

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
TELECHECK SERVICES, INC.	:	DETERMINATION
	:	DTA NO. 822275
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 March 1, 1999	:	
through November 30, 2005.	:	

Petitioner, TeleCheck Services, 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 March 1, 1999 through November 30, 2005.

A hearing was held before Frank W. Barrie, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on December 9, 2008 at 9:30 A.M., with all briefs to be submitted by May 11, 2009, which date commenced the six-month period for issuance of this determination (Tax Law § 2010[3]). Petitioner appeared by McDermott, Will & Emery, LLP (Arthur R. Rosen, Esq., and Lance E. Rothenberg, Esq., of counsel). The Division of Taxation appeared by Daniel Smirlock, Esq. (Robert A. Maslyn, Esq., of counsel). Administrative Law Judge Barrie retired from State service during the pendency of this matter and the same was transferred to Dennis M. Galliher, Administrative Law Judge. After review of the evidence and arguments, Judge Galliher renders the following determination.

ISSUES

I. Whether petitioner's service of providing check verification, whereunder a merchant receives from petitioner a recommendation to either accept or reject a customer's check in payment for goods or services, constitutes the provision of a taxable information service.

II. Whether, assuming check verification constitutes a taxable information service, petitioner has established any basis warranting the reduction or elimination of penalty.

FINDINGS OF FACT¹

1. Petitioner, TeleCheck Services, Inc., provides paper and electronic check services, including check verification and check guarantee services. The service at issue in this matter pertains solely to petitioner's check verification service.²

2. Petitioner's check verification customers are primarily retail merchants, although they may be any business. Petitioner's customers range from very large national retail merchants to smaller local retail merchants.

3. A merchant subscribes to and purchases petitioner's check verification service to assist it in determining whether the merchant will or will not accept payment from one of its own customers in the form of a check. Check verification is an important tool that assists merchants

¹ The parties entered into a Stipulation of Facts setting forth some 30 individually numbered and agreed to facts. These stipulated facts are included in the Findings of Fact with the exception of those stipulated facts numbered 2, 3, 4, 5 and 6, which pertain solely to procedural matters, and 7 and 8, which set forth the Division of Taxation's position regarding the taxability of the service petitioner provides.

² Petitioner's check guarantee service is related to petitioner's check verification service. With check guarantee, if petitioner advises a merchant to accept a customer's check (based upon petitioner's check verification analysis of the likely validity of that customer's check) and that check ultimately is dishonored by the issuing bank, then petitioner will pay the merchant. Thus, petitioner "guarantees" the validity of the check (up to the amount of the guarantee). The Division has previously determined that the discrete service of check guarantee provided by petitioner is not subject to the sales tax (*In re Telecheck Services, Inc.*, TSB-A-96(22)S [1996]).

to expedite the handling of checks and reduces the probability of check fraud, thereby assisting merchants to accelerate cash flow, lower operating expenses and increase sales.

4. A merchant uses petitioner's check verification service when a customer attempts to make a purchase from that merchant by paying with a check (in contrast to paying by cash or by credit or debit card).

5. When a customer presents his or her check to a merchant, the merchant may use petitioner's check verification service by submitting certain information, captured at the point of sale, pertaining to the customer, the customer's check and/or the bank upon which the customer's check to petitioner is being drawn, typically by entering such information into a point-of-sale terminal. The type of information provided by a merchant to petitioner includes the following: the customer's check number, the amount of the customer's check, the issuing bank, the bank account number and bank routing number and, sometimes, the customer's driver's license number. Certain additional information is implicitly supplied, such as the time of day or night of the transaction, the address of the merchant's store where the transaction is occurring, and the type of merchant.

6. Upon receipt of the information provided by the merchant, petitioner performs two steps of analysis.

a) First, the check data described above is run through petitioner's proprietary, self-created and updated "activity database," petitioner's primary database which was built in-house and contains all check data that petitioner has amassed over the past seven years. Any historical data that appears linked to the customer's check data (such as the checking account number or driver's license number) is identified for any positive or negative indications. Petitioner also subscribes to a restricted third-party database called "Early Warning," which contains bank

account information that is collected and provided by participating financial institutions. The check data is run through this database to identify any positive or negative indications. Petitioner does not purchase or utilize other third-party data such as criminal conviction records, credit bureau credit reports or county clerk records.

b) Second, the check data together with any historical check data (gleaned from the foregoing process) is run through petitioner's "risk scoring system." The risk scoring system consists of highly proprietary and sophisticated computer systems which petitioner built in-house. These systems perform a risk analysis applying intricate, complex, confidential and proprietary statistical models, algorithmic processes and other risk assessment tools to the check data and any historical check data, with the goal of making a determination as to whether or not the customer's check is too risky for the merchant to accept. The risk scoring process makes use of multi-variable (multi-variate) regression analysis to sort through up to 400 different variables (such as the number of checks the customer has written in the past 7 days, past 30 days, the number of checks the customer has written to this merchant, the average check amount, and the like) per transaction. The number and type of variables may differ for different merchants, and the relative weight assigned to each variable may likewise differ for different merchants, and the risk analysis formulae can be merchant specific or industry specific.

7. Petitioner's ultimate goal, by use of its predictive models, is to mitigate the risk to a merchant that a customer's check will be dishonored. The aim of petitioner's process is to develop accurate predictive risk models and formulae tailored to particular merchants or particular industries so as to accurately assess the likelihood that a merchant's customer's check will or will not be dishonored, and thus advise its client (the merchant) as to whether or not to accept a customer's check.

8. Petitioner's risk analysts identify and evaluate each of the up to 400 variables that may be relevant in determining check risk for a particular merchant or industry. Each variable, in turn, must be assigned a correlation coefficient or weight to determine its relative impact on the risk scoring analysis. Petitioner's risk analysts determine the relevant variables and the relative weight to be assigned to each using petitioner's highly proprietary Orion computer system, which uses statistical modeling software to perform the regression analysis. Using this system involves approximately 10,000 computations for each variable, and another approximately 10,000 iterations weighting the variables against each other. The foregoing process is highly complex and requires highly specialized skills. Petitioner's risk analysts bring education, training and professional experience skills, including advanced degrees in economics, engineering, finance and computer science, commensurate with the complexity of the process. Petitioner's employees have expended many thousands of hours, and petitioner has expended a great deal of capital, in developing the proprietary computer systems employed in petitioner's check verification process, and petitioner and its employees continue these expenditures on an ongoing basis testing, enhancing, rebuilding and improving the computer systems. Consequently, petitioner considers its models and algorithms to be trade secrets and does not share them with anyone.

9. After analyzing the information using the processes described above, petitioner formulates a communication as to whether a particular check should be accepted or not, and provides its communication to the merchant regarding whether the merchant should or should not accept the check. A merchant receives petitioner's communication (i.e., petitioner's opinion, advice or recommendation) in the form of a code number, either 0 or 1 or 3 or 4, signifying, respectively, whether the merchant is being advised to reject the check (0), accept the check (1), obtain additional information to be submitted to petitioner (3), or resubmit the information due to

an error (4). Depending upon the merchant's equipment, the equipment will display the code number itself, i.e., 0, 1, 3, or 4, or will display the words "decline," or "accept," or "call" (and a number to call), or "error."

10. The communication provided by petitioner to a merchant, whether or not to accept the check, pertains only to the single check transaction of that one customer and that one purchase. The same code numbers, i.e., 0, 1, 3, or 4, or the words "decline," "accept," "call" or "error," can be provided to different merchants concerning checks issued by the same person (e.g., a customer goes to one merchant to make a purchase and thereafter goes to a different merchant to make a purchase). The same recommendation as to whether to accept or decline a check may, or may not, be made to each of the different merchants, depending upon the risk parameters specific to the customer and the specific merchant.

11. The result of each check verification transaction that is performed by petitioner for any merchant is added to petitioner's in-house activity database, such that the database is continually updated with new information, which may impact any future check verification analyses. Thus, a revised database is used each time a check verification analysis is performed by petitioner.

12. The communication provided to the merchant, whether or not to accept a particular check, is not provided to anyone other than that specific merchant who requested that specific check verification. Petitioner's communication, whether or not to accept the customer's check, is nonbinding upon a merchant.

13. The Division of Taxation (Division) conducted a sales and use tax field audit of petitioner for the period spanning March 1, 1999 through November 30, 2005. As a part of that audit, the Division requested in writing from petitioner certain books, records and other material documents including source records.

14. By a Test Period Agreement signed June 14, 2007, petitioner consented to the use of a test period audit method to determine the tax due, if any, on sales and, the same was performed by the Division, using the period June 1, 2003 through August 31, 2003 as the test period.

15. Petitioner differentiates in its accounts between receipts from check verification services and receipts from check guarantee services. Petitioner did not charge or collect sales tax on its receipts from check verification services.

16. As a result of the test period audit, the Division determined that there were additional taxable sales of \$6,087,129.51 during the audit period, with additional sales tax due thereon in the amount of \$525,014.92. In turn, the Division issued to petitioner a Notice of Determination (L-028633146-2) dated May 29, 2007 assessing sales tax due for the period March 1, 1999 through November 30, 2005 in the amount of \$525,014.92, plus interest and penalty.³ Petitioner contests the taxability of its check verification service, but does not contest the method of computation of the tax assessed or the dollar amount thereof.

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.

³ By a series of consents extending the period of limitation on assessment, petitioner agreed that the Division could determine and assess tax for the period March 1, 1999 through May 31, 2004 at any time on or before June 20, 2007.

B. 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]; L 1990, ch 190, eff September 1, 1990). Since petitioner's check verification communications to its merchant-clients are not printed, mimeographed, or multigraphed, its check verification service could only be taxable pursuant to Tax Law § 1105(c)(9). However, since 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," the issue of whether petitioner is furnishing a taxable information service requires analysis under Tax Law § 1105(c)(1).

C. Regulations of the Commissioner of Taxation, 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).

D. 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 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.

E. Under the foregoing rubric, to be an information service, the taxpayer must be in 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 Principal Connections, LTD.*, Tax Appeals Tribunal, February 12, 2004). Petitioner’s service undeniably involves the “furnishing of information,” i.e., its communication as to whether to accept or reject a given

check is, in fact, a piece of information. However, viewed in its entirety petitioner's service principally involves giving advice, based on analysis, with respect to a particular transaction. That is, the primary function of petitioner's service is to provide a recommendation or opinion based upon its sophisticated risk scoring analysis of the information provided to it (the check data), and in its possession (in its own activity database and in the Early Warning database), as to the likelihood that a particular check will or will not be honored.

F. Petitioner does not disseminate the data upon which its recommendation or advice is based, nor does it provide to its clients the analytical processes by which its recommendation or advice is determined. Petitioner's clients are not privy to, do not seek, and do not receive such information, but rather subscribe to petitioner's service for the primary purpose of obtaining advice as to whether or not to accept a customer's check in payment for goods or services furnished. Unlike the furnishing of a credit report, petitioner's clients do not seek and do not receive particular information concerning a potential customer's personal credit circumstances or history (e.g., credit activity, balances, lines of credit, bankruptcies, credit defaults, and the like), upon which they could undertake a review and analysis and, based thereon, make the ultimate decision as to whether a customer's payment check should or should not be accepted. Petitioner does not furnish to its clients any information as to the creditworthiness of the clients' customers (the check writers) or any other information particular to the customers. Petitioner's clients do not know or understand what piece or pieces of data petitioner utilizes, or what weight was assigned any such piece or pieces of data, in the process of arriving at its recommendation and advice to its client to accept or decline a particular check. In turn, petitioner's clients can accept or decline petitioner's advice regarding whether or not to accept a customer's check. It is at least noteworthy, with regard to the accuracy of the advice petitioner provides concerning acceptance

or rejection of a given check, that petitioner's own check guarantee service itself relies upon petitioner's check verification process (*see* footnote 2). In sum, petitioner is consulted by its clients to provide advice rather than to provide its collected, compiled or analyzed information (data). Petitioner provides that advice in the form of a one-word recommendation or opinion as described, as contrasted with the provision of the information itself or the analysis upon which such recommended opinion or advice was based. In this case, the true object of the service petitioner provides is the advice and opinion resulting from its skilled application of sophisticated analysis to the data it collects and maintains, and not the dissemination of such collected, compiled or analyzed data. Since the primary function of petitioner's service is not to collect, compile, analyze and disseminate information, but rather is the provision of advice, petitioner is not providing an enumerated taxable service. Accordingly, petitioner's receipts from providing its check verification service are not properly subject to sales tax under Tax Law § 1105(c).

G. Having concluded that petitioner's check verification services do not constitute a taxable information service, it is not strictly necessary to address whether the receipts from such a service, if taxable, would nonetheless be excluded from tax 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 advice and opinion as to whether a merchant should accept or reject a customer's check pertains only to that check and to that unique transaction between that particular merchant and its customer. The positive and negative data upon which petitioner's analysis and opinion is based relates only to the check and transaction in question. Neither such data nor the particular advice and opinion to accept or

reject the proffered check are shared with or communicated to anyone, other than to the extent that the merchant who utilized petitioner's verification service (and its customer) receive the ultimate accept or reject advice. Furthermore, given that petitioner's database is continually updated by including ongoing transactions, it follows that a verification inquiry for the same customer made by a different merchant (or even the same merchant) might result in the same advice to accept or reject, or result in advice which is entirely opposite to the prior advice. For instance, a communication advising a merchant to accept a large denomination check from a particular customer might lead to a subsequent communication advising another merchant (or the same merchant) to reject a check from that same customer based on the impact of the previously accepted check on the customer's (ongoing) risk profile, as well as the risk tolerances particular to the subsequent merchant as embedded in the risk analysis formula particular to that merchant (or industry). Finally, petitioner's analysis utilizes data supplied by the merchant's customer (the check writer's check data), together with data contained in petitioner's own in-house proprietary activity database accessible only by petitioner's employees, and in the restricted third-party subscription database Early Warning, which is accessible only by participating financial institutions. Thus, the data sources from which petitioner's check acceptance opinion and advice, after analysis, is derived are clearly not themselves single data repositories or widely accessible or publicly available databases. Accordingly, even if petitioner's check verification 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 may not be substantially incorporated in reports furnished to others.

H. The petition of TeleCheck Services, Inc. is hereby granted and the Notice of Determination dated May 29, 2007 is cancelled.

DATED: Troy, New York
November 5, 2009

/s/ Dennis M. Galliher
ADMINISTRATIVE LAW JUDGE