

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition :  
of :  
**NERAC, INC.** :  
for Revision of a Determination or for Refund of :  
of Sales and Use Taxes under Articles 28 and 29 :  
of the Tax Law for the Period December 1, 1996 :  
through February 29, 2008. :

DETERMINATION  
DTA NOS. 822568  
AND 822651

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In the Matter of the Petition :  
of :  
**JOHN RUEST** :  
for Revision of a Determination or for Refund of :  
of Sales and Use Taxes under Articles 28 and 29 :  
of the Tax Law for the Period December 1, 2005 :  
through February 29, 2008. :

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Petitioner, Nerac, Inc., filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 1996 through February 29, 2008. Petitioner, John Ruest, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 2005 through February 29, 2008.

A consolidated hearing was held before Dennis M. Galliher, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington , New York, New York, on August 4, 2009 at 10:30 A.M., with all briefs to be submitted by January 18, 2010, which date commenced

the six-month period for issuance of this determination (Tax Law § 2010[3]). Petitioner appeared by Morrison & Foerster, LLP (Irwin M. Slomka, Esq., of counsel). The Division of Taxation appeared by Daniel Smirlock, Esq. (Robert A. Maslyn, Esq., of counsel).<sup>1</sup>

### ***ISSUES***

I. Whether petitioner has established that the service it provides for its clients through its analysts did not constitute an information service subject to tax pursuant to Tax Law § 1105(c)(1),(9)(i).

II. Whether, if petitioner's service was an information service, the same must be excluded from being subject to tax because the information provided was personal and individual in nature and was not substantially incorporated in reports furnished to others.

### ***FINDINGS OF FACT***

1. Petitioner Nerac, Inc. (Nerac), is a research and advisory firm providing technical, scientific and engineering research and tracking services to its clients, most of whom are domestic and international companies engaged in the research, discovery and development of new and innovative products and technologies. Nerac's beginnings followed the passage of the Space Act by the United States Congress in 1958. The enabling legislation required the newly-created agency, the National Aeronautics and Space Administration (NASA), to disseminate the results of its research findings to the public for the "maximum public good." Nerac, the acronym resulting from the name New England Research Application Center, was established in or about 1966 as one of several industrial applications centers sited at various universities throughout the

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<sup>1</sup> Petitioner John Ruest appears in this proceeding because of his status as an officer of petitioner Nerac, Inc. Mr. Ruest does not contest this status or his resulting personal liability for any tax determined to be due herein from petitioner Nerac, Inc. Accordingly, references to petitioner shall mean petitioner Nerac, Inc., unless otherwise specified or required by context.

United States to work closely with business and industry to transfer NASA technology. Nerac was sited at and worked in collaboration with the University of Connecticut.

2. Nerac was an active agency under contract with NASA at the University of Connecticut until the summer of 1985, at which point it was reformed as a separate private not-for-profit corporation which maintained its relationship with NASA but was independent of its former university host. Nerac maintained its formal ties with NASA until 1989, when the industrial application environment changed and became aligned with the structure of the six federal laboratories. At this time, Nerac severed its contractual ties with NASA, but maintained a good working relationship under which Nerac continued to have access to NASA information, although it was no longer officially a part of NASA's network. Shortly thereafter, Nerac became a for-profit corporation.

3. Petitioner is staffed by approximately 100 highly trained and experienced scientists, engineers and other professionals (Analysts), who present an impressive array of notable professional credentials and advanced educational degrees in diverse industries and disciplines. Sixteen of petitioner's Analysts have doctorates in such disciplines as nuclear physics, biological systems engineering and electrical engineering. Thirty-five have master's degrees in disciplines such as organic chemistry, physics and aerospace engineering. Eight have M.B.A.'s in disciplines ranging from international business and finance to strategic marketing and operation management. Six Analysts have law degrees. Petitioner's Analysts conduct or have conducted both primary research, described as "research aimed at trying to make something work," and secondary research, described as "looking at other peoples' research in trying to find a solution to a specific problem." Petitioner's Analysts conduct far more secondary research than primary research in addressing the problems brought to petitioner by its clients.

4. Petitioner's Analysts use their multi-disciplinary knowledge and industry experience to help clients explore new applications, resolve critical research challenges and avoid potential problems in product development, enabling clients to develop or refine a technology, explore market opportunities and evaluate intellectual property strategies. Clients contact petitioner with very specific questions or problems, often directly contacting an Analyst with whom the client may have previously worked. The Analysts work closely with the client to understand the client's specific problem or inquiry, to design research strategies and parameters with respect thereto, and to implement such specialized research projects in response to that client's inquiry. Petitioner's Analysts conduct both retrospective (look back) research and prospective (forward tracking or alerting) research for clients. Retrospective research was described as finding, evaluating, providing to and assisting a client in understanding information within the published literature about a particular specific topic area or particular problem so as to allow the client to make an informed decision about that topic area or rectify a particular problem. Prospective research, by contrast and described in the vernacular as the "crystal ball" approach, involves creating, in response to a client's projected future aims, the opportunity to anticipate, search for, retrieve, evaluate and provide to and assist such client in understanding relevant information which may be discovered or uncovered and published in the future but which does not, at present, exist.

5. A typical research project begins with a client request for assistance, either involving a request for a specific Analyst with whom the client may have a preexisting working relationship, as noted, or involving a "topic" request in response to which Nerac would attempt to best match the nature and area of the request with the most relevant and specific scientific discipline, background and technical expertise of one (or more) of its Analysts.

6. In response to a client request, the assigned or matched Analyst will interview the client to obtain a clear understanding of the client's problem or needs. Based on the client interview and discussions, the Analyst will as necessary familiarize himself with the topic area of focus via research and, often, consultation with other colleague Analysts. The Analyst then uses his or her expertise to hone the characteristics of the client's problem or circumstances so as to frame the client's request, develop a search strategy and identify the most helpful databases in which to search. The Analyst will then research the query involving, in most cases, running several search strategies for each client inquiry, and in many cases involving further discussions with the client. The Analyst's strategy may involve several combined strategies designed to benefit from the strengths and nuances of the more than 100 different databases and other information resources available to petitioner's Analysts. These databases and information resources, in addition to the Analysts' own experience, include internet based sources consisting of both public domain and proprietary private domain (licensed) databases, petitioner's own internal database, and previously published material. The Analyst will then manually review the raw search results for relevance and responsiveness to the query, and choose the final results based upon the search parameters developed with the client.

7. Petitioner has refused requests for service, including instances where the question is known not to have an answer or where the query in reality represents corporate espionage (in which petitioner does not engage) rather than corporate intelligence or research. Nerac has also, on occasion, turned down a request where it could not provide the requisite analytical talent to properly handle the topic area of the request, although it will sometimes attempt to reach out and find someone (via networking) who could help the client. Petitioner has also advised clients, on rare occasions, that the topic area of a request is simple enough that the client can find the

relevant information on its own. Petitioner's clients, however, are described as sophisticated customers who bring sophisticated questions to petitioner, leaving this latter instance of simple queries, at best, a very infrequent event. At the same time, there are instances where a solution to a client's seemingly difficult inquiry or problem might be described as fairly obvious to an Analyst but simply overlooked by the client. Petitioner attributes such instances to the fact that its Analysts are, unlike its clients, "outside the box, looking in," and thus to some degree able to notice things the client does not notice or understand things that the client has difficulty understanding, an aspect described as some of the "value-addition" that petitioner is able to bring to its clients.

8. For nearly all client inquiries involving retrospective research, petitioner provides the client with a written research report of the Analyst's results, specifically tailored to each client. These reports generally contain the specific question presented, the steps taken by the Analyst to research the question, a summary of the published information, the Analyst's conclusion, and citations to the sources selected by the Analyst as most relevant. Citations are provided so the client can review the cited literature itself and make certain the Analyst's proposed solution is based on valid ground. If more than one Analyst has been significantly involved in the process, the report furnished to the client will note this collaboration and provide appropriate attribution as to the Analyst's collaborating colleagues. Petitioner does not provide a written report in response to every client inquiry, either because a solution to the inquiry cannot be found or because a response to the inquiry is capable of being furnished orally. The process, as encapsulated in a written report, does not necessarily reflect the amount of work, analysis or time that has gone into reaching the conclusion, advice, solution or suggested course of action

specified in a report. Petitioner retains client reports for only six months, with no archiving thereafter.

9. The development of a prospective search strategy, in which clients receive updates rather than a written report, is nearly identical to that of a retrospective strategy. A prospective search strategy often results from a retrospective project, modified to develop a discrete information-tracking tool. That is, the client and Analyst work to develop a query and search strategy that is on target with and relevant to the particular problem posed or research requested by the client. Prospective search results receive the benefit of vetting for relevance by the Analyst both via the process of designing the search strategy in discussion with the client and by monitoring of the results by the Analyst.

10. Each client inquiry is researched and analyzed by an Analyst without reference or access to reports furnished to other clients. The information shared with petitioner by its clients is often highly sensitive and proprietary to the client. Consequently, petitioner and its clients execute nondisclosure agreements whereby petitioner is contractually prohibited from disclosing to third parties any information pertaining to its client, or any searches requested by or performed for any of its clients, and petitioner is prohibited from using that confidential information, or information developed in its research for that client, in performing research for other clients.

11. While no two reports are the same, it is remotely possible that a single document or piece of information uncovered by an Analyst's research might be referenced in reports furnished to different clients. However, given the unique nature of each client inquiry, and the Analyst's lack of access to prior reports, there is virtually no possibility that the contents of a report furnished to one client will ever be substantially incorporated into a report furnished to another

client. Petitioner's witnesses could not recall any instance of the same inquiry being made by different clients.

12. Petitioner charges an annual subscription fee entitling its clients to one year of access to petitioner's Analysts' services.<sup>2</sup> This fee is initially based on petitioner's estimate of a given client's anticipated use of petitioner's Analysts' services. Subsequent years' subscription fees are based on the client's actual use of services during the prior year and its expected or projected usage in the upcoming year. Petitioner and its clients initially execute a Master Services Agreement and a Subscription Participation Agreement (allowing a client to receive output from certain databases subject to licenses and copyright restrictions imposed with respect thereto). For ensuing years, each executes a Renewal of On Demand Services Agreement and a Subscription Renewal Participation Agreement, with the latter two documents "integrally attached" to the previously executed Master Services Agreement.

13. The Master Services Agreement provides that petitioner "provides research advisory services for scientific and technical research and development, intellectual property strategy, and market and business strategy." Pursuant to a Statement of Work also executed by and between the parties, petitioner delivers its services as described above (*see* Findings of Fact 4 through 11). The Statement of Work describes a "Research Report" as a "summary conclusion" to the research topic defined through a client request along with citations and references in support of those conclusions, and describes an "Alert" as having been established by an Analyst "to report

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<sup>2</sup> Petitioner also charged its clients for certain additional discrete services, such as a separate document service that involved only the retrieval of documents. In June 2003, petitioner became registered for sales tax purposes and began reporting its sales (income) from the document retrieval service at such time. Tax in the amount of \$5,711.02 is encompassed within the assessment for the period June 1, 2003 through February 29, 2008 on receipts from this service based on petitioner's failure to report and pay tax thereon for such period. This amount is not in issue in this proceeding.



on any new publications, announcement, or industry events that are relevant to a research topic.” The Statement of Work makes clear that citations and references provided may, in some instances, include copyright fees in order to read the full-text versions thereof (as opposed to the Research Report summary conclusion furnished by the Analyst).

14. Under the foregoing agreements, petitioner’s clients may contact petitioner’s Analysts to address a proposed issue or problem by web access, e-mail, or telephone, and the Analysts will respond to the specific client employee who initiated the request for petitioner’s research services via e-mail, web or telephone, ultimately by providing a Research Report or establishing an Alert.

15. As representative of its Analysts’ services, petitioner provided two of its Analysts, Michael Mahoney and John Leavitt, PhD, each of whom testified about their handling of client inquiries. Each described his respective area of expertise, his experience, and his application of the same in the provision of services to petitioner’s clients.

16. Mr. Mahoney, an electrical engineer, maintained direct and ongoing contact with clients on each project, so as to best understand the nature of the problem presented, what the client was trying to accomplish, and how the client intended to use the results of Mr. Mahoney’s research. He described three research projects he worked on for clients:

- a) determining the market for carbon resistors.
- b) forecasting food storage or food preparation technology in the future.
- c) assisting a client (a flashlight company) that was seeking to invalidate a competitor’s patent.

17. Dr. Leavitt holds a doctorate in biochemistry and has expertise in the biotechnology and pharmaceutical industries. He emphasized his knowledge of “biomedical language,” gained from his many years of experience, as essential to his ability to understand, research and find

solutions to client inquiries in his particular field of expertise. He described three research projects he worked on for clients:

- a) advising a gelatin manufacturer on how to inactivate swine flu from the gelatin manufacturing process.
- b) assisting a client (a vaccine manufacturer) that was seeking to invalidate a competitor's patent.
- c) advising an Italian university on the viability of a potential diagnostic test to ascertain predisposition to cancer from a virus in the DNA found in human cells.

18. Petitioner also offered the testimony of Alan J. Salzburg, PhD, who qualified and was permitted to testify as an expert in statistics, and who performed a statistical database review study of the mainframe "search strategies" conducted by petitioner's Analysts. The purpose of the study was to quantify the level of duplicative searches in order to determine the frequency with which the results of the Analysts' searches could be furnished to petitioner's other clients (i.e., where more than one client could be given the same search result or report). Dr. Salzburg testified, and petitioner posits, that if the Analysts' searches were found to be unique, it follows that the results of those searches contained in reports furnished to clients would also be unique to each client. Dr. Salzburg's study utilized mainframe (computer) search strategies and not the reports furnished to clients, since petitioner retains the reports it provides to clients only for a period of six months leaving the same unavailable to Dr. Salzburg for review and analysis.

19. Dr. Salzburg reviewed nearly 1.5 million "search strategies" developed and used by petitioner's Analysts over a ten-year period covering the tax periods in issue. A "search strategy" was defined by Dr. Salzberg as a combination of terms (usually words and phrases) searched, databases searched in, and keys (such as title or author) searched. Dr. Salzburg reviewed two historical search logs maintained by petitioner and covering the tax periods in question. Based on his review and analysis of the search data, Dr. Salzburg concluded that at least 97% of the

search strategies employed by petitioner's Analysts were unique and therefore could not be used for multiple clients. He also performed a "stratified" sample, randomly selecting 100 search strategies and analyzing them individually. Based on this sample Dr. Salzberg refined his earlier result, concluding that 99.3% of the search strategies were unique to each client. He expressed his opinion that such unique search strategies would, in turn, result in unique search results. Finally, Dr. Salzberg also ascertained the number of different search strategies employed by petitioner on behalf of each client. He considered this relevant because if he found that petitioner's Analysts performed only one search strategy for each client, any duplicate search strategies might suggest that the same research was being performed for several clients. His review determined that for 87% of petitioner's clients, petitioner's Analysts employed more than a single search strategy, and that for more than 50% of those clients, petitioner's Analysts performed four or more search strategies.

20. In January 2004, the Division of Taxation (Division) commenced a sales tax audit of petitioner. According to the Tax Field Audit Record (Audit Log), the Division's initial auditor concluded that petitioner was furnishing a taxable information service, apparently on the basis that petitioner's Analysts did not receive any data from petitioner's clients.

21. On March 25, 2005, petitioner filed a petition seeking an Advisory Opinion from the Division's Technical Services Bureau as to whether petitioner's services constituted the provision of a taxable information service per Tax Law § 1105(c)(1), the same issue in the then-pending sales tax audit. Upon receipt of the request for an Advisory Opinion, the Division's audit was placed on hold.

22. Petitioner provided examples representative of the research projects performed by its Analysts for the Division's consideration in connection with the request for an Advisory

Opinion.<sup>3</sup> Petitioner also provided, at a June 2005 meeting with the Division, three representative written reports prepared by its Analysts for clients. In response, petitioner was orally advised that its services should not be considered taxable information services, primarily because of the involvement and expertise of petitioner's Analysts in performing the services, and was further advised that a draft Advisory Opinion would be prepared, subject to internal review, concluding that petitioner's services were not subject to sales tax. Thereafter, a draft Advisory Opinion was prepared concluding that petitioner's services were not subject to sales tax.

23. The draft Advisory Opinion was not finalized. Instead, in November 2007, the draft Advisory Opinion was redrafted to conclude that:

a) petitioner's services regarding a "Solution for an Adhesion Problem" as described in the request for Advisory Opinion, involved an instance where petitioner had been actively involved in the development of the client's project and was viewed by the Division as constituting a consulting service which was not an enumerated service subject to sales tax.

b) petitioner's service regarding a "Solution for Patent Litigation", involved a search for information regarding a specific issue which would by itself answer the query. The service was determined to be facilitating information tracking and retrieval, and the tracking, retrieval and compiling of such information was from a source which could be used to furnish the same information to other clients in response to their requests, thus leading the Division to conclude that petitioner was providing a taxable information service.

c) when petitioner's sales of the taxable and nontaxable services described in [the Advisory Opinion] are bundled in the annual subscription fee, the entire charge is subject to tax.

Upon learning of this revised conclusion, petitioner withdrew its request for an Advisory Opinion by letter dated November 30, 2007.

24. In February 2008, the Division returned to the conduct of its audit of petitioner. The auditor visited petitioner's premises and, according to the Audit Log, reviewed four sales

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<sup>3</sup> The examples are "Solution for an Adhesion Problem" and "Solution for Patent Litigation" (*see* Finding of Fact 23).

contracts and some sample research reports. The auditor concluded and advised petitioner that the reports he read would not be considered personal and individual in nature, could be incorporated into reports furnished to others, and thus should be considered subject to tax. More directly, the auditor determined that petitioner was not charging sales tax on its invoices to its clients for subscription fees, that such fees entitled clients to receive information and documents or documents only, and that since the fees were not segregated for specific services and the auditor could not determine whether nontaxable consulting services (as in Finding of Fact 23 [a]) were mixed with allegedly taxable information services (as in Finding of Fact 23 [b]), thus resulting in the entire fee being held subject to sales tax.

25. As a result of its audit, the Division issued to petitioner Nerac, Inc., a Notice of Determination (L-030653968-7) dated September 15, 2008 assessing sales tax due in the amount of \$573,738.14, plus interest, on additional sales in the amount of \$7,185,027.80 for the period December 1, 1996 through February 29, 2008. The Division also issued a Notice of Determination (L-030929052) dated November 7, 2008 to petitioner John Ruest, as an officer of petitioner Nerac, Inc., assessing sales tax due in the amount of \$109,241.67 for the period December 1, 2005 through February 29, 2008.

### ***CONCLUSIONS OF LAW***

A. Tax Law § 1105(c) imposes tax upon the receipts from every sale, except for resale, of nine specifically enumerated services. As is relevant to this matter, Tax Law § 1105(c)(1) imposes tax upon the service of:

The furnishing of information by printed, mimeographed or multigraphed matter or by duplicating written or printed matter in any other manner, including the services of collecting, compiling or analyzing information of any kind or nature and furnishing reports thereof to other persons, but excluding the furnishing of information which is personal or individual in

nature and which is not or may not be substantially incorporated in reports furnished to other persons.

In 1990, Tax Law § 1105(c) was expanded by the addition of paragraph nine so as to impose tax upon the receipts from every sale, except for resale, of an information service that is provided via telephony or telegraphy (Tax Law § 1105[c][9][i], as added by L 1990, ch 190, eff. September 1, 1990). Section 1105(c)(9) provides that “[i]n no event (i) shall the furnishing or provision of an information service be taxed under this paragraph unless it would otherwise be subject to taxation under paragraph one of this subdivision if it were furnished by printed, mimeographed or multigraphed matter.” Thus, the essential issue of whether petitioner is furnishing a taxable information service requires analysis under Tax Law § 1105(c)(1).

B. Regulations of the Commissioner of Taxation and finance, at 20 NYCRR 527.3, in relevant part identify taxable information services to include “credit reports, tax or stock market advisory and analysis reports, and product and marketing surveys.” (20 NYCRR 527.3[a][3].) Examples of taxable information services include a weekly newsletter showing the range of commodity prices, a monthly bound volume of current advertising rates, lists of prospective customers’ telephone numbers, and a computer service company’s print-out of cases and statutes containing the word “assessment” as requested by customers (20 NYCRR 527.3[a], examples 1-4). Examples of nontaxable information services include a private detective agency’s report to its client, an auto insurance damages appraisal report, and a computer services company’s withholding tax payroll report to subscribers (20 NYCRR 527.3[b], examples 1-3).

C. As a general rule services, as opposed to tangible personal property, are not subject to sales tax unless they are specifically enumerated in the Tax Law (*see Matter of Rochester Gas and Electric Corp.*, Tax Appeals Tribunal, January 4, 1991). The “furnishing of information” is

such an enumerated taxable service under the law (Tax Law § 1105[c][1],[9]). However, there is a distinction between a taxable information service and the furnishing of a nontaxable service where information is merely a component of that service. In *Matter of SSOV '81 Ltd.* (Tax Appeals Tribunal, January 19, 1995), the Tribunal explained that the term “information service”

has been interpreted to mean “the sale of the service of furnishing information by a business whose function it is to collect and disseminate information which is taxable under Tax Law § 1105(c)(1) and not the mere sale of information” . . . . In order to determine a service’s taxability, the analysis employed by the New York courts and the Tax Appeals Tribunal focuses on the service in its entirety, as opposed to reviewing the service components or by the means in which the service is effectuated. (Citations omitted.)

In *Matter of SSOV '81 Ltd.*, the Tribunal focused on the “primary function” of the service, which was to enable members of a dating referral service to meet others. In concluding that such primary function was not one of the enumerated taxable services set forth in Tax Law § 1105(c), the Tribunal recognized that the proper focus should be on the primary function itself and not upon whether the service might, as an incident thereof, involve the provision of information, stating that:

[t]o neglect the primary function of petitioner’s business in order to dissect the service it provides into what appears to be taxable events stretches the application of Article 28 far beyond that contemplated by the Legislature.

Under the foregoing rubric, to be an information service the taxpayer’s primary function must be the business of furnishing information. As the Tribunal has stated, “the mere fact that information is being transferred will not create a taxable event” (*Id.*; see *Matter of Principal Connections, LTD.*, Tax Appeals Tribunal, February 12, 2004).

D. Petitioner first argues that the assessment should be canceled because the Division has not established a rational basis for its issuance. This argument is rejected. Here, the Division

commenced an audit, then held the same in abeyance while considering the taxability of petitioner's business through the Advisory Opinion process as initiated by petitioner. As detailed, and notwithstanding an alleged initial belief that petitioner's service was not a taxable information service, the process of review resulted in a draft Advisory Opinion concluding that at least some of petitioner's service constituted a taxable information service (*see* Finding of Fact 23). In turn, petitioner withdrew its request for an Advisory Opinion and the audit process was resumed. Upon further review of what he believed to be representative examples of petitioner's contracts with its clients and a number of sample Analysts' research reports, the Division's auditor concluded that the information found and relayed to the client by the Analyst's report could be incorporated into reports furnished to other clients and was not personal or individual in nature. The auditor also apparently concluded that since petitioner charged its clients a single subscription fee and did not distinguish between what would be a taxable information service consisting of retrieval and furnishing of documents versus what would be considered nontaxable consulting services, the entire subscription fee was subject to tax. Against this background of review, it cannot be said that the Division had no basis for its determination that petitioner was providing, at least in part, a taxable information service or that there was no support for the issuance of the notice of determination concluding that the full subscription charge for petitioner's service was subject to tax. While a full presentation of the facts at hearing leads to a different conclusion, as set forth below, the Division's assessment does not fail at the outset for lack of a rational basis to support its issuance.

E. Turning to the primary question in this case, petitioner's service undeniably involves the "furnishing of information," at least in a very literal sense. However, viewed in its entirety petitioner's service principally involves giving guidance and advice, based on analysis, with



respect to a particular transaction, set of circumstances or discrete problem. That is, the primary function of petitioner's service is to provide a solution or resolution to a problem or to provide a course of action regarding a particular issue or question faced by a client. To be sure, petitioner's clients receive information, in the form of citations to scientific and technical papers, studies and reports derived from the Analyst's research efforts and in support of the Analyst's conclusions concerning resolution of the client's problem. However, to conclude that the client's receipt of information in this fashion is enough to make petitioner's business a taxable information service leaves the Analysts as mere conduits who simply find and funnel raw data or information to the clients. This view ignores the critical role of the Analysts and the value of their expertise, education and experience in the process of resolving clients' problems.

F. Petitioner's role, as carried out by its Analysts, is clearly distinguishable from the admittedly taxable service of simply retrieving, collecting, compiling and furnishing information. Petitioner employs a relatively large roster of highly skilled, educated and experienced "problem solvers" who function as consultants. Petitioner's clients subscribe to petitioner's service for the primary purpose of obtaining guidance, advice, input and direction to or toward solutions to resolve technically difficult problems. Petitioner's clients' own scientific and technical abilities are described as considerable. Nonetheless, they are at times apparently unable to satisfactorily resolve certain discrete technical issues without additional specific topic-area scientific or technical assistance. Petitioner maintains and makes accessible to its clients a highly qualified and specialized staff of over 100 Analysts, possessing a broad range of education, work experience, including significant research experience, and expertise. Petitioner's service affords its clients access to such experts and their range of analytical, scientific and technical knowledge as needed on an ad hoc rather than full time basis without bearing the full and likely prohibitive

expense of employing such a broadly diverse and highly technical work force. Petitioner's clients can access petitioner's Analysts to address not only technical and product development issues, but to anticipate and address ancillary or tangential aspects of their business so as to avoid potential problems in marketing, maintaining and safeguarding the products or processes they develop. To accept that petitioner simply provides the service of furnishing references to available information oversimplifies and understates, to the point of nearly ignoring the role and importance of the Analysts, essentially relegating them to mere facilitators providing access to collected information upon request.

G. Petitioner is more than simply a "clearinghouse" for access and dissemination of technical and scientific information. Its clients' inquiries are typically highly specific, unique and technical, and the service petitioner provides, through its Analysts, is far more than merely facilitating the mechanical retrieval, compilation and presentation of citations to relevant information. While petitioner does provide citations or references to written materials regarding the client's specific issue or problem, petitioner is consulted by its clients to perform investigation and analysis for the primary purpose of giving advice and direction, rather than simply to provide collected and compiled information. Petitioner provides such advice and direction in the form of a recommendation or opinion, sometimes orally but usually in written form. In this case, the true object of the service petitioner provides is the advice and solution resulting from the skilled application of the knowledge, education, expertise and experience of petitioner's Analysts. A large part of the Analyst's value comes from knowing where to search for possible solutions to petitioner's clients' problems. The conclusion that the experience, expertise, and research and analysis capabilities of petitioner's Analysts is the primary purpose

for which petitioner is engaged by its clients, is brought out by the testimony of Mr. Mahoney, as follows:

Well, . . . if it [resolving the issue] was that easy, why didn't the guy [client] know to just go and look at the NASA database. I had to try a lot of different things and read a lot papers to find one that I really thought would be something that could be applied to [the client's particular query]. I didn't send the guy 150 statements and say, here, you know, pick one of these, read it, it's bound to solve your problem.

Petitioner's Analysts have access to over 100 databases, and nearly half of such sources are proprietary. Nonetheless, even in the more common databases, including the open internet sources, petitioner's Analysts may see or bring to the client something that may be manipulated or adapted in a different manner to resolve a client's problem or used in a new or different or future application. Without the level of skill, experience, education and expertise of its Analysts, petitioner's service would be of little apparent value. In sum, petitioner through its Analysts conducts and provides sophisticated consultation, custom research and problem resolution for its clients. Since the primary function of petitioner's service is not to collect, compile, analyze and disseminate information, petitioner is not providing an enumerated taxable service, and thus petitioner's receipts (excepting those receipts concerning its document service [*see* Finding of Fact 12, footnote 2]), are not properly subject to sales tax under Tax Law § 1105(c)(1),(9).

H. Having concluded that petitioner's service does not constitute a taxable information service, it is not strictly necessary to address whether the receipts from its service, if taxable, would nonetheless escape taxation under Tax Law § 1105(c)(1) as "the furnishing of information which is personal or individual in nature and which is not or may not be substantially incorporated in reports furnished to other persons." However, in the interest of providing full analysis, this issue will be briefly addressed. First, petitioner's Analysts' advice and report

pertains, in virtually every instance, only to that unique transaction query brought by one particular client, and the particular resulting advice, opinion and report are not shared with or communicated to anyone else. Search parameters, developed by the Analyst in consultation with each client, are specifically designed to address and resolve the particular problem or issue unique to each client, or to monitor ongoing relevant developments with respect thereto.

Petitioner's Analysts do not search one single public or common database for solutions or information, but rather have available and use over 100 databases, as described. The clients' queries and Analysts' responses thereto are highly proprietary in nature and may involve competing interests, hence leading to a high priority in keeping the client requests as well as the proposed solutions or suggestions individual to each particular client and not disclosed to others. Petitioner acknowledges the possibility that a discrete piece of research information could be included in reports furnished to two different clients. However, given that the search strategies are unique in nearly every instance, as supported by the statistical study conducted by petitioner's witness Dr. Salzberg, it follows that the responses will also be unique and specific. This is further borne out by the process through which the query itself is first honed by the Analysts in discussions with the client, as well as by the following process in which the Analyst reviews the materials resulting from the research to determine that the same are in fact relevant and applicable to the specific query posed. The possibility that a research derived citation may at some point "overlap" and appear in more than one client's report does not constitute substantial incorporation of the same information in reports furnished to other clients. Such a conclusion would effectively remove the term "substantially" from the language of the statute. The fact that petitioner does not archive its Analysts' reports but rather destroys the same after six months further effectively limits the availability of such reports for use in preparing reports for others and

incorporating the results from one client's report in a report subsequently furnished to a different client. Accordingly, even if petitioner's service was considered to be an information service, the receipts derived therefrom would be excluded from taxation because the information furnished is personal and individual in nature and is not and may not be substantially incorporated in reports furnished to others.

I. The Division's assessment was in part premised on the position that even if some part of petitioner's service was not a taxable information service, the fact that petitioner charged its clients a single subscription fee without differentiating or separately stating the nontaxable versus taxable portions on client invoices rendered the entire subscription fee subject to tax. In support of this position, the Division cites to 20 NYCRR 527.1(b), the so-called "bundled transaction" rule. However, since it has been concluded that none of the services in question constitute an information service subject to tax, this issue need not be addressed.<sup>4</sup> Likewise, petitioner's equitable estoppel argument seeking to prevent the Division's collection of tax prior to November 2007, based on alleged uncertainty as to the tax status of petitioner's service prior thereto and on alleged delays in the Advisory Opinion process, has been rendered academic and need not be addressed herein.

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<sup>4</sup> 20 NYCRR 527.1(b) applies by its own terms to sales of *tangible personal property* composed of taxable and exempt items sold as a single unit, as opposed to sales of *services*, including information services potentially subject, in part or in full, to sales tax. The question of differentiating between taxable and nontaxable *services* on customer invoices so as to avoid the "bundled transaction" rule of 20 NYCRR 527.1(b) apparently arises from language in the Division's draft Advisory Opinion stating that "if the charges for nontaxable services were separately stated on the customer bill or invoice and such charges were reasonable in relation to the total charges, then Petitioner would not be required to collect tax on such charges."

J. The petitions of Nerac, Inc., and of John Ruest are hereby granted and the notices of determination dated September 15, 2008 and November 7, 2008, respectively, are cancelled.

DATED: Troy, New York  
July 15, 2010

/s/ Dennis M. Galliher  
ADMINISTRATIVE LAW JUDGE