

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

TSB-A-98(27)S
Sales Tax

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO.S980112A

On January 12, 1998, the Department of Taxation and Finance received a Petition for Advisory Opinion from Xecu-Track Accounting Services, Inc., 239 New Road, Parsippany, NJ 07054.

Petitioner, Xecu-Track Accounting Services, Inc., is a computer sales and consulting firm which, among other computer related services, installs and services computer hardware and software, writes original computer programs, and customizes computer software.

Petitioner describes six scenarios involving its sales of computer hardware, software and/or computer related services and inquires as to its sales tax obligations and liabilities in each instance. These scenarios are described in the opinion portion of the advisory opinion.

Applicable Authority

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 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 prewritten computer software and subject to such taxes. . . . 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.

Prewritten computer software 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.

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.

* * *

Sale of Software Upgrades

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.

* * *

Customer Support and Related Services

Services taxable under section 1105(c) of the Tax Law are exempt from tax under section 1115(o) of the Tax Law where performed on any computer software. However, where such services to be performed on software are sold in conjunction with the sale of tangible personal property, such as prewritten software, the charge for such services is exempt only if it is reasonable and separately stated on the invoice or billing statement given to the customer. Thus, 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. 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

The following are the scenarios presented by Petitioner concerning its computer business and the appropriate answers.

Scenario 1: Petitioner is called to service a computer because it is not functioning properly. For example, an internal part, such as a hard drive or network card, may have become defective. In servicing the computer, Petitioner opens it up and puts in a new part, such as the hard drive or network card. Approximately half Petitioner's time is spent assessing what the problem is and the other half is spent on actual repairs. Petitioner bills by the hour for the time it takes to do this.

Answer: The internal parts of a computer, such as a hard drive or network card, fall within the definition of the term "hardware," i.e., the physical components (as electronic and electrical devices) of a computer (Webster's Ninth New Collegiate Dictionary (1985 Ed.)). For purposes of sales and use tax, computers and peripheral devices commonly described as "hardware" are considered tangible personal property as defined in Section 1101(b)(6) 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. Accordingly, the total receipts Petitioner receives from its services of maintaining, servicing and repairing computer system hardware are subject to sales tax (see David Zucker, Adv Op Comm T&F, September 5, 1996, TSB-A-96(53)S; TSB-M-93(3)S, supra).

Scenario 2: Petitioner configures the operating software of a computer network, in order to set up all the network computers and the software on those computers to work together. In this scenario, the computer is not opened; the work is done using the keyboard. This service could also include the sale of software and/or hardware. Petitioner inquires as to the taxability of its services both at the time of the initial network installation or configuration and at a later date when it returns to service the network (using the keyboard only) and charges the client hourly.

Answer: TSBM-93(3)S, supra, provides guidance with respect to sales of computer software and related services. The services of installing, maintaining, servicing or repairing tangible personal property which are taxable under Section 1105(c)(3) of the Tax Law are exempt from tax under Section 1115(o) of the Tax Law where performed on any computer software, provided the charge for the service is reasonable and separately stated on an invoice or other document of sale given to the customer. Accordingly, if Petitioner's charges for the initial installation or configuration and servicing (even at a time after the original installation) of network operating software are separately billed on an invoice from the sale of any additional taxable services or tangible personal property Petitioner concurrently sells to its customer, receipts from such charges are not subject to sales tax (David Zucker, supra).

Contrarily, when Petitioner's nontaxable services are included within a contract which includes taxable elements, and the total receipts Petitioner receives from the sale of such contract are billed to the customer as a lump sum, the total receipts are subject to the tax imposed under Section 1105 of the Tax Law (David Zucker, supra; State Tax Resources Group, Adv Op Comm T&F, July 11, 1996, TSB-A-96(44)S; Moore Business Forms, Inc., Adv Op Comm T&F, February 15, 1995, TSB-A-95(6)S). Taxable elements include the sale and/or installation of computer hardware and the sale of pre-written software. Pre-written software is subject to tax whether sold as part of a package or separately.

If computer network charges include the sale of additional software, the only software that is exempt from sales and use taxes is software designed and developed to the specifications of a specific purchaser (TSB-M-93(3)S, supra). If Petitioner is merely selecting and/or enhancing particular pre-written software programs for its customers, or is designing personalized computer programs by configuring the proper combination of software modules (some of which are pre-written), the receipts from the fees Petitioner charges its customers for the sale of such software are considered sales of tangible personal property and are subject to the taxes imposed by Sections 1105 and 1110 of the Tax Law. Provided they are separately stated on an invoice or other statement given to the customer, receipts attributable to any unique programming of software, including modifications or enhancements, and updates, are not subject to tax (see TSI International Software Ltd., Adv Op Comm T&F, September 30, 1997, TSB-A-97(59)S; Software Dynamics, Inc., Adv Op Comm T&F, July 23, 1997, TSB-A-97(45)S; State Tax Resources Group, supra). However, in a transaction where the charge is for both taxable elements and qualifying exempt software or programming, the total charge is subject to sales and use taxes unless the portion of the charge applicable to the qualifying exempt software or programming is reasonably allocated and separately stated from the other charges.

Scenario 3: Petitioner services a computer network that is experiencing a malfunction. The technician who goes out to the customer site does not need to open up or service the computer hardware. He or she only needs to debug the software to correct problems, such as printer problems. Petitioner inquires as to the sales tax obligations that would arise if 1) all of the service is performed by the technician on site using the keyboard, or 2) the technician is able to fix the problem over the phone by coaching the customer to use the keyboard, and the technician charges hourly for these services.

Answer: Software maintenance and repair services are exempt from tax under Section 1115(o) of the Tax Law. Accordingly, Petitioner's receipts from charges to its customer, either in person or by telephone, which are exclusively for customer support, or diagnostic or troubleshooting services, rendered in connection with pre-written or custom software are exempt from tax (TSB-M-93(3)S, supra).

Alternatively, the entire charge for such services performed under a maintenance agreement which includes both taxable and nontaxable elements, as discussed in Scenario 2 above, is subject to sales tax unless, as mandated by Section 1115(o) of the Tax Law, the charge is separately stated between the taxable and exempt items provided under the agreement (see Arthur Anderson and Co., Adv Op Comm T&F, November 8, 1991, TSB-A-91(70)S; Software Dynamics, Inc., supra).

Scenario 4: Petitioner sells a software service contract to its customer under which Petitioner provides unlimited software support by telephone only. The customer is billed a flat fee for one year.

Answer: Charges for customer (user) software support either in person or by telephone related to pre-written or custom software are not subject to sales tax under section 1105(c) of the Tax Law. See Section 1115(o) of the Tax Law. Accordingly, Petitioner's receipts from the flat fee it charges to customers exclusively for software telephone support are exempt from tax (Arthur Anderson and Co., supra; TSB-M-93(3)S, supra).

Scenario 5: Petitioner sells a customer a package of annual software updates. This will only involve sending the customer the update (on a disc or CD-ROM) with instructions as to how to load the software on the customer's computer.

Answer: Generally, the sale of a revision or upgrade of pre-written software is subject to sales and use tax as the sale of tangible personal property under Sections 1105 and 1110 of the Tax Law. If, however, Petitioner designs and develops the software update to the specifications of a specific customer, charges attributable to such update are not subject to tax provided they are separately stated on an invoice or other statement given to the customer (Software Dynamics, supra).

Scenario 6: Petitioner re-sells a third-party software service contract which provides unlimited telephone support on a software package. For example, the manufacturer of the software package sells Petitioner a phone support plan for \$500 and Petitioner, in turn, sells it to a customer for \$1,000. The customer calls the manufacturer to get any phone support it requires under the contract; Petitioner does not actually provide the service to the customer.

Answer: Charges for telephone software support services are not subject to sales and use taxes as described in Scenario 4 above. Therefore, in this instance, if the only services performed under a maintenance

contract Petitioner purchases from a third party supplier and resells to its customer are telephone support services, Petitioner's charges to the customer are not subject to tax. However, if the maintenance contract were to provide for the sale of taxable elements (for example, pre-written computer software and pre-written upgrades) in conjunction with telephone support, the entire charge for the maintenance contract would be subject to sales tax unless the charge for the taxable and exempt elements provided under the agreement were reasonable and separately stated on an invoice or other statement of the price given to the customer (Arthur Anderson and Co., *supra*; Moore Business Forms, Inc., *supra*). Petitioner, as the reseller of the service contract, would be required to collect from its customer any sales and use tax due on the sale of the service contract. Petitioner could purchase the service contract from a third-party in New York State exempt from tax as a purchase for resale. See Section 1101(b)(4)(i) of the Tax Law and Section 526.6(c) of the Sales and Use Tax Regulations.

DATED: April 14, 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.