

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

TSB-A-93 (36)S
Sales Tax
June 14, 1993

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S920709A

On July 9, 1992 a Petition for Advisory Opinion was received from Neuromedical Systems, Inc., 2 Executive Boulevard, Suffern, New York 10901.

Petitioner, Neuromedical Systems, Inc., has set forth various questions concerning the application of New York State and local sales and use tax to its business of manufacturing, selling and leasing a semi-automated device for use in the screening of cervical (PAP) smears and has also requested affirmation of previous correspondence from the Technical Services Bureau. Because of the information submitted by Petitioner in the Petition for Advisory Opinion, the questions submitted in the previous correspondence will be readdressed in this Advisory Opinion in Questions and Answers 1 through 9. The information requested by specific questions presented in the Petition for Advisory Opinion will be addressed in Questions and Answers 10 through 16.

Petitioner is in the business of manufacturing, selling and leasing a semi-automated device, referred to as a "Classifier", for use in the screening of cervical (PAP) smears.

The "Classifier" will use advanced computer technology to analyze PAP smears, selecting the sixty-four most unusual looking cells from each slide and displaying them on a color video monitor for review by qualified medical technologists.

The main components of the system include an automated microscope, color video monitor and advanced computer software which links the units together, and allows them to function effectively as one.

Currently, the component hardware parts of the system are purchased outside of New York State. Software research and development and integration of the entire system is performed within New York State. Integration consists of linking the system together both physically and with software.

Petitioner anticipates it will sell and/or lease these systems both within and without New York State.

The "Classifiers" are by nature very delicate and normal shipping stress will necessitate the "Classifiers" to be realigned. Labor necessary for the re-alignment or re-calibration is considered to be significant.

Petitioner is also considering whether to enter into an agreement to process slides for non-related medical laboratories on a price per slide basis. Petitioner would process (scan for cancerous cells or malignancies) all slides received by Petitioner's laboratory located in New York State. Pictures of the 128 most unusual looking cells from each slide to be considered for diagnosis would be transferred to magnetic media (magnetic tape). The magnetic media would contain only pictures

of cells from each slide with no formal diagnosis. The media would be returned to the sending laboratory (Petitioner's customer) where Petitioner would provide reviewing stations for trained cytologists (employees of the sending laboratory) to review the data contained in the media and render a diagnosis.

The review stations located at the sending laboratories would belong to Petitioner and would be provided without charge. Diagnosis would be performed by employees of Petitioner's customers, the sending laboratories.

The following are the questions submitted by the Petitioner and the answers thereto.

Question 1: Assuming the "Classifiers" are sold to laboratories, would such a sale be subject to New York State and Local sales tax?

Answer 1: Section 1115(a)(3) of the Tax Law provides an exemption from sales and use tax for receipts from certain retail sales including receipts from retail sales of "medical equipment and supplies required for use in the cure, mitigation, treatment or prevention of illnesses or diseases in human beings ... or to correct or alleviate physical incapacity, ... but not including ... medical equipment (including component parts thereof) ... purchased at retail for use in performing medical and similar services for compensation."

Section 525.2 of the Sales and Use Tax Regulations defines the sales tax in part, as '... a "destination tax", that is, the point of delivery or point at which possession is transferred by the vendor to the purchaser or designee controls both the tax incident and the tax rate '

New York State Department of Taxation and Finance Publication 840 (11/88), New York State and Local Sales Tax Information for Drugstores states, on page 3, that "[s]ales of medical equipment and supplies are exempt from New York State and local sales and use taxes under certain circumstances.

All medical equipment and supplies purchased for use in providing medical or similar services (services of ... clinical laboratories...) for compensation are taxable "

Petitioner's sales of "Classifiers" to laboratories located within New York State for use in performing a medical or similar service for compensation will not qualify for the exemption provided under Section 1115(a)(3) of the Tax Law but will fall within the exclusion provided under Section 1115(a)(3) and therefore will be subject to New York State and local sales tax. However, any sales of "Classifiers" to laboratories located outside New York State will not be subject to New York State or local sales tax provided delivery occurs outside New York State.

Question 2: Assuming the "Classifiers" are leased to laboratories, based on a cost per slide, would such a lease be subject to New York State sales tax?

Answer 2: Section 1101(b)(5) of the Tax Law defines sale, selling or purchase as "[a]ny transfer of title or possession or both, exchange or barter, rental, lease or license to use or consume "

Section 1101(b)(4)(i) of the Tax Law defines retail sale as "[a] sale of tangible personal property to any person for any purpose, other than (A) for resale as such or as a physical component part of tangible personal property "

Petitioner's lease of a "Classifier" to a laboratory (lessee) will be considered to be a retail sale under the provisions of Section 1101(b)(4)(i) and 1101(b)(5) of the Tax Law. Accordingly, Petitioner's receipts from charges to the lessee of a "Classifier" will be subject to New York State and local sales tax where delivery occurs to a lessee located within New York State. The receipts from charges to a lessee located outside New York State will not be subject to state or local sales tax provided delivery to the lessee occurs outside New York State.

The method of determining the amount of the lease payment due, in the instant matter on a cost per slide basis, will not have any consequence in determining the amount of sales tax due.

Question 3: If Petitioner provides slide screening services to the general public or to the medical profession, would the service be subject to New York State sales tax?

Answer 3: Since Petitioner's slide screening service does not result in Petitioner presenting clients with a written diagnosis but instead results in Petitioner furnishing the client with a form of magnetic media containing pictures of the 128 most unusual looking cells on each slide submitted by the client, Petitioner is considered to be selling tangible personal property to the client. Petitioner's receipts from the sales of the magnetic media to the clients will be subject to the tax imposed under Section 1105(a) of the Tax Law except in instances where delivery occurs outside of New York State.

Question 4: Assuming the above mentioned "Classifiers" are sold or leased to a laboratory outside New York State, would that exclude the transaction from New York State sales tax?

Answer 4: Where Petitioner leases or sells a "Classifier" to a laboratory located outside New York State with delivery also occurring outside New York State the receipts from such lease or sale will not be subject to New York State or Local Sales Tax. (See Answer 1, above.)

Question 5: Are the component hardware parts to be purchased outside New York State subject to New York State compensating use tax?

Answer 5: Petitioner's out-of-state purchases of component hardware parts which are to become physical component parts of "Classifiers" for sale or lease will be considered as purchases for resale falling within the exclusion from retail sales as provided under Section 1101(b)(4)(i) of the Tax Law and will not be subject to the sales or compensating use tax.

Question 6: Is Petitioner's software research, development and integration subject to New York State sales or use tax?

Answer 6: Section 1115(a)(10) of the Tax Law provides an exemption from sales and use tax on receipts from retail sales of "[t]angible 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 "

Section 528.11(b) of the Sales and Use Tax Regulations provides, in part, that "(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 "

Accordingly, where Petitioner can substantiate that "software research or development", which had as an ultimate goal any of the resulting activities listed under Section 528.11(b)(1) of the Regulations, has occurred, any tangible personal property purchased by Petitioner for use or consumption directly or predominantly in such research and development will be exempt from the tax imposed under Section 1105(a) of the Tax Law.

Where Petitioner charges a customer for integration of a system and delivery occurs within New York State, the charge for integration will be subject to the tax imposed under Section 1105(c)(3) of the Tax Law.

Question 7: Assuming the integration of the entire system is performed in New York State and the machine is subsequently shipped to laboratories outside New York State where substantial recalibration on the system must be performed, will the answers to Questions 1, 2 or 3 above change?

Answer 7: No.

Question 8: Assuming the system is never fully integrated within New York State, would any labor and/or other activities be subject to New York State sales or compensating use tax?

Answer 8: Regardless of whether system integration is performed within or outside New York State, the transaction will not be subject to New York State or local sales or compensating use tax provided that the system is delivered to the customer outside New York State.

Question 9: Assuming Petitioner provides repair and maintenance services for "Classifiers" which are either sold or leased, would such services be subject to New York State sales tax?

Answer 9: Section 1105(c)(3) of the Tax Law imposes a tax on receipts from the sale of the services of installing, maintaining, servicing or repairing tangible personal property. Petitioner's receipts from charges to a customer for repairing and maintaining a "Classifier", whether sold or leased to the customer, will be subject to the tax imposed under Section 1105(c)(3) of the Tax Law, unless the service is performed outside the state or the repaired or maintained "Classifier" is delivered to a customer outside New York State.

Question 10: Are any component parts of the scanning machines which are used for commercial purposes in Petitioner's offices in New York State subject to New York State or Local sales or use tax.

Answer 10: Where Petitioner's scanning machines are used directly and predominantly (more than 50% of use) to produce pictures of cells on magnetic media for transfer to customer's, without any diagnosis being provided by Petitioner, Petitioner's purchases of component parts for such machinery or equipment will qualify for the tax exemption provided under Section "1115(a)(12) of the Tax Law and will not be subject to New York State or local sales tax.

Question 11: Are any component parts of scanning machines located in New York State but used for research and development purposes subject to New York State or local sales or use tax?

Answer 11: Where Petitioner's scanning machine is used directly and predominantly in research and development as defined under Section 528.11(b) of the Regulations, Petitioner's purchases of component parts for such specific scanning machines will be exempt from New York State and local sales and use tax.

Question 12: Are receipts from the service provided by Petitioner, the scanning of PAP smears, subject to New York State sales or use tax?

Answer 12: Since Petitioner transfers the magnetic media to customers without providing a diagnosis, Petitioner is considered to be selling the customers tangible personal property. Accordingly, the receipts from such sales will be subject to New York State and local sales tax. Petitioner will be liable for collecting sales tax on each transaction at the time of the sale. However, where delivery of the magnetic media to a customer occurs outside New York State such transaction will not be subject to New York State or local sales tax.

Question 13: Are component parts of the review stations, which are owned by Petitioner but located at the customer's site, subject to New York State sales or use tax?

Answer 13: Since customers are allowed use of the review stations, without any charge for such use, Petitioner is not considered to be reselling the review stations. Also, since customers use the review stations for the purpose of viewing the pictures of cells transferred on the magnetic media, the review stations are not considered to be part of Petitioner's production process. Accordingly, Petitioner's purchases of the various components which make up the review station will be subject to New York State and local sales tax at the time such purchases occur. If Petitioner purchases any of the various components without paying sales tax at the time of such purchase, Petitioner will be liable for the compensating use tax based on the purchase price of such items. Petitioner will be required to report and submit the use tax due on the applicable sales and use tax return for the filing period in which the purchases occur.

Question 14: Are the magnetic tapes which are used for transferring the information to customers subject to New York State sales or use tax?

Answer 14: Since Petitioner does not provide a diagnosis and is considered to be selling tangible personal property in the form of the magnetic tape, to the customer, Petitioner's purchases of the magnetic tape are considered to be purchases

for resale and will not be subject to state or local sales tax. Petitioner should give the supplier of the tapes a properly completed form ST-120, Resale Certificate, as substantiation that the transaction is exempt from tax.

Question 15: Will any of the determinations in Questions 10 through 14 differ if the customer (the sending laboratory) is located outside New York State or the United States?

Answer 15: The determination in Question 13 will differ since the components of the sending laboratory will be used at a customer's location outside New York State. Petitioner will not be subject to New York State sales or use tax on the purchase of components for a review station which is located outside New York State or the United States.

Question 16: Petitioner intends to use scanning machines for training or demonstration purposes. Will any of the components of such machines be subject to sales or use tax?

Answer 16: All purchases of components which will be used for training or demonstration purposes will be subject to New York State and local sales or use tax. Since the components are to be used for training or demonstration purposes, Petitioner will not be considered to have purchased such items for use in a production process nor for the purpose of resale.

DATED: June 14, 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.