

New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

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Sales Tax
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Purchases of Equipment and Services by a State Contractor

The issues are:

1. Whether equipment and services purchased by XYZ pursuant to its contract with New York State Agency for use in a computer system installed at establishments located throughout the state of New York are subject to sales tax.
2. Whether XYZ may issue a resale certificate for purchases of equipment and services to install equipment when the equipment will become an integral part of the computer system.
3. Whether XYZ may issue a resale certificate to the subcontractor who will install wiring for the central system.

XYZ is a company that develops, implements, and supports high-speed, interactive solutions for government programs. XYZ offers comprehensive systems for delivering, managing, recording, auditing, and tracking program activity.

XYZ entered into a contract with a New York State Agency (State Agency) to provide and operate a computer system at licensed establishments in New York. The system includes a central computer system, on-site system controllers (site controllers), all wiring and connectivity at the licensed establishments, training of State Agency staff, installation of all equipment, monitoring of the central computer system, and technical support for the computer system. XYZ will not provide the actual computer terminals.

The system will consist of the following:

- Central computer system and supporting equipment (including, but not limited to, disk and tape drives, printers, controllers, management, and data entry terminals) to be located at the primary data center.
- Computer system, with supporting peripheral equipment, located at the backup data center.
- Terminal controllers (site controllers) located in each licensed establishment.
- Application and system software required to operate the central computer system and equipment.
- Front-end communications processors and network connections for the central computer system.
- Verification devices at licensed establishments to record State Agency program transactions.

The primary data center will be located in the State Agency office within New York. XYZ will lease space from State Agency to house the central computer system. The lease payments will be based on State Agency's cost of its lease of such space. State Agency will reimburse XYZ for reasonable pre-approved building site costs to modify or refurbish the space. XYZ employees will monitor and provide technical support for the system from this location and from a data center located outside the state of New York.

Site controllers will be located at licensed establishments located throughout the state of New York. XYZ will have subcontractors install the wiring used to connect the site controllers to the licensed establishment's computer terminals. XYZ does not retain ownership of the installed wiring. Each site controller is linked to the central computer system.

The agreement to provide the computer system will be for a period of 6 years and can be renewed annually thereafter by State Agency. XYZ will retain title to the equipment provided to State Agency. XYZ will charge State Agency a monthly fee based on a percentage of the net revenues from the State Agency program. The following are pertinent excerpts from the agreement:

1. *Scope of Services.* The State Agency hereby engages Contractor [XYZ] to furnish professional services to implement and operate a central computer system for the conduct and administration of the Agency Program at licensed establishments within the State of New York, including hardware, software, and support services, as more specifically described in this Agreement, Appendices, the RFP, and the Proposal, all of which are incorporated herein by reference and hereby made a part of this Agreement. The Contractor hereby accepts such engagement upon the terms and conditions of the RFP and the Proposal except as modified by this Agreement and Appendices.

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3. *Financial Arrangements.*

(a) *Compensation.* Payment to the Contractor shall be made in the manner set forth in Contractor's pricing proposal unless otherwise stated herein.

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5. *Mutual Cooperation.* The objectives of this Agreement include maximizing the net proceeds to the State of New York at reasonable rates of compensation to Contractor through the installation and use of a centralized computer system as more fully described in the RFP and the Proposal. The parties agree to cooperate fully and in good faith and to assist each other, to the extent reasonably practicable, in order to accomplish these objectives. Contractor agrees to commit to the level and quality of staffing as specified in

its Proposal, and to submit quarterly reports to the New York State Agency specifying current staffing levels, personnel, vacancies and plans for filling vacancies.

6. *Contractor's Proprietary Rights.* The New York State Agency acknowledges the Contractor's proprietary and intellectual property rights in and to Contractor's hardware, system specifications and details set forth in the Proposal and the software heretofore and hereafter created by Contractor for operation of the system on hardware of both the Contractor and the New York State Agency. The New York State Agency further acknowledges that such rights shall survive the expiration or termination of this Agreement and agrees to maintain the confidentiality thereof to the extent allowed by law and to render such reasonable assistance as may be necessary to protect and preserve Contractor's interests therein.

The following are pertinent excerpts from the State Agency's Request for Proposals for the Implementation and Operation of Agency's Program System (RFP)

2.15 Property Insurance

The contractor must maintain insurance on all buildings, furniture, fixtures, computer and communications equipment used in operating and supporting the central system in an amount equal to or greater than the actual replacement cost thereof. Coverage must include an All Risk Property Floater to insure personal property including contents equipment, and mobile items against fire, theft, collision, flood, etc. The State of New York, the State Agency, and licensed establishment will not be responsible for insuring any equipment or facilities included in or associated with the central system.

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3.2 Vendor Responsibilities

This section describes several areas in which the contractor must provide support and services during the term of the contract. These items pertain to the overall operation and support of the computer system and are not specific to any particular component.

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G. On-site Resource

In addition to the personnel required to run (monitor) the central system, the State Agency will require one on-site technical support position at the primary site for the duration of the contract.

In addition, two data base analyst individuals will be required to work at the State Agency's New York office to assist the State Agency and licensed establishments in utilizing the central system data.

Applicable law and regulations

Section 1101(b) of the Tax Law provides, in part:

When used in this article for the purposes of the taxes imposed by subdivisions (a), (b), (c) and (d) of section eleven hundred five and by section eleven hundred ten, the following terms shall mean:

* * *

(4) Retail sale. (i) A sale of tangible personal property to any person for any purpose, other than (A) for resale as such or as a physical component part of tangible personal property, or (B) for use by that person in performing the services subject to tax under paragraphs (1), (2), (3), (5), (7) and (8) of subdivision (c) of section eleven hundred five where the property so sold becomes a physical component part of the property upon which the services are performed or where the property so sold is later actually transferred to the purchaser of the service in conjunction with the performance of the service subject to tax. . . .

* * *

(5) Sale, selling or purchase. Any transfer of title or possession or both, exchange or barter, rental, lease or license to use or consume (including, with respect to computer software, merely the right to reproduce), conditional or otherwise, in any manner or by any means whatsoever for a consideration, or any agreement therefor, including the rendering of any service, taxable under this article, for a consideration or any agreement therefor.

* * *

(9) Capital improvement. (i) An addition or alteration to real property which:

(A) Substantially adds to the value of the real property, or appreciably prolongs the useful life of the real property; and

(B) Becomes part of the real property or is permanently affixed to the real property so that removal would cause material damage to the property or article itself; and

(C) Is intended to become a permanent installation.

Section 1105 of the Tax Law provides, in part:

Imposition of sales tax. On and after June first, nineteen hundred seventy-one, there is hereby imposed and there shall be paid a tax . . . upon:

(a) The receipts from every retail sale of tangible personal property, except as otherwise provided in this article.

* * *

(c) The receipts from every sale, except for resale, of the following services:

* * *

(3) Installing tangible personal property . . . or maintaining, servicing or repairing tangible personal property . . . not held for sale in the regular course of business, whether or not the services are performed directly or by means of coin-operated equipment or by any other means, and whether or not any tangible personal property is transferred in conjunction therewith, except:

* * *

(iii)for installing property which, when installed, will constitute an addition or capital improvement to real property, property or land, as the terms real property, property or land are defined in the real property tax law as such term capital improvement is defined in paragraph nine of subdivision (b) of section eleven hundred one of this chapter;

Section 1110(a) of the Tax Law provides, in part:

Except to the extent that property or services have already been or will be subject to the sales tax under this article, there is hereby imposed on every person a use tax for the use within this state . . . except as otherwise exempted under this article, (A) of any tangible personal property purchased at retail, . . .

Section 1115(a) of the Tax Law provides in part:

Receipts from the following shall be exempt from the tax on retail sales imposed under subdivision (a) of section eleven hundred five and the compensating use tax imposed under section eleven hundred ten:

* * *

(17) Tangible personal property sold by a contractor, subcontractor or repairman to a person other than an organization described in subdivision (a) of section eleven hundred sixteen, for whom he is adding to, or improving real property, property or land by a capital improvement, or for whom he is about to do any of the foregoing, if such tangible personal property is to become an integral component part of such structure, building or real property; provided, however, that if such sale is made pursuant to a contract irrevocably entered into before September first, nineteen hundred sixty-nine, no exemption shall exist under this paragraph.

Section 526.6 of the Sales and Use Tax Regulations provides, in part:

Retail sale. (a) The term *retail sale* or *sale at retail* means the sale of tangible personal property to any person for any purpose, except as specifically excluded.

* * *

(c) Resale exclusion. (1) Where a person, in the course of his business operations, purchases tangible personal property or services which he intends to sell, either in the form in which purchased, or as a component part of other property or services, the property or services which he has purchased will be considered as purchased for resale, and therefore not subject to tax until he has transferred the property to his customer.

(2) A sale for resale will be recognized only if the vendor receives a properly completed resale certificate. See sections 532.4 and 532.6 of this Title.

(3) Receipts from the sale of property purchased under a resale certificate are not subject to tax at the time of purchase by the person who will resell the property. The receipts are subject to tax at the time of the retail sale.

* * *

(7) Tangible personal property purchased for use in performing a service not subject to tax is not purchased for resale.

Opinion

XYZ entered into a contract with a New York State Agency (State Agency), which provides that XYZ, for a single all-inclusive charge, will implement, operate, and support the administration of the Agency Program at licensed establishments within the state of New York. The terms of the contract require XYZ to provide computer hardware, computer software, network connections, staff, and various related services. The terms of the RFP and contract

provide that the contractor providing the computer central system will retain ownership of the equipment, will be required to maintain insurance coverage on all equipment, and will provide the staffing required for operation and support of the system. As stated in the terms of the contract, the primary objective of the agreement is to provide professional services to implement and operate a central computer system that is part of the Agency Program system. There is no separation of charges in the contract between the equipment and the services provided. Based on the terms of the RFP and contract, it appears that the contractor, XYZ, has been contracted to provide services to State Agency. XYZ's activities in implementing and operating the computer system in performance of its contract with State Agency are not enumerated services subject to tax under section 1105(c) of the Tax Law. XYZ owns and is responsible for the operation of the equipment it uses to provide these services. Any use of the equipment granted to State Agency is in conjunction with the services XYZ has agreed to provide. Therefore, the equipment and any parts purchased as part of the equipment by XYZ for use by XYZ in fulfilling its contract for the provision of services to State Agency are not purchased exclusively for resale within the meaning of section 1101(b)(4) of the Tax Law. See section 526.6(c)(7) of the Sales and Use Tax Regulations.

Accordingly, XYZ may not issue a resale certificate for its purchases of such equipment or parts. XYZ's purchases of such equipment and parts are retail purchases subject to sales tax under section 1105(a) of the Tax Law when such property is delivered to XYZ in New York. If XYZ takes delivery of such equipment and parts outside New York, use of such property in New York by XYZ is subject to compensating use tax under section 1110(a)(A) of the Tax Law. XYZ's purchases of installation services for such equipment are not purchases for resale. Such services are enumerated services and are subject to sales tax under section 1105(c)(3) of the Tax Law when such services are performed in New York.

It should be noted that XYZ's purchases of equipment and installation services from a subcontractor would not be subject to sales or use tax if the installation of the equipment by the subcontractor resulted in a capital improvement to real property within the meaning of section 1101(b)(9)(i) of the Tax Law. See sections 1105(c)(3)(iii) and 1115(a)(17) of the Tax Law. Since XYZ will retain title to the equipment used in its contract with State Agency and is the lessee of the space in the State Agency offices, it appears that the installation of the equipment does not result in a capital improvement. See *Beaman Corporation*, Adv Op Comm T&F, September 6, 1982, TSB-A-82(32)S.

XYZ hires subcontractors to install the wiring used to connect the site terminals located at licensed establishments within New York State. Petitioner has stated that XYZ does not retain ownership of the wiring. There does not appear to be a separate charge by XYZ for installation of the wiring. Based on the information provided in the Petition, it appears that charges for the installation of the wiring are merely an expense that XYZ necessarily incurs in order to provide the contracted services. Accordingly, XYZ may not issue a resale certificate for the purchase of the installation of the wiring.

The charges for the installation of the wiring in New York will be subject to sales tax under section 1105(c)(3) of the Tax Law unless such installation results in a capital improvement to the real property. See *Sales and Use Tax Classifications of Capital Improvements and Repairs to Real Property*, Publication 862 (4/01).

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