STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition of **STRATA SKIN SCIENCES, INC.** 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, 2014 through August 31, 2017.	:	DECISION DTA NO. 828704

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on January 21, 2021. The Division of Taxation appeared by Amanda Hiller, Esq. (Anita Luckina, Esq., of counsel). Petitioner appeared by Wilson Law Group LLC (Margaret C. Wilson, Esq., of counsel).

The Division of Taxation filed a brief in support of its exception. Petitioner filed a brief in opposition. The Division of Taxation filed a reply brief. Oral argument was heard by teleconference on January 27, 2022, which date began the six-month period for issuance of this decision.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUE

Whether petitioner's sales under its usage agreements were subject to sales and use tax as the sale of tangible personal property.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge, except finding of fact

7, which we have modified to more completely reflect the record. The modified finding of fact, together with the facts as found by the Administrative Law Judge, are set forth below.

1. Petitioner is a publicly traded Delaware corporation that develops, manufactures, and commercializes products for the treatment of dermatological disorders. In June 2015, petitioner acquired an excimer laser technology called the XTRAC laser from PhotoMedex, Inc. (PhotoMedex). The XTRAC laser is an ultraviolet light excimer laser system that generates and delivers targeted ultraviolet light at the 308 nanometer (nm) wavelength to affected skin areas. Petitioner manufactures the XTRAC lasers that it provides to physicians.

2. The XTRAC laser is not a tool for general use for the physician; instead, it performs only one function: the delivery of phototherapeutic light treatments approved by the federal Food and Drug Administration (FDA) for the clinical treatment of skin diseases. Currently, the FDA has approved it to be marketed for the treatment of psoriasis, vitiligo and other skin disorders.

3. Phototherapeutic light treatments of 308nm wavelength can only be delivered using a device that produces that light. There is no inventory of light in the XTRAC laser. The phototherapeutic light is created on demand inside the device when a mixture of two gases is excited by an arc of electricity. The light is guided and dispensed through a light guide, ending in a handpiece that is placed on the affected skin. The patient cannot see or feel the therapeutic treatment when it is delivered by the XTRAC laser, as the light emitted by the device has no tangible properties and cannot be perceived by touch or sight.

4. In July 2016, the Division of Taxation (Division) commenced a field audit of petitioner for the period (after extensions) of March 1, 2014 through August 31, 2017 (audit period). The audit was conducted in detail. The audit determined that petitioner had properly

collected sales tax on its outright sales of the XTRAC lasers in New York and those sales are not at issue herein. The parties disagreed during the audit, however, about the sales tax consequences of petitioner's recurring revenue model for marketing the XTRAC laser in New York and nationally during the audit period. Under this model, petitioner placed the XTRAC laser in a physician's office at no up-front cost to the physician and charged the physician to use the laser on a per-treatment basis, pursuant to a usage agreement, which also entitled the physician who entered into the usage agreement (participating physician) to a suite of services. The Division took the position that, for sales tax purposes, the usage agreements embodied taxable sales of the XTRAC lasers. Petitioner disagreed, arguing that the revenue it received under the usage agreements was for phototherapy light services and thus not subject to sales tax. Alternatively, petitioner argued that its sales under the usage agreements were exempt from sales tax as drugs or medicines, citing Tax Law § 1115 (a) (3). When the parties could not come to an agreement, the Division issued to petitioner notice of determination number L-047770120, dated February 23, 2018, asserting additional sales and use tax due of $529,935.46, plus penalty and interest.[1]

5. To use the XTRAC laser, the participating physician first had to purchase treatment codes from petitioner. In fact, before petitioner would locate an XTRAC laser in the physician's office, the doctor would generally have to buy an initial set of treatment codes from petitioner. The cost of the treatment code was governed by the participating physician's usage agreement, which used three Current Procedure Terminology (CPT) codes established by the Center of

[1] The parties stipulated that on May 3, 2018, petitioner paid (i) $36,154.75 in use tax, computed based on the depreciated materials cost of its XTRAC laser equipment placed in its physician customers' clinics in New York State during the audit period, and (ii) $6,458.15 for the period May l, 2014 through May 31, 2015, on issues not in dispute in this matter, reducing the amount still at issue between the parties to $487,322.56 in tax.

Medicare Services (CMS). CMS set a different approximate national payment amount for each CPT code, as shown in the following table for 2016:

CPT Code	Skin Surface Area Affected	Approximate National Payment Amount
96920	Less than 250 square centimeters	$158.27
96921	250 to 500 square centimeters	$174.42
96922	More than 500 square centimeters	$240.81

The usage agreement for each participating physician included a table showing the cost of a treatment code for each of the above CPT codes. Generally, petitioner charged an amount that was approximately 50% of the insurance reimbursement for that CPT code for that physician, although petitioner did offer some discounts based on volume, usage, or longevity of the customer. Thus, the cost of the treatment code was based only on the size of skin surface area being treated and was not related to what model XTRAC laser petitioner placed in the participating physician's office, or the length of time in which the device was in the doctor's office. After the physician completed the purchase of treatment code lots (typically 30), petitioner would supply the participating physician with a random-access code that, once entered into the XTRAC laser's software, would load the treatment uses and make them available for delivery to the patient. Each time the XTRAC laser was used, a treatment is deducted from the total number of treatments available to be delivered. After purchasing the treatment codes, the physician customer incurred no additional charges from petitioner at any time before, during or after the XTRAC laser was placed in the physician's office.

6. The audit file includes four invoices for payment under the usage agreement. All four show only charges for treatment codes.

7. The parties' stipulation of facts contains five examples of petitioner's usage agreement, four dated in 2016, and one dated in 2017. The five agreements are similar, appearing to vary mostly in the amounts charged for the treatment codes. The agreements include a cover page and terms and conditions on one or more subsequent pages. A four-column table at the top of the cover page entitled "Treatment Fee Schedule" details petitioner's charges for four categories of treatments, the first three that correspond to the CPT codes set forth in finding of fact 5, while the fourth is for the purchase of a bundle that includes a combination of the first three categories. Beneath that table is a two-column grid, showing nine "Support Services Included With Usage Agreement," identically worded in all five agreements:

Reimbursement Support	Dedicated Line, Highest Priority Status
Phone Support Priority	Highest Priority Status
Clinical Support	Highest Priority Status
Marketing Support/Marketing Allowance	✓
Patient Co-Pay Support Value	Up to $10,000 Annual
Laser Consumables and Accessories	✓
Service Response Time	Highest Priority Status
Software Upgrades	Included, Guaranteed Non-obsolescence
Laser Renewal Program	Guaranteed Non-obsolescence

The reverse side of the agreement is entitled "Usage Agreement Terms and Conditions." It explains that petitioner has "consigned" an XTRAC laser to the customer physician at the customer's site listed on the cover page, and that petitioner retains all ownership rights in the equipment. Under the agreement, the physician may not relocate the device without petitioner's prior written approval and must use the device only for its intended uses. The participating

physician must give petitioner access to the device for purposes of maintaining it at petitioner's own cost. Petitioner is to "upgrade" the device as provided on the cover page and provide all consumable supplies needed during the life of the device. The consumables in question are the gases used in the device, the arm on the device and goggles worn by the clinician using the device. Under the agreement, "if the Customer intends to use an excimer light source to treat a patient, Customer shall use the equipment to do so, provided the treatment falls within the intended uses of the equipment and that use of the equipment is judged by the physician to be in the patient's best interest." There were no minimum purchase obligation or time-based payment requirements under the agreement, nor were there a time-based limitation or conditions on the use of petitioner's services so long as the agreement was in place. In addition, the usage agreement explicitly grants petitioner's physician customers a royalty-free license to use petitioner's laser equipment to treat specified conditions. The parties stipulated that petitioner can "remove the XTRAC Laser from the physician's office anytime at [p]etitioner's sole discretion," including if a participating physician ceases to make purchases from petitioner.

8. At the hearing, petitioner presented the testimony of Dr. Dolev Rafaeli, who has been president and chief executive officer (CEO) of petitioner since 2018 and is in overall operational control of the company. He became aware of the XTRAC laser technology in 2007, when it was owned by PhotoMedex, and he was the president and CEO of a different company, which eventually merged with PhotoMedex. Dr. Rafaeli managed the business of the combined companies until 2015 when the assets of PhotoMedex were sold to a company by the name of MELA, which eventually changed its name to Strata Skin Sciences, Inc. As a result of his role as president and CEO of petitioner since 2018 and its predecessor company, he was familiar with

the financial statements of petitioner going back to 2007 and had closely monitored the company's business from that time.

9. Dr. Rafaeli testified that initially the company that owned the XTRAC laser technology leased the devices to the doctors using the device to treat patients in exchange for per treatment payments from the physician customers. That proved uneconomical, however, because of insufficient usage, so, starting in 2006 or 2007, the company adopted the present recurring revenue model of making the device available to doctors as part of a suite of services, which aimed to facilitate the use of the technology and the flow of the patients into its physician customers' offices, with the physician paying per use of the device. Dr. Rafaeli testified at length about the services petitioner performs under the usage agreement, as enumerated above, based on printouts of slides that petitioner uses in making sales presentations to prospective participating physicians, from which testimony the facts below are derived.

10. An introductory slide used in petitioner's sales presentation shows a picture of the XTRAC laser encircled by a series of balloons that detail the services and other items that the participating physician would receive under the usage agreement. These encompass the same items that are set forth on the second table on that agreement's cover page (***see*** finding of fact 7). While the usage agreement refers to all the items as "services," for sales tax purposes, three of the items (i.e., "software," "Laser Renewal Program" and "Laser Consumables and Accessories") are tangible personal property, not services.

11. At the heart of petitioner's service package is its patient awareness/direct to the customer (DTC) advertising program, which is designed to drive more patients to participating physicians' offices for possible XTRAC laser treatments. In 2011, when the patient awareness program first started, petitioner advertised on national and local radio stations by media market.

Since 2017, petitioner has moved most of its advertising to social media, which allows it to target persons who might benefit from the XTRAC laser technology within the zip codes surrounding a participating physician's location. The advertisements promote the name "XTRAC," and always include petitioner's contact information, as the goal is to have the prospective patient search for treatment under that term, and thereby be led to petitioner's phone bank. It will be difficult for a patient without an existing relationship with a dermatologist to find a doctor that has the XTRAC laser but is not under a usage agreement with petitioner because petitioner's contact information will dominate the results when that term is searched for on popular search engines, in part due to copyright restrictions on the use of that term in advertisements. Petitioner also helps its participating physicians to create their own advertising for the XTRAC laser technology, by assisting them in developing mailers and in-office advertisements. Petitioner spent 13.3%, 11%, and 4.5% of its revenue on its patient awareness advertising in 2015, 2016, and 2017, respectively.

12. Another sales presentation slide shows that, through its advertisements in 2015, petitioner generated around 36,000 inquiries. These inquiries resulted in approximately 10,000 patients being added to petitioner's proprietary database system of patients receiving treatments from petitioner's participating physicians (RDX database program). In 2015, the participating physicians themselves generated another around 16,000 patients to that database. Some of those 16,000 patients probably first learned of petitioner's XTRAC laser technology through petitioner's advertisements since, when petitioner significantly decreased its national advertising in 2017, the number of patients added by the participating physicians also significantly decreased.

13. When a potential patient clicks on petitioner's on-line advertisement, or calls the patient support phone lines, the potential patient is connected with petitioner's in-house call center, where petitioner has a staff of about 20 persons. The call center staffers educate the patients about the XTRAC laser treatments and the medical outcomes to be expected based on clinical studies. If the caller is interested in receiving the treatment, the staffer then obtains the caller's personal information, his or her social security number, health insurance information, and clinical history, including any other medical conditions the patient might have, which information is entered into petitioner's RDX database program for tracking the course of patients' treatment. Next, the staffer asks the caller if he or she would like to be set up for a consultation with a participating dermatologist. If the caller wants to take that step, the staffer would first call the prospective patient's insurance company to see if the XTRAC laser treatment would be covered and to ascertain what the person's co-pay and/or deductible would be. Secondly, the staffer would find the participating physician that is closest to the prospective patient who would accept the patient's insurance. This is important because the treatment generally requires two visits a week to the doctor's office for anywhere from four to 16 weeks, with the average being eight weeks. The staff person works with the office of the chosen doctor and the patient to find an acceptable appointment time. Then, 24 to 48 hours before the appointment, the staff person calls both the patient and the doctor's office to remind both of the impending appointment. At the appointment, the patient may or may not get any XTRAC laser treatment, as that is up to the clinical judgement of the participating physician. These reminder phone calls are helpful, according to Dr. Rafaeli, because the appointment will have been made sometime out in the future, and the patient could easily have forgotten it, while some dermatologists see 50 to 150 patients a day and can easily lose track of the fact that a patient

potentially needing an XTRAC laser treatment would be coming in for an appointment. Those physicians who buy an XTRAC laser outright do not benefit from petitioner's call center service, as the call center staff does not set up prospective patients for appointments with those physicians.

14. Dr. Rafaeli emphasized the importance of the liaison work that petitioner's call center does, in that the participating physician ends up with a visit by a patient "with a predisposed decision that they are going to be getting an XTRAC treatment," whose preexisting conditions are known and whose insurance company has authorized reimbursement for the XTRAC laser treatment. The table below, compiled from a slide in petitioner's sales presentation, shows the effectiveness of petitioner's advertising and call center activities in referring patients who potentially might benefit from an XTRAC laser treatment.

Year	Appointments Made by the Call Center	XTRAC Treatments Resulting
2015	8648	2463
2016	6149	1646
2017	1119	367

15. As part of its patient assistance service, petitioner provides participating physicians with access to its RDX database program. This database has the insurance information obtained by petitioner's call center staff from the patient's insurance company. The database facilitates the physician's work with the insurance companies to get full reimbursement for XTRAC treatments they provide. Participating physicians can also use the system to track the course of treatment of those patients who come to their office other than through petitioner's call center, as they can add the patient to the RDX database program. If the physician encounters difficulty with obtaining reimbursement from an insurance company, it can enlist the assistance of

petitioner's staff of 12 employees assigned to help with insurance reimbursement issues. That team of employees also seeks to obtain reimbursement reauthorization for XTRAC treatments regarding each of the active patients in the RDX database program each year. This is important because insurance companies only authorize a medical treatment for an annual period and the diseases on which the XTRAC laser is used are long-term in nature and may straddle two such annual periods. If an insurance company that has authorized coverage later refuses to reimburse the participating physician for the treatment, petitioner will reimburse the physician. Finally, petitioner works with the participating physician's new back office staff to train them in obtaining full reimbursement from insurance companies.

16. Under the patient assistance program, petitioner's call center staff assists patients in understanding the cost of treatment with respect to their deductible and co-pay obligations, in addition to assisting the patients with insurance company disputes.

17. Petitioner also assists patients in satisfying the co-pay portion of their financial obligation through a mail-in rebate program. The program appears to be limited to $10,000.00 per practice per year and petitioner's advertisements indicate that a patient is limited to $400.00 in co-pay reimbursements. Petitioner spent 3.8% of its revenue on this co-pay support program in 2015 and 2016, and 3.9% in 2017.

18. During the audit period, the XTRAC device was available in several models, which differed in the speed at which the phototherapeutic light is delivered. Under the laser renewal program in the usage agreement, petitioner commits itself to providing the participating physician with a non-obsolete model. In its sole discretion, petitioner decides which model of the XTRAC laser to place with each physician based on the number of potential patients to be treated with phototherapeutic light treatments in that office. During the term of the usage

agreement, petitioner may decide to upgrade or downgrade the XTRAC model at the customer's site at petitioner's sole discretion.

19. Under the clinical support aspect of the usage agreement, petitioner's clinical training team works with its participating physicians one-on-one in the physician's offices to train their staff in treating patients using the XTRAC laser during an initial training period, and then as needed and without limitation throughout the term of the usage agreement. This is an important benefit because some practices have a 30 to 40 percent turnover in clinical staff per year. Only clinical individuals who had been specifically authorized by the physician and trained by the physician (e.g., nurse, nurse practitioner or physician assistant) are allowed to deliver the phototherapeutic light treatments. Petitioner has five employees as part of its clinical training team, as well as 31 territory managers who typically visit each participating physician's office between two and four times a month, providing training and retraining to existing participating physicians and their medical staff.

20. The usage agreement requires petitioner to maintain the XTRAC lasers, for which it has 15 employees across the country. Petitioner has a 24-hour cycle time between when a problem is reported until it is resolved, which is important because patients need to be treated twice a week, and a non-functioning device might interfere with that schedule.

21. In 2015, petitioner charged $80,000.00 per XTRAC laser that it sold outright. Outright purchasers of the equipment during the audit period did not receive any of the services listed on the usage agreement, except that they could purchase, for an additional amount, a maintenance program and supplies from petitioner. They can use the devices without the need for any authorization or treatment code from petitioner.

22. Dr. Rafaeli testified that an XTRAC laser has a useable life of 10 years or more and that petitioner's participating physicians paid petitioner $40,000.00 on average in 2015 for treatment codes. Petitioner provided no documentation showing how Dr. Rafaeli arrived at the $40,000.00 per participating physician figure. Review of petitioner's 2016 form 10-K reveals that 775 XTRAC devices were being used under a usage agreement in that year. In that year, petitioner reported revenue from its recurring revenue model of $24,558,000.00, meaning that, on average, petitioner received $31,687.74, per participating physician that year, according to the form 10-K.

23. The form 10-K also states that the XTRAC lasers have an "estimated useful life of five-years." Dr. Rafaeli testified that an XTRAC laser had a "useable life" of 10 years or more. He did not explain the difference between that figure and the five-year "useful life" figure provided in the form 10-K.

24. Petitioner also presented the testimony of Dr. Michael Nazareth, a practicing dermatologist who owns a dermatology practice in Buffalo, New York. In 2017, Dr. Nazareth entered into a usage agreement with petitioner. He testified that the sales presentation for the usage agreement that Dr. Raffaeli discussed in his testimony looked familiar to him, except that he did not think he saw as much about the DTC advertising program. Prior to entering into the usage agreement with petitioner, he considered purchasing the XTRAC laser outright, but "given the difficulties with reimbursement and copays and cost, we decided it was an avenue we did not want to pursue." He explained that he wanted to purchase the full suite of services from petitioner, not just the XTRAC laser alone, because it would have been very difficult to navigate the prior authorization process with patients' insurance companies, and the arrangement with

petitioner relieved his practice of the risk of nonpayment of the co-pay due from the patient or the reimbursement due from the insurance company:

> "[I]f a patient can't afford co-pays or now you get a red[u]ction on that or, you know, you finally go through this process and then I have to re-up everything for the next year, for the amount of effort that is going into that, I didn't see us getting enough patients to make the ROI worth it, or return on investment worth it."

He also testified that:

> "I think that one of the biggest advantages for my practice and why we chose it in the first place is prior authorization, which is a very time-consuming process. Because of this system, it is Strata who is actually doing the work behind the scenes with the insurance company to get it approved and if it is not approved they tell us. It saves my team of people a lot of time in doing that."

25. Dr. Nazareth's practice uses petitioner's RDX database program, which he referred to as "a complete tool for us," both with regard to patients he gets from petitioner and those patients that come directly to him for which he prescribes the XTRAC laser treatment. Petitioner has assisted him in resolving reimbursement issues where patients' insurance companies have retracted payment after patients received treatment. In cases where the insurance coverage dispute could not be resolved, petitioner reimbursed Dr. Nazareth's practice, although he did not recall if petitioner reimbursed the amount of the cost of the treatment code or the amount of his practice's charge to the insurance company. Dr. Nazareth also explained that petitioner's reimbursement of co-pays for patients is important because in 2017, for most of his patients, the co-pay for an office visit to a specialist, such as a dermatologist was about $40, which has increased since then. According to Dr. Nazareth, "[f]or a lot of patients this would not be an affordable therapy if they need 20 treatments and they have to pay $40 or $50 . . . twice a week for 10 weeks" without petitioner's co-pay reimbursement program.

26. Dr. Nazareth estimated that the amount his practice pays petitioner was "probably in the six-figure range" annually, although not initially.

27. Petitioner's form 10-K for 2016 under the heading "Critical Accounting Policies and Estimates," and the subheading "Revenue Recognition" states:

> "We recognize revenue from product sales when the following four criteria have been met: . . .
>
> * * *
>
> We have two distribution channels for our phototherapy treatment equipment. We either (i) place our lasers in a physician's office (at no charge to the physician) and generally charge the physician a fee for an agreed upon number of treatments or (ii) sell our lasers through a distributor or directly to a physician. In some cases, when the lasers placed in a physician's office at no charge, we and the customer stipulate to a quarterly or other periodic target of procedures to be performed and accordingly revenue is recognized ratably over the period.
>
> When we place a laser in a physician's office, we generally recognize revenue based on the number of patient treatments performed, or purchased under a periodic commitment, by the physician."

In the form 10-K, petitioner reports the revenues and expenses of its recurring revenue model business in its "Dermatology Recurring Procedures" business segment. The form 10-K shows both petitioner's revenue and its expenses from that business segment.

28. The parties entered into a stipulation of facts, relevant portions of which were incorporated into this determination.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge began his determination by citing section 1105 (a) of the Tax Law, which imposes sales tax on retail sales of tangible personal property. He set forth the statutory definitions of several terms used in the statute and summarized the arguments of the parties. The Administrative Law Judge also noted petitioner's argument that its revenues under the usage agreements did not constitute a rental or a license to use. The Administrative Law Judge noted the Division's assertion that transfer of possession of the laser equipment for

consideration in the form of per treatment charges established a taxable lease. The Administrative Law Judge observed that petitioner argued that the true object of the transactions in question should determine their taxability.

The Administrative Law Judge considered the caselaw where transfers of tangible personal property were deemed to be leases, setting forth several factors enunciated by the courts, including whether 1) the seller's agreement with its customer is structured as a lease and uses lease language; and 2) whether a separate charge is made for the tangible personal property transferred. Considering the factors cited in those cases, the Administrative Law Judge concluded that petitioner's usage agreement did not constitute a lease for sales tax purposes. For the Administrative Law Judge, the fact that the usage agreement was not explicitly called a lease, was not structured as a lease and referred to the laser equipment as being "consigned" was sufficient to reach this conclusion. The Administrative Law Judge considered petitioner's additional argument that exclusive possession of the laser equipment was not transferred pursuant to the usage agreement, and thus such agreements did not constitute leases of the equipment, but ultimately dismissed the argument as the cases cited therefor were distinguishable.

Although deemed unnecessary in light of his determination that the usage agreements did not constitute taxable leases of petitioner's laser equipment, the Administrative Law Judge next considered petitioner's argument that proper treatment of the usage agreements should be determined using the true object test. While the Administrative Law Judge found that the cases cited by petitioner did not explicitly adopt that test, he found that this Tribunal had applied a related doctrine, the primary function test, to mixed sales of services. Citing to a Division advisory opinion, the Administrative Law Judge determined that the Division had likewise

applied the primary function test to mixed bundled sales of tangible personal property and services, which he considered consistent with the caselaw cited by petitioner.

The Administrative Law Judge next considered the Division's arguments that the primary function of petitioner's usage agreements was to sell its laser equipment. He dispensed with the Division's first argument that the services at issue are merely additional expenses in marketing its laser equipment, reasoning that because the services are included in the usage agreement, they are part of the offering to petitioner's customers. The Administrative Law Judge similarly dismissed the Division's argument that petitioner's SEC filings refer to "product" sales and thus the transactions at issue must be deemed to be sales of tangible personal property. The Administrative Law Judge rejected the Division's position that the term could not refer to a set of income-producing services.

The Administrative Law Judge then considered petitioner's last two arguments. The Administrative Law Judge dismissed petitioner's argument that because the light therapy delivered by the laser equipment was imperceivable, any purported sale was of an intangible and thus not subject to sales tax. The Administrative Law Judge noted that because the usage agreement obligated petitioner to deliver laser equipment to its customers, such an argument was inconsistent with the language of the agreement. Lastly, the Administrative Law Judge determined that the light treatments provided through the laser did not constitute a drug or medicine, and thus did not qualify for the drug or medicine exemption under Tax Law § 1115 (a)(3). In addition, he observed that medical equipment sold to persons using it to perform medical services for compensation was excluded from the exemption.

In light of his conclusion that the usage agreements did not constitute a taxable lease of tangible personal property, the Administrative Law Judge cancelled the penalties proposed in the

notice of determination. The Administrative Law Judge thus granted the petition and directed the Division to modify the assessment in accordance with his determination.

ARGUMENTS ON EXCEPTION

The Division states that the Administrative Law Judge erred in determining that petitioner sold a nontaxable service rather than taxable tangible personal property. It notes that under the Tax Law sales tax is imposed on every transfer of tangible personal property for a consideration. It argues that the services bundled with the transfer of the laser equipment represent marketing and support services facilitating its sales rather than what was actually being purchased. It argues that the Administrative Law Judge erred in applying the primary function test and concluding that managing the nonmedical aspects of providing medical treatments using its own laser equipment was the service being sold rather than the laser equipment itself. It states that the Administrative Law Judge correctly determined that petitioner did not sell intangible light treatments or a drug or medicine. The Division claims that, in light of the foregoing, the Administrative Law Judge improperly cancelled the penalties on the assessment.

Petitioner urges us to affirm the determination of the Administrative Law Judge, arguing that he correctly determined that the usage agreements did not constitute taxable leases of tangible personal property and that it was the services provided thereunder that were the true object of the transactions here at issue. Petitioner argues that there can be no lease found where, as the Administrative Law Judge found, there is no lease language contained in the usage agreement, and thus the purchases of treatment codes are not subject to sales tax. Petitioner rejects the Division's position that ***Matter of EchoStar Satellite Corp. v Tax Appeals Trib. of the State of N.Y.*** (20 NY3d 286 [2012]) is distinguishable because there the issue was whether the transfers of tangible personal property to the taxpayer's customers qualified under the resale

exemption. According to petitioner, the issue here is whether the sales were of nontaxable integrative therapeutic services with merely incidental transfers of tangible personal property consisting of petitioner's laser equipment. Petitioner urges us to endorse the Administrative Law Judge's application of the true object or primary function test to the sales here at issue and to similarly conclude that, on balance, it is the services delivered to its customers that should be deemed the object of the usage agreements rather than the laser equipment itself.

OPINION

We disagree with the determination of the Administrative Law Judge and reverse for the reasons stated below.

Tax Law § 1105 (a) imposes sales tax on the retail sale of tangible personal property. All receipts from sales of property described under Tax Law § 1105 (a) are presumptively subject to sales tax until the contrary is established (Tax Law § 1132 [c]). "Sale, selling or purchase" for purposes of the sales tax is defined as "[a]ny transfer of title or possession or both, exchange or barter, rental, lease or license to use or consume . . . conditional or otherwise, in any manner or by any means whatsoever for a consideration, or any agreement therefor . . ." (Tax Law § 1101 [b] [5]; ***see also*** 20 NYCRR 526.7 [a]). A "purchaser" is defined as a person who purchases property, the receipts of which are taxable under article 28 of the Tax Law (Tax Law § 1101 [b] [1]). A "retail sale" is defined as a sale of tangible personal property to any person for any purpose other than sale for resale as such or for use by the purchaser in performing services taxable under Tax Law § 1105 (c) (***see*** Tax Law § 1101 [b] [4]). In turn, under the Division's regulations, the term "consideration" is defined as including "monetary consideration, exchange, barter, the rendering of any service, or any agreement therefor" (20 NYCRR 526.7 [b]).

The Division argues that the transactions at issue are taxable because the usage agreements involve a transfer of possession of tangible personal property for consideration in the form of per treatment charges. Petitioner counters that its sales of the treatment codes are not subject to sales tax because its usage agreements do not constitute leases of or licenses to use its laser equipment, citing ***Matter of EchoStar Satellite Corp*** for the proposition that a transfer of goods cannot be taxable as a lease absent clear indication of an agreement for the lease of tangible personal property. We disagree. Here, it is clear that petitioner, pursuant to the usage agreement with its customers, is transferring possession of its laser equipment to participating physicians (in addition to performing certain services and providing necessary consumables) for a consideration in the form of payments from its customers' purchases of treatment codes, which, in turn, permit petitioner's customers to use the laser equipment to deliver therapeutic treatments. Concluding otherwise ignores the language of the usage agreements, the statute and regulations (***see*** Tax Law §§ 1101 [b] [4], [6]-[7]; ***see also*** 20 NYCRR 526.1, 526.7 [a] [1]-[2] [including licenses to use tangible personal property as within the definition of the terms "sale," "selling" and "purchase"]).

While the Administrative Law Judge concluded that petitioner's sales to its customers represent sales of nontaxable services because the usage agreements do not represent leases, such a conclusion is unnecessary in light of the language contained therein describing the transactions here at issue. In his determination, the Administrative Law Judge overlooks the language contained in the usage agreements that clearly states that petitioner's customers are being granted a license to use the excimer laser equipment. Specifically, we note the contractual language contained in the usage agreements attached to the stipulation of facts regarding petitioner's

granting of a royalty-free license to its customers to use this equipment to treat vitiligo, among other conditions (***see*** finding of fact 7).

While the Court of Appeals has held that substance triumphs over form in analyzing whether a taxable sale has occurred (***see Burger King, Inc. v State Tax Commn.***, 51 NY2d 614, 623 [1980]), we find no inconsistency between the form and substance of the usage agreements and our conclusion. The usage agreements themselves accord with our finding that petitioner made taxable retail sales of the laser equipment when it extended to its customers licenses to use its laser equipment to deliver therapeutic services and delivered the laser equipment to its customers' clinical settings following their purchases of treatment codes. This is because a "use" for purposes of article 28 of the Tax Law is defined as "[t]he exercise of any right or power over tangible personal property . . . by the purchaser thereof, and includes, but is not limited to, the receiving, storage or any keeping or retention for any length of time . . . any installation, any affixation to real or personal property, or any consumption of such property . . ." (Tax Law § 1101 [b] [7]; ***see also*** 20 NYCRR 526.9 [a]). Mindful that a purchase includes transfer of title or possession of tangible personal property for a consideration (***see*** Tax Law § 1101 [b] [5]), we find that such consideration was provided by petitioner's customers' purchases of treatment codes prior to delivery of the laser equipment (***see*** finding of fact 5). Petitioner claims that it is selling "integrative therapy services," but it is in fact petitioner's customers who are selling therapeutic services by using the tools petitioner makes available to them pursuant to their usage agreements (***see e.g. Matter of Best Taxi Management, Inc.***, Tax Appeals Tribunal, January 24, 2002, ***confirmed*** 306 AD2d 650, 652 [3d Dept 2003] [confirming the transaction as a transfer of possession and use of both the taxi cab and medallion to the cab driver and not for the service of

transport to the passengers]). Accordingly, petitioner has failed to distinguish its recurring revenue model from other examples of hybrid sales we have considered in the past.

We are similarly unpersuaded by petitioner's argument, adopted by the Administrative Law Judge in his determination, that the true object test is the near equivalent of the primary function test and should be applied in this case. The Administrative Law Judge's conclusion that the Court of Appeals' reasoning in ***Dun & Bradstreet, Inc. v City of New York*** (276 NY 198, 205 [1937]) and ***Matter of Business Statistics Org. v Joseph*** (299 NY 443, 452 [1949]) is consistent with the primary function test as applied by this Tribunal was incorrect. First, as set out by the court in ***Dun & Bradstreet, Inc.***, cases involving mixed bundled sales of finished products having a market value are distinguishable (***see Matter of United Artists Corp. v Taylor***, 273 NY 334, 341 [1937]); ***People ex rel. Walker Engraving Corp. v Graves***, 243 AppDiv 652 [3d Dept 1935], ***affd*** 268 NY 648 [1935]); ***People ex rel. Foremost Studio, Inc., v Graves***, 246 AppDiv 130 [3d Dept 1935]). It is clear from the facts that petitioner sells its laser equipment as a stand-alone product distinct from its services and that such equipment has market value as reflected in its retail price. Secondly, as pointed out by the Division, this Tribunal has not applied the primary function test to bundled sales of tangible personal property and services, but rather only to bundled sales of taxable and nontaxable services (***see e.g. Matter of SSOV '81, Ltd., d/b/a People Resources***, Tax Appeals Tribunal, January 19, 1995; ***Matter of Principal Connections, Ltd.***, Tax Appeals Tribunal, February 12, 2004). Considering that transfers of tangible personal property are presumptively taxable (***see*** Tax Law § 1132 [c] [1]), we remain unpersuaded by petitioner's argument that all mixed bundled sales of tangible personal property and services should be analyzed using the primary function test.

Petitioner's reliance on ***Matter of EchoStar Satellite Corp.*** and ***Galileo Intl. Partnership*** (Tax Appeals Tribunal, March 24, 2005, ***confirmed*** 31 AD3d 1072 [3d Dept 2006], ***lv denied*** 7 NY3d 715 [2006]) is similarly misplaced, as those cases do not stand for the legal holding petitioner claims they do. ***Galileo*** dealt with the transfers of computer equipment pursuant to contracts between a company offering access to its travel reservation system software to its travel agency customers. In that case, the contracts referred to the computer equipment transfer as a lease. The Division determined that the full amounts of the monthly charges for access to the software and use of the computer equipment were subject to tax. The taxpayer challenged that determination arguing that the true object of the contracts with the travel agencies was to provide services on which no sales tax was imposed. The Appellate Division agreed with our analysis that the transactions there at issue were in fact for the lease of the computer equipment, which was reflected by the contract terms. Contrary to petitioner's assertion, the Appellate Division did not hold that "a transfer of goods cannot be taxable as a lease unless there is a lease agreement," but rather affirmed our finding that the purported service contracts were, in fact, taxable leases of tangible personal property as such (***Galileo Intl. Partnership***, 31 AD3d at 1075).

Matter of EchoStar Satellite Corp. does not support petitioner's argument, either. That case concerned whether the taxpayer's purchase of satellite television receiver equipment from its manufacturers qualified for the sales tax exclusion for resale of tangible personal property as such (***see*** Tax Law § 1101 [b] [4]). The Court of Appeals held that the monthly equipment fee the taxpayer charged its customers constituted a resale of the equipment as such, finding that evidence in the record supported the finding of a lease, as was the case in ***Galileo*** (20 NY3d at 292). This does not mean that no taxable lease can be found in the absence of a formal lease agreement; to the contrary, it stands for the proposition that a taxable lease of tangible personal

property can be found where the structure of the overall transaction indicates that the tangible personal property was acquired for resale as such.

We have considered the Division's other arguments on exception but consider them moot in light of our holding above.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division is granted;

2. The determination of the Administrative Law Judge is reversed;

3. The petition of Strata Skin Sciences, Inc. is denied; and

4. The notice of determination dated February 18, 2018, as modified by the stipulation of facts entered into by the parties, is sustained.

DATED: Albany, New York
May 5, 2022

/s/ Anthony Giardina
Anthony Giardina
President

/s/ Dierdre K. Scozzafava
Dierdre K. Scozzafava
Commissioner

/s/ Cynthia M. Monaco
Cynthia M. Monaco
Commissioner