

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

TSB-A-99(31)S
Sales Tax
June 7, 1999

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S981027B

On October 27, 1998, the Department of Taxation and Finance received a Petition for Advisory Opinion from David H. Posmantier, E.A., 414 Maple Avenue, Westbury, New York 11590.

The issues raised by Petitioner, David H. Posmantier, are the following:

1. Whether the development of custom computer software is subject to sales tax.
2. Whether the development of custom computer artwork is subject to sales tax.
3. Whether the development of Internet Web sites is subject to sales tax.
4. Whether the method of delivery of software to a client affects whether the software is subject to sales tax.

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

Petitioner's client ("Developer") is in the business of developing computer software for its clients. The software is developed exclusively for a particular client and is not marketed to other clients. However, Developer may use parts of software developed for Client A in developing software for Client B. Commonly, an off-the-shelf software program is modified or is used in writing the custom designed software. Developer pays sales tax for all off-the-shelf software purchased. The software developed may include extensive amounts of artwork designed and developed exclusively for each client. In rare cases, the end product is solely computerized artwork.

Developer also designs and develops Internet Web sites for clients. In producing a Web site, Developer may use artwork provided by the client or may design and develop the artwork. A Web site is a specific type of software program designed to interact with the Internet.

Software is delivered to clients in one of two ways: (1) disks shipped by Federal Express or, (2) transmitted over telephone wires. Many clients are out of state.

Applicable Law and Regulations

Section 1101(b) of the Tax Law provides, in part:

(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

TSB-A-99(31)S
Sales Tax
June 7, 1999

manner or by any means whatsoever for a consideration, or any agreement therefor, including the rendering of any service, taxable under this article, for a consideration or any agreement therefor.

(6) Tangible personal property. Corporeal personal property of any nature. However, except for purposes of the tax imposed by subdivision (b) of section eleven hundred five, such term shall not include gas, electricity, refrigeration and steam. 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(a) of the Tax Law imposes a tax on the receipts from every retail sale of tangible personal property, except as otherwise provided.

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 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.

Opinion

Issue 1

Petitioner's client, Developer, is designing computer software for its customers. Developer uses "off the shelf" software and makes modifications to customize the software for its clients, or may use components of software developed for Client A to develop Client B's software.

When Developer uses prewritten "off-the-shelf" software to develop software for its clients, the software developed for its clients is subject to tax. Prewritten software is tangible personal property subject to tax under Section 1105(a) of the Tax Law. Prewritten software includes prewritten software that is modified or enhanced to the specifications of a specific purchaser. Accordingly, when Developer makes modifications to "off the shelf" software to produce software for its clients, the entire charge for the software is subject to tax as prewritten software unless the billing statement or invoice shows reasonable, separately stated charges for the modifications. In that instance, only the charges attributable to the prewritten portion are subject to sales tax. If, however, the prewritten "off the shelf" software used by Developer is merely a library of routines or functions that is incidental to custom software designed by Developer to the specifications of a particular client, such custom software is not subject to tax.

When Petitioner uses Client A's software, or portions thereof, to develop software for Client B, the software is subject to tax. Software that was originally designed and developed to the specifications of a specific purchaser becomes prewritten software when sold to someone other than the person for whom it was specifically designed. Software created by combining two or more prewritten programs or portions of a prewritten program are subject to tax. (See Section 1101(b)(14) of the Tax Law.) If Petitioner combines prewritten software programs and makes custom modifications or enhancements for which a reasonable and separately stated charge is made on the invoice, then the separate charge for the modification is not subject to tax. Petitioner must still collect sales tax on the charge for the prewritten portion of the software.

If the software is shipped to clients out of New York for use outside New York, then the charges for this software are not subject to sales tax.

Issue 2

Developer may develop computerized artwork for a client. Such custom computer artwork is taxable artwork when delivered in a tangible form such as a disk. If the artwork is transmitted electronically, it is intangible property not subject to sales tax.

If Developer ships the artwork to clients outside New York for use outside New York, the artwork is not subject to sales tax.

TSB-A-99(31)S
Sales Tax
June 7, 1999

Issue 3

Developer's Internet design and development services are not subject to sales tax. Internet design and development services are not among the enumerated services subject to sales tax under Section 1105(c) of the Tax Law. (See CAV CORP dba Stone Soup Multimedia, Adv Op Comm T & F, December 29, 1997, TSB-A-97(87)S.)

Issue 4

The method of delivery of the computer software does not change its taxability. Prewritten software is taxable whether sold on a disk, tape or by electronic transmission over telephone lines. Custom software designed and developed to the specifications of a specific purchaser, sold in any format, is not subject to sales tax.

The method of delivery of artwork does affect its taxability. Artwork sold in a tangible form such as a disk or tape is tangible personal property subject to sales tax. However, artwork transmitted electronically is not subject to sales tax, as discussed in Issue 2 above.

DATED: June 7, 1999

/s/
John W. Bartlett
Deputy Director
Technical Services Bureau

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