

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

TSB-A-98(73)S
Sales Tax
November 5, 1998

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO.S980428A

On April 28, 1998, the Department of Taxation and Finance received a Petition for Advisory Opinion from STS Systems, Ltd., 2800 Trans-Canada Highway, Pointe-Claire, Quebec, Canada H9R 1B1.

The issues raised by Petitioner, STS Systems, Ltd., are:

- (1) Whether the sales of its point of sale ("POS") system maintenance agreements to provide computer hardware and software maintenance/support services qualify for exemption from New York State sales tax under Section 1115(o) of the Tax Law.
- (2) What criteria are used to determine whether or not computer software service charges are reasonable.
- (3) Whether the "hardware help desk" telephone support services Petitioner provides relating to its customers' computer hardware purchases are subject to New York State sales tax.
- (4) Whether charges made by Petitioner to its customers for travel expenses incurred in the performance of its services are subject to sales tax.
- (5) Whether restocking charges made by Petitioner to its customers for the cancellation of equipment orders are subject to sales tax.

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

Petitioner is a computer sales and consulting firm which sells, installs and maintains computer hardware and software and provides customer support. Petitioner's software service billings encompass several different activities such as initial review meetings, consultations and software modifications. The activities, with the exception of travel expenses which are reimbursed by the customer, are not itemized separately on the customer's invoice. However, they are itemized on the back-up documentation which is used to create the invoice. Both the invoice and the back-up documentation are sent to the customer.

As part of its petition, Petitioner submitted copies of a sample contract and several invoices including their back-up documentation for review. The sample contract covers the customer's hardware purchase, software license and point of sale ("POS") system maintenance agreement. The point of sale system is described in the agreement as, collectively, the integrated system consisting of equipment, software and all associated telecommunications equipment purchased, licensed or sublicensed from Petitioner. Under Section 4.4 of the contract, if a customer cancels an equipment order less than thirty days prior to its scheduled delivery date, Petitioner charges a 20% restocking charge for which the customer is liable.

The "POS" system maintenance agreement entitles the customer to hardware and software maintenance, user support including call-in for technical assistance and any upgrades and enhancements (installable by the customer) provided during

specific coverage periods. The maintenance fee for these services and upgrades is billed separately on an annual basis and is applicable to equipment and software installed during the one-year period. As part of the agreement, extended maintenance and support services of the same nature are also available to the customer outside the contracted period of coverage, e.g., on one of the ten U.S. holidays published in the agreement, or outside the scope of the agreement, e.g., repairs needed due to accident or misuse of equipment. These extended services are separately billable to the customer at prevailing published time and materials hourly rates pursuant to Exhibits K and N of the agreement.

Section 11.1 of Petitioner's "POS" system maintenance agreement provides for the sale of consulting and diagnostic, troubleshooting and on-site maintenance services related to computer software, pre-written software upgrades/enhancements and hardware maintenance including call-in for technical assistance and replacement of unserviceable parts. Petitioner's charge for annual maintenance service is separately stated from the charges for computer software and hardware in Exhibits D-1, D-2 and G. The portion of the annual maintenance fee which is allocable to hardware maintenance is also separately stated. However, with the exception of Fujitsu Atrium unit releases, all pre-written software upgrades, enhancements and the updated manuals relative to such releases are also included in the annual maintenance charge.

The invoices submitted with the petition include maintenance and support services performed both during the contract coverage period, for which there is no charge, and outside the scope of the contract coverage period/agreement, which are billed at the prevailing published time and materials rates. Several of the software service invoices include Petitioner's travel expenses which are billable to the customer and are separately stated.

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:

* * *

(3) Receipt. The amount of the sale price of any property and the charge for any service taxable under this article, valued in money, whether received in money or otherwise, including any amount for which credit is allowed by the vendor to the purchaser, without any deduction for expenses or early payment discounts and also including any charges by the vendor to the purchaser for shipping or delivery regardless of whether such charges are separately stated in the written contract, if any, or on the bill rendered to such purchaser and regardless of whether such shipping or delivery is provided by such vendor or a third party. . . . (Emphasis added)

* * *

(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 of the Tax Law provides, in part:

(a) 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:

* * *

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

* * *

(o) 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. (Emphasis added)

Section 526.5(e) of the Sales and Use Tax Regulations provides:

All expenses . . . incurred by a vendor in making a sale, regardless of their taxable status and regardless of whether they are billed to a customer are not deductible from receipts.

Example 1: A photographer contracts with a customer to furnish photographs at \$50 each in addition to expenses.

The customer is billed as follows:	
Photographs(2)	\$100
Model fees	60
Meals	10
Travel	25
Props(Flowers)	<u>5</u>
Total due	\$200
Receipt subject to tax is \$200	

Example 2: An appliance repairman charges \$10 per hour plus expenses when on a service call. The customer is billed as follows:

3 hrs. at \$10	\$30
Travel	15
Parts	20
Meals	<u>5</u>
Total due	\$70

Receipt subject to tax is \$70

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.

* * *

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.

* * *

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. . . .

* * *

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. (Emphasis added)

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.

* * *

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. (Emphasis added)

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.

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Petitioner sells computer hardware, software and related services. The sample contract provided by Petitioner covers the customer's hardware purchase, software license and point of sale ("POS") system maintenance agreement. The point of sale system consists of equipment, software and all associated telecommunications equipment purchased, licensed or sublicensed from Petitioner. The contract includes a fee schedule and description of the items and services provided in the package.

Under the terms of the sample contract submitted with the petition, the customer is entitled to, with the exception of Fujitsu Atrium unit releases, any upgrades and enhancements (installable by the customer) provided during a specific coverage period. Petitioner's software upgrades and enhancements would be considered pre-written software, unless they are designed and developed to the specifications of a specific user. To the extent that such upgrades and enhancements are tangible personal property, Petitioner's sales, including licenses to use such software, would be subject to sales and compensating use taxes (see ALLTEL Financial Information Services, Inc., Adv Op Comm T&F, May 2, 1996, TSB-A-96(27)S; TSB-M-93(3)S, supra).

The maintenance fee is billed separately on an annual basis and is applicable to equipment and software installed during the one-year period. Section 11.1 of Petitioner's "POS" system maintenance agreement provides for the sale of both nontaxable elements (e.g., consulting and diagnostic, troubleshooting and on-site maintenance services related to computer software) and taxable elements (e.g., pre-written software upgrades and enhancements and hardware maintenance which includes replacement of unserviceable parts and call-in technical assistance for the computer hardware). If a software maintenance agreement provides for the sale of both taxable elements and nontaxable elements, 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 (TSB-M-93(3)S, supra). In the sample contract, Petitioner's charge for annual maintenance service is separately stated from the charges for computer software and hardware in Exhibits D-1, D-2 and G. The portion of the annual maintenance fee which is allocable to hardware maintenance is also separately stated. However, with the exception of Fujitsu Atrium unit releases, all pre-written software upgrades, enhancements and the updated manuals relative to such releases are also included in the annual maintenance charge. Accordingly, the receipts from the entire annual maintenance charge as stated in Exhibits D-1, D-2 and G of Petitioner's agreement, with the exception of fees allocable to the Fujitsu Atrium unit software support, are subject to tax (see SAP America, Inc., Adv Op Comm T&F, March 24, 1998, TSB-A-98(20)S; Moore Business Forms, Inc., Adv Op Comm T&F, February 15, 1995, TSB-A-95(6)S; ALLTEL Financial Information Services, Inc., supra). Provided charges for the Fujitsu Atrium unit software support are separately itemized on the invoice or statement of price given to the customer, such charges are not subject to tax. The sample back-up documentation submitted with the petition qualifies as a "statement of price given to the customer," provided it is furnished with the invoice in conjunction with the provision of the service.

It is noted that effective June 1, 1998, sales of computer system hardware that is used or consumed by the purchaser directly and predominantly in designing and developing computer software for sale are exempt from sales and use taxes. See Section 1115(a)(35) of the Tax Law.

Extended maintenance and support services are also available to the customer for additional fees. The customer is entitled to extended hardware and software maintenance and support services pursuant to section 11.2 of the "POS"

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system maintenance agreement. This applies to services delivered outside the contracted period of coverage or outside the scope of the maintenance and support services provided under Section 11.1 of the agreement. Rates for the extended maintenance and support services are separately stated in Exhibits K and N of the contract, between hardware and software support. The exemption in Section 1115(o) of the Tax Law does not apply to charges for computer hardware support (TSB-M-93(3)S, supra). Provided charges for software support are reasonable and separately stated on the invoice or attachment to the invoice given to the customer, Petitioner's receipts from extended maintenance and repair services performed on computer software are exempt from sales and use taxes (Xecu-Track Accounting Services, Inc., Adv Op Comm T&F, April 14, 1998, TSB-A-98(27)S).

Concerning issue "2," the term "reasonable charge" is not defined by statute or regulation. Neither is there any set formula to establish whether a charge for software support is reasonable. The extended maintenance and support rates in Petitioner's sample contract vary from \$110/hour on weekdays to \$250/hour on Sundays and holidays. If Petitioner's charges are comparable to standard industry rates for similar services, and the balance of the charge for tangible personal property sold in conjunction with the software support is comparable to standard industry rates for such tangible personal property, the maintenance charges will be considered reasonable for purposes of Section 1115(o) of the Tax Law.

With regard to issue "3," charges for Petitioner's "hardware help desk" telephone support are included in the annual maintenance fee when performed during the coverage period and in the billable hourly rate for hardware support when performed outside the coverage period or scope of Section 11.1 of the agreement. In either case, charges for hardware help desk telephone support are part of the overall contract maintenance charges established for hardware support, which also include preventative and remedial computer equipment repair. For purposes of sales and use tax, computers and peripheral devices commonly described as "hardware" constitute tangible personal property as defined in Section 1101(b)(6) of the Tax Law (Xecu-Track Accounting Services, Inc., supra). The tax treatment of Petitioner's computer hardware telephone support service, provided for as part of the hardware support charges in the maintenance agreement, follows the tax treatment of other maintenance or service contracts to service tangible personal property. Pursuant to Section 527.5(c) of the Sales and Use Tax Regulations, the purchase of a maintenance or service contract is a taxable transaction. Accordingly, the total receipts Petitioner receives from its "hardware help desk" service are subject to tax (TSB-M-93(3)S, supra).

Concerning issue "4," all reimbursed expenses including air fare, hotel and meals, incurred by Petitioner and included in its charges to its customers are included in the definition of "receipt" provided in Section 1101(b)(3) of the Tax Law and Section 526.5(e) of the Sales and Use Tax Regulations. Therefore, the charge to a customer for such reimbursed expenses is subject to tax, provided that the receipts from Petitioner's sale are subject to tax. When Petitioner makes a nontaxable sale, the amount charged to its customers, including such reimbursed expenses, is not subject to tax (see Salomon & Leitgeb, CPA's, LLP, Adv Op Comm T&F, July 23, 1997, TSB-A-97(44)S). For additional information on the taxability of sales of computer software and related services, Petitioner should refer to Technical Services Bureau Memorandum TSB-M-93(3)S.

With respect to issue "5," if a customer cancels an equipment order less than thirty days prior to its scheduled delivery date, Petitioner charges a 20% restocking charge for which the customer is liable according to the terms of the contract. Restocking charges are not subject to sales tax. Since the equipment on order does not enter New York State and is not transferred by Petitioner to

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its customer within the meaning of Section 1101(b)(5) of the Tax Law, no incidence of tax arises. Thus, when Petitioner charges its customers for a cancellation of an order for property which has not been shipped, it need not collect sales tax on such charge.

DATED: November 5, 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.