whether, for purposes of the State and local sales and use taxes imposed under Article 28 of the Tax Law and pursuant to Article 29 of the Tax Law, its purchases in 1999 and prior to September 1, 2000, of computer hardware that is used in its business described below qualify for exemption as purchases of production equipment.

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

Petitioner is a digital marketing solutions company whose clients include marketers and Web publishers. Petitioner is headquartered in Silicon Alley in New York City, occupying three floors and over 30,000 square feet. Through its patented DART (Dynamic, Advertising, Reporting and Targeting) ad serving technology, the platform for many of Petitioner's solutions, Petitioner services ads for its clients worldwide, and delivers targeted advertisements to Internet users worldwide.

Petitioner provides the infrastructure that makes marketing work in the digital world. Combining media, data, and technological expertise, Petitioner's products and services enable marketers to timely deliver their advertising message to the appropriate audience, while helping publishers maximize their revenue and build their business online. Through the infrastructure it provides, Petitioner offers planning, execution, measurement, and refinement of online media campaigns to its clients. Petitioner tackles all of these facets of the digital marketing process through its three business units described below.

- **DoubleClick TechSolutions.** Offers publishers, advertisers, and merchants worldwide the leading technology and service bureau solutions for their digital marketing needs. Through its application service provider solutions (DART technology) or licensed software solution (the DoubleClick AdServer software), Petitioner enables Web sites to generate advertising revenue.
- Petitioner's DART technology platform provides Web publishers with a comprehensive solution for ad inventory management and ad targeting, delivery, and reporting, and allows advertisers and their agencies to streamline and control their online ad campaigns right across the Web. When a user visits a site enabled with DART technology, *Image Tags* that are embedded in the page link the user's browser to the DART server and a connection is established between the two. A graphic file is requested from the DART server to fill the ad space on the Web page being loaded

TSB-A-03(19)S
Sales Tax
May 8, 2003

on the user's screen, usually near the top of the page. The user's IP address is referenced and identifies the user. The user's network address is noted. These network addresses are referenced against the DART server's database of more than 400,000 mapped networks. Each mapped network reveals the user's Domain (e.g., att.net, microsoft.com, etc.). DART assembles and reviews all the information it has collected on the user to this point, including referencing the content (news, sports, etc.) of the sites being visited. DART assigns each individual user a unique user ID number, primarily to track the number of times a user has seen each banner in order to control frequency, or deliver sequential banners to that user. DART then scans the many ads waiting for delivery, matching the ad and its targeting criteria with the user and the information gathered. The appropriate ad is selected and delivered to the user within milliseconds. When the user "clicks-through," DART redirects the user's browser to the site that placed the ad.

Since DART is a service, there are no costs associated with lengthy installment periods, and there is no need for Petitioner's client to have an in-house engineering department. There is no equipment to buy, install, maintain, or fix. With one payment, DART includes bandwidth for all ads, in addition to overhead for managing and continually improving the client's system.

Through its DARTmail Service, Petitioner offers its clients e-mail marketing solutions powered by a newly-developed platform based on the DART technology. This service enables Petitioner's clients to deliver highly personalized e-mail communications to their customers for the purposes of building long-term, profitable relationships with their existing customers and acquiring new customers.

- Petitioner's AdServer software products offer its clients online advertising and marketing management software solutions. AdServer software automates critical processes needed to run a successful online marketing business, including sophisticated inventory and order management, precision targeting, dynamic delivery, tracking, and detailed campaign reporting.

DoubleClick TechSolutions' offerings are backed worldwide by support teams offering service 24 hours a day, seven days a week. Petitioner provides comprehensive education and consulting services that help its clients maximize the value of its services and products.

- **DoubleClick Media.** Offers Web publishers the opportunity to participate in and advertisers the opportunity to advertise on the worldwide DoubleClick networks, which provide fully outsourced advertising sales, delivery, and related services to Petitioner's clients. For example, the DoubleClick Network, Petitioner's flagship media product, is a collection of highly-trafficked and branded sites on the Web where Petitioner's clients can advertise. These media purchasing opportunities allow Petitioner's clients to increase revenue without the management costs of running their own sales forces and without incurring the expenses

associated with establishing, maintaining, upgrading, and operating the technology infrastructure for ad delivery.

DoubleClick Media uses the DART and DARTmail technologies to deliver, target, and report on Petitioner's campaigns.

- **DoubleClick Data.** This unit is comprised of two components:

- *Abacus.* Offers information products and marketing research services to the direct marketing industry, both online and offline. Applying advanced statistical modeling techniques to the Abacus Alliance database of consumer purchasing behavior (which contains information contributed by over 1,800 direct marketing members), Abacus identifies those consumers most likely to purchase a particular product or service, and enables its members to reach identified consumers by direct mail and e-mail.

The Abacus Online Alliance was formed in late 1999 to extend the Abacus modeling techniques, alliance relationships, and tools to the Internet and other interactive media.

Also, by combining an expertise in database analysis with DART technology, Abacus enables e-commerce merchants and Web publishers to deliver Web advertising targeted to Internet users based on user interests inferred from anonymous non-sensitive behavioral information.

- *DoubleClick Research.* Offers sophisticated research about the online market and advanced campaign measurement tools and planning systems. Petitioner's targeting planning systems provide advertisers with market research to identify the Web sites visited by their target audience, and allow Web publishers to better define their audience. Such targeting planning systems are Web based, allowing Petitioner's clients to perform searches, queries, and campaign planning on demand.

Additionally, Petitioner's advertising effectiveness studies supply its clients with tools to evaluate the performance and effectiveness of their online marketing efforts using branding based measures. Using survey research, these studies measure audience response to a marketing message.

During an extensive period of capital investments in 1999 and prior to September 1, 2000, Petitioner purchased computer hardware including servers, modems, routers, repeaters, and other similar equipment, used in its business to house client data, client Internet ads, marketing intelligence, and demographics related to its Internet network. None of the referenced computer hardware is used for any administrative, financial, or general business function and it is all physically segregated in its own production area at Petitioner's New York City headquarters.

Applicable Law and Regulations

Section 1101(b) of the Tax Law provides, 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. . . .

Section 1105(a) of the Tax Law imposes sales tax on “[t]he receipts from every retail sale of tangible personal property, except as otherwise provided in this article.”

Section 1105(b)(1) of the Tax Law imposes tax, in part, upon:

The receipts from every sale, other than sales for resale, of . . . (B) telephony and telegraphy and telephone and telegraph service of whatever nature except interstate and international telephony and telegraphy and telephone and telegraph service. . . .

Section 1110(a) of the Tax Law imposes a use tax “for the use within this state . . . of any tangible personal property purchased at retail.”

Section 1115(a)(12) of the Tax Law, as in effect in 1999 and prior to September 1, 2000, exempted from the sales tax imposed by Section 1105(a) and from the compensating use tax imposed by Section 1110 of the Tax Law:

Machinery or equipment for use or consumption directly and predominantly in the production of tangible personal property . . . for sale, by manufacturing, processing, generating, assembling, refining, mining or extracting, or telephone central office equipment or station apparatus or comparable telegraph equipment for use directly and predominantly in receiving at destination or initiating and switching telephone or telegraph communication or in receiving, amplifying, processing, transmitting and retransmitting telephone or telegraph signals. . . . (Emphasis added)

Section 1115(a)(35) of the Tax Law, as in effect in 1999 and prior to September 1, 2000, exempted from the sales tax imposed by Section 1105(a) and from the compensating use tax imposed by Section 1110 of the Tax Law:

Computer system hardware used or consumed directly and predominantly in designing and developing computer software for sale. (Emphasis added)

Pursuant to Chapter 407 of the Laws of 1999 and effective March 1, 2001, computer system hardware used or consumed directly and predominantly “in providing the service, for sale, of designing and developing internet websites” is also exempt.

Section 527.2(d) of the Sales and Use Tax Regulations provides, in part:

Telephony and telegraphy; telephone and telegraph service. (1) The provisions of section 1105(b) of the Tax Law with respect to telephony and telegraphy and telephone and telegraph service impose a tax on receipts from intrastate communication by means of devices employing the principles of telephony and telegraphy.

(2) The term *telephony and telegraphy* includes use or operation of any apparatus for transmission of sound, sound reproduction or coded or other signals.

* * *

(4) A service is not considered telegraphy or telephony if either of these services is merely an incidental element of a different or other service purchased by the customer.

Section 528.13 of the Sales and Use Tax Regulations provides, in part:

(a) *Exemption.* (1) Exemption from statewide tax. An exemption is allowed from the tax imposed under subdivisions (a) and (c) section 1105 of the Tax Law, and from the compensating use tax imposed under section 1110 of the Tax Law, for receipts from sales of the following:

(i) Machinery or equipment (including parts with a useful life of more than one year) used or consumed directly and predominantly in the production for sale of tangible personal property. . . . (Emphasis added)

(ii) Telephone central office equipment or station apparatus or comparable telegraph equipment (including parts with a useful life of more than one year) for use directly and predominantly in receiving at destination or in initiating and switching telephone or telegraph communication when such equipment or apparatus is purchased or leased by the vendor of such service for sale. (Emphasis added)

* * *

(f) *Telephone and telegraph equipment.* (1) Telephone and telegraph central office equipment or station apparatus, used directly and predominantly in receiving at destination or initiating and switching telephone and telegraph communication is exempt, when such equipment and apparatus is purchased or leased by the vendor of such service for sale.

(2) The purchase or lease of equipment by a person subscribing to a telephone or telegraph service, which is comparable to telephone or telegraph central office equipment or station apparatus is not eligible for exemption.

* * *

Example 2: An airline company purchases consoles which initiate, receive and switch telephone calls which are sent over telephone company lines. The consoles are not exempt, as they were not purchased by a telephone company in connection with a telephone service for sale.

Technical Services Bureau Memorandum entitled Exemption for Computer System Hardware, June 8, 1998, TSB-M-98(5)S, provides, in part:

. . . Section 97 of Chapter 56 amended the New York State Tax Law to exempt from New York State and local sales and compensating use (use) taxes purchases, leases or rentals of computer system hardware that is used or consumed directly and predominantly in designing and developing computer software for sale. This exemption, which is provided for under Tax Law §1115(a)(35), is effective June 1, 1998.

* * *

Only the purchase of those components of the computer system hardware and associated parts that are used directly and predominantly in the design and development of computer software for sale is exempt from sales and use taxes under section 1115(a)(35).

Computer System Hardware. *Computer system hardware* is any organized assembly of physical equipment that is united and regulated by interaction or interdependence to accomplish a set of specific computer system functions. The term includes any connected or directly related device or equipment which enables the computer to store, retrieve or communicate to or from a person, another computer or another device, the results of computer operations, computer programs or computer data.

Examples of computer system hardware are: microcomputers; main-frame computers; personal computers; external hard drives; portable disk drives; compact disc read only memory (CD-ROM) drives; external modems; printers; scanners; servers; monitors; keyboards; mice; network interfaces; network hubs; and network routers.

* * *

Directly and Predominantly. The purchase of computer system hardware is eligible for the exemption only if the computer hardware meets the tests of direct and predominant use.

Directly means that the computer system hardware is actually used in designing and developing computer software for sale, or that the hardware has an active, causal relationship in the design and development of computer software for sale. For example, computer system hardware that is used to create, modify or store computer programs under the control of a developer is considered to be used directly in the design and development of computer software. . . .

Computer system hardware used in activities that are collateral to the actual design and development process is not considered to be used directly in designing and developing computer software for sale. For example, use of computer system hardware in administration, production or distribution activities is not considered direct use for purposes of this exemption. . . .

* * *

Predominantly means that the computer system hardware must be used more than 50% of the time in the design and development of computer software for sale.

* * *

Designing and Developing. The term *designing and developing* includes systems analysis, program design, coding, testing, debugging and documentation that are part of the design and development of computer software for sale. Thus, the term includes activities carried on from the conceptual stage, through the planning, evaluation and testing stages of development.

* * *

Supplies. This exemption does not apply to consumable supplies such as toner, ink, printer paper, floppy diskettes, removable disk cartridges, high capacity disks, portable disk drive disks, writeable and erasable CD-ROM drive disks, mouse pads, wrist pads, and the like.

TSB-A-03(19)S
Sales Tax
May 8, 2003

Opinion

Petitioner provides Internet marketing solutions to online publishers and interactive advertisers through its sale of digitized products and services over the Internet. Through its patented DART ad serving technology, Petitioner's clients are able to dynamically target and track ads delivered to Internet users worldwide.

In this Opinion, Petitioner is seeking the benefit of any production exemption provisions contained in the Tax Law for its purchases of computer hardware during 1999 and up to September 1, 2000, used in its business to house client data, client Internet ads, marketing intelligence, and demographics related to its Internet network.

Commonly referred to as the "manufacturing exemption," Section 1115(a)(12) of the Tax Law, as in effect during the period at issue, provided an exemption from sales and use tax for sales of 1) machinery or equipment used or consumed directly and predominantly in the production of tangible personal property for sale and 2) certain telephone communication equipment. Petitioner's electronic transfer of its digital products and services does not constitute the sale of tangible personal property, except as noted below. See The Stock Market Photo Agency, Inc., Adv Op Comm T&F, November 12, 1999, TSB-A-99(48)S. Accordingly, to the extent that the computer hardware purchased for use in Petitioner's digital marketing solutions business is not used to produce tangible personal property for sale, it is not exempt from taxation under the first part of Section 1115(a)(12) of the Tax Law. See Matter of Marriott Family Restaurants, Inc. v. Tax Appeals Tribunal, 174 AD2d 805 lv denied 78 NY2d 863. However, computer hardware used to produce prewritten computer software for sale may qualify for exemption under Section 1115(a)(12), since prewritten computer software is considered tangible personal property in New York State. See Section 1101(b)(6) of the Tax Law. Moreover, the exemption contained in Section 1115(a)(35) of the Tax Law would apply to such hardware, as discussed below.

With regard to telephone communication equipment, in order to qualify for exemption such equipment must meet the statutory tests of being classified as either central office equipment or station apparatus and of being used both directly and predominantly in performing the function of receiving, initiating or switching telephone communication or in receiving, amplifying, processing, transmitting and retransmitting telephone or telegraph signals. In Eastman Kodak Company v. Department of Taxation and Finance, Sup Ct, Monroe County, November 22, 1989, the court declared that this part of Section 1115(a)(12) of the Tax Law was designed to eliminate pyramiding of the sales tax by exempting equipment used by a telephone company and taxing, under Section 1105(b) of the Tax Law, only the distribution of the "finished product," i.e., a telephone service. Examples of qualifying equipment would be switch equipment used to route incoming circuits (calls) and termination equipment which provides the interface between the facilities of a local and long distance telephone company. See MCI Telecommunications Corp., et al, Adv Op Comm T&F, November 12, 1991, TSB-A-91(71)S. The computer hardware at issue in this opinion does not constitute telephone central office equipment or station apparatus as required by Section 1115(a)(12) of the Tax Law. Moreover, the essence of telephone and telegraph services is the transmission of intelligence from one point to another whereby the role of the purveyor is that of a mere conduit (see

TSB-A-03(19)S
Sales Tax
May 8, 2003

Satellite Signals Unlimited, Inc., Adv Op St Tx Comm, October 15, 1984, TSB-A-84(26)S). The essential object of Petitioner's service, however, is to provide digital marketing solutions. Therefore, the computer hardware is not used by Petitioner to provide telephone services for sale to its clients. Accordingly, since such computer hardware is not of the type or for the use intended by the statute, it is not exempt from taxation under the second part of Section 1115(a)(12) of the Tax Law either.

On the other hand, purchases by Petitioner of those components of computer system hardware that are used directly and predominantly in the design and development of its AdServer Software products for sale are exempt from sales and use taxes under Section 1115(a)(35) of the Tax Law, both prior to September 1, 2000, and currently. See Technical Services Bureau Memorandum Exemption for Computer System Hardware, June 8, 1998, TSB-M-98(5)S. *Directly* means that the computer system hardware is actually used in designing and developing computer software for sale, or that the hardware has an active, causal relationship in the design and development of computer software for sale. Use of computer system hardware in administration, production, or distribution activities is not considered direct use for purposes of this exemption. *Predominantly* means that the computer system hardware must be used more than 50% of the time in the design and development of computer software for sale. The term "designing and developing" includes activities carried on from the conceptual stage, through the planning, evaluation, and testing stages of development. See TSB-M-98(5)S, *supra*.

It is noted that to the extent computer hardware is used by Petitioner in providing services to its customers rather than in the production of software for sale to customers, this exemption will not apply. Software used by Petitioner to provide services to customers is not considered to be software produced for sale.

Also, in any instance where Petitioner purchases an asset which will perform both taxable and exempt functions, the predominant (more than 50%) use of such asset will determine the sales tax status of such purchase. MCI Telecommunications Corp., *supra*.

DATED: May 8, 2003

/s/
Jonathan Pessen
Tax Regulations Specialist IV
Technical Services Division

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