

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

TSB-A-93 (12)S
Sales Tax
February 25, 1993

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S921110A

On November 10, 1992 a Petition for Advisory Opinion was received from Kapiti Inc., 114 West 47th St., New York, New York 10036.

The issue raised by Petitioner, Kapiti Inc., is whether for the period prior to September 1, 1991 certain payments made for certain computer software were subject to the use tax imposed under Section 1110 of the Tax Law.

Kapiti Limited ("Ltd."), a United Kingdom corporation not engaged in a trade or business in the United States, produces computer software ("The System") to be used by banks. Under a 1989 license agreement with Petitioner its wholly-owned United States subsidiary, Ltd. has granted Petitioner exclusive marketing rights for the System in the United States.

The System, which is copyrighted, consists of one or more designated sets of programs together with all manuals and documentation necessary to install and run the programs and all modifications or improvements to the program developed subsequent to the licensing agreement.

The licensing agreement gives Petitioner the right to develop and sub-license The Systems to end-users which were banks located in the United States. The System is customized and installed by Petitioner, tailored to the specific requirements of the end-user. Before entering into a licensing agreement with the end-user, Petitioner must notify Ltd. with respect to variations to The System, payment schedule, type or computer and delivery date.

In a typical sub-licensing engagement in which Petitioner's staff is engaged, its staff spends a period of time ranging up to six months studying and understanding the sublicensee's needs and developing a tailored business system to meet these needs. As part of this procedure, Petitioner uses The System, i.e. the base computer software system licensed from Ltd. This base system is parameterized with respect to the sub-licensee's staff, financial products, the nature of the sub-licensee (whether it is the branch office of an international based bank or a major money center financial institution), the types of reporting such licensee is required to provide, how much of a system is actually required, the licensee's hardware configuration, number of users and so on. Once the customized system is developed, Petitioner has created a tailored software package which has been designed to meet the specific needs of this particular licensee.

Section 1105(a) of the Tax Law imposes a tax on the receipts from every retail sale of tangible personal property while Section 1110 imposes a compensating use tax upon "... tangible personal property purchased at retail " Sale as defined in Section 1101(b)(5) of the Tax Law includes any rental, lease or license to use tangible personal property.

The tax status of receipts from computer program ("software") sales and services is explained in Department of Taxation and Finance Technical Services Bulletin 1978-1(s), issued February 1, 1978 and is applicable to taxable periods prior to September 1, 1991.

The Bulletin provides in part that:

Software [means] instructions and routines which, after analysis of the customer's specific data processing requirements, are determined necessary to program the customer's electronic data processing equipment to enable the customer to accomplish specific functions with his EDP system. To be considered except 'software' for purposes of this bulletin, one of the following elements must be present:

A. Preparation or selection of the program for the customer's use requires an analysis of the customer's requirements by the vendor.

or

B. The program requires adaptation, by the vendor, to be used in a specific environment i.e., a particular make and model of computer utilizing a specified output device. For example, a software vendor offers for sale a pre-written sort program which can be used in several computer models. Prior to operation, instructions must be added by the vendor which specify the particular computer model in which the program will be utilized.

The software may be in the form of:

- a. Systems programs (except for those instruction codes which are considered tangible personal property in paragraph 1 above) - programs that control the hardware itself and allow it to compile, assemble and process application programs.
- b. Application programs - programs that are created to perform business functions or control or monitor processes.
- c. Pre-written programs (canned) - programs that are either systems programs or application programs and are not written specifically for one user.
- d. Custom programs - programs created specifically for one user.

Software meeting the above criteria, whether placed on cards, tape, disc pack or other machine readable media or entered into a computer directly, is deemed to be intangible personal property for sales tax purposes, and as such its sale is exempt from New York State and local sales and use taxes. Software or programs which do not meet the criteria are subject to tax.

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The software produced by Ltd. and used by Petitioner was not acquired by Petitioner to meet the requirements of a particular customer. Thus, at the time Petitioner purchased the software from Ltd., it did not meet the conditions set forth in A or B above. It was only after Petitioner contracted with its customers that it made changes in the software which enabled it to meet the specific needs of a customer.

Consequently, Petitioner was purchasing tangible personal property from Ltd. which it then converted to intangible property for use by its customers. Therefore, payments made by Petitioner to Ltd. were subject to sales or use tax pursuant to the provisions of Sections 1105(a) or 1110 of the Tax Law while the payments it received from its customers were not subject to sales tax as they were receipts from the sale of an intangible.

DATED: February 25, 1993

/s/
PAUL B. COBURN
Deputy Director
Taxpayer Services Division

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