STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
AUTOMATION, INC. D/B/A PC AMERICA	:	DETERMINATION DTA NO. 822409
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 June 1, 2004 through August 31, 2004.	:	

Petitioner, Automation, Inc. d/b/a PC America, 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 June 1, 2004 through August 31, 2004.

A hearing was held before Timothy Alston, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on February 19, 2009 at 10:30 A.M., with all briefs to be submitted by June 4, 2009, which date commenced the six-month period for the issuance of this determination. Petitioner appeared by William P. Hughes, CPA. The Division of Taxation appeared by Daniel Smirlock, Esq. (Sarah Dasenbrock, Esq., of counsel).

ISSUE

Whether the Division of Taxation properly assessed sales tax on certain assets, identified as software on the contract of sale, which were transferred to petitioner in a bulk sale.

FINDINGS OF FACT

1. Petitioner, Automation Inc. d/b/a PC America, is an independent software vendor. Petitioner sells point of sale software to members of the retail business sector. Unrelated to the matter at issue, petitioner also sells computer hardware.

2. On or about June 30, 2004, petitioner purchased the assets of H & S Business Express, Inc., in a bulk sale. The purpose of the purchase was to acquire a business known as PC America. The stated consideration for the bulk sale was $1,490,033.94. At the time of the transfer, petitioner did not file any bulk sale notification with the Division of Taxation (Division).

3. The Division began a sales and use tax audit of petitioner in September 2006. During the course of that audit the Division discovered the prior occurrence of the bulk sale and advised petitioner of the necessity of filing a bulk sale notification with the Division.

4. Petitioner subsequently filed a Notification of Sale, Transfer or Assignment in Bulk (Form AU-196.10) dated December 6, 2006 and received by the Division on March 30, 2007. Petitioner's bulk sale notification indicated a total sales price for the transfer of $1,490,034.00 and allocated such sales price, in part, as follows: $12,000.00 for tangible personal property (furniture, fixtures, etc.) and $1,348,034.00 for manufacturing equipment, tools and supplies. Petitioner's bulk sale notification also indicated, under the heading terms and conditions of sale, the following: "Manufacturing equipment includes computer software, software licenses, and computer equipment for use or consumption directly in the production of tangible personal property for sale by manufacturing and processing."

5. The Agreement of Sale between petitioner and H & S Business Express in respect of the June 30, 2004 transfer of assets indicates a purchase price of $1,490,033.94, of which

$12,000.00 is allocated to furniture, fixtures and machinery and $1,348,033.94 is allocated to software.

6. Pursuant to the Agreement of Sale, among the assets transferred to petitioner in the sale was the following:

> [A]ll intellectual property rights held by Seller [H & S Business Express] in connection with the business, PC America, including all trademarks, copyrights and/or patents whether registered or by common law, including all rights, title and interest of Seller in and to all software developed for or on behalf of PC America.

7. Following a review of the Notification of Sale, Transfer or Assignment in Bulk and the Agreement of Sale, the Division concluded that the assets identified as software in the Agreement of Sale were subject to sales tax. Accordingly, on May 21, 2007, the Division issued to petitioner a Notice of Determination which assessed $110,502.76 in additional tax due,[1] plus penalty and interest, for the period June 1, 2004 through August 31, 2004.

8. As noted, petitioner sells point of sale software to members of the retail business sector. One software product that petitioner has developed and licenses is known as Cash Register Express. Typically, petitioner sells its customers a license to use a customized version of the Cash Register Express program along with a license to use the source code for the customized Cash Register Express program. The customer can use the source code to further modify the software.

9. The assets referred to as software in the Agreement of Sale consisted, for the most part, of source code.

10. Petitioner's balance sheet as of December 31, 2004 identified the $1,348,033.94 in assets acquired in the bulk sale as software.

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[1] The assessment includes $975.00 in tax due on the transfer of $12,000.00 of furniture, fixtures, etc. This portion of the assessment is not at issue in this matter.

CONCLUSIONS OF LAW

A. Preliminarily, it is observed that all receipts from sales of tangible personal property are presumed taxable and the burden of proving that any such receipts are nontaxable is on the petitioner (Tax Law § 1132[c]; 20 NYCRR 3000.15[d][5]).

B. Generally, all retail sales of tangible personal property are subject to sales tax (Tax Law § 1105[a]). A "sale" includes a license to use (Tax Law § 1101[b][5]). "Tangible personal property" includes "pre-written computer software" (Tax Law § 1101[b][6]), defined, in relevant part, as:

> Computer software (including pre-written upgrades thereof) which is not software designed and developed by the author or other creator to the specifications of a specific purchaser. . . . Pre-written software also includes software designed and developed by the author or other creator to the specifications of a specific purchaser when it is sold to a person other than such purchaser. (Tax Law § 1101[b][14].)

C. Petitioner contends that source code is not software and thus the transfer of such assets in the bulk sale was not a taxable transfer of tangible personal property, but a nontaxable transfer of intellectual property.

D. Software is not defined in the Tax Law. It is therefore appropriate to use dictionary definitions to ascertain its meaning (***see Matter of Publishers Clearing House***, Tax Appeals Tribunal, July 22, 1997). According to the Merriam-Webster Online Dictionary (merriam-webster.com), software is "the entire set of programs, procedures and related documentation associated with a system and especially a computer system; specifically: computer programs." Additionally, the Free On-Line Dictionary of Computing (foldoc.org) defines software as "the instructions executed by a computer . . . [and] includes both source code written by humans and executable machine code produced by assemblers or compilers."

E. As for a definition of source code,[2] which does not appear in the Tax Law, according to Merriam-Webster, source code is "a computer program in its original programming language" (Merriam-Webster Online Dictionary [merriam-webster.com]). It is written by a programmer in a formal programming language (Free On-Line Dictionary of Computing [foldoc.org]). The source code is compiled or translated into a machine code or an object code so that its series of instructions can be executed by a computer (Webopedia Computer Dictionary [webopedia.com]).

F. According to the foregoing definitions, then, source code is a computer program and a computer program is software. Thus, source code is software. Indeed, source code is specifically included in the Free On-Line Dictionary of Computing's definition of software. Its position in the instant matter notwithstanding, petitioner has also considered source code to be software. Specifically, petitioner used the term software in the Agreement of Sale to describe the source code transferred in that transaction and also used software on its balance sheet to describe the source code acquired in the bulk sale (***see*** Finding of Fact 10). It is concluded, therefore, that the source code transferred in the subject bulk sale was software for purposes of Tax Law § 1101(b)(6) and (14).

G. It is further concluded that, contrary to petitioner's contention, the source code was *pre-written* computer software under Tax Law § 1101(b)(14) and therefore tangible personal property under Tax Law § 1101(b)(6). There is no evidence (and, indeed, petitioner does not

[2] There is no expert or authoritative evidence in the record explaining source code and its role or function in computer programming.

contend) that the source code was designed to its specifications as would be required for exclusion from the statutory definition.[3]

H. Petitioner also contends that its purchase of the source code in the bulk sale was exempt from tax pursuant to the production exemption of Tax Law § 1115(a)(12), which provides for an exemption from sales tax with respect to purchases of:

> Machinery or equipment for use or consumption directly and predominantly in the production of tangible personal property for sale, by manufacturing, processing, generating, assembling . . . .

I. Statutes and regulations authorizing exemptions from taxation are to be strictly and narrowly construed against the taxpayer (***see Matter of International Bar Assn. v. Tax Appeals Tribunal***, 210 AD2d 819, 620 NYS2d 582 [3rd Dept 1994], ***lv denied*** 85 NY2d 806, 627 NYS2d 323 [1995]; ***Matter of Lever v. New York State Tax Commn.***, 144 AD2d 751, 535 NYS2d 158 [3rd Dept 1988]). "Petitioner has the burden of showing clear entitlement under a provision of the law plainly giving the exemption (citations omitted)" (***Matter of Old Nut Co. v. New York State Tax Commn.***, 126 AD2d 869, 871, 511 NYS2d 161, 163 [3rd Dept 1987], ***lv denied*** 69 NY2d 609, 516 NYS2d 1025 [1987]).

J. As noted above, the production exemption is available where the subject machinery and equipment produce *tangible personal property* for sale. As also noted herein, the statutory definition of tangible personal property specifically includes pre-written computer software (Tax Law § 1101[b][6]) and therefore, by irrefutable inference, excludes customized software, i.e., software designed to the specifications of a specific purchaser (***see Matter of Helmsley***

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[3] With respect to this conclusion, it is noted that petitioner's business, in which it typically sells a customized version of its Cash Register Express program, is not relevant in determining whether the software petitioner purchased in the bulk sale transaction was pre-written.

Enterprises, Inc., Tax Appeals Tribunal, June 20, 1991, ***confirmed*** 187 AD2d 64, 592 NYS2d 851 [3rd Dept 1993], ***lv denied*** 81 NY2d 710, 600 NYS2d 197 [1993]).

K. Here, the record shows that petitioner sold customized versions of its Cash Register Express program (***see*** Finding of Fact 8). Indeed, petitioner has consistently asserted throughout this proceeding that it produced customized software designed to its customers' specifications. The record in this matter thus does not support a finding that the software sold by petitioner was pre-written software under Tax Law § 1101(b)(14). Absent such a finding, the statutory definition of tangible personal property (Tax Law § 1101[b][6]) compels the conclusion that the software sold by petitioner was not tangible personal property and that, therefore, petitioner is not entitled to the exemption under Tax Law § 1115(a)(12).[4]

L. The petition of Automation, Inc. d/b/a PC America is in all respects denied and the Notice of Determination dated May 21, 2007 is sustained.

DATED: Troy, New York
October 8, 2009

/s/ Timothy J. Alston
ADMINISTRATIVE LAW JUDGE

[4] As it is unnecessary to do so, this determination does not address the question of whether the source code would qualify as "machinery or equipment" for purposes of Tax Law § 1115(a)(12) or whether the source code met the "directly and predominantly" requirement for exemption under 20 NYCRR 528.13(c)(1) as asserted by the Division.