New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Taxpayer Guidance Division

TSB-A-08(28)S
Sales Tax
June 17, 2008

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. S050314A

On March 14, 2005, the Department of Taxation and Finance received a Petition for Advisory Opinion from DoubleClick Inc.,111 Eighth Avenue, 10th Floor, New York, NY 10011.

The issue raised by Petitioner, DoubleClick Inc., is whether its purchases of computers for use in its development of new technology service offerings, as well as other related purchases of tangible personal property, as described below, qualify for the research and development exemption pursuant to section 1115(a)(10) of the Tax Law.

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

Petitioner is a digital-marketing-solutions company whose clients include advertisers, direct marketers, and Web publishers. Petitioner was incorporated in Delaware in 1995 and is headquartered in New York City. Through its patented DART ("Dynamic, Advertising, Reporting and Targeting") ad service technology, which is the software platform for many of its offerings, Petitioner services Internet ads for its clients worldwide and delivers targeted advertisements to Internet users worldwide.

Petitioner's business is to provide an infrastructure for marketing in the digital world. Combining media, data, and technological expertise, Petitioner's products and services enable marketers to deliver their advertising message to the desired audience, while helping publishers maximize their advertising revenue and build their business online. Through the infrastructure it provides, Petitioner offers its clients planning, execution, measurement, and refinement of online media campaigns. Petitioner handles all of these facets of the digital-marketing process through its TechSolutions business unit. TechSolutions operates principally as an application service provider and clients pay user fees to access the software.

DART

Petitioner's DART technology platform provides Web publishers with a comprehensive solution for ad inventory management, targeting, delivery, and reporting and allows advertisers and their agencies to streamline and control their online advertising campaigns. When a Web user visits a site with DART technology, image tags embedded in the page link the user's browser to the DART server and establish a connection between the two. A graphic file is requested from the DART server to fill the ad space on the Web page being loaded on the user's screen, usually near the top of the page. The user's network address (user's IP address) maps to the user's DART profile. The network address is 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 of the information it has collected

on the user to this point, including the content (news, sports, etc.) of the sites being visited. DART assigns each individual user a unique user ID number (i.e., a DoubleClick cookie ID). DART then scans the many ads waiting for delivery, matching an ad and its targeting criteria with the user and the information gathered. Using the unique user ID number, DART also reviews the number of times the user has seen a specific ad, in order to control frequency, and evaluates whether a sequential ad should be delivered. A targeted ad is selected and delivered to the user within milliseconds. When a user clicks on the ad, the DART technology redirects the user's browser to the site that placed the ad.

Development of DART

The architecture behind the DART technology was developed over a number of years. The initial years of Petitioner's existence saw significant research and development activity and extensive capital investment. Petitioner purchased a great deal of computer hardware, including servers, switches, routers, and other related equipment, and purchased software as well, to facilitate the research and development of the DART technology. Once a working platform had been developed, research and development continued to expand to modify and improve product offerings and maintain a leading competitive position.

Phase I (Fourth Quarter 1995 – Third Quarter 1996)

DART was first conceptualized as a tool to facilitate the trafficking of Internet advertising for Petitioner's Media business. The initial development phase saw the creation of three core systems. Ad Server software was developed to execute ad delivery and simple targeting of ads to Internet users. Ad Manage software was developed to provide DART users with an interface to manage ad campaigns using the DART system. Finally, Reports software was developed to generate reports of ad campaign performance, billing, and revenue share splitting. Shortly after this rudimentary creation of DART, it became apparent that there could be a separate market to sell this ad delivery service to Web publishers directly as an ASP (i.e., not as an add-on to Petitioner's Media offering). Pursuit of this opportunity led DART development into Phase II.

Phase II (Fourth Quarter 1996 - Second Quarter 1997)

During Phase II, the beta version of DART was developed for Web publishers. The beta version contained similar core systems as the model used in the Media network, but it was much more robust. Development on the Ad Server component resulted in more sophisticated targeting and the ability to track an advertisement. A new component called Show Availability was added, providing users with an inventory forecasting tool. Ad Manage was enhanced to give DART customers the ability to directly manage ad campaigns (in the Phase I version, clients had to instruct Petitioner to execute changes to the campaign). The Reports software was replaced with RepM, which enhanced reporting capabilities for tracking campaign performance and providing more billing, accounting, and revenue split detail.

Phase III (Third Quarter 1997 - Second Quarter 1998)

Development efforts during Phase III resulted in the creation of the commercial version of DART, called DART for Publishers or DFP. Aimed strictly at Web publishers, DFP contained more features than the beta version, including enhanced targeting and reporting features, and most importantly, provided for scalability. During this period, use of the Internet grew exponentially and, with it, the market for advertising. Due to the increased volume of ads being delivered, Petitioner made significant research and development and capital investment to handle the rapidly expanding volume and provide enhanced scalability capabilities to its clients.

Also during this period, it became apparent that DART could not only serve Web publishers in trafficking ads to their sites, but could also serve the advertisers themselves (and their agencies) in sending ads to specific publisher sites. Further development was undertaken to create DART for Advertisers or DFA. DFA used similar systems as DFP (e.g., Ad Server, Ad Manage, and RepM) but expanded those systems to address needs unique to advertisers. For instance, DFA contained a new system called Spotlight, which tracked advertisements "post-click." With Spotlight, a DFA client could track whether an advertisement resulted in a sale, among other things. The commercial version of DFA was made available to advertisers in mid-1998.

This Advisory Opinion addresses Petitioner's purchases of computers and other tangible personal property during the period from December 1, 1995, through November 30, 1998.

Applicable law and regulations

Section 1115(a) of the Tax Law provides, in part:

> 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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> * * *
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> (10) Tangible personal property purchased for use or consumption directly and predominantly in research and development in the experimental or laboratory sense. Such research and development shall not be deemed to include the ordinary testing or inspection of materials or products for quality control, efficiency surveys, management studies, consumer surveys, advertising, promotions or research in connection with literary, historical or similar projects.
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> * * *

(12) Machinery or equipment for use or consumption directly and predominantly in the production of tangible personal property . . . for sale, by manufacturing, processing, generating, assembling . . . but not including parts with a useful life of one year or less or tools or supplies used in connection with such machinery or equipment. . . .

* * *

(35) Computer system hardware used or consumed directly and predominantly in designing and developing computer software for sale or in providing the service, for sale, of designing and developing internet websites.

Section 528.11 of the Sales and Use Tax Regulations provides, in part:

(b) Research and development. (1) *Research and development*, in the experimental or laboratory sense, means research which has as its ultimate goal:

(i) basic research in a scientific or technical field of endeavor;
(ii) advancing the technology in a scientific or technical field of endeavor;
(iii)the development of new products;
(iv) the improvement of existing products; and
(v) the development of new uses for existing products.

(2) Research and development in the experimental or laboratory sense does not include:

(i) testing or inspection of materials or products for quality control (for machinery and equipment used for quality control in the production of products for sale, see section 528.13 of this Part);

(ii) efficiency surveys;

(iii) management studies;

(iv) consumer surveys, advertising and promotions; and

(v) research in connection with literary, historical or similar projects.

(c) Directly, predominantly, exclusively. (1) *Direct use in research and development* means actual use in the research and development operation. Tangible personal property for direct use would broadly include materials worked on, and machinery, equipment and supplies used to perform the actual research and development

work. Usage in activities collateral to the actual research and development process is not deemed to be used directly in research and development.

(2) Tangible personal property is used predominantly in research and development if over 50 percent of the time it is used directly in such function.

Opinion

Petitioner is a digital-marketing-solutions company whose clients include advertisers, direct marketers, and Web publishers. Through its patented DART technology, the software platform for many of its offerings, Petitioner services Internet ads for its clients and delivers targeted advertisements to Internet users worldwide. These targeted advertisement deliveries are premised on the information Petitioner gathers and analyzes with regard to persons viewing the ads.

Petitioner asserts that during the period described in this Opinion (Fourth Quarter 1995 – Second Quarter 1998), Petitioner conducted research in connection with its DART technology and was continually developing new or enhancing existing technology. Although the activities Petitioner describes were undertaken in the development of new and better software programs and applications that enhanced the DART technology, it does not appear from the facts in this Opinion that such activities entailed more than the trial and error testing and implementation of programs, and the integration of preexisting and new applications. Such activities do not constitute research and development in the experimental or laboratory sense for purposes of section 1115(a)(10) of the Tax Law and section 528.11(b) of the Sales and Use Tax Regulations. Petitioner's purchases of computers and other tangible personal property used for such activities, therefore, did not qualify for the exemption from sales and use taxes under section 1115(a)(10).

Computer system hardware used to design and develop software, including custom software, for sale became eligible for exemption pursuant to section 1115(a)(35) of the Tax Law effective June 1, 1998.

Prewritten computer software, as well as compact discs (CDs), tapes, and other tangible media encoded with prewritten software, is considered to be tangible personal property. See section 1101(b)(6) of the Tax Law. The machinery and equipment used directly and predominantly (more than 50% of its use) to create and encode the actual discs and tapes sold, which equipment might include the computers that directly operate the production machinery encoding and creating the tangible personal property, qualify for the exemption from sales tax under section 1115(a)(12) of the Tax Law for machinery and equipment used directly and predominantly in the production of tangible personal property for sale. (But see also *Matter of Empire Vision Center*, Dec Tax App Trib, Nov 7, 1991, DTA No.805767, where the computers used to determine the setting necessary to calibrate the exempt machinery and equipment that produced the property being sold were themselves not considered to be directly involved in production and, therefore, did not qualify for the exemption.)

To the extent Petitioner was engaged in creating software to market for sale, as opposed to software for its own use in delivering its marketing services, the computers used directly and predominantly in the research, design, and development of software for sale, whether prewritten software or custom software, may have qualified for exemption from tax under section 1115(a)(35) of the Tax Law, on and after June 1, 1998.

However, if such computers were used to create software that Petitioner itself used and did not sell separate and apart from its sales of marketing services, such computers, as well as any other machinery and equipment used to create the software, will not qualify for exemption under the provisions of either section 1115(a)(12) or 1115(a)(35) of the Tax Law. Accordingly, computers and other equipment purchased by Petitioner during the period described in this Opinion that were used to create software for Petitioner's own use in providing services to its customers were not exempt under section 1115(a)(12) or (35), or section 1115(a)(10), of the Tax Law. See *Doubleclick, Inc.*, Adv Op Comm T&F, May 8, 2003, TSB-A-03(19)S.

DATED: June 17, 2008

/s/
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NOTE: An Advisory Opinion is issued at the request of a person or entity. It is limited to the facts set forth therein and is binding on the Department only with respect to the person or entity to whom it is issued and only if the person or entity fully and accurately describes all relevant facts. An Advisory Opinion is based on the law, regulations, and Department policies in effect as of the date the Opinion is issued or for the specific time period at issue in the Opinion.