STATE OF NEW YORK

TAX APPEALS TRIBUNAL

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In the Matter of the Petition	:
of	:
INSURANCE AUTOMATION SYSTEMS, INC.	:
for Revision of a Determination or for Refund of Sales and	:
Use Taxes under Articles 28 and 29 of the Tax Law for the	
Period June 1, 1988 through May 31, 1991.	:

DECISION
DTA No. 811672

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Petitioner Insurance Automation Systems, Inc., 3737 Park East Drive, Suite 202, Beachwood, Ohio 44122, filed an exception to the determination of the Administrative Law Judge issued on May 10, 1994. Petitioner appeared by Lombardi, Reinhard, Walsh & Harrison, P.C. (Dale F. Jeffers, Esq. and Mary Elizabeth Slevin, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Vera R. Johnson, Esq., of counsel).

Petitioner filed a brief in support on July 11, 1994. The Division of Taxation filed a responding brief on August 18, 1994. Petitioner's reply brief was received on September 6, 1994, which date began the six-month period for the issuance of this decision. Petitioner withdrew its request for oral argument.

The Tax Appeals Tribunal renders the following decision per curiam.

ISSUE

Whether petitioner was engaged in providing customized computer software which was not subject to sales tax, or an information service subject to sales tax pursuant to Tax Law § 1105(c)(1).

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge and make an additional finding of fact. The Administrative Law Judge's findings of fact and the additional finding of fact are set forth below.

In or about 1984, petitioner, Insurance Automation Systems, Inc. ("IAS"), first developed its computer software programs known as "The Solution" and "The Commercial Solution". This software was developed toassist independent insurance agents and insurance brokers[1] in calculating and providing insurance premium quotes to prospective insureds. Petitioner's software enables calculations of premium cost quotes for auto insurance, homeowners insurance and certain commercial lines of insurance. Petitioner's customers typically represent and offer premium quotes for between three to ten different insurance companies.

As the first step in developing its software, IAS obtains underwriting guidelines, underwriting policies and procedures, and rating factors (including risk factors) for the different types of insurance and coverage amounts offered by many different individual insurance companies. To date, petitioner has obtained and used this data as provided by over 70 individual insurance companies which operate in New York. IAS obtains this information directly from the insurance companies at no cost. While such information is not generally made available to the public, it is available to IAS's competitors.[2] IAS employs rate analysts, described as experts in insurance rating, who utilize the insurance company data (methods and underlying principles) to prepare formulas used to determine premium amounts for various insurance coverages. The rate analysts' formulas are passed to petitioner's computer programmers who convert the formulas into computer-readable format. The formulas are then stored on hard drive on petitioner's computer system at its premises. Petitioner notes that the formulas, as initially developed and stored on its hard drive, are not "complete" such that they could function to provide a premium quote on behalf of a particular insurance company for a particular proposed insured by a particular agency or broker. Rather, petitioner must insert additional specific information, such as the agency or brokerage name, particular insurance

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[1]Insurance brokers would represent more than one insurance company.

[2]Presumably such information would be available to anyone seeking the same, although the value thereof to persons other than petitioner and its competitors is unknown.

companies and territories for and in which the agency or brokerage writes insurance, and the agency or brokerage (including individual agent) underwriting limitations, if any.

Each time a software system is prepared for license to a customer, petitioner's personnel make a field visit to the customer's location at which time the customer's computer assets (e.g., computer hardware, other software, etc.) are noted along with any particular computer requirements needed. From the information gleaned from petitioner's visit to the customer's site, petitioner then customizes its software system with the additional specific information described above (i.e., agency-specific information such as agency or brokerage name[s], underwriting limitation[s], insurance companies included in the package, etc.), so as to enable its customer to input information into its computer system regarding a proposed insured and receive out, in turn, insurance premium quotes for the types and amounts of insurance coverage desired from the insurance companies for whom that agency or brokerage writes. Petitioner's software is generally further customized such that the quote(s) may be embodied in a customized proposal letter to be issued by the agency or brokerage to the proposed insured, and included on an application form to be submitted to the insurance company for approval. In addition, the software may be written to interact with a customer's data management system so as to allow data regarding premiums and other information to be transferred to the agency or brokerage accounting and billing system.

When a software package is ready for delivery, IAS employees install the same at the customer's site and thereafter train the customer's personnel in the operation of the software.

Petitioner charges its customers a basic licensing fee for its software plus a monthly maintenance fee, which latter amount increases based on the number of insurance companies included in the program. Petitioner charges additional fees based on different types (sizes) of computer disks used, the number of user stations involved (with higher fees for greater numbers of user stations), adding or switching insurance companies or types of insurance coverages (e.g., adding homeowners to existing auto coverages), etc. In addition, the software (including the basic rating formulas) is updated by petitioner when insurance companies change their

underwriting information. Although unspecified, this latter item is presumably included as part of the monthly maintenance fee.

Petitioner offers support for the software it licenses in three ways. With regard to general questions, nontechnical personnel are available by phone via a toll-free number. Technical personnel are also available by phone to answer technical questions. The third level of support provided by petitioner involves on-site visits to the client's premises by IAS representatives.

During the period at issue herein, IAS did not collect or pay sales tax on any of the software systems it sold.[3] Petitioner's president, James Harris, testified that the reason IAS did not collect and remit tax on its software system sales was based on petitioner's investigation as to the need for such collection and payment. He explained that petitioner first raised the question of taxability when it began to license its software. More specifically, he testified that in connection with obtaining sales tax forms from the Division with regard to its taxable computer hardware sales, IAS also inquired as to the taxability of its software systems and was advised that such software was exempt. The record, however, does not specify the person(s) to whom this inquiry was directed or from whom such advice was received. Mr. Harris also testified that petitioner queried its competitors and was told of their belief that their similar software was exempt. At some point in its corporate history, petitioner was purchased by Progressive Insurance Company which, as part of its purchase, allegedly conducted an independent investigation to confirm that the software was exempt. The record does not further detail such investigation. Finally, petitioner notes that periodic review of its tax compliance by its outside auditing firm (KMPG Peat Marwick), as well as ongoing internal review by petitioner's controller, continued to confirm petitioner's belief that it was selling customized software not subject to tax. Petitioner also notes that it has, since the inception of its business, collected and paid sales tax to New York State with respect to any sales of computer hardware (see, footnote "3").

In May 1991, the Division conducted a sales tax audit of petitioner's receipts for the

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[3]Petitioner formerly also sold certain computer hardware, and did collect and remit tax with regard to such sales.

period at issue herein. In conjunction with this audit and at the suggestion of the auditor,

petitioner sought an Advisory Opinion from the Division concerning the tax status of its

software.

In its petition for Advisory Opinion, filed June 21, 1991, petitioner stated that its

computer software program:

> "underwrites, calculates and ultimately quotes prices for commercial, homeowners
> and automobile insurance. In order for the program to perform its various
> functions, each user's insurance company contracts, computer hardware
> requirements, and existing computer software requirements have to be set in the
> program to design the software sold by petitioner.
>
> "When petitioner makes a sale to a customer, who is typically a licensed
> insurance agent, petitioner makes a field visit and analyzes the customer's computer
> requirements (i.e., model, hardware and software capabilities, etc.) and notes the
> individual companies the agent writes for. Each individual insurance company
> used by an agent has a unique rating structure that takes into account different
> territories of potential customers of the agent and other demographic data based on
> those territories. Prior to delivery to the customer, the program is created and
> customized to reflect these structures and requirements of the Buyer's need.
>
> "Upon delivery to the customer, petitioner installs on-site the software,
> further customizes it to fit the agent's specific computer needs, and trains
> appropriate personnel as to operation of the software. During this on-site
> installation, software modifications are made which include: (i) Creation of
> customized proposal letters, unique to the agency, (ii) Creation of unique quote
> profiles matching the particular risk quoting requirements of the customer, (iii)
> Changes to the default settings of virtually all variables, based on projected quoting
> needs of the customer; and (iv) Creation of commercial rating factors which vary
> not only by company represented, but which also can vary by agency. At this point,
> the program is able to calculate insurance rates from individual companies, based
> on the prior data gathered from the agents combined with each insurance company's
> unique rating structure, and generate proposals for the agent's prospective
> customers.
>
> "Each report generated by the program is based on the prospective customer's
> individual needs, demographics, and territory, and therefore the proposal will be
> unique and useful only to that customer. For example, if a potential customer
> desires to buy automobile insurance, the agent will input into the computer such
> data as the customer's age, family status, type of car, traffic violation points, etc.
> The program combines this information with the data unique to the individual
> agent (based on the insurance companies they work with) that is already
> incorporated into the program by petitioner in his initial set-up and adaption, and it
> will produce a report and proposal unique to that customer.
>
> "The program will also incorporate those proposals into a letter addressed to
> the prospective customer, and the letter includes an insurance price quote. If a
> customer decides to buy an insurance policy from the agent based on the program,
> the program will also produce the individual applications that are forwarded to the
> insurance company."

In response to its request for the Advisory Opinion, petitioner received from the Division Advisory Opinion No. S910621A, dated November 26, 1991. The Division concluded in this opinion that petitioner's system contained or consisted of two parts. According to the Division, the first part consisted of a database stored on electronic disks and containing the rating factors of individual insurance companies which operated in New York State. The Division concluded that this database of information was not personal or individual in nature since it was available to any insurance agent willing to purchase it from petitioner, that it was immaterial that petitioner's customer might in turn use the information to produce a different quote for each of its customers, and that this portion of the software system sold by petitioner was properly subject to tax pursuant to Tax Law § 1105(c) and 20 NYCRR 527.3(a)(1). The Division further concluded that the second part of petitioner's system represented customized application computer software (requiring analysis of the customer's computer equipment and modifications necessary to make petitioner's software compatible with such equipment and to the customer's individual needs). Hence, the Division concluded that, in accordance with its Technical Services Bulletin 1978-1(S) (dated February 6, 1978), the second part of petitioner's system represented the type of prewritten application program entitled to exemption from tax as intangible personal property. Finally, in that petitioner's system was sold as a single unit, consisting of both a taxable information service and a nontaxable customized computer program, the Division concluded that tax was due on the total price thereof.

On March 2, 1992, following the field audit noted above, the Division issued to petitioner a Notice of Determination and Demand for Payment of Sales and Use Taxes Due assessing sales tax for the period spanning June 1, 1988 through May 31, 1991 in the amount of $231,490.72, plus penalty and interest.[4]

In addition to the facts found by the Administrative Law Judge, we find the following.

> Petitioner's customers cannot access the rate formulas contained in the software as those files are compiled so that the customer would only get an incomprehensible listing of symbols which would have no

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[4]Petitioner executed a series of validated consents with regard to the period of limitations on assessment, the latest of which allowed the Division to make its assessment at any time on or before March 20, 1992.

meaning.

OPINION

Tax Law § 1105(c)(1) imposes a tax on receipts from the "furnishing of information by printed, mimeographed or multigraphed matter . . . including the services of collecting, compiling or analyzing information of any kind or nature and furnishing reports thereof to other persons." The statue excludes from tax the "furnishing of information which is personal or individual in nature and which is not or may not be substantially incorporated in reports furnished to other persons" (Tax Law § 1105[c][1]).

The Administrative Law Judge concluded that petitioner did not "simply provide customized application software enabling its customers' computers to interact, calculate or utilize information already in the customers' possession or input by such customers [footnote omitted]" (Determination, conclusion of law "E"). Instead, the Administrative Law Judge found that petitioner also provided "within each software package a core of information (taken from its general bank of information) from which premium rates for various types of insurance can be obtained for any of the insurance companies selected by petitioner's customer" (Determination, conclusion of law "E"). The Administrative Law Judge found that as a result of this core of information, the IAS software system encompassed an information service that was subject to tax if: (1) a report was furnished, (2) the information was not within the exclusion for information that is personal and individual in nature, and (3) the Division could tax the entire receipt for the software even though a portion of the receipt was concededly derived from the sale of nontaxable customized software.

The Administrative Law Judge concluded that "[s]torage and transfer of the formulas or parts thereof (the collected, complied and analyzed information) via the computer disk carrying the entire software program, suffices to constitute a 'report' furnished to petitioner's customers . . ." (Determination, conclusion of law "G").

Next, the Administrative Law Judge relied on Matter of ADP Automotive Claims Servs. v. Tax Appeals Tribunal (188 AD2d 245, 594 NYS2d 96, lv denied 82 NY2d 655, 602 NYS2d

804) to hold that because the information came from a common source or data repository that was readily available and was not confidential, it was not personal or individual.

With respect to the second part of the exclusion, the Administrative Law Judge held that because "the same basic formulas (or portions thereof) would be incorporated into different customers' software programs wherever such different customers quote insurance for companies in common" the information might be substantially incorporated in programs furnished to other customers (Determination, conclusion of law "I").

The Administrative Law Judge also held that "in the absence of any allocation between taxable and nontaxable portions of a receipt, the Division may impose sales tax upon the entire unallocated receipt" (Determination, conclusion of law "K").

Lastly, the Administrative Law Judge determined that penalty should be abated.

The issue in this case arises because the Division issued Technical Services Bureau Bulletin 1978-1(S) on February 6, 1978 which concluded that customized software was not subject to sales tax. Under the provisions of this Bulletin, software was described to include:

> "Instructions and routines (programs) which, after an analysis of the customer's specific data processing requirements, are determined necessary to program the customer's electronic data processing equipment to enable the customer to accomplish specific functions with his EDP system. To be considered exempt 'software' for purposes of this bulletin, one of the following elements must be present:
>
> > "A. Presentation or selection or the program for the customer's use requires an analysis of the customer's requirements by the vendor.
> >
> > or
> >
> > "B. The program requires adaption, by the vendor, to be used in a specific environment, i.e., a particular make and model of computer utilizing a specified output device. For example, a software vendor offers for sale a pre-written sort program which can be used in several computer models. Prior to operation, instructions must be added by the vendor which specify the particular computer model in which the program will be utilized."

It is undisputed in this case that petitioner's software satisfies these criteria. The Division contends, however, that the software is a taxable information service because included in the

software are the rating formulas.

The Division states that petitioner "provided its clients with knowledge (i.e. underwriting guidelines, underwriting policies and procedures, rating factors, etc.) that it did not possess prior to the purchase of petitioner's software. In doing so, the petitioner furnished information" (Division's brief, p. 11).

In response, petitioner argues that:

> "[a] computer program is a sequence of coded instructions that can be inserted into a computer that will direct the computer to perform logical routines to produce a desired result. These coded instructions may be a mathematical formula (reduced to code) or other types of instructions (also reduced to code) such as instructions governing the operation of peripheral equipment such as monitors, printers and modems, and instructions governing the storage and retrieval of data. If the sale of programs containing instructions that are mathematical or rating formulas is a taxable information service, then logic dictates that the sale of programs containing instructions of any nature is also a taxable information service" (Petitioner's brief on exception, pp. 7-8).

As a result, petitioner argues, all software programs, even if customized would be taxable information systems.

We reverse the Administrative Law Judge.

The essential issue of the matter is whether the rating formulas are information. We conclude they are not.

The dictionary meaning of information is: "the communication or reception of knowledge or intelligence" (Merriam-Webster's Collegiate Dictionary 599 [10th ed 1993]). This definition was obviously relied on by the Court when it concluded in Matter of ADP Automotive Claims Servs. v. Tax Appeals Tribunal (supra, 594 NYS2d 96, 98) that an information service "generates a report which contains intelligence that the customer did not have originally."

The rating formulas included in petitioner's software could not be accessed, nor ascertained, by petitioner's customers. The computer program files containing the formulas were compiled so that if the contents of the files were printed out, the customer would see only an incomprehensible listing of symbols. These incomprehensible symbols convey no intelligence to petitioner's customers. Petitioner's customers were only able to use these

formulas, without learning them, by inputting information about a proposed insured and, in response, receiving insurance premium quotes. In our view, because petitioner's software was designed so that the customers could not learn the rating formulas, the rating formulas were not knowledge or intelligence communicated to or received by the customers. Therefore, the rating formulas were not information to the customers and petitioner was not providing an information service.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Insurance Automation Systems, Inc. is granted;

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

3. The petition of Insurance Automation Systems, Inc. is granted; and

4. The Notice of Determination dated March 2, 1992 is cancelled.

DATED: Troy, New York
       February 23, 1995

               /s/John P. Dugan
                 John P. Dugan
                 President

               /s/Francis R. Koenig
                 Francis R. Koenig
                 Commissioner