



A New York Sales & Use Tax Guide for Computer Software and SaaS

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Introduction

Business models that rely on the sale of computer software and software as a service (SaaS) have never been more popular in our internet-based economy. While SaaS provides many commercial benefits, it's been known to create confusion and inconsistent application with states' sales and use tax laws and the different revenue departments that enforce them.

New York is not unique in this regard as the taxation of SaaS often centers around the issue of whether the purchase is of taxable software or of nontaxable integrated services. This issue, combined with the current guidance on the general taxability of computer software, makes it tough for SaaS companies to know if their offerings are subject to New York sales and use tax or not.

With this guide, our aim is to explain some of that uncertainty by looking at current information from the New York Department of Taxation and Finance (NYDTF) as well as recent cases from the Division of Tax Appeals. We finish this guide with some commentary on the issues central to the taxation of SaaS for consideration of best practices in New York.

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How New York Sales Tax Applies to Computer Software and Related Services

New York broadly taxes the sale of computers and *prewritten* software as the sale of tangible personal property.¹ This is the case regardless of how the purchaser receives the software. For example, through a disk, electronic transmission, or remote access. The sale of licenses to remotely access software are also taxable. The situs for determining the applicable sales tax rate in New York is the location where the buyer uses the software or directs its use.

Sales Tax Exemptions for Computer Software and Related Services

The following exemptions generally apply to the sale of software:

- **Custom Software and Custom Software Upgrades:** exempt when designed and developed to the specifications of a particular purchaser.² It could become taxable when transferred or sold to another party.
- **Related Software Services:** Items including training, consulting, installation, repairs, maintenance, and other standard services are generally exempt.³ However, when services are sold as part of the sale of *prewritten* software, the charge must be reasonable and separately stated on the invoice.
- **Software Sold for Production or R&D:** New York exempts the sale of *prewritten* software when it's sold for direct and predominant use in the production of tangible personal property or in research and development.⁴ The seller must obtain Form ST-121 from the buyer.
- **Resales and Transfers to Certain Corporations or Partnerships:** The resale or transfer of custom software is exempt when made from the original purchaser to an affiliated corporation or to a partnership where

¹ See [TB-ST-128](#) (August 5, 2014).

² *Id.*

³ *Id.*

⁴ See [TB-ST-235](#) (June 2, 2011) and [TB-ST-773](#) (February 3, 2014).

the purchaser and members of the affiliated group have a 50 percent or more interest in capital or profit.⁵

What Is SaaS and How Is It Different from Taxable Computer Software?

From a business perspective, the sale of SaaS is different from the traditional sale of computer software in a few important ways.

First, is the method of purchase. Traditional sale of software usually involves a one-time purchase of a license to use it in perpetuity. In contrast, SaaS is typically rented to customers through a subscription model that requires renewed payments to continue access.

Second, is the method of access. Most sales of computer software involve the transfer of the program itself through download or other installation. With SaaS, customers don't always receive the software, rather they receive access to it through the internet.

Third, is the likelihood of SaaS companies packaging their software with other products and services. This increases the odds for an integrated service transaction that contains both taxable and nontaxable elements but is not easily separated for sales tax purposes. To help illustrate, consider the difference between the sale of video editing software versus the purchase of a professional video editing service accessed with web-based software. The former is clearly taxable as the sale of prewritten software while the latter involves the use of software to receive a potentially sales tax-exempt service for film production.⁶

Does New York Sales Tax Apply to SaaS?

New York's sales tax laws and administrative regulations do not explicitly address the sales and use tax consequence for the purchase of SaaS. However, an exemption does exist when taxable services listed under § 1105(c) are performed on computer software and are separately stated on an invoice when performed in conjunction with the sale of tangible personal property.⁷

⁵ See [TSB-M-93\(3\)S](#) (March 1, 1993).

⁶ See [TB-ST-276](#) (July 26, 2012).

⁷ See [N.Y. § 1115\(o\) \(Consol. 2021\)](#).

Despite, the differences noted previously, it is often difficult to differentiate the sale of SaaS as taxable prewritten software as opposed to the sale of nontaxable services. Application often becomes subject to the case-by-case analysis and discretion of the NYDTF, which is known to take the position that most SaaS business models are the sale of taxable prewritten software. For example, the following Advisory Opinions, while not law and from several years ago, have shown the tendency of the NYDTF to broadly apply sales tax to software-related products and services:

- **TSB-A-08(62)S:** Sale of a license to use a photo editing and manipulation program is taxable.⁸
- **TSB-A-09(25)S:** Charges for the use of a process management platform for home healthcare facilities and their subcontractors is taxable as prewritten software.⁹
- **TSB-A-09(44)S:** A product that adds functionality to a website of searchable database of real estate listings, including the ability to enter one-time or private advertising information is taxable.¹⁰
- **TSB-A-13(22)S:** Access to a website with form templates that would allow a customer to input their data onto the form and download it after purchase is taxable.¹¹

Recent Sales Tax Appeals Over SaaS and the Primary Function Test

Aside from NYDTF guidance and advisory opinions, further insight on the taxability of SaaS in New York can be found through recent appeals of sales tax assessments through the Division of Tax Appeals (OTA). When a combination of SaaS and nontaxable services are involved, the OTA must rely on the state's primary function test, which determines the taxability of an integrated service (i.e., one that contains taxable and nontaxable components).¹² The primary function test looks at the component parts as whole, rather than individually, to determine the taxability. The below cases show mixed results for taxpayers in

⁸ See [TSB-A-08\(62\)](#) (November 24, 2008).

⁹ See [TSB-A-09\(25\)S](#) (June 18, 2009).

¹⁰ See [TSB-A-09\(44\)S](#) (September 24, 2009).

¹¹ See [TSB-A-13\(22\)S](#) (July 25, 2013).

¹² *Matter of SSOV '81 Ltd.*, [DTA Nos. 810966 and 810967](#) (N.Y. Tax App. Trib. Jan. 19, 1995).

these cases, with the OTA upholding the assessment in one case and cancelling it in the other two.

In the Matter of the Petition of Beeline.com, Inc.

The OTA upheld the NYDTF's sales tax assessment against the petitioner totaling **\$686,570.66 plus \$306,698.60 interest** for its charges to customers related to its vendor management system (VMS) as the taxable sale of prewritten software.¹³ The VMS is a software platform that automates the hiring process of contract workers with improved reporting analytics. The petitioner delivered the VMS as a web-based application through a SaaS model. The petitioner also had a managed supplier program (MSP) where it provided professional services that the OTA concluded was partially taxable in periods where the MSP was bundled with the VMS.

In its analysis, the OTA relied on testimony from the petitioner's COO, who confirmed they typically tried to use the *same* software with all customers but could customize when necessary. The OTA also noted the contract referred to the product as "standardized software" with options for customization. When determining the taxability of the bundled services, the OTA looked to the primary function/purpose test and found the customer's use of the VMS along with the MSP was not an incidental transfer of tangible personal property. Rather, the taxable VMS was completely intertwined with the MSP and a major part of its value, thus making it a primary component of the bundled services.

In the Matter of the Petition of Yesware, Inc.

The OTA cancelled a sales tax assessment of **\$308,481.91, plus interest** against the petitioner because it sold an exempt personalized information service that the NYDTF misclassified as prewritten software.¹⁴ The petitioner provided data reporting and analysis to better assist its clients with their email marketing campaigns and customer engagement, which the petitioner's clients could access through its website or Salesforce.

In its discussion, the OTA reasoned the petitioner's clients were purchasing synthesized information and not the proprietary software the petitioner used to track the email data. The fact that the petitioner's clients could not use, access,

¹³ *In the Matter of the Petition of Beeline.com, Inc.*, [DTA No. 829516](#) (February 9, 2023).

¹⁴ *In the Matter of the Petition of Yesware, Inc.*, [DTA Nos. 829638](#), 829639, and 829640 (September 29, 2022).

or control the software at issue supported this conclusion. The OTA further confirmed the ability to share templates through a browser extension, was incidental to the information services. Additionally, the petitioner's label of the transaction as a "license" was not enough to transform the basis of the sale as individualized information services to prewritten software.

In the Matter of the Petition of 1Life Healthcare, Inc.

The OTA revoked an **\$1,952,603.69 assessment** against the petitioner in this case for its membership fees that the NYDTF initially taxed as receipts for the sale of prewritten software.¹⁵ Rather, the OTA agreed with the petitioner that its membership fees were for nontaxable "care navigation services." The petitioner provided customers with a healthcare platform that, among other things, provided medical provider selection advice, specialist referral management, primary care, procedure booking, and billing/insurance assistance.

The petitioner's clients could access the platform through a mobile app, website, phone, email, and in person meeting. Part of the membership fee included a license to use the mobile app and website, which the NYDTF assessed as taxable software. However, the OTA disagreed with this assessment under the primary function test because the petitioner's clients could access its medical care administrative assistance services through other methods.

Key Takeaways for SaaS Businesses

You might think of the taxability of SaaS product models in New York as a sliding scale. On one end, the product could be a taxable sale of prewritten software or information services. On the opposite end, SaaS is part of an integrated service that is nontaxable under the primary function test. The tax analysis will turn on a few key issues:

- How you describe the transaction in contracts, invoices, and other billings.
- Description of the SaaS product in advertising materials.
- The extent of access, use, and control your clients have over the software.
- Whether other methods exist for your clients to access the services other than using software.

¹⁵ *In the Matter of the Petition of 1Life Healthcare, Inc.*, [DTA No. 829434](#) (November 10, 2021).

- The allocation of value to your clients between transfers of taxable software and the nontaxable services provided.

It's important to consider these elements when setting up your client's sales tax position, maintaining compliance, and defending past reporting during an audit or assessment. We always encourage CPAs to schedule periodic consultations with our office to discuss their SaaS clients' sales tax practices or to discuss strategy in the event of a recent notice from the NYDTF. **You can click [here](#) to schedule a free consultation today.**

[About Sales Tax Helper, LLC](#)

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