Alert 10-177

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New York Addresses the Taxation of Information Services

On July 19, 2010, the New York State Department of Taxation and Finance ("Department") issued TSB-M-10(7)S addressing the sales and compensating use tax imposed on information services. The Department has characterized the memorandum as an attempt to clarify the application of the primary function analysis used to determine whether a service is an information service. While the new guidance provided by the Department pays lip service to the primary function analysis, in reality it pre-supposes that the primary function of certain services is providing information, thus transforming the primary function test from a subjective to an objective analysis. The Department's position is in clear conflict with prior precedent on this issue.

Background: New York's Sales Tax on Information Services

New York imposes sales tax on the provision of "information services", which are defined as:

> The furnishing of information by printed, mimeographed or multigraphed matter or by duplicating written or printed matter in any other manner, including services of collecting, compiling or analyzing information of any kind or nature and furnishing reports thereof to other persons, but excluding the furnishing of information which is personal or individual in nature and which is not or may not be substantially incorporated into reports furnished to other persons.[1]

The Department's New Guidance

The memorandum provides that, as a general rule, the following activities will be considered taxable information services: (1) furnishing information created or generated from a common database; (2) selling information that is widely accessible; or (3) gathering information from a variety of sources and recasting that information into a report. The memorandum states that "[w]hether a service qualifies as an information service depends on its primary function," and that even though "one element of a service is an information service does not mean that the whole is taxable as an information service." According to the memorandum, the "customer's chief purpose in paying for the service" must be the receipt of information in order for it to be taxable.

More specifically, the memorandum states that "[a] service is taxable as an information service if its primary function" is one of a list of specified services, including advertising rate reports, consumer product reports, credit monitoring services, employment history reports, Internet-based data and web search services, news clipping services, online dating services, sports scouting reports, survey reports, etc.

In addition, the memorandum notes that two of the services included in the list of specified information services were services that were not treated as information services under existing Department interpretations. First, the sale of an abstract of title to real property will now be treated as the sale of a taxable information service. This is distinguished from opinions of title offered by attorneys, which are considered nontaxable legal services. Second, the sale of a service whose primary function is to provide risk management analysis reports will now be treated as a sale of a taxable information service. The Department provides that a risk management analysis report would include any report that "relies on statistical models and historical data to generate a report analyzing and forecasting the risk associated with various aspects of a client's business." Furthermore, the report will not be considered personal or individual in nature even if it contains a client's personal information, if that information may "be obtained from a common database or information that is widely accessible." Both of these changes in existing Department interpretations will be effective September 1, 2010.

Primary Function Analysis

While clearly some of the specific services listed in the memorandum may be information services under the statute in some circumstances, the Department's application of the primary function analysis is incorrect. In *Matter of SSOV*, the Tax Appeals Tribunal ("Tribunal") established the use of a primary function analysis in regard to information services in its determination that a dating service was not a taxable information service because the primary function of the service was not to furnish information.[2] In so holding, the Tribunal explained that determination as to a "service's taxability focuses on the service in its entirety, as opposed to reviewing the service by components or by the means in which the service is effectuated." The Tribunal further added that, "[t]o neglect the primary function of Petitioners' business in order to dissect the service it provides into what appear to be taxable events stretches the application of Article 28 far beyond that contemplated by the Legislature."[3]

Just days before the release of the Department's new guidance in TSB-M-10(7)S, an Administrative Law Judge in *Matter of Nerac, Inc.* emphasized the importance of the primary function analysis, determining that technical, scientific and engineering research, and tracking services were not a taxable information service. It was clear that information was furnished in providing the service; however, the information was not the primary function of the service. Rather, the Administrative Law Judge determined that "the primary function of petitioner's service is to provide a solution or resolution to a problem or to provide a course of action regarding a particular issue or question faced by a client."[4]

The Department's guidance in TSB-M-10(7)S circumvents the primary function analysis by concluding that certain specified services should automatically be deemed to be information services without further analysis of the service itself. For example, dating services that were analyzed by the Tribunal in *SSOV* and found not to be subject to tax as an information service are now in the Department's pre-determined listing of taxable information services. The only distinction between the services deemed to be information services in the memorandum and those analyzed in *SSOV*, appears to be that the service provided in *SSOV* was not provided over the Internet, which raises questions as to whether the Department's position is in violation of the federal Internet Tax Freedom Act.[5]

Conclusion

TSB-M-10(7)S represents an attempt by the Department to side-step the primary function analysis. However, the decisions in *SSOV* and *Nerac* make clear that such an analysis is key to determining whether a transaction is a taxable information service. Of course, the memorandum only reflects the Department's interpretation of the law and is not binding on any court. However, the memorandum will likely be applied broadly in audits, and service providers in many cases are going to need to proceed through the administrative appeals process. It is through the appeals process that taxpayers will have the best opportunity to impose some limits on the Department's expansive view of information services.

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For more information on New York's tax treatment of information services, please contact either of the authors of this Alert, or the Reed Smith attorney with whom you regularly work. For additional information on Reed Smith's State Tax Practice, visit www.reedsmith.com/NYtax.

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1. New York Tax Law Sections 1105(c)(1) and (9).
2. *Matter of SSOV '81 Ltd.*, DTA No. 810966 and 810967 (N.Y. Tax Appeals Tribunal, January 19, 1995).
3. *Id*.
4. See *Matter of Nerac, Inc.*, DTA No. 822568 and 822651 (N.Y. Div. of Tax Appeals July 15, 2010). Administrative Law Judge decisions are not precedential. New York Tax Law Section 2010(5).
5. 47 U.S.C. § 151.

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