

New York Sales Taxation of Electronic Commerce: Recent Developments

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In this article, Reed examines recently issued New York State Department of Taxation and Finance advisory opinions on three electronic services that had no previous guidance — infrastructure as a service; Internet vendors such as Amazon Prime; and drop shipment facilitation services.

New York has not enacted a comprehensive statutory regime addressing the sales tax treatment of electronic commerce transactions. In the absence of detailed statutory guidance, it is generally necessary to request an advisory opinion if the sales tax consequences of an electronic commerce transaction must be known with certainty. When something less than certainty is acceptable, prior existing advisory opinions can be parsed to predict the likely New York sales tax treatment of an online service or transaction. Because advisory opinions have become the most comprehensive source of New York sales tax guidance, those that break new ground are worthy of careful review.

Recently, the New York State Department of Taxation and Finance issued three sales tax advisory opinions addressing electronic commerce topics for which there was no previous guidance. This article discusses the three recent rulings after first providing a short overview of New York's sales tax treatment of electronic commerce.

I. Background: New York Sales Tax Treatment of Electronic Commerce Transactions

Like most states, New York imposes sales tax on receipts from sales of tangible personal property and certain services. In connection with electronic commerce, tangible personal property, information services, and telecommunications are particularly relevant.

A. Tangible Personal Property — Prewritten Computer Software and Cloud Computing

Under New York law, prewritten (canned) computer software is treated as tangible personal property subject to

sales tax. The term “prewritten computer software” is not limited to physical diskettes, but rather includes all prewritten software, “regardless of the medium by which such software is conveyed to the purchaser.”¹

Starting in late 2008, the department began issuing advisory opinions stating that canned software provided electronically is subject to sales tax. The first ruling addressed whether New York sales tax applies to Adobe Photoshop — a software program available for purchase in tangible form at bricks-and-mortar stores — when delivered electronically to customers who pay to access the program electronically.² It concluded that customers were paying for a taxable license to use canned software.

Subsequent rulings state that software available only online is subject to sales tax even where not also sold in tangible form.³ Typically, the rulings consider software as a service (SaaS) fact patterns in which customers do not download software and do not install any software on their computers, but pay a monthly or annual charge for the ability to access software using a Web browser.⁴ The rulings encompass scenarios in which customers pay for something akin to a canned software program and also scenarios in which customers pay for something that seems more like a service, but that is provided through the use of software.⁵

Overall, the department's position is that sales tax applies if a customer pays for non-custom software delivered electronically or for a service provided electronically through automated software that does not involve a substantial human component.

B. Information Services — Online Databases

New York imposes sales tax on receipts from the “furnishing of information . . . in any manner, including the services

¹N.Y. Tax Law section 1101(b)(6).

²*Id.*

³*See, e.g.*, TSB-A-13(37)S (Oct. 7, 2013).

⁴*See id.*

⁵*See, e.g.*, TSB-A-12(3)S (Feb. 27, 2012) (customers pay to access a product that allows for access to electronic catalogs of standardized item data); and TSB-A-09(2)S (Jan. 21, 2009) (customers pay to access a library of online e-learning courses designed to meet specific technical and professional certification requirements and that allow customers to receive educational certificates).

of collecting, compiling or analyzing information of any kind, but excluding the furnishing of information which is personal or individual in nature.”⁶ That statutory language at least arguably calls to mind a narrow range of information services — perhaps, for example, mailing lists or lists of property prices. However, administrative guidance indicates that a wide spectrum of services that are now frequently purchased online qualify as information services, including electronic sports information, Internet newsletters, searchable online databases, and even online dating services.⁷ Online databases are particularly susceptible to being deemed an information service.⁸ In a typical fact pattern, customers pay a monthly or annual charge to access a common database of information online that is searchable but not unique to any customer; the database could include health information, sports information, or even state tax information. The moral is that if a customer is paying to receive data or information online, that service should be evaluated to determine whether it is a taxable information service.

C. Telecommunications — Electronic Data Interchange

Under New York law, receipts from “sales of telephony and telegraphy . . . of whatever nature” are subject to sales tax.⁹ The department has interpreted the “of whatever nature” language to include modern electronic communications, such as e-mail and electronic data interchange (EDI).¹⁰ This position has been challenged and has been upheld in litigation.¹¹ Therefore, charges for e-mail, EDI, and similar modern electronic communications are subject to New York sales tax.

II. 3 Recent Electronic Commerce Sales Tax Advisory Opinions

A. Infrastructure as a Service

As discussed above, the department over the last five years has consistently issued guidance concluding that receipts from non-custom SaaS programs are subject to sales tax. But until recently, the department had not comprehensively addressed infrastructure as a service (IaaS).

A recent advisory opinion finally tackles IaaS.¹² The advisory opinion states that the petitioner requesting the ruling sells a cloud computing product that offers “Internet infrastructure for businesses.” That product can be used for various purposes, such as running internal applications or

hosting a commercial website. To access the product, customers create a virtual server and select a configuration of memory, CPU, and storage. They access the product in units consisting of hardware and software called “instances.” Customers cannot physically access the servers that provide the computing power. To use the product, customers use either the petitioner’s open-source operating system software or a designated third-party operating system software.

Once customers have requested an operating system and an instance, the petitioner configures it so that customers can connect with the instance’s operating system and run the program. Customers receive a free software development kit that includes application programming interfaces (APIs) that they can use to request data on cloud computing price history or to request new resources (that is, new instances) from the data center servers. Customers also have the option of using a free Web-based console to manage the computing power they have ordered.

The pricing for the product is based on the operating system customers select (systems that must be specifically licensed and that are not open-source cost more), the amount of computing power built into the instance, and the length of time the product is used.

On those facts, the advisory opinion concludes that the IaaS product is not prewritten software subject to sales tax, because customers pay to receive computing power, a non-taxable service, rather than software. While only precedential regarding the company that requested the advisory opinion,¹³ the language in the advisory opinion should give some level of comfort to similar IaaS providers.

B. Amazon Prime or Similar Membership

There is intense competition among Internet vendors to attract online customers, with Internet vendors competing on both pricing and delivery speed.¹⁴ Some experts expect that in the future, online purchases will be delivered to customers by drone within as little as 30 minutes after an order is placed. For now, it is not uncommon for Internet vendors to offer two-day delivery within at least some geographic areas.

Several Internet vendors are offering annual fee-based memberships that allow customers to receive faster delivery and in many cases reduced pricing or free products. A recent New York advisory opinion addresses whether such annual membership fees are subject to New York sales tax.¹⁵

The requester of the advisory opinion provides the following benefits to purchasers of an annual membership: (1)

⁶N.Y. Tax Law section 1105(c)(1).

⁷See TSB-M-10(7)S (July 19, 2010).

⁸See, e.g., TSB-A-15(5)S (Mar. 23, 2015).

⁹N.Y. Tax Law section 1105(b)(1)(B).

¹⁰See TSB-A-09(17)C (Dec. 15, 2009).

¹¹*Easylink Services International Inc. v. New York State Tax Appeals Tribunal*, 955 NYS2d 271 (N.Y. App. Div. 2012).

¹²TSB-A-15(2)S (Apr. 14, 2015).

¹³N.Y. Tax Law section 171 (“Such advisory opinions, which shall be published and made available to the public, shall not be binding upon such commissioner except with respect to the person to whom such opinion is rendered”).

¹⁴Although the requester of the advisory opinion is not named, the benefits of the membership as described in the advisory opinion are similar to those offered by Amazon Prime.

¹⁵TSB-A-15(15)S (Mar. 24, 2015).

free two-day shipping and other expedited shipping options; (2) select free streaming movies and television programs; (3) some free e-books for a select electronic book reader/tablet; (4) special pricing and discounts on items available through the website; and (5) a flat shipping fee for up to 45 pounds of heavy/bulky items.

The advisory opinion indicates that there are different companies working in unison to provide the benefits of the membership service. There is the retailer that operates the website from which customers order, there is an affiliate that sells the goods on the website, and there is a fulfillment affiliate that ships the goods to customers.

It might be expected that a membership fee is intangible property not subject to New York sales tax. This is supported by a 1996 advisory opinion, which holds that a membership fee allowing for discounts at designated places of business is a nontaxable “sale of an intangible.”¹⁶

However, the advisory opinion addressing the Amazon Prime-like membership fee concludes that the membership fee is taxable. The advisory opinion conceives the membership as a package of taxable and nontaxable benefits, and views customers as purchasing taxable shipping and discounts through their purchase of the membership fee. As such, the advisory opinion concludes that the membership fee is subject to New York sales tax.

Interestingly, this analysis contrasts with recent Illinois guidance that appears to address exactly the same issue for exactly the same requester.¹⁷ Unlike the New York advisory opinion, the Illinois ruling concludes that the membership fee is a nontaxable intangible asset not subject to service occupation (sales) tax.

C. Drop Shipment Facilitation Service

Internet vendors increasingly want their websites to be as comprehensive as possible so that they can offer one-stop shopping for customers seeking to buy multiple items. In many cases, it is neither possible nor desirable to keep in inventory and warehouse a gigantic amount of diverse tangible personal property. For some Internet vendors, the solution is to offer goods on their websites, but rely on unrelated third-party drop shippers to fulfill orders of the

goods. Drop shippers warehouse the goods, and when orders are received from Internet vendors, they ship the goods directly to purchasers.

A recent advisory opinion addresses whether a service that facilitates communications between Internet vendors and drop shippers is subject to sales tax.¹⁸

The service connects Internet vendors and drop shippers through a Web-based hub that receives, processes, translates, and relays orders and inventory-related data between the parties. Once a purchase is made, drop shippers using the service are immediately forwarded orders from Internet vendors, and Internet vendors can track when orders are processed and shipped. The process is automated, allowing for the fast transmission of order information without sending a fax or e-mail.

Fees for the service include a per-order charge and a monthly base fee. There is an implementation and training fee for setting up the service along with separate fees for the conversion and transfer of inventory files, and an additional fee if the service provider obtains the services of a value added network.

The advisory opinion concludes that the service is not subject to sales tax.¹⁹ It describes the service provider as selling a package of “integrated services” and identifies the most important service as the information exchange — particularly the processing of messages between Internet vendors and drop shippers. This aspect of the service is tantamount to data processing, which is a nontaxable service in New York. Accordingly, the advisory opinion concludes that the drop shipment facilitation service is nontaxable.

III. Conclusion

Determining the proper sales tax treatment of electronic commerce transactions can be crucial. Even if the sales tax at stake in a given transaction, is insignificant, with a huge volume of transactions the numbers can be staggering. In New York there is no comprehensive guidance addressing the sales tax treatment of electronic commerce transactions. Accordingly, an advisory opinion must often be requested if certainty is necessary. The three new advisory opinions addressing electronic commerce transactions discussed in this article are worthy of careful review because they all address areas for which there was no prior guidance. ☆

¹⁶TSB-A-96(15)S (Feb. 28, 1996).

¹⁷See Ill. Department of Revenue General Information Letter ST 15-0027-GIL (Apr. 30, 2015).

¹⁸TSB-A-15(20)S (May 26, 2015).

¹⁹The author of this article obtained the favorable advisory opinion for the service provider.