STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions	:	
of	:	
CHECKFREE SERVICES CORPORATION	:	DETERMINATION DTA NOS. 825971
for Redetermination of Deficiencies or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Periods July 1, 2004 through December 31, 2008 and January 1, 2009 through December 31, 2009.	:	AND 825972

Petitioner, CheckFree Services Corporation, filed petitions for redetermination of deficiencies or for refund of corporation franchise tax under Article 9-A of the Tax Law for the periods July 1, 2004 through December 31, 2008 and January 1, 2009 through December 31, 2009.

A hearing was commenced before Dennis M. Galliher, Administrative Law Judge, in New York, New York, on September 9, 2015 at 10:30 a.m., and was continued to conclusion on September 10, 2015, with all briefs to be submitted by April 8, 2016, which date began the six-month period for the issuance of this determination.[1] Petitioner appeared by Reed Smith LLP (Aaron Young, Esq., Jack Trachtenberg, Esq., and Jennifer Goldstein, Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (Clifford M. Peterson, Esq., and Ellen K. Roach, Esq., of counsel).

[1] By a letter dated October 4, 2016, that period was extended, per Tax Law § 2010(3), for an additional three months.

ISSUES

I. Whether petitioner's receipts from its electronic bill payment and presentment transactions are properly classified as receipts derived from the performance of services, pursuant to Tax Law former § 210(3)(a)(2)(B), or as other business receipts, pursuant to Tax Law former § 210(3)(a)(2)(D).

II. Whether, upon determining the proper classification of the foregoing receipts, any portion thereof is properly allocable to New York, and if so, what is the proper method of such allocation.

III. Whether the Division of Taxation's notices of deficiency should be canceled because they were: a) issued without a rational basis, b) issued pursuant to a rule not properly promulgated as a regulation under the State Administrative Procedure Act, c) issued on the basis of a retroactive interpretation and application of law and policy, or d) issued prior to the conduct and completion of an audit and for the sole purpose of avoiding the expiration of the period of limitations on assessment.

IV. Whether the Division of Taxation's notices of deficiency violate the due process and commerce clause provisions of the United States Constitution and New York State Constitution.

FINDINGS OF FACT

1. Petitioner, CheckFree Services Corporation (CheckFree), was founded in 1981 and is incorporated in the state of Delaware.[2] At all times relevant to this proceeding, petitioner was headquartered in Norcross, Georgia, and conducted three lines of business, as follows:

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[2] Fiserv, Inc. (Fiserv) bought CheckFree Corporation (CheckFree's parent) on December 4, 2007.

a) Investment Services Division: provides investment services and other products to brokers and financial advisors.

b) Software Division: provides software, maintenance, support and professional services to large financial service providers and other companies across a range of industries.

c) Electronic Commerce Division: provides electronic bill payment and presentment (EBPP) services that enable consumers to pay bills through a variety of methods and to receive bills electronically.[3]

The tax treatment of petitioner's receipts from its Investment Services Division and its Software Division is not at issue herein, and the sole tax computation issue is whether petitioner properly characterized, classified and sourced its Electronic Commerce Division's EBPP receipts under Article 9-A of the Tax Law.

Petitioner's Electronic Commerce Division EBPP Business Activities

2. Petitioner's customer base for its EBPP business consists of consumer service providers (CSPs), direct billers, and health and fitness facilities. The largest portion of petitioner's EBPP customer base consists of CSPs, and includes large financial institutions, credit unions, and many of the more than 15,000 community banks across the United States. Petitioner's EBPP business allows consumers, i.e, the customers of CSPs, direct billers and health and fitness facilities (also referred to herein as "petitioner's customers' customers"), to log onto petitioner's website and authorize a single payment, or recurring payments, to any merchant or vendor in the United States as designated by the consumer, whether an individual or an entity, with funds drawn from the consumer's account with its CSP. Payments can be scheduled up to a year in advance.

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[3] The term "services" and the phrase "EBPP services" are used as convenient nomenclature to reference the functions, activities and transactions at issue from which the receipts in question arise. Use of such terms in this manner is clearly not determinative as to the core issue of whether the receipts in question, arising from petitioner's EBPP business functions, activities and transactions within its Electronic Commerce Division line of business constitute and are properly classified as "receipts from the performance of services" as opposed to "other business receipts" for purposes of Tax Law Article 9-A.

Consumers can also receive and manage their bills, and direct and authorize electronic payments thereof, through their CSP accounts using Microsoft's Money or Intuit's Quicken programs in conjunction with petitioner's EBPP systems. Petitioner's website appears to the consumer, when he or she logs on, to be their own CSP's website (***see*** Finding of Fact 3). In the case of larger merchants, such as JC Penney Card Services, AT&T, Sam's Club Credit, Macy's, Home Depot Consumer Accounts, Lowe's Consumer Credit Card, Sprint PCS, Verizon Corporation, Chevron and Exxon/Mobil, consumers are also able to receive and view their bills electronically through petitioner's website, with such website appearing to be that merchant's website.

3. During the audit period, petitioner derived the vast majority of its EBPP receipts from its business with CSPs.[4] Petitioner provides its CSP customers with the ability to outsource their bill payment and presentment functions, while at the same time preserving the CSPs' unique brands, i.e., petitioner's bill payment and presentment function is set up to look like it is a CSP's own website-based electronic bill payment function. Thus, a consumer may log onto its CSP's website, view bills, due dates, amounts and account balances, determine which bill or bills are to be paid and when, and direct and authorize payments to be made to designated payees.

4. Electronic bill presentment and payment are functions that CSPs are often unable to perform themselves due to lack of expertise, resources and merchant relationships.[5] At the same time, electronic bill payment is a function that consumers demand and that CSPs want to provide. It offers ease of use, convenience and efficiency in managing bill payments, and replaces the need for consumers to manually write checks and mail bill payments. Petitioner noted that when

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[4] The terms "audit period" and "period at issue" are used interchangeably and refer, collectively, to the period spanning July 1, 2004 through December 31, 2009.

[5] A few very large financial institutions have their own in-house EBPP departments and personnel.

a CSP provides EBPP capability, its customers are 95% less likely to terminate their relationship with that CSP in favor of finding a CSP that does offer EBPP. Petitioner noted further that CSPs that offer EBPP capability are over 250% more profitable than those that do not, because the CSPs' increased interactions with their customers (more consumer visits to the CSPs' websites) affords the CSPs more opportunities to market other profitable products and services to their customers (e.g., mortgage and other loan products, credit and debit cards, insurance products, and the like). During the period at issue, petitioner derived approximately 75% of its EBPP receipts from its business with CSPs.

5. Petitioner's customer base for its EBPP business also includes certain large merchants that offer their customers the option to receive bills electronically and to pay bills through the merchants' websites (Direct Billers). In such cases, consumers can authorize and direct the payment of a Direct Biller's invoice with funds drawn from their bank accounts, and the electronic bill payment would occur directly through the Direct Biller's website. As noted, petitioner's EBPP business enables consumers to receive their bills from Direct Billers electronically such that, like the CSPs, petitioner provides the Direct Billers the ability to outsource their bill presentment and payment functions. This option is more cost-effective for Direct Billers than issuing (distributing) paper bills and thereafter receiving paper (individual check) payments via mail to and from their individual customers. During the period at issue, petitioner derived approximately 20% of its EBPP receipts from its business with Direct Billers.

6. A small portion of petitioner's customer base for its EBPP business consists of health and fitness facilities. These facilities use petitioner to electronically process payment of their members' recurring monthly membership fees. During the period at issue, petitioner derived approximately 5% of its EBPP receipts from its business with health and fitness facilities.

7. The parties submitted sample EBPP customer contracts into the record (***see*** Exhibits GG and 12). These EBPP contracts are representative of petitioner's arrangements with its CSP, Direct Biller, and health and fitness facility customers during the period at issue.

8. Petitioner uses its Genesis system, a proprietary transaction processing technology platform, to process online bill payment transactions. Through the use of its Genesis system, petitioner enables consumers to electronically direct and authorize the payment of any electronic bill delivered by petitioner, and to direct and authorize the payment of any other bill the consumer has received from any individual or entity that has a mailing address within the United States. In most cases, the electronic bill payment is completed using the Federal Reserve's Automated Clearing House (ACH), which is the primary electronic funds transfer system that financial services organizations use to move funds electronically through the banking system.

9. Petitioner's employees program Genesis to ensure that the ACH debit and credit files it creates are NACHA compliant. NACHA is an acronym for the National Automated Clearing House Association, a not-for-profit trade association that develops operating rules and business practices for the nationwide network of automated clearing houses and for other areas of electronic payments. NACHA manages the development, administration, and governance of the ACH network, and is the national association responsible for ACH payments.

10. Genesis is bifurcated into two "engines" that batch and process ACH files. The first engine, the Debit Engine, batches ACH debit transactions that are deducted from the consumer's bank account and credited to an account held by petitioner's affiliate, Bastogne, Inc. Genesis packages the files that are then transmitted to the Electronic Payment Network (EPN) via a secure line. EPN functions as the ACH operator.

11. The second engine, the Credit Engine, takes the consumer's authorized and directed payment request and determines the most efficient way to deliver the payment to the payee, e.g., a merchant. As with the Debit Engine, Genesis packages the files that are then transmitted to the EPN via a secure line. For merchants that maintain a direct connection, the Credit Engine batches payment instructions provided by the merchant (petitioner's customer), into the ACH credit files that are credited to the merchant's account. All the relevant payment details are uploaded to the merchant's accounting system to help ensure error-free posting. The Credit Engine also processes account balance transfers, which allows consumers to transfer balances from one credit card to another.

12. In some cases, petitioner is unable to electronically move funds from the consumer to the merchant. For example, the consumer may log on to direct and authorize an electronic payment to satisfy a bill from a merchant that is not set up to receive electronic payments. An example would be an electronically scheduled payment to the consumer's baby-sitter, who is unlikely to have an established relationship with petitioner to receive payments electronically. In that case, petitioner would typically debit the consumer's bank account for the amount of the payment and would, in turn, issue a paper check, drawn on its trust account with its affiliate, Bastogne, Inc., to the baby-sitter. Payees that are set up to receive electronic payments are referred to as "managed payees," while those that are not, i.e., paper check payees, are referred to as "un-managed payees."

13. Paper checks are printed at petitioner's Dublin, Ohio, and Phoenix, Arizona, facilities, and are mailed to the merchant or other un-managed payee. The process of printing and mailing checks is labor intensive because it requires packaging multiple checks into one envelope in the case of paying un-managed merchants receiving multiple payments. The facility at which any

given paper check is printed, and from which it is mailed, is determined upon the printing location's geographic proximity to the payee, while taking into consideration the means (air versus overland) and relative speed at which mail delivery will be accomplished. Paper checks accounted for roughly 20% of all payments processed by petitioner during the period in issue.

14. Electronic payments scheduled through petitioner's system can never be paid instantaneously. When a payment is sent to a merchant electronically, the fastest the payment can be made is either the next day or the day after, depending on when the consumer scheduled the payment relative to the ACH mandated cut-off time and to the Genesis cut-off time for batching and processing payment instructions. When a payment is made by paper check, the fastest the payment can be made is in four days, unless the consumer requests that the check be delivered via overnight mail.

15. Petitioner's EBPP business operates almost entirely on a "Risk Processing" model. Under the Risk Processing model, petitioner assumes the risk for the consumer's payment instructions because petitioner simultaneously initiates the credit (payment) to the merchant and the debit to the consumer's bank account (withdrawal or removal of funds) so that they post on the same day. The debit from the consumer's bank account is posted to petitioner's affiliate's (Bastogne, Inc.) account, and the payment credit to the merchant is made using petitioner's own funds from such account. Petitioner thus assumes the credit risk that the consumer's debit may "bounce" for insufficient funds. Since petitioner has already sent the credit to the merchant, if the consumer's debit is returned for insufficient funds, petitioner must seek to collect reimbursement for its payment from the consumer.

16. Petitioner's Risk Processing model is what makes it the leading provider in the EBPP field. By assuming the risk of default, petitioner benefits its CSP customers by allowing them, in

turn, to provide a more attractive electronic bill payment experience for their customers (consumers), specifically by enabling quicker payment turnaround time, thereby allowing the consumers to maintain control of their own money for a longer period of time and minimizing the consumers' exposure to interest charges, penalties and fees resulting from late payments. The alternative to the Risk Processing is the "Good Funds" model. Under the Good Funds model, the EBPP provider sends the debit to the consumer's bank account, but the credit is not sent to the merchant until the EBPP provider is sure the debit will not be returned for insufficient funds, a process described in essence as placing a "hold" on the consumer's funds. The time difference between the two models can be significant, with essentially no delay or "lag" under the Risk Processing model versus up to a several day hold on funds under the Good Funds model.

17. The Risk Processing model is proprietary to petitioner. Petitioner's main competitors use the Good Funds model. In total, petitioner completed over one billion electronic bill payment transactions during each year of the period in issue worth over one trillion dollars per year. During the period at issue, approximately 99% of the payments petitioner processed were completed under the Risk Processing model.

Petitioner's EBPP Business Employees

18. During the period in issue, petitioner's EBPP business operated primarily at facilities located in Norcross, Georgia; Dublin, Ohio; Aurora, Illinois; and Phoenix, Arizona. At no time during the period in issue were employees, assets or offices involved in generating the EBPP receipts at issue located in New York.

19. Petitioner employed between 3,050 and 4,300 full-time employees during the period in issue. For the tax year ended June 30, 2007, the federal consolidated group that included petitioner reported deductible wages on its federal income tax returns of $279,812,521.00. Of

that amount, $242,599,659.00 was attributable to petitioner. Approximately 70% to 80% of petitioner's employees were assigned to functions in the EBPP business.

20. During the period in issue, the employees that were assigned to EBPP functions worked in various groups and teams. The "sales" and "remittance management" groups were responsible for establishing and managing merchant relationships and gathering all of the information necessary for consumers to make, and merchants to receive, payments electronically. This process includes direct human contact with merchants throughout the United States and the manual creation and ongoing manual updating of merchant accounts in petitioner's Genesis system. During the period in issue, the sales and remittance management groups were located in Dublin, Ohio.

21. When a new CSP relationship is established, petitioner's "implementation team" works to create the interface that connects the merchants, CSPs and consumers to petitioner's system. The implementation team collects and inputs bank routing numbers and demand deposit account information that allows petitioner to access the consumers' accounts. Because these identifying numbers are not static (e.g., a consumer opens a new account with a new account number, or a merchant changes the payment deposit account or payment center to which a particular payment is to be sent), the implementation team is continuously manually updating the information to ensure that funds are properly transmitted. The implementation team also works with the CSPs to ensure that their internet website access portal meets the needs and requirements of both the CSPs and petitioner. Petitioner's witness described both the initial input and subsequent ongoing updating work performed by the sales, implementation and remittance management groups as "hideously, tediously manual." During the period in issue, the implementation team performed its functions in Norcross, Georgia, and in Dublin, Ohio.

22. Petitioner's "credit returns" and "debit returns" groups monitor payments that are not processed successfully. The credit returns group works to identify incorrect banking, routing or other information in petitioner's system that may have led to an unsuccessful payment. In turn, they work with the merchants, banks, United States Postal Service (USPS), and petitioner's remittance management and implementation teams to fix the problem. The debit returns group addresses situations where there are insufficient funds in the consumer's bank account. In that case, the debit returns group attempts to re-clear the payment. During the period in issue, both groups were located in Norcross, Georgia, and in Dublin, Ohio.

23. Because petitioner operates on a Risk Processing model, it maintains a "credit risk" group to evaluate the level of risk associated with each transaction. The credit risk group operates and maintains a proprietary algorithm that reviews the consumer's risk scores, banking history, history with petitioner, the amount of the payment and the identity of the merchant being paid to determine the level of risk and best method for completing a scheduled payment. The algorithm is continuously updated based on information obtained by the credit risk group. If a particular transaction is determined to be too risky, the transaction will be "dropped" to a "laser draft" (i.e., a check to be drawn directly on the consumer's bank account). The check will be mailed to the merchant, and if the consumer has insufficient funds to cover the payment, the check will bounce back to the merchant, and not to petitioner. During the audit period, the credit risk group was located in Norcross, Georgia, and in Dublin, Ohio.

24. If the credit risk group allows an electronic payment to go through and the consumer's debit is returned for insufficient funds, petitioner's "collections" group must seek to collect the payment from the consumer. The collections group will attempt to collect the defaulted payment by freezing the consumer's account and contacting the consumer with a letter stating that they

cannot make any future electronic payments until the debt is satisfied. If the consumer does not resolve the liability, the collections group will continue to seek payment through escalating collection activity. During the period in issue, the collections group was located in Norcross, Georgia, and Dublin, Ohio.

25. Petitioner also monitors the transactions in its system for potential fraud using its Fraud Net system. If a potentially fraudulent transaction is detected, petitioner's "fraud prevention" group will review the transaction and interact with the consumer to verify the validity of the payment. If the payment is determined to be fraudulent, the fraud prevention group will report the fraud to the Federal Bureau of Investigation (FBI) and, when necessary, work with the FBI to stop additional fraud from taking place. During the period in issue, the fraud prevention group, which was located in Dublin, Ohio, successfully prevented approximately $500 million in fraudulent transactions.

26. During the period in issue, petitioner employed over 1,000 individuals in call centers located in Dublin, Ohio, Phoenix, Arizona, and (for a portion of the period) Aurora, Illinois, offering two levels of customer support (Tier 1 and Tier 2). Tier 1 customer service calls are routed directly to petitioner. In such cases, petitioner answers the call on behalf of the particular CSP (i.e., in answering, petitioner uses the bank's name as if it were the bank), and works directly with the consumer to resolve the problem. This manner of responding is part of preserving the identity of each CSP's unique brand (***see*** Finding of Fact 3). Tier 2 customer service calls are routed directly to the CSPs. In some cases, however, the CSPs are unable to resolve the Tier 2 calls because they do not have the information necessary to resolve the problem related to the consumer's scheduled payment. In that case, the CSP will call petitioner to resolve the problem. Call center employees are trained to answer questions ranging from

technical support to explanations of the full breadth of petitioner's payment activities. Customer service representatives can also manually schedule payments for consumers if they are otherwise unable to do so online. CSPs and consumers utilize petitioner's call center before, at the time of, and after scheduling a payment.

27. Petitioner's employees engage in a number of other activities related to the provision of petitioner's EBPP business. The "treasury function" includes cash management, and a "settlement and reconciliation" group is responsible for tracking the roughly one trillion dollars a year that goes through petitioner's system. They ensure that all of the debits and credits that are supposed to be processed actually get processed and that the outgoing debits are balanced against the outgoing credits, such that when the debits and credits clear they match the activity in petitioner's corporate bank account. Petitioner also maintained a "systems operations" group (i.e., computer engineers, programmers and developers) to monitor and ensure the proper functioning of the Genesis system, a "disaster recovery team," a "regulatory compliance" group, and a legal department. During the period in issue, the treasury function was located in Norcross, Georgia, and Dublin, Ohio, and the systems operations group was located in Norcross, Georgia.

The Division's Audit

28. For the period in issue, petitioner filed Form CT-3 (General Business Corporation Franchise Tax Return) on a separate company basis for each of the tax years within the period spanning July 1, 2004 through December 31, 2008.[6] On each of those returns, petitioner was required to compute a business allocation percentage (BAP) that included a receipts factor. For allocation purposes under Tax Law § 210, petitioner treated its EBPP receipts as arising from

[6] The Division's audit resulted in a determination that petitioner was required to file on a combined basis with its affiliate, Bastogne, Inc., and its affiliate, CheckFree Investment Corporation. Petitioner did not contest this determination and it is not at issue in this proceeding.

services performed, and determined that such services were performed entirely outside of New York.

29. Petitioner relied in part for its reporting position, i.e., that its EBPP receipts during the period in issue were service receipts allocable outside of New York, upon a 50-state "Cost of Performance Study" conducted by PricewaterhouseCoopers (PwC) in 2003. The PwC study determined that petitioner's EBPP receipts should be sourced as service receipts for state income tax purposes. In states that use a market-based sourcing method for service receipts, petitioner followed the PwC study to source its EBPP receipts based on customer location. In New York, the PwC study determined that petitioner's EBPP receipts should be sourced based on where the services were performed. The PwC study was updated in 2006, when Ernst & Young conducted a similar study that reached the same results.

30. On April 9, 2010, the Division of Taxation (Division) began an audit of petitioner's New York State general business corporation franchise tax returns for the period July 1, 2005 through December 31, 2008. During the week of June 7, 2010, the Division conducted an initial field visit at petitioner's Brookfield, Wisconsin, facility to begin reviewing documentation. Following the initial field visit, the audit period was enlarged to include July 1, 2004 through June 30, 2005.

31. Between June 2010 and March 2013, petitioner provided the Division with documentation and information related to, among other things, its EBPP functions and the nature, classification and sourcing of its EBPP receipts. The documentation provided included a response by petitioner to Information Document Request (IDR) #1, which was issued by the Division on December 28, 2010. Petitioner also responded to IDR #2, which the Division issued on February 21, 2013.

32. Among the documentation provided in response to the two IDRs was a report detailing the revenue earned by petitioner from its New York customers. That report shows the amount received from each of petitioner's New York customers based on the customer's billing address. Neither IDR #1 nor IDR #2 requested documentation or information regarding the location of the individual consumers, i.e., the customers of petitioner's customers. Indeed, at no time during the audit did the Division obtain information or documentation regarding the location of the consumers that scheduled electronic payments during the period in issue, and it is unclear if petitioner tracked such information or compiled reports thereof as a matter of regular course.[7]

33. During its audit, the Division did not ask petitioner for information regarding the number of individuals employed by petitioner or the particular functions petitioner's employees performed. The Division never requested information or documentation regarding petitioner's remittance management group, sales group, implementation team, credit returns group, debit returns group, credit risk group, collections group, fraud prevention group, customer service call center, settlement and reconciliations group, systems operations group, disaster recovery team, regulatory compliance group, treasury or legal department. The Division did not inquire about or obtain any documentation regarding petitioner's risk processing model, and the Division's witness at hearing testified that she was not familiar with the risk processing or good funds models, and could not articulate how those two processing models were relevant to the audit.

34. On or about March 21, 2013, via a telephone conference call, the parties discussed the sourcing of petitioner's EBPP receipts. The Division advised petitioner of its disagreement with

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[7] As a practical matter, the location of such consumers, i.e., petitioner's customers' customers, might vary from time to time and from point to point, depending upon the location and manner (e.g., home or other computer, mobile device, etc.) by which payments were scheduled and authorized. While it may be possible to track such information, it does not appear that petitioner specifically did so during the time period at issue. In any event, that information was not provided during the course of the audit examination.

petitioner's classification of such receipts as derived from the performance of services (per Tax Law former § 210[3][a][2][B]), and asserted that the same should be classified as "other business receipts (per Tax Law former § 201[3][a][2][D]) to be sourced to New York based on the New York location of petitioner's customers' customers (the consumers) or upon the New York locations (New York addresses) of petitioner's customers (such latter basis was used for purposes of the Division's calculations underlying the notices of deficiency issued in this matter; ***see*** Finding of Fact 32). On or about March 22, 2013, the Division provided adjusted audit schedules and, thereafter, on or about May 28, 2013, sent an initial Consent to Field Audit Adjustments proposing to resolve the classification/sourcing issues for the period spanning July 1, 2004 through December 31, 2008 by allocation of a portion of petitioner's EBPP receipts to New York.

35. On or about July 10, 2013, and in connection with ongoing discussions aimed at reaching a mutually acceptable resolution, the Division requested that petitioner execute a Form AU-1 (Consent Extending Period of Limitation for Assessment), in order to extend the period of limitations within which the Division could assess additional tax for the period spanning July 1, 2004 through December 31, 2008 (then due to expire on September 30, 2013). By a letter dated August 15, 2013, following further but unsuccessful settlement discussions, the Division's extension request was denied and petitioner requested that the Division issue a notice of deficiency asserting additional tax such that petitioner could file its appeal challenging such deficiency.

36. By a responding letter dated August 28, 2013, the Division advised petitioner that a subsequent audit for the period spanning January 1, 2009 through December 31, 2009 was in progress, and simultaneously requested the execution of another Form AU-1 to extend the period

of limitations on assessment with respect to such period. Petitioner, in turn, advised the Division that it had not received any prior notification of the commencement of an audit for the noted period and further declined the Division's request to extend the period of limitations with respect to such period (then due to expire on September 15, 2013).

37. On September 6, 2013, the Division issued to petitioner a new IDR (IDR #3) for the period spanning July 1, 2004 through December 31, 2008, stating that the additional requested documentation and information was necessary "to complete the review of the receipts allocation factor." The IDR indicates that the requested material was to be supplied by October 7, 2013 (i.e., seven days after the period of limitation for that period was due to expire; ***see*** Finding of Fact 35).

38. On September 6, 2013, the Division issued to petitioner a Notice of Deficiency (Assessment ID L-040043558-9) asserting additional corporation franchise tax due for the period spanning January 1, 2009 through December 31, 2009 in the amount of $508,469.00, plus interest and penalties. Petitioner never received from the Division an audit initiation or appointment letter, a request for books or records, any workpapers regarding an adjustment to its corporation franchise tax liabilities, or a statement of proposed audit changes prior to the issuance of the Notice of Deficiency pertaining to this portion of the audit period.

39. On September 18, 2013, the Division issued to petitioner a Notice of Deficiency (Assessment ID L-040108575-5) asserting additional corporation franchise tax liabilities for the period spanning July 1, 2004 through December 31, 2008 in the amount of $1,419,541.00, plus interest and penalty.

40. At hearing, the Division's witness testified that in determining the classification of a receipt for apportionment purposes under Tax Law Article 9-A, the Division follows Generally

Accepted Accounting Principles (GAAP), including GAAP rules for revenue recognition. As such, receipts from services performed are to be recognized as earned (generally) when the services are completed. Petitioner, in accordance with GAAP, takes the position that its services are completed and its EBPP receipts are earned when the funds associated with an electronic bill payment have been made available to the merchant, either through the completion of an ACH transaction or through the issuance of a paper check.

41. Subsequent to the period in issue, the Legislature amended the relevant provisions of the Tax Law regarding, among other things, the sourcing of service receipts under Tax Law former § 210(3)(a)(2)(B) (***see*** Tax Law § 210-A; L 2014, ch 59, eff January 1, 2015).

42. Petitioner submitted proposed findings of fact numbered 1 through 50. The Division objected to those numbered 1 through 48, principally upon the assertions that such proposed facts are: "too vague," "irrelevant," "lack specificity," inappropriate as representing conclusions of law rather than findings of fact, not supported by the record, or "argumentative."[8] Careful review of the proposed findings of fact in light of the issues presented, including specifically the Division's assertion, first articulated in its brief, that the receipts in question resulted from the grant of licenses to access and use intangible assets and hence should be categorized as "other business receipts" on that basis, reveals that the same are not vague, are relevant, are indeed supported by the record, do not lack specificity, are not "argumentative" and are not conclusions

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[8]. Proposed findings numbered 49 and 50, to which the Division does not object, specify that:

-if the Division's position regarding petitioner's EBPP receipts is sustained then petitioner will be liable for additional tax for the audit period in the amount of $450,958.00 plus interest;

-if petitioner's position regarding its EBPP receipts is sustained then petitioner will be entitled to a refund for the audit period in the amount of $165,808.00 plus interest; and

-the Division has agreed to cancel all penalties listed in the notices of deficiency that are at issue in this proceeding.

These proposed facts are also set forth in the parties' stipulated facts numbered 5, 6 and 10 (***see*** Partial Stipulation of Facts; Exhibit AAA).

of law.[9] The Division's objections on the basis of relevance, specificity and argumentative nature, essentially speak to the amount of weight to be appropriately accorded to such proposed facts. In sum, and upon careful review, the proposed findings of fact have been generally accepted and incorporated herein, except for proposed findings of fact numbered 34 through 37, to the extent of excluding therefrom the specific terms of proposed settlements that did not come to fruition, and proposed findings of fact numbered 45 through 48, which simply propound, in summary, the parties' respective legal positions in this matter, as set forth hereafter.

SUMMARY OF THE PARTIES' POSITIONS

43. Petitioner contends that its EBPP receipts during the years at issue were properly classified as "service receipts" under Tax Law former § 210(3)(a)(2)(B), and that as such, the receipts must be sourced to the location where the services were performed, which, in this case, was outside of New York State. Alternatively, petitioner argues that if the EBPP receipts should be classified as "other business receipts," per Tax Law former § 210(3)(a)(2)(D), they should nonetheless be sourced outside of New York State because they were earned at the out-of-state locations where the activities and work that generated the receipts were performed.

44. Petitioner also maintains that the notices of deficiency should be canceled on the following bases:

> a) the Division seeks to tax petitioner on the basis of a retroactive interpretation of law and policy i.e., receipt sourcing based on customers' locations (New York addresses), or customers' customers (consumers)

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[9] Of particular note, for example, is the Division's objection to the use of the term "audit period" as "too vague." In fact, the "audit period" is clearly identified as the period July 1, 2004 through December 31, 2009, as set forth and specifically stipulated to by the parties (***see*** Partial Stipulation of Facts, Exhibit AAA at 1). Similarly, the Division's specific objection to the sixth sentence of proposed finding of fact 2 as constituting a conclusion of law and not a finding of fact is somewhat baffling given that this same statement is specifically stipulated to as a fact by the parties (***see*** Partial Stipulation of Facts, Exhibit AAA at 2).

locations (locations of consumers computers used to access petitioner's systems);

b) the Division attempts to impose a rule of broad applicability in violation of the State Administrative Procedures Act (SAPA) i.e., expanding the scope of a statute (Tax Law former § 210[3][a][2][B]) by its interpretation and application of the attendant regulation (20 NYCRR 4-4.3[a]) as requiring there to be human involvement at the time of the transaction in order for the receipt derived therefrom to be classified as earned from the performance of services per the statute;

c) the Division's position lacks a rational basis, i.e., the notices were issued without the completion of an adequate audit process and solely for the purpose of avoiding expiration of the period of limitation on assessment; and

d) the Division's imposition of tax offends the United States and New York State Constitutions on due process and commerce clause grounds, i.e, that the tax is imposed on extraterritorial values (receipts) not sufficiently connected to New York and unfairly apportions tax liability to New York so as to result in a burden and a chilling effect on interstate commerce.

45. The Division, on the other hand, maintains that petitioner's EBPP receipts should be classified as other business receipts, as opposed to receipts derived from the performance of services, since there allegedly was no human involvement (i.e., performance of services by persons) in the transactions that generated the receipts. In addition, and articulated for the first time in its post-hearing brief, the Division maintains that the receipts in issue were generated as the result of petitioner allowing access to and use of intangible assets (i.e., its website and EBPP systems). The Division's argument is that pursuant to the terms of the representative contracts in evidence, petitioner granted its customers, and its customers' customers (i.e., authorized consumers) the right to access and use petitioner's EBPP systems, such that the receipts at issue resulted from the granting of a license or contractual right, i.e., an intangible for franchise tax

classification and sourcing purposes.[10] The Division maintains that such receipts therefore constitute other business receipts (per Tax Law former § 210[3][a][2][D]), and must in turn be sourced to where they were earned. In this case, the Division maintains the receipts were earned at the locations of petitioner's customers' customers (i.e., the locations of the consumers' computers where such consumers gained access to petitioner's website and EBPP systems). The Division further maintains that even if the receipts in issue are properly classified as service receipts, they are nonetheless allocable to New York on the same basis (i.e., the location of the consumers' computers) because that is where the services were performed. The Division goes on to argue that, in either case, since it was unable to obtain information as to the location of the various individual consumers' computers, it was reasonable to allocate petitioner's receipts to New York on the basis of the New York addresses of petitioner's customers. Finally, the Division also disputes that its assessments are violative of the Unites States Constitution and New York State Constitution.

CONCLUSIONS OF LAW

A. Article 9-A of the Tax Law imposes a franchise tax on all domestic and foreign corporations doing business, employing capital, owning or leasing property, or maintaining an office in New York State (Tax Law former § 209[1]).[11]

B. In New York, corporate taxpayers report their tax liability based on their computation of the highest of four income bases, one of which is their entire net income base (Tax Law former § 210[1][a-d]). A corporation's entire net income base is computed by calculating its entire net

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[10] The contracts in evidence were offered and accepted as representative of those entered into between petitioner and its EBPP customers during the period in issue (***see*** Finding of Fact 7).

[11] An additional surcharge tax is imposed, per Tax Law former § 209-B, upon corporations located or doing business within the Metropolitan Commuter Transportation District (MCTD).

income (ENI), generally consisting of its investment income (Tax Law former § 208[6]), and its business income (Tax Law former § 208[8]; ***see*** Tax Law former §§ 210[1][a]; [3]; 208[9]; 209[1]). In turn, the corporation's investment income and business income are allocated to New York pursuant to the corporation's investment allocation percentage (IAC) (Tax Law former § 210[3][b]) and its BAP (Tax Law former § 210[3][a]), with the resulting amounts totaled to arrive at the corporation's entire net income base.

C. For tax years beginning on or before December 31, 2005, a corporation's BAP consisted of three factors, to wit, property, receipts (double weighted) and payroll (Tax Law former § 210[3][a][1-4]). For tax years beginning on or after January 1, 2006, New York began a transition to a BAP consisting of a single weighted receipts factor, with the same becoming fully effective for tax years beginning on or after January 1, 2007 (Tax Law former § 210[3][a][10][A][ii]).[12]

D. This case solely concerns petitioner's calculation of its receipts factor for the years at issue. The receipts factor is a fraction. The numerator of the fraction is the amount of petitioner's receipts allocable to New York from: (i) sales of tangible personal property shipped to points within the state, (ii) services performed within the state, (iii) rentals from properties situated, and royalties from the use of patents or copyrights, within the state and (iv) all other business receipts earned within the state. The denominator of the fraction is all of petitioner's receipts similarly computed and arising during the taxable period from: (i) sales of tangible

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[12] For MCTD surcharge purposes, corporations calculated their liability via an MCTD business allocation percentage (MCTDBAP). Notwithstanding the change to a single receipts factor BAP that became effective for purposes of the tax imposed by Tax Law former § 209(1), the MCTDBAP consisted of the arithmetic average of the three separate percentages resulting from the corporation's (1) property, (2) payroll and (3) receipts (single weighted) within the MCTD as compared to the corporation's (1) property, (2) payroll and (3) receipts (single weighted) within New York State (Tax Law former § 209-B[2]).

personal property, (ii) services, (iii) rentals and royalties, and (iv) all other business receipts, whether within or without the state (Tax Law § 210[3][a][2][A-D]). Even more specifically, this case devolves to first discerning the correct classification of petitioner's EBPP receipts as either (a) receipts from the performance of services (per petitioner) or (b) other business receipts (per the Division). Thereafter, the question becomes whether, and upon what method, any of such receipts are properly allocable to and taxable by New York.

E. In addressing the initial classification question of receipts from "services performed within the state" versus "other business receipts," the word "services" itself is not expressly defined under Article 9-A. The statute, for purposes of this issue, simply identifies "services performed within the state" (Tax Law former § 210[3][a][2][B]). In cases of statutory interpretation, the prerogative of the adjudicatory body is to ascertain and give effect to the intent of the Legislature (***Patrolmen's Benevolent Assn. v. City of New York***, 41 NY2d 205 [1976] citing ***Matter of Petterson v. Daystrom Corp.***, 17 NY2d 32 [1966]). The language of the statute is the clearest evidence of such intent (McKinney's Cons Laws of NY, Book 1, Statutes § 51[d]). Where no ambiguity exists, "the court should construe it so as to give effect to the plain meaning of the words used" (***Patrolmen's Benevolent Assn. v. City of New York*** at 208). Generally, words of ordinary import are to be given their ordinary and usual meaning (McKinney's Cons Laws of NY, Book 1, Statutes § 232).

F. The term "services" may be properly defined in the present context as "useful labor that does not produce a tangible commodity" (Webster's Ninth New Collegiate Dictionary, 1076) or "performance of labor for benefit of another, or at another's command" (Black's Law Dictionary 1227 [5th ed 1979]). In turn, an examination of the nature of petitioner's EBPP transactions,

when considering the ordinary meaning of the word "services," leads to the conclusion that the receipts at issue were the result of services performed by petitioner.

G. First, petitioner's CSP customers (i.e., financial institutions, banks and credit unions) are effectively required to provide EBPP capability, as the result of their own customers' (consumers) expectations that the same will be available as a matter of course. At the same time, petitioner's CSP customers desire to provide EBPP functions because they understand that in doing so, they gain the benefits of (a) customer retention as well as (b) the opportunity for significant profitability increases resulting from product and service marketing opportunities due to their customers' ongoing website interactions (more online "visits") with the CSPs (***see*** Finding of Fact 4). In similar fashion, petitioner's direct biller customers as well as its customers who receive recurring payments (health and fitness facilities) also benefit by outsourcing their EBPP functions. That is, these customers reduce their cost of paper bill creation and issuance (mailing), as well as payment intake and posting, and in so doing increase the accuracy of their posting of payments function (***see*** Findings of Fact 5, 6 and 11). However, the necessary human and technological resources, the accompanying significant costs, and the expertise required to provide this EBPP capability leaves doing so beyond the means of most CSPs. Thus, petitioner's customers choose to outsource their EBPP functions to outside providers, including petitioner.

In turn, petitioner carries out the foregoing activities and in so doing, is performing a "service" to its customers, and to its customers' customers (consumers), as contemplated by the use of that word in the statute. As described, a consumer receives a bill, either electronically (including from petitioner's direct biller customers) or otherwise, accesses petitioner's website via logging on to its CSP's website, initiates a payment direction for the particular bill (i.e.,

designates the payee, and the amount and time of payment) and authorizes the payment to be made. Thereafter, petitioner executes the steps necessary to transfer the funds so as to effectuate the payment, either electronically or by the issuance of a paper check depending upon the particular circumstances. All of the activities necessary to carry out an EBPP function are part of petitioner's process, and occurred whether petitioner's customers' customers (consumers) logged on to petitioner's system (configured to appear as the given CSP's system for branding purposes) to direct and authorize payments, or were involved in a telephone call to a live person via petitioner's customer service centers. Petitioner's customers pay petitioner for providing this service to and for their own customers. The consumers who direct and authorize bill payments, and the merchants who authorize bill presentment and accept payments do not carry out the EBPP function, but rather that is what petitioner is paid to do (i.e., undertake the necessary steps to carry out presentment and thereafter payment of bills, as directed and authorized, by its own means). It is of no moment that the ultimate fulfillment of the desired service is, in petitioner's case, accomplished electronically. In this respect, and due to the advance of technology, the computers, servers, data centers and secure electronic connections (i.e., the portions of the overall service petitioner provides that have been automated) are simply the tools used by petitioner (and its employees) to perform and provide its EBPP services. Petitioner's Genesis platform, as created and used by petitioner, is the tool by which, after all of the information and instructions are entered, petitioner physically carries out the process of presentment and payment, as desired by consumers and as paid for by petitioner's customers. In sum, petitioner does not simply provide technology, or grant open-ended access to and use of technology, but rather utilizes its proprietary technology (including granting access thereto as a necessary component step in allowing consumers to initiate the process of directing and authorizing bill payments) as

an integral part of carrying out, and hence providing, its overall service of online or electronic bill presentment and payment for its customers and its customers' customers.

H. The Division points to its regulations to support its classification of petitioner's receipts as other business receipts and not as receipts from the performance of services. The relevant regulation states, in pertinent part:

> "The receipts from services performed in New York State are allocable to New York State. All receipts from such services are allocated to New York State, whether the services were performed by employees, agents or subcontractors of the taxpayer, or by any other persons" (20 NYCRR 4-4.3[a]).

The Division maintains that petitioner's receipts cannot qualify as receipts from services performed as no employees, agents, subcontractors or other persons on behalf of petitioner were involved in performing the transactions in question. Specifically, the Division asserts that, pursuant to its regulation, there must be human involvement for the receipts to have resulted from services performed. Since there was not, according to the Division, the receipts at issue must be classified as "other business receipts" under Tax Law former § 210(3)(a)(2)(D).

I. The Division's interpretation of the regulation, in this case, however, represents an impermissible expansion of Tax Law former § 210(3)(a)(2)(B). Case law dictates that "a tax statute may not be extended by implication beyond the clear import of the language used" (***Yonkers Racing Corp. v. State***, 131 AD2d 565, 567 [2d Dept 1987]). Unquestionably, 20 NYCRR 4-4.3(a) discusses the allocation of receipts from services, and the clause within it pointed to by the Division - "whether the services were performed by employees, agents or subcontractors of the taxpayer, or by any other persons" - simply attempts to prevent the avoidance of allocation when services are performed by an individual that may tangentially be related to a corporate taxpayer, rather than the taxpayer itself. Where, as here, words of a statute

have a definite and precise meaning, it is not necessary to look elsewhere in search of conjecture so as to restrict or extend that meaning (***Matter of Erie County Agricultural Society v. Cluchey***, 40 NY2d 194 [1976]). By its plain language, Tax Law former § 210(3)(a)(2)(B) does not require human involvement at the moment of sale in order for services to have been performed, and the regulation must not be interpreted to improperly restrict the meaning of the word "services" by adding such a limiting requirement.

Moreover, the regulation upon which the Division relies is clearly aimed at the *allocation* of receipts and not at the *classification* of receipts. That is, the direct language of the first sentence of the regulation states that "[t]he receipts from services performed in New York State are allocable to New York State" (20 NYCRR 4-4.3[a]). This language thus directly presupposes that the receipts to which it pertains are, in fact, service receipts. The Division's argument that there can be no service receipts without direct human involvement results from reading into the second sentence of the regulation an absolute requirement that the services must be performed by "persons" (i.e., employees, agents, subcontractors or any other persons) to the exclusion of any other means by which services might be provided. However, as noted above, the evident aim of this second sentence of the regulation is to prevent a taxpayer from excluding such service receipts from being allocated to New York State by the simple expedient of using agents, subcontractors or other intermediaries. In essence, the Division's reading of the regulation, and the statute to which it relates, as standing for the proposition that there must be human involvement at the time the service is performed in order for such receipts to qualify as service receipts, rather than as simply addressing the allocation of such service receipts, serves to limit the scope of what type of activities can be viewed as performing services per the relevant statute. The fact that a corporation may, as here, employ technology in performing its services does not,

per se, remove the resulting receipts from the realm of receipts derived from the performance of services, yet this is the result sought by the Division in imposing a requirement that services must only be performed by persons. In fact, technological advances occurring over time have had the practical result of expanding the means by which service activities may be provided, and the Division's reading of the regulation improperly serves to eliminate any consideration of such advances (***see People v. Eulo***, 63 NY2d 341, 354-355 [1984]; ***cf Hudson Riv. Tel. Co. v. Watervliet Turnpike & Ry. Co.***, 135 NY 393, 403-404 [1892]).

Interestingly, and in connection with its argument that the receipts in question result from and constitute fees for licenses granting access to and use of intangible assets and not receipts from performing services (***see*** Conclusion of Law K), the Division notes that the Federal Financial Institutions Examination Council (FFIEC) would classify petitioner as a "technology *service* provider" (***see*** Division's Brief at 19; italics added). While apparently conceding that such FFIEC classification carries with it the understanding that entities such as petitioner, to whom financial institutions outsource technology services, in fact perform "services," the Division nonetheless posits that the resulting receipts cannot be classified as such under Tax Law § 210(3)(a)(2)(B) because the services are not directly performed (or carried out physically) by persons. Again, this argument that the amounts at issue would be receipts from services but for the (alleged) absence of human involvement in their performance circles back to improperly interpreting the relevant statute to include a requirement not found therein.[13]

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[13] The context of the Division's reference to technology service providers appears in an FFIEC statement concerning "Risk Management of Outsourced Technology *Services*," wherein the FFIEC identifies entities to which financial institutions outsource technology *services* as follows:

"Technology *service* providers encompass a broad range of entities including but not limited to . . . nonaffiliated entities, . . . providing products and *services*. This may include but is not limited to: core processing; information and transaction processing and settlement activities that support banking functions such as lending, deposit taking, funds transfer, fiduciary, or trading activities; Internet related *services;* security monitoring; systems development and maintenance; aggregation *services*; digital certification *services*, and call centers."

J. Additionally, and as petitioners correctly argue, even if the Division's interpretation of 20 NYCRR 4-4.3(a) is correct, its conclusion on this point is factually incorrect as it entirely overlooks the evidence of human involvement throughout petitioner's process of providing its EBPP services. In this regard, petitioner provided the means by which bills could be (and were) electronically presented (or distributed) to consumers, and provided the means by which such consumers could direct and authorize the payment of such bills, as well as other bills not presented electronically (***see*** Finding of Fact 12). Petitioner also provided significant pre-and post-transaction customer support in the form of its customer call centers (***see*** Finding of Fact 26). During the years at issue, petitioner employed between 3,050 and 4,300 people, who were involved in the creation of its Genesis system, in identifying and negotiating agreements with its various customers, in compiling information, in programming and operating its systems, in updating the inputs and ongoing corrections to such systems, in creating and maintaining the website interfaces and telephonic and electronic customer service centers, in manning such centers, and in complying with all of the requirements necessary to accurately and securely effectuate all of its EBPP functions. In fact, it is uncontroverted that some of petitioner's consumer-initiated payment transactions occurred telephonically. The human involvement in petitioner's performance of its services, as evidenced by the record, clearly meets any requirement found in the Division's reading of the regulation to require human involvement in the provision of services. In sum, even if the Division's interpretation of the regulation were

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The statement additionally provides as follows:

"Financial institutions increasingly rely on *services* provided by other entities to support an array of technology-related functions. While outsourcing . . . can help financial institutions manage costs, obtain necessary expertise, expand customer product offerings, and improve *services,* it also introduces risks that financial institutions should address. This guidance covers four elements of a risk management process: risk assessment, selection of *service* providers, contract review, and monitoring of *service* providers" (italics added).

accepted, petitioner's receipts resulted from the performance of services, as described in former section 210(3)(a)(2)(B).

K. The Division has also argued that petitioner is merely providing access to and use of the EBPP technology it has created, such that the receipts at issue resulted from the licensing of intangible assets, and as such constituted other business receipts. This argument is based on language found in the representative contracts in evidence pursuant to which petitioner granted to its customers, and in turn to its customers' own authorized customers (consumers), access to and use of petitioner's EBPP systems as well as access to and use of petitioner's customer care centers.

L. As an initial matter, this argument was first raised in the Division's post-hearing brief. Petitioner asserts that this argument represents a new theory of liability that was not set forth in the Division's pleadings, presents the need for additional factual inquiry, and should therefore not be addressed herein (***see Matter of Mitnick***, Tax Appeals Tribunal, January 25, 1991). In particular, petitioner maintains that the Division's manner and timing of raising the argument imposes significant limitations on petitioner's ability to respond, including by submission of additional evidence. Petitioner specifically argues that it is hampered in responding by its inability to provide evidence to distinguish the EBPP contract language relied upon by the Division, from allegedly different language found in contracts used in its other business divisions, and in particular contracts used in its Software Division that pertain to the sale of intangible assets including licenses to use software. At the same time, however, the Division's argument is directly framed and relies upon the language set forth in the representative EBPP contracts in evidence. These contracts specifically pertain to petitioner's Electronic Commerce Division from which the EBPP receipts in issue were derived, and according to the Division, the

language therein on its own leads to the legal conclusion that petitioner is simply licensing access to and use of its website and systems, and thus is not providing any services to its customers.

M. The Division's "sale of intangible assets" argument does proceed specifically from such representative EBPP contracts in evidence, but critically only from a portion of the language found therein. As explained hereafter, while the contractual language upon which the Division relies might, *in isolation*, support the Division's "receipts from sales (licenses) of intangible assets rather than from services" argument, an examination of the representative contracts *in their entirety*, so as to determine the primary purpose and true nature of petitioner's EBPP business, overcomes any support for the Division's alternative legal theory of liability. Accordingly, the Division's argument, though late-raised, may be effectively addressed herein upon review of such representative EBPP-specific contracts, in their entirety and in the context of the integrated agreements set forth therein, without need for the submission of additional evidence.

N. Resolving the question of whether petitioner's EBPP receipts are simply derived from granting licenses allowing access to and use of intangible assets, and not as receipts from the performance of services, requires ascertaining the primary purpose and true nature of petitioner's EBPP business as viewed in its entirety, so as to determine what is being purchased and paid for from the perspective of the purchasing customers. In this regard, the Tax Appeals Tribunal has explained:

> "It is well established that classification for corporation tax purposes is to be determined by the nature of the taxpayer's business and not by the words in its certificate of incorporation, nor by focusing on one aspect of its business operations. The business must be viewed in its entirety and from the perspective of its customers – what they buy and pay for" (***Matter of Capitol Cablevision Sys., Inc.***, Tax Appeals Tribunal [June 9, 1988] [quoting ***Quotron Sys., Inc. v. Gallman***, 39 NY2d 428 (1976); ***Holmes Electric***

> ***Protective Company v. McGoldrick***, 262 AD 514 (1941), ***affd*** 288 NY 635 (1942); ***McAllister Bros. v. Bates***, 272 AD 511 (1947)]).

In addressing the issue of whether a corporation providing cable television programming was taxable as a general business corporation (per Tax Law Article 9-A) or as a transmission business (per Tax Law Article 9), the Tribunal concluded that transmission was "not the [taxpayer's] business," that the true nature of the taxpayer's business was selling television entertainment to its subscribers, and that its transmission activities were "merely the means by which [the taxpayer] conveys its product to its customers."

The Tribunal further relied upon the following analysis and reasoning:

> "In determining whether a cable television company is engaged in the service of telephony or telegraphy one must focus on the nature of the service provided and not whether as an incident of providing that service there is a telegraphic or telephonic transmission of a signal . . . . It makes sense, therefore, to focus upon the complete package or item purchased by an individual in order to determine whether he must pay a sales tax upon the purchase of that item . . . . [I]t is clear that the cable television subscriber is not purchasing telephony or telegraphy. Instead, he is purchasing entertainment or enjoyment" (***New York State Cable Tel. Assn. v. State Tax Comm.***, 59 AD2d 81 [1977], ***affg*** 88 Misc 2d 601 [Sup Ct, Albany County 1976]).

O. Applying the foregoing analysis and guidance to the matter at hand, the Division's argument regarding licensing of intangibles is rejected as essentially focused in isolation on one aspect of the manner in which petitioner provides its EBPP services. When properly viewed in its entirety and from the perspective of petitioner's customers, petitioner's business is providing and performing for its customers an electronic bill presentment and payment service, and any rights granted to access and use its systems represent only a necessary incident or aspect of the means by which petitioner provides such service. The primary purpose and true aim of petitioner's EBPP business is not the sale, by license, of intangible assets, but rather is the

business of providing for its customers an outsourced, turn-key electronic bill presentment (distribution) and payment service. Obviously, a requisite part of providing an EBPP service is allowing consumers to access petitioner's website for purposes of initiating the process by which petitioner is advised of a payment direction by a consumer (to whom, in what amount, and when a payment is to be made), and is authorized to proceed with the transaction and make such payment. Petitioner, in turn, accepts and undertakes the responsibility and obligation of carrying out and accomplishing that payment direction and authorization. In fact, petitioner's EBPP functions could not be carried out unless those wishing to avail themselves of such functions were allowed access so as to provide a direction for petitioner to fulfill (pay my bill), and were allowed access thereafter so as to ascertain (if they desired) that the service was in fact successfully performed as directed.

P. Petitioner did not simply create an electronic bill payment system and then simply charge users for access to and use of the same with no further involvement by petitioner beyond maintaining and updating such system. Petitioner does not simply provide and maintain a series of connections through which consumers may, upon access, self-effectuate the payment of bills. Rather, the record shows that petitioner and its personnel were involved throughout the entire process of carrying out payments, as directed and authorized by consumers who accessed the system. This involvement included, but was not limited to, credit-worthiness assessment, consequent determination as to method of payment (***see*** Finding of Fact 23 describing risk-based payments using petitioner's own funds versus payment by laser drafts), fraud monitoring, and customer service activities (including petitioner's personnel taking directions and authorizations by telephone to carry out payments). It is particularly noteworthy that in a significant portion (roughly 20%) of the bill payment transactions petitioner handles, it cuts and issues a paper check

as opposed to causing payment via an electronic transfer of funds to the payee, and that petitioner will also, if requested, expedite check payments through delivery via overnight mail (***see*** Finding of Fact 14). Furthermore, the contracts upon which the Division relies are rife and repetitive in expressing that petitioner is providing a service as opposed to merely licensing access to and use of intangible assets (i.e., access to a system or database to be utilized or manipulated by the user to carry out a particular end on their own).[14] The right to access and use language in the EBPP customer contracts is necessary to enable petitioner to provide its EBPP services by allowing those seeking to utilize such services to access, and in turn, direct and authorize petitioner to provide the requested service of carrying out the payment of a bill. It is the bill presentment and payment functions, and all of the necessary accompanying activities required to carry out such functions, that constitute the service paid for by petitioner's customers.

Q. The fact that petitioner employs technology to carry out many aspects of the foregoing service, i.e., fulfilling payments either electronically or by the mechanized printing and mailing of paper checks, does not change the fact that petitioner is in fact providing a service. The moment of a transaction's completion (i.e., when the funds are transferred to the payee or the bill is presented) does not encapsulate the entirety of the service, for the activities that petitioner engages in to provide its services are far more involved and entail much more than allowing a user to log on so as to simply move funds from one point to another, essentially as an exercise in simple data manipulation or "self-service." The Division's limited view of petitioner's EBPP

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[14] ***See*** Exhibit 12 at ¶ 1 (petitioner agrees to provide "electronic commerce services"); ¶ 3.1 (petitioner grants the right to "access and use the [s]ervices"); p 13 (petitioner provides a "payment service"); p 15 (petitioner provides an electronic "banking service"); p 28 (the term "services" shall mean "electronic commerce system" and "electronic commerce services"); p 79 at ¶ 2 and p 85 at ¶ 1 (petitioner's EBPP system is comprised of its "products, services and support systems"), and p 88 at ¶ 6.1 (users have the ability to utilize petitioner's EBPP "service to pay bills presented by the service.")

function is too restrictive, for it ignores the totality of the actions petitioner performs, and gives no accounting for what is actually desired by petitioner's customers. EBPP functions are part of the banking services to which consumers have become accustomed and which consumers demand be provided by their financial institutions. In fact, petitioner's customers' competitors provide such services. It is therefore both necessary, as a practical matter, as well as beneficial to petitioner's customers to do so, both for customer retention and for additional profitability purposes. However, petitioner's customers are largely unable to provide such services on their own because, notwithstanding the role technology plays therein, providing EBPP services is highly labor-intensive and requires a large base of employees (in petitioner's case some three to four thousand employees), is expensive (requiring a large platform and technology infrastructure), is complicated and risky (carrying significant regulatory compliance and funds risk components) and is evolving (both technologically and with respect to the updating of ongoing information input requirements and regulatory compliance matters). Given these factors, petitioner's customers choose to outsource their provision of EBPP services, and pay petitioner to perform the same.

R. Having concluded that petitioner's EBPP receipts were derived from the provision of services, it must next be determined whether such receipts were properly allocated by the Division to New York. Tax Law former § 210(3)(a)(2)(B) states that receipts from the performance of services must be allocated to the location where they are performed (***see also*** 20 NYCRR 4-4.3[a]). The New York Court of Appeals has been instructive on this issue in ***Matter of Siemens Corp. v. Tax Appeals Tribunal*** (89 NY2d 1020 [1997]). In ***Matter of Siemens Corp.***, the Court examined Tax Law former § 210 and found that to the extent interest income from loans resulted from work performed in New York, "the income may fairly be characterized

as 'earned in New York.'" In reaching its conclusion, the court noted that the Tax Appeals Tribunal had earlier found that the activities performed in connection with the loans, such as accounting, financing, and general support services occurred in New York. Although the court ultimately dealt with an allocation of other business receipts under Tax Law former § 210(3)(a)(2)(D) rather than services under Tax Law former § 210(3)(a)(2)(B), the essence of the decision was that, in analyzing the allocation of receipts generally under Tax Law former § 210, the location of the activities performed that gave rise to income in connection with the transaction is determinative. As was true in ***Matter of Siemens Corp.***, the EBPP services performed by petitioner had many components. Contrary to the Division's position, the services performed consisted of much more than a simple, instantaneous, fully automated transaction only taking place when a consumer clicked on his or her computer. The ultimate provision of bill presentment and payment for a consumer required all of the steps detailed herein, including the programming and maintenance of the Genesis system, the anti-fraud, credit-worthiness, method of payment and maintenance of customer service centers, and none of these functions were performed in New York. Following the dictates of ***Matter of Siemens Corp.***, since petitioner's EBPP functions constituted the performance of services, and since all of the functions performed in carrying out such services were performed outside of New York State, the receipts resulting therefrom may not be allocated to New York. Furthermore, consistent with the rationale of ***Matter of Siemens Corp.***, even if the receipts in issue were "other business receipts," the same must be allocated to the location where the work that generated the income was performed - which in this case, was outside of New York State. Thus, under either classification, petitioner properly allocated its EBPP receipts outside of New York and the Division's adjustments thereto were incorrect.

S. Finally, the New York Legislature recently (and after the period at issue) amended the Tax Law to change the allocation of service receipts, such as petitioner's, to a customer sourcing approach beginning with 2015 (Tax Law § 210-A; L 2014, ch 59 eff January 1, 2015).[15] Such a change would be unnecessary if former section 210 was interpreted as the Division suggests. As petitioner correctly points out, rules of statutory construction provide that "[w]hen the Legislature amends a statute, it is presumed that the amendment was made to effect some purpose and make some change in the existing law" and that "[b]y enacting an amendment of a statute and changing the language thereof, the Legislature is deemed to have intended a material change in the law" (***Matter of Stein***, 131 AD2d 68, 72 [2d Dept 1987], citing McKinney's Cons Laws of NY, Book 1, Statutes §§ 191, 193). In the instant case, by allocating petitioner's receipts either to the site of the consumers' computers, as preferred by the Division, or based on its customers' addresses, as was done here for lack of information as to the locations of the consumers' computers, the Division has applied a customer sourcing approach that was not effective until January 1, 2015, and runs contrary to the statutory scheme in place during the years at issue.

T. As petitioner's application of Tax Law former § 210 is deemed correct its alternative arguments, identified as Issues III and IV and more fully described in Finding of Fact 44, are moot and it is unnecessary to address the such arguments.

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[15] The memorandum in support of the amendment states that "New York's current sourcing rules fail to acknowledge the shift to a service-based economy. Companies that generate significant receipts from services can incur greater tax liability if they increase their activity in New York. This reform proposal would source a business's receipts to the location of its customers. This assigns income to various states based on where the customers are located and eliminates factors that would increase tax if a company increased its activity in New York. This removes a previous disincentive to locating in New York" (2014-2015 New York State Executive Budget, Revenue Article VII Legislation, Memorandum in Support, Part A).

U. The petitions of CheckFree Services, Inc. are hereby granted, and the notices of deficiency are to be modified such that, as stipulated between the parties, petitioner is entitled to a refund in the amount of $165,808.00, plus interest, for the period in issue.

DATED: Albany, New York
January 5, 2017

/s/ Dennis M. Galliher
ADMINISTRATIVE LAW JUDGE