

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition :

of :

GALILEO INTERNATIONAL PARTNERSHIP :

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 March 1, 1991 through November 30, 1993. :

DECISION
DTA NOS. 818671
AND 818672

In the Matter of the Petition :

of :

APOLLO GALILEO USA PARTNERSHIP :

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 September 1, 1993 through February 29, :
1996.

Petitioners Galileo International Partnership, c/o Cendant Corp., Attn: Andrew H. Solomon, 6 Sylvan Way, Parsippany, New Jersey 07054 and Apollo Galileo USA Partnership, c/o Cendant Corp., Attn: Andrew H. Solomon, 6 Sylvan Way, Parsippany, New Jersey 07054, filed exceptions to the determination of the Administrative Law Judge issued on October 23, 2003. Petitioners appeared by Morrison & Foerster, LLP (Irwin M. Slomka, Esq., of counsel). The Division of Taxation appeared by Christopher C. O'Brien, Esq. (James Della Porta, Esq., of counsel).

Petitioners filed a brief in support of their exception and the Division of Taxation filed a brief in opposition. Petitioners filed a reply brief. Oral argument, at petitioners' request, was heard on September 28, 2004 in Troy, New York.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUES

I. Whether petitioners, Galileo International Partnership and Apollo Galileo USA Partnership, leased tangible personal property to travel agencies under their subscriber services agreements.

II. Alternatively, if petitioners did lease tangible personal property under their subscriber services agreements, whether the Division of Taxation properly determined the taxable receipts for the leased tangible personal property.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

1. Petitioner Galileo International Partnership began business on January 1, 1988 as the Covia Partnership ("Covia"). Covia was a Delaware partnership doing business in New York State throughout the period beginning March 1, 1991 through November 30, 1993 (the "first tax period"). Two subsidiaries of United Airlines, Covia Corporation and Cypher Corporation, were Covia's original partners. Prior to 1988, Covia was a division of United Airlines. On August 5, 1988, five additional partners were added to the partnership. From March 1, 1991 through

September 1993, Covia's offices were located in Rosemont, Illinois. In September 1993, Covia changed its name to Galileo International Partnership ("Galileo").¹

2. During the period, March 1, 1991 through September 1993, Galileo owned and operated a computer reservations system ("CRS") called the Apollo system and the National Distribution Company ("NDC"). The CRS is a database computer system used to provide travel related ticketing and reservations services.² The data available through the CRS includes participating air carriers flight departures and arrival times, seat availability and cost, car rental availability and cost, hotel availability and cost, and cruise line availability and cost. The NDC provides subscribers with access to the CRS, which allows them to efficiently process travel related reservations and ticketing transactions, and with equipment and software to access the CRS.

3. Since the beginning of passenger air travel in the United States, travel agents have performed the service of booking travel reservations for airlines in exchange for a commission. Initially, this service was conducted by telephone between the travel agents and the airlines and without the benefit of computers. In the late 1970s, Congress deregulated the airline industry, and as a result, the travel industry underwent significant changes. First, the airlines could no longer fix the commission rates paid to travel agents. This change caused commission rates paid to travel agencies to rise significantly. Second, fare competition among a larger number of airlines led to lower air fares. This, in turn, led to a commensurate increase in the number of air

¹ Unless otherwise noted, all references will be made to Galileo instead of Covia inasmuch as Galileo is the named petitioner for the first tax period.

² The operation by air carriers and their affiliates of computer reservations systems used by travel agents is subject to rules and regulations codified by the United States Department of Transportation at 14 CFR part 255 (1992).

travelers. The setting of fares in this competitive environment became increasingly complex, often leading to the establishment of different fares for the same flight. Third, airline routes were not as fixed as they were before deregulation because carriers now had the ability to enter or exit routes without regulatory review or delays. The volume and complexities of booking travel reservations following deregulation led to further dependence by the airlines on the travel agency system to market their services. Airline deregulation led to a proliferation of travel agencies in order to meet the demands resulting from an increased volume of travelers and due to the complexities of competitive airfares. The number of U.S. travel agencies increased from approximately 15,000, prior to deregulation, to as many as 40,000 at its peak level by the mid-1990s. Given the dramatic consequences of deregulation, access to computer reservations systems became essential in order for travel agencies to conduct their business. Such access was critical because it gave the travel agencies vital reservations and fare information and enabled them to book reservations and, as a result, earn commissions.

4. The genesis of computer reservations systems can be traced to developments in computer technology that took place in the 1970s. Major airlines, such as American Airlines and United Airlines, developed their own computer reservations systems. Specifically, American Airlines developed the Sabre system and United Airlines developed the Apollo system. By the periods in issue, four computer reservations systems were operating in the United States.

5. At first, the computer reservations systems contained only reservation information for their respective owner airlines. Over time, these systems began carrying fare and reservation information for competing airlines, as well as hotel and car rental information and reservations.

6. Owners of computer reservations systems enter into participation agreements with competing airlines and other travel suppliers. Airlines participate in multiple computer reservations systems because they cannot afford to lose access to significant sources of traffic and still operate successfully. Under the terms of a participation agreement, the owner of a CRS agrees to house and display a participant's flight schedules, fares and seat availability and, on behalf of the participant, to make and house reservations³ or issue tickets through its system for air transportation. The participant is charged booking fees for having its services housed, displayed and booked (sold) through the computer reservations system. The owners of the systems typically charge a specified fee per booking, i.e., each segment of travel ("booking fee"), for each level of service. If a carrier participates only in the basic CRS display and booking functions, it pays one fee, while a higher fee is charged carriers that participate in a service enhancement, such as the direct access function.⁴ In the case of Galileo, air carriers pay fees based on the level of participation chosen by the carrier. For a fee, CRS operators also make marketing and booking data available to participating carriers. Galileo offers that service to its participating carriers and benefits from that revenue opportunity.

7. In the early days, Covia Corporation entered into contracts with travel agencies throughout the United States that permitted them to connect to the CRS to make travel reservations for the public. Under these early contracts, Covia Corporation, for a fixed charge each month ("monthly fixed charge"), provided computer equipment that allowed the agency

³ The actual reservation is maintained within the computer mainframe of the reservations system.

⁴ The direct access function involves a link between the CRS and the participating carrier's internal reservations system.

connectivity and access to the CRS, provided maintenance of such equipment, as well as training.

8. From the beginning of computer reservations systems, the CRS operators provided computer equipment and software to travel agencies. Initially, CRS operators required that travel agencies lease computer equipment from them, principally for security reasons, in order to obtain connectivity to their systems. Later, the United States Department of Transportation promulgated rules that required CRS operators to allow subscribers to use their own computer equipment and software.

9. Prior to the first tax period, Covia entered into Apollo Reservations and Ticketing Service subscriber lease agreements with travel agencies (“subscribers”), which terms typically ran for 60-month periods. Those agreements allowed travel agencies to utilize Covia’s Apollo Reservations and Ticketing Service (“Apollo Services”), to install and utilize certain related computer equipment and software, and to receive maintenance, support and training for the “Apollo Equipment and Apollo Services.” Among other things, the agreements required subscribers to use the Apollo Services for business purposes only, as set forth in the Apollo Services procedures manual, and to insure the equipment. Travel agencies were required to pay monthly fixed charges for the equipment and “for interconnection to Apollo Services, including associated maintenance, repair and support services” for each location set forth on an Attachment A that formed part of the subscriber lease agreements. Each Attachment A identified the location, the specific items of equipment installed at that location, each item’s insurance value and installation or deinstallation charges, if any. The Attachment A also set forth the amount of the monthly fixed charge, the amount Covia would credit each month during

which the subscriber performed all of its obligations under the agreement and the net monthly fixed charge - - the amount the subscriber was required to pay. Another part of the subscriber lease agreement, the Attachment F set forth parameters under which the subscriber would be entitled to an automation credit from Covia for the monthly fixed charge (rack rates) on its use of the equipment. During the first year of the contract, the subscriber would receive a 70% discount off the rack rates. For subsequent accounting periods, the automation credit - - “the discount (as a percentage of Covia’s rack rates)” - - was based on the subscriber meeting required levels of both average bookings and yearly total net bookings, and could possibly be 100% if a certain level of bookings was attained.

10. During the period March 1, 1991 through September 30, 1993, Galileo entered into the following types of subscriber services agreements with third parties: standard pricing or fixed discount contracts⁵ and productivity-based contracts. The standard pricing contracts were more prevalent during this period. Nearly all of the parties with whom Galileo entered into agreements were travel agencies. These contracts generally were for 60-month periods.

11. Standard pricing contracts bear the heading “Subscriber Services Agreement.” Each standard pricing contract consists of a Subscriber Services Agreement, attachments and Riders (Subscriber Services Agreement, Article 1.A). A sample standard pricing contract is part of the record. It consists of an 8-page Subscriber Services Agreement containing 27 articles, an Attachment A labeled “Apollo/Focalpoint Hardware,” an Attachment B, a 6-page Apollo Reservations and Ticketing Service Rider containing 14 articles and an Attachment labeled

⁵ Although the phrase “standard pricing” is the term used in both the contract and the stipulation, all references in the audit work papers are to fixed discount contracts not standard pricing contracts.

“Subscriber Booking Incentive Program Attachment (‘Incentives’).” Pertinent sections of the sample standard pricing contract are set forth below.

12. The definitions of terms used in the sample standard pricing contract are set forth in Article 1 of the Subscriber Services Agreement and in Article 1 of the Apollo Reservations and Ticketing Service Rider. Some pertinent terms are defined as follows. “Charges” is defined as “all amounts payable by Subscriber to [Galileo] under this Agreement” (Subscriber Services Agreement, Article 1.D). “Hardware” is defined as “all equipment leased or sold by [Galileo] to Subscriber” (Subscriber Services Agreement, Article 1.F). The term “rider” means “each attachment hereto entitled ‘Rider’ which pertains to one or more Services selected by Subscriber and which is incorporated into this Agreement by reference” (Subscriber Services Agreement, Article 1.H). “Services” is defined as “Hardware, Software, and other services provided by [Galileo] to Subscriber” (Subscriber Services Agreement, Article 1.I). “Software” is defined as “all computer software licensed by [Galileo] to Subscriber” (Subscriber Services Agreement, Article 1.J). “Apollo Equipment” is defined as “Hardware used in conjunction with Apollo Services, such as CRT sets, ticket printers and itinerary/invoice printers, and the hardware required for the provision of Focalpoint” (Apollo Reservations and Ticketing Service Rider, Article 1.A). “Apollo Services” is defined as “[Galileo’s] computerized Apollo reservations and ticketing service, which performs flight, hotel and rental car reservations and ticket issuance functions” (Apollo Reservations and Ticketing Service Rider, Article 1.C). “Focalpoint” is defined as “[Galileo’s] proprietary software package offered to Apollo subscribers through specified hardware components that provides expanded reservation and office management

functionality. For purposes of this Agreement, the terms ‘Apollo Services’ and ‘Apollo’ include Focalpoint” (Apollo Reservations and Ticketing Service Rider, Article 1.D).

13. The standard pricing contract provides that:

[Galileo] shall license the Software and sell or lease the Hardware set forth on each Attachment A to Subscriber pursuant to the terms and conditions of this Agreement. Software and Hardware shall be licensed, sold or leased (as applicable) for use only at the particular location, which is Subscriber-owned, controlled, or authorized to provide Services, associated with that Software or Hardware as set forth on each Attachment A (Subscriber Services Agreement, Article 2).

Article 4.A(I) of the Subscriber Services Agreement provides the subscriber with “a nonexclusive license to use the Software” during the term of the contract. Article 4.A(ii) of the Subscriber Services Agreement states that “[t]itle and full ownership rights to the Software remain” with Galileo. That article goes on to describe the Software as Galileo’s “proprietary information and trade secret.” The contract further states that “Subscriber desires to lease Hardware and to license Software as identified on each Attachment A - Apollo/Focalpoint Hardware . . . in order to utilize [Galileo’s] Apollo Reservations and Ticketing Service. [Galileo] agrees to provide such Hardware and to license such Software to Subscriber. . .” (Apollo Reservations and Ticketing Service Rider).

14. The standard pricing contract requires that Galileo “shall install or cause to be installed the applicable Apollo Equipment at Locations as set forth on the Apollo Attachments and shall interconnect the Apollo Equipment to Apollo Services” (Apollo Reservations and Ticketing Service Rider, Article 2.A). It requires the subscriber to “take all necessary precautions to protect the Hardware owned by [Galileo] and installed on Subscriber’s premises” (Subscriber Services Agreement, Article 6.A). The contract further requires the subscriber to

maintain insurance coverage on all supplied equipment (Subscriber Services Agreement, Article 6.C[i]). It also provides that the subscriber “shall be liable to [Galileo] for any loss or damage to the Hardware, regardless of the cause thereof, occurring while leased to Subscriber or while in the possession, custody, or control of Subscriber” (Subscriber Services Agreement, Article 6.D[i]).

Additionally, Article 13 of the Apollo Reservations and Ticketing Service Rider states that:

A. It is understood and agreed that: (I) all Apollo Equipment shall remain the sole property of [Galileo]; (ii) Subscriber shall not remove any identifying marks from any Apollo Equipment; (iii) Subscriber shall not subject the Apollo Equipment to any lien or encumbrance; and (iv) [Galileo] may enter Subscriber’s premises to remove the Apollo Equipment immediately upon termination of this Rider or the Agreement.

B. Subscriber agrees to make, execute, acknowledge and deliver, any time or from time to time, all documents, instruments and assurances, including, without limitation, financing statements under the Uniform Commercial Code, as may be requested by [Galileo] to preserve [Galileo’s] ownership rights and title in and to the Apollo Equipment, and hereby authorizes [Galileo], where permitted by law, to file financing statements and amendments thereto relating to the Apollo Equipment without Subscriber’s signature where desirable in [Galileo’s] judgment to preserve [Galileo’s] ownership rights and title in and to the Apollo Equipment. Upon deinstallation of the Apollo Equipment, [Galileo] shall, upon Subscriber’s request, take all steps necessary to terminate any Uniform Commercial Code filing made with respect thereto.

15. The standard pricing contract requires a subscriber to use and operate “the Apollo Services and Apollo Equipment” in accordance with the provided operating instructions and “solely for the performance of the specific business functions designated in applicable Apollo Services training guides and manuals” (Apollo Reservations and Ticketing Service Rider, Article 6.A). The agreement strictly prohibits, among other things, personal messages, servicing other subscribers, travel agencies or any other third party, and speculative or fictitious bookings.

The agreement requires a subscriber to call the Help Desk/Covia Technical Support Center to obtain maintenance, repair and support services required for the Apollo Equipment and Apollo Services, or in the event of an interruption in Apollo Services (Apollo Reservations and Ticketing Service Rider, Article 7.B). The contract also provides that, with prior approval, a subscriber could use third-party-provided hardware and software in connection with its use of Apollo Services (Apollo Reservations and Ticketing Service Rider, articles 4.A and 5.A). However, the subscriber is liable for any loss or damage resulting from such use, including all costs incurred by Galileo to restore subscriber's interconnection to Apollo Services (Apollo Reservations and Ticketing Service Rider, articles 4.B and 5.B).

16. The terms of the standard pricing contract require the subscriber to pay Galileo "license, lease, purchase, installation, and service fees; taxes; and other fees" set forth in the agreement and in each Rider, Attachment A and all other attachments, "without setoff or counterclaim. Monthly fees commence upon the Services being operational" (Subscriber Services Agreement, Article 11.A). The contract provides for an adjustment to the Charges when the "Hardware or Software configuration" changes (Subscriber Services Agreement, Article 11.B). Pursuant to Article 8.B of the Apollo Reservations and Ticketing Service Rider, the subscriber shall pay Galileo "monthly, in advance, a Monthly Fixed Charge for the Apollo Equipment and for interconnection to Apollo Services, associated maintenance, repair, and support services, as set forth on the Apollo Attachments."

17. Pursuant to the terms of the agreement, the subscriber is required to pay variable charges for supplemental services⁶ (Apollo Reservations and Ticketing Service Rider, articles

⁶ The variable charges are not at issue in this matter.

8.C and 8.D). The supplemental services that subscribers could elect to purchase include, among other things, the ability to print passenger tickets and travel itineraries; the use of certain print queues, preview demands and file creators; the ability to maintain and generate reports in various levels of detail and support services outside the normal terms of the agreement.

18. In the standard pricing contract, the parties acknowledged that the charges have been established at a level reflecting the expectation that the subscriber “shall actively use Apollo Services in its operations to process Apollo Net Bookings” (Apollo Reservations and Ticketing Service Rider, Article 10.A). The contract requires the subscriber, each month, to process through each terminal or personal computer workstation used in conjunction with Apollo Services (“Apollo workstation”), the monthly minimum guarantee of Apollo net bookings (Apollo Reservations and Ticketing Service Rider, Article 10.B). The agreement defines an Apollo Net Booking as a travel related booking processed through Apollo Services, including, but not limited to, an airline, hotel, tour or rental car booking, or any other travel related service booking, that is not subsequently canceled (Apollo Reservations and Ticketing Service Rider, Article 1.B). It also defines the monthly minimum guarantee as 50 percent of the monthly Apollo workstation mean average of Apollo Net Bookings processed by the locations listed on attachments during the first six months of the agreement or during the period that the equipment is installed and operational, whichever period is shorter (Apollo Reservations and Ticketing Service Rider, Article 10.C).

19. In the event that, prior to the expiration of the term of the standard pricing contract, it is terminated by the subscriber or Galileo, the contract requires the subscriber to pay “liquidated damages consisting of amounts calculated in accordance with the Riders . . . , the amount of the

deinstallation charges for Services terminated . . . and interest . . .” (Subscriber Services Agreement, Article 19.A). The contract provides that liquidated damages calculated in accordance with the Rider are the sum of the following:

A. For each location, the amount of the Monthly Fixed Charge, under Article 8.B hereof and as specified on each Apollo Attachment [Attachment A], shall be multiplied by the number of months, including any portion thereof, remaining under the term of the Agreement pertaining to such Location and the product thereof multiplied by .80.

B. For each Location, the total of Variable Charges, under Article 8.C hereof and all supplements to this Agreement specified on Subscriber’s invoice dated the calendar month immediately preceding the date of termination shall be multiplied by the number of months, including any portion thereof, remaining under the term of the Agreement pertaining to such Location and the product thereof multiplied by .80.

C. For each Location, the Monthly Minimum Guarantee shall be multiplied by the Airline Booking Fee and the product thereof shall be multiplied by the product of the number of months, including any portion thereof, remaining under the term of the Agreement pertaining to such Location multiplied by the number of Apollo workstations reflected on each Apollo Attachment as of the date of termination. For purposes of this Article 11.C, except for terminations that occur in the month of January, the Airline Booking Fee shall be the total annual airline booking fees billed by [Galileo] during the calendar year immediately preceding termination, divided by the total annual air Apollo Net Bookings during that period. For terminations that occur during the month of January, the relevant Airline Booking Fee for the purpose of this Article 11.C shall be that based on figures for the year prior to the calendar year immediately preceding termination. (Apollo Reservations and Ticketing Service Rider, Article 11)

20. Each standard pricing contract included an Attachment A that identified the specific items of equipment being provided to the subscriber, by location, each item’s insurance value, any installation or deinstallation charges, the amount of the monthly fixed charge, the amount of the credit, and the amount of the net monthly fixed charge. The amount of the credit was negotiated by the parties and represented a fixed percentage of the monthly fixed charge. The percentage varied, based on the subscriber’s ability to generate target bookings levels. The

greater the average bookings, the greater the percentage and the amount of the credit. Under the standard pricing contracts, subscribers never paid the gross monthly fixed charges, only the net monthly fixed charge amounts. Galileo always collected and remitted to the Division sales tax on the net amounts paid by their New York subscribers.

21. The sample standard pricing contract includes a Subscriber Booking Program Attachment (“Incentives”) which provides, in pertinent part, that:

1. [Galileo] shall pay Subscriber seventy-five cents U.S. (\$0.75) for each Apollo Services automated car and hotel booking made during a calendar month by each Location automated with Apollo Equipment pursuant to the Agreement.
2. [Galileo] shall not pay Subscriber for car or hotel bookings that are cancelled by any means or that result in “no-shows” or multiple bookings of hotel or car rentals for a continuous duration.
3. Payment by [Galileo] to Subscriber for car or hotel bookings made in any one month shall be in the form of a credit applied to Subscriber’s monthly automation invoice provided by [Galileo] pursuant to the Agreement. Payment shall be based on car and hotel bookings as reported by Apollo Services. In the event that credits exceed the total amount due [Galileo] from Subscriber for its use of Apollo Services, [Galileo] shall issue a credit memo for the net amount of credit due Subscriber. . . .

22. Under the standard pricing contracts, the subscribers were billed on a monthly basis. Sample invoices sent to subscribers are part of the record. Each invoice identified the month for which the fixed charges and any variable charges were due and contained an itemization of the “Apollo Subscriber Charges.” The invoice listed, on separate lines, among other things, the phrase “monthly fixed charge,” with one of the following listed: Apollo, Apollo Focalpoint or satellite ticket printer, and the amount of the monthly fixed charge (identified as taxable), the specific items and quantity of equipment supplied, the percentage and amount of the monthly

credit (identified as taxable), the amount subject to tax along with the tax rate applied and the tax due, and the subtotal Apollo Subscriber Charges.

23. Productivity-based contracts also bear the heading “Subscriber Services Agreements.” Each productivity-based contract consists of a Product Designator, a Subscriber Services Agreement, attachments and Riders (Subscriber Services Agreement, Article 1.A). A sample productivity-based contract is part of the record. It consists of a one-page Product Designator, a 9-page Subscriber Services Agreement containing 28 articles, an Attachment A, an Attachment B, a one-page Productivity Attachment, and a 5-page Apollo Reservations and Ticketing Service Rider containing 13 articles. Pertinent sections of the sample productivity-based contract are set forth below.

24. The sample Product Designator contains a list of documents from which the parties designated the components of the productivity-based contract, i.e., the Subscriber Services Agreement, the Attachments and the Riders. Among the documents listed are the following Riders: the Apollo Reservations and Ticketing Service Rider, the Satellite Ticket Printer Rider, the “TS2000 Software License Rider (Monthly Lease),” and the “TS2000 Software License Rider (One-Time Fee).”⁷

25. The definitions of terms used in the sample productivity-based contract are set forth in Article 1 of the Subscriber Services Agreement and in Article 1 of the Apollo Reservations and Ticketing Service Rider. Pertinent terms are defined as follows. “Charges” is defined as “all amounts payable by Subscriber to [Galileo] under this Agreement” (Subscriber Services Agreement, Article 1.D). “Hardware” is defined as “all equipment leased or sold by [Galileo] to

⁷ The TS2000 is Apollo’s backroom accounting system offered to subscribers. Neither the TS2000 Software License Rider (Monthly Lease) nor the TS2000 Software License Rider is part of the record.

Subscriber” (Subscriber Services Agreement, Article 1.G). The term “Rider” means “each attachment hereto entitled ‘Rider’ which pertains to one or more Services selected by Subscriber and which is incorporated into this Agreement by reference” (Subscriber Services Agreement, Article 1.J). The term “Services” is defined as “Hardware, Software, and other services provided by [Galileo] to Subscriber” (Subscriber Services Agreement, Article 1.L). “Software” is defined as “all computer software licensed by [Galileo] to Subscriber” (Subscriber Services Agreement, Article 1[M]). The term “Apollo Equipment” is defined as “Hardware provided by [Galileo] which is used in conjunction with Apollo Services, such as personal computer workstations, CRT sets, ticket printers. . . . [T]he term ‘Apollo Equipment’ shall include all Software provided by [Galileo] which is installed on the Apollo Equipment” (Apollo Reservations and Ticketing Service Rider, Article 1.A). “Apollo Services” is defined as “the computerized Apollo reservations and ticketing service, which performs flight, hotel, rental car, and other reservations and ticket issuance functions” (Apollo Reservations and Ticketing Service Rider, Article 1.C).

26. The productivity-based contract provides that Galileo “shall license the Software and lease the Hardware set forth on each Attachment A, or other attachment, to Subscriber pursuant to the terms and conditions of this Agreement” (Subscriber Services Agreement, Article 2.A). It also grants the subscriber “a nonexclusive license to use the Software during the term of this Agreement” (Subscriber Services Agreement, Article 4.A[i]). The contract states that “[t]itle and full ownership rights to the Software” remain with Galileo (Subscriber Services Agreement, Article 4.[ii]). It describes the Software as the “proprietary information and trade secret” of Galileo (Subscriber Services Agreement, Article 4.[ii]). The contract states that the “Subscriber desires to utilize the Apollo Reservations and Ticketing Service and, in conjunction therewith,

may also lease Hardware and license Software from [Galileo], as specified on each Attachment A [Galileo] agrees to provide such Services. . .” (Apollo Reservations and Ticketing Service Rider).

27. Pursuant to the productivity-based contract, Galileo “shall install or cause to be installed the Apollo Equipment, as applicable, only at the Locations as set forth on each Apollo Attachment A and shall provide Subscriber connection to Apollo Services” (Apollo Reservations and Ticketing Service Rider, Article 2.B). Galileo is also required to provide the subscriber with “appropriate and sufficient internal training in Subscriber’s use of leased Apollo Equipment and Apollo Services” (Apollo Reservations and Ticketing Service Rider, Article 3.A). The contract provides that only personnel “who have satisfactorily completed the training program applicable to Subscriber’s use of leased Apollo Equipment and Apollo Services” (designated users) and the subscriber’s employees trained by the designated users, “shall be permitted to use Apollo Services and operate Apollo Equipment” (Apollo Reservations and Ticketing Service Rider, Article 3.B). It requires the subscriber to “take all necessary precautions to protect the Hardware owned by [Galileo] and installed on Subscriber’s premises” (Subscriber Services Agreement, Article 6.A). The contract further requires the subscriber to maintain insurance coverage on the Hardware (Subscriber Services Agreement, Article 6.B). It also provides that the subscriber “shall be liable to [Galileo] for any loss or damage to the Hardware, regardless of the cause thereof, occurring while leased to Subscriber or while in the possession, custody, or control of Subscriber” (Subscriber Services Agreement, Article 6.C[i]).

In addition, Article 11 of Apollo Reservations and Ticketing Service Rider states that:

A. It is understood and agreed that: (I) all Apollo Equipment shall remain the sole property of [Galileo]; (ii) Subscriber shall not remove any identifying marks

from any Apollo Equipment; (iii) Subscriber shall not subject the Apollo Equipment to any lien or encumbrance; and (iv) [Galileo] may enter Subscriber's premises to remove the Apollo Equipment immediately upon termination of this Rider or the Agreement.

B. Subscriber agrees to make, execute, acknowledge and deliver, any time or from time to time, all documents, instruments, and assurances, including, without limitation, financing statements under the Uniform Commercial Code, as may be requested by [Galileo] to preserve its ownership rights and title in and to the Apollo Equipment, and hereby authorizes [Galileo], where permitted by law, to file financing statements and amendments thereto relating to the Apollo Equipment without Subscriber's signature where desirable in the judgment of [Galileo] to preserve its ownership rights and title in and to the Apollo Equipment. Upon deinstallation of the Apollo Equipment, [Galileo] shall, upon Subscriber's request, take all steps necessary to terminate any Uniform Commercial Code filing made with respect thereto.

28. The productivity-based contract requires that the subscriber use and operate "the Apollo Services and Apollo Equipment" in accordance with provided operating instructions (Apollo Reservations and Ticketing Service Rider, Article 5.A). The agreement strictly prohibits, among other things, nonbusiness uses, personal messages, servicing other subscribers, travel agencies, or any other third party, speculative, duplicative or fictitious bookings. The subscriber is also required to "take all precautions necessary to prevent unauthorized operation or use of Apollo Services and the Apollo Equipment" (Apollo Reservations and Ticketing Service Rider, Article 5.C).

The agreement provides that Galileo "shall provide or cause to be provided to Subscriber support, repair and maintenance services required for the Apollo Equipment and Apollo Services" (Apollo Reservations and Ticketing Service Rider, Article 6.A). The agreement requires the subscriber to call the help desk to obtain maintenance, repair or support services, or in the event of an interruption in Apollo Services (Apollo Reservations and Ticketing Service Rider, Article 6.A). The contract also provides that, with prior approval, the subscriber could

use third-party-provided hardware and software (“third party product”) in connection with its use of Apollo Services (Apollo Reservations and Ticketing Service Rider, articles 4.A and 4.B). However, the subscriber is liable for any loss or damage to either Apollo Services or the Apollo Equipment resulting from the use of third party products, including all costs incurred by Galileo to restore its connection to Apollo Services (Apollo Reservations and Ticketing Service Rider, Article 4.F).

29. The terms of the productivity-based contract requires the subscriber to pay Galileo “license, lease, purchase, installation, and service fees; taxes, and other fees” set forth in the agreement and in each Rider, Attachment A, and all other attachments, “without setoff or counterclaim. Monthly fees commence upon the Services being operational” (Subscriber Services Agreement, Article 13.A). The contract provides for an adjustment to the Charges when the subscriber’s “Hardware and Software configuration” changes (Subscriber Services Agreement, Article 13.B). The terms of the agreement also provide that all credits issued by Galileo to subscriber “expire with the expiration of the initial term” of the contract (Subscriber Services Agreement, Article 13.F). The subscriber is required to pay Galileo monthly, in advance, a monthly fixed charge “for access to Apollo Services and the Apollo Equipment,” and “associated maintenance, repair, and support services for the Services provided” (Apollo Reservations and Ticketing Service Rider, Article 8.B).

In the agreement, the parties acknowledged that “all charges, credits, discounts, incentives, assistance, and the like (collectively, ‘Incentives’)” provided to the subscriber were established at a level reflecting the expectation that the subscriber would “make substantial use of Apollo Services during the entire term of the agreement.” The contract defines substantial use as “the

continuous achievement of at least . . . 50 percent of the average number of Apollo Net Bookings achieved by Subscriber” during the first six months of the agreement or, the six-month period prior to the effective date of the agreement, whichever is greater (Apollo Reservations and Ticketing Service Rider, Article 8.F[ii]). The contract further provides that if the subscriber fails to make substantial use of Apollo Services, then Galileo “may, at its sole discretion . . . , eliminate any or all future Incentives and may require reimbursement of any or all Incentives provided to Subscriber subsequent to the first month that such failure occurred” (Apollo Reservations and Ticketing Service Rider, Article 8.F[iii]).

30. The terms of the productivity-based contract require the subscriber to pay variable charges for supplemental services (Apollo Reservations and Ticketing Service Rider, articles 8.C and 8.E). The supplemental services that subscribers could elect to purchase included, among other things, the ability to print passenger tickets and travel itineraries; the use of certain print queues, preview demands and file creators; the ability to maintain and generate reports in various levels of detail and support services outside the normal terms of the agreement.

31. In instances where the subscriber defaults or breaches the contract, if the default or breach relates to fewer than all locations or Riders, the productivity-based contract allows Galileo to exercise its rights to terminate the entire agreement or only with respect to the location(s) or Rider(s) involved (Subscriber Services Agreement, Article 17.D). The contract also provides that, if either the subscriber or Galileo terminates the contract prior to its expiration, then the subscriber shall pay Galileo “all amounts of Promotional Support . . . , an amount equal to any discounts to Charges that were provided to Subscriber by [Galileo] prior to

the termination, and an amount equal to any Charges that were waived by [Galileo] prior to the termination.” (Subscriber Services Agreement, Article 17.E).

32. Each productivity-based contract contains an Attachment A that identified, under the heading “Services,” the specific items of equipment being provided to the subscriber, by location, the monthly fixed charge and insurance value for each item of equipment as well as any one-time charges. For example, in the sample Attachment A, Galileo provided the subscriber with the following, among other services: 2 VDT - monthly fixed charges of \$170.00 and insurance values of \$400.00; 1 VDT - monthly fixed charge of \$85.00 and insurance value of \$200.00; 1 MEGA TPU-A - monthly fixed charge of \$50.00 and insurance value of \$650.00.

33. The productivity-based contract also includes an attachment labeled “Productivity Attachment” which states that “Subscriber may be entitled to a credit applicable to the Monthly Fixed Charges on Subscriber’s use of the Hardware and Software set forth on each such Attachment A to the Agreement or may be charged according to an alternative formula.” Under the provisions of the Productivity Attachment, for a specified number of months (usually six months), the subscriber’s credit is “equal to the percentage identified below as ‘Starting Discount’,” which can be between 60% and 100% but usually is 100% (Productivity Attachment, Article 1). Upon completion of the initial period, for each month thereafter, if the subscriber “achieves the level of monthly average Apollo Net Bookings specified” in the attachment (“Target Bookings”), a credit of 100% shall be applied to the subscriber’s monthly fixed charges for the following month (Productivity Attachment, Article 2.A). If the subscriber did not achieve the target bookings level, “then, for the following month, the aforementioned Monthly Fixed Charges and credit shall not apply and instead, Subscriber shall pay” Galileo

shortfall charges “in an amount equal to two dollars (\$2.00) multiplied by a figure representing the difference between the average monthly Apollo Net Bookings made by Subscriber during the Review Period and the Target Bookings level specified” in the attachment (Productivity Attachment, Article 2.B).

34. The terms of the Productivity Attachment also provide that:

[w]hen Subscriber’s average Monthly Fixed Charges (rack rates) for the applicable Review Period increase or decrease, Subscriber’s Target Bookings shall be increased or decreased as applicable, through application of the Target Bookings Adjustment as specified below. The Target Bookings Adjustment shall be multiplied by the average Monthly Fixed Charges for the most recent Review Period, and the product thereof shall be divided by 100, to determine the revised Target Bookings level. In no event shall the revised Target Bookings level be reduced below the Target Bookings level established on the initial date of the Agreement. (Productivity Attachment, Article 3)

35. Galileo considered the shortfall charge to be a penalty for lack of productivity, and its imposition enabled Galileo to recoup its costs from unproductive subscribers. The shortfall charge also discouraged travel agencies from requesting more equipment than they could reasonably use. The financial terms of each productivity-based contract were unique and the result of separate negotiations with each subscriber. No two contracts contained identical financial terms, i.e., the credit percentage (starting discount percentage), the length of the initial period, the number of target bookings and the target bookings adjustment. In nearly all cases, there was no relationship between the shortfall dollar amount and the amount of the credit against the monthly fixed charges. Galileo collected and remitted sales tax on the shortfall charges and these charges are not in issue in this case.

36. Under the productivity-based contracts, subscribers were billed on a monthly basis. The record includes sample invoices that reflect the manner in which subscribers were billed

under both situations described above. All invoices issued under the productivity-based contracts identified the month for which the fixed charges and any variable charges were due and contained an itemization of the “Apollo Subscriber Charges.” In instances where a subscriber achieved its target bookings, the invoice listed, on separate lines, among other things, the phrase “monthly fixed charge,” along with one of the following listed: Apollo, Apollo Focalpoint or satellite ticket printer and the amount of the monthly fixed charge (identified as taxable), the specific items and quantity of equipment supplied, and the amount of the monthly credit of 100% (identified as taxable). In instances where a subscriber failed to achieve its target bookings, the invoice identified the month for which the fixed charges and shortfall charges were due. It also listed, on separate lines, among other things, the phrase “monthly fixed charge,” along with one of the following listed: Apollo, Apollo Focalpoint, or satellite ticket printer and the amount of the monthly fixed charge (identified as taxable), the specific items and quantity of equipment supplied, the amount of the monthly credit of 100% (identified as taxable), the number of bookings that the subscriber failed to achieve at a rate of \$2.00 and the “booking shortfall amount due” (identified as taxable), the amount subject to tax along with the applicable rate and the tax due, and the subtotal Apollo Subscriber Charges.

37. The record includes two invoices sent to subscribers in March of 1993. In the first invoice, a subscriber was billed for lost equipment. On that invoice, the phrase “Equipment Purchase Due to Loss/Theft:” appeared on the same line as the amount of \$10,275.00. Directly beneath that phrase, on separate lines, two pieces of equipment and their costs were listed, i.e., “1 ADP2200 10,000.00” and “1 EXT-MODEM 275.00.” The next line of the invoice listed “Subtotal Apollo Subscriber Charges” in the amount of \$10,275.00. The second invoice was

issued to a subscriber who was using its own equipment, specifically, a satellite ticket printer (“STP”). That invoice stated that the fixed charges were for the month of March 1993. It also listed the following under the heading “Apollo Subscriber Charges:” “Non-Covia Provided STP,” along with a quantity of 1. Nothing was listed in the amount column and the invoice total was listed as \$0.00.

38. Galileo considered the standard pricing contracts and the productivity-based contracts that it entered into with subscribers to be bundled contracts because it provided subscribers with computer equipment and software, access to the database, access to the help desk, and training in the use of the cryptic codes necessary to make reservations.

39. In September 1993, Galileo transferred certain assets and operations (but not the CRS assets and operations) to the following two partnerships: Apollo Galileo USA Partnership and Galileo Japan Partnership. Apollo Galileo USA Partnership (“Apollo”) did business as Apollo Travel Services Partnership during the period September 1, 1993 through February 29, 1996 (“second tax period”). Its offices were located in Rosemont, Illinois through March of 1994. Thereafter, Apollo’s offices were located in Rolling Meadows, Illinois.

40. In September 1993, Galileo and Apollo entered into a Galileo International Distributor Sales and Service Agreement (“distributor sales and service agreement”). As part of its obligations under the distributor sales and service agreement, Apollo was required to provide a national network of connectivity between the travel agencies and the Galileo database. The national network dealt with computer equipment that would channel signals from around the country, would bundle and send those signals down a private pipeline to the Galileo database and, then, receive the signals back to distribute them to wherever they originated, i.e., at the

travel agent's desk. Apollo was also required to ensure that the network was up and running approximately 99 percent of the time. In addition to being the network provider, Apollo was required to contract with travel agencies in its local market and provide them with connectivity to the CRS, equipment, training, and the help desk so that the travel agencies could use the system efficiently.

41. Apollo operated the NDC during the second tax period, and provided equipment and software to subscribers, under the name Apollo Travel Services Partnership, and as such is the successor to Galileo in the business of contracting with United States travel agencies. Galileo owned and operated the computer reservations system during the second tax period.

42. On a monthly basis, pursuant to the distributor sales and service agreement, Galileo paid Apollo a distribution fee for providing distribution services, connectivity services and negotiating with travel agencies. That fee was based on a percentage of the booking fees received by Galileo from airlines in Apollo's market. This arrangement was similar to the distributor sales and service agreements that Galileo had with over 70 other NDC's throughout the world.

43. During the second tax period, Apollo entered into subscriber services agreements with third parties, principally travel agencies. Like Galileo, Apollo principally entered into standard pricing contracts and productivity-based contracts, although the productivity-based contracts were more prevalent than in the earlier period. The terms of Apollo's standard pricing contracts and productivity-based contracts were substantially the same as those set forth in Galileo's standard pricing contracts and productivity-based contracts. Apollo billed its subscribers, under both type of contracts, in the same manner as Galileo had.

44. The record includes a sample two-page Satellite Ticket Printer Rider (“STP Rider”) incorporated into a productivity-based contract entered into by Apollo during the second tax period. The Satellite Ticket Printer Rider provides, in pertinent part that, the subscriber “desires to lease Hardware from [Apollo], specifically, satellite ticket printer equipment, . . . to be used in conjunction with Apollo Services. [Apollo] agrees to provide such Hardware to Subscriber. . . .” Article 2.B of the STP Rider requires Apollo to install the satellite ticket printer and Communications Equipment - - “[Apollo]-owned equipment used to facilitate communications in conjunction with the use of Apollo Services (e.g., modems, dedicated circuit, transaction processing units)” (Satellite Ticket Printer Rider, Article 1.B) - - and to interconnect the satellite ticket printer to Apollo Services. Article 3 of the STP Rider requires the subscriber and its client users to use the “[Apollo]-owned STP and Communications Equipment only in conjunction with the use of Apollo Services.”

The STP Rider also requires the subscriber to pay, among other charges, “monthly, in advance, a Monthly Fixed Charge for the STP and Communications Equipment and for interconnection to Apollo Services, as set forth on each STP Attachment A” (Satellite Ticket Printer Rider, Article 5.B). The monthly fixed charge includes the associated maintenance, repair and support services. Article 4 of the STP Rider provides, in pertinent part, that “this lease for STPs terminates upon termination or expiration of the lease term for Apollo Equipment as set forth in Attachment B to the Agreement. . . .”

45. Apollo considered the standard pricing contracts and the productivity-based contracts that it entered into with subscribers to be bundled contracts because it provided subscribers with computer equipment and software, access to the database, access to the help desk, training and

account management which included ensuring that subscribers were satisfied with the services provided, and keeping them informed of new techniques on utilizing the system and any new products.

46. In June 1995, Apollo entered into a Master Agreement with the American Automobile Association (“AAA”) as well as subscriber services agreements with individual AAA clubs.⁸ These subscriber services agreements (“AAA contract”) were significantly different from the standard pricing contracts and the productivity-based contracts.⁹ Unlike those contracts, the AAA contract reflected a negotiation under which AAA was to deliver a much higher level of bookings and, in turn, was to receive significantly higher financial incentives from Apollo. In addition, the designated charges for the equipment in the AAA contract were significantly lower than the monthly fixed charges in the other contracts.

47. The record includes a AAA Subscriber Services Agreement which consists of a Subscriber Services Agreement, Services Designators and attachments. Under the terms of the agreement, for a period of 60 months, Apollo is required to provide the Apollo Reservations and Ticketing Service and related products including all software, hardware, documentation and any other services selected by the subscriber and designated on the Services Designator. The subscriber is required “to utilize the Services strictly in accordance with the operating instructions provided by Apollo,” and is prohibited from, among other things, nonbusiness uses, personal messages, servicing other subscribers, travel agencies, or any other third party, and speculative, duplicative or fictitious bookings (Subscriber Services Agreement, Article 4.A).

⁸ The Master Agreement is not part of the record.

⁹ The AAA contract is not related to the tax in dispute.

The subscriber is required to pay the monthly fixed charges, variable charges, and other charges applicable to the Services as set forth on the Services Designator or other attachment. However, for each Apollo booking made by the subscriber during the month, Apollo credits a booking incentive in the amount of \$1.75 to the subscriber (Subscriber Services Agreement, Article 3.A). The agreement also provides that, if the booking incentives for the month exceed all charges for the month, Apollo shall pay the subscriber the difference; and if all charges exceed the bookings incentives, the subscriber shall pay Apollo the difference (Subscriber Services Agreement, Article 3.B).

48. Each subscriber services agreement includes one or more Services Designator that contains, among other things, the detailed list of available services (pieces of equipment, communications lines, software, help desk support, and operating systems), each service's separate monthly unit charge and separate monthly maintenance fee, the specific quantity and type of services chosen, the exact location to which the services are to be provided and the total monthly fixed charges. The Services Designator states that the subscriber is required to "pay the Monthly Fixed Charges specified below which are the sum of the Unit Charge and Maintenance Fee for the Services selected." For example, on one of the Services Designators that is part of the record, the subscriber, the AAA Club in Canandaigua, New York, is required to pay total monthly fixed charges of \$903.00 for the following selected services, among others, 3 Workstation (286 / 386) - - unit charge of \$25.00 each and maintenance fee of \$10.00 each - - for a monthly fee of \$105.00, 1 Apollo Document Printer - - unit charge of \$160.00 each and maintenance fee of \$40.00 each - - for a monthly fee of \$200.00, 1 Apollo ALC Connection - -

unit charge of \$300.00 and maintenance fee of zero - - for a monthly fee of \$300.00 and 1 Multi-user software license (includes support) - - \$200.00 per location - - for a monthly fee of \$200.00.

49. Apollo considered the AAA contract to be an “unbundled” contract because the charge for leasing equipment related solely to the equipment, while charges for other services - - such as access to the help desk and connectivity to the CRS - - were separately stated. The AAA contract was the only “unbundled” contract in place during either tax period.

50. At the hearing, petitioners presented the testimony of Arthur Schiff, an attorney in private practice in New York. From 1973 through 1982, Mr. Schiff worked for the American Society of Travel Agents as its Counsel and later as its General Manager. Since 1982 he has been in the private practice of law and the majority of his clients are retail travel agents. Mr. Schiff has lectured and published articles in travel trade publications about legal and marketing issues in the travel industry. He was accepted as an expert in the travel business.

51. Over the years, Mr. Schiff has represented travel agencies in their negotiations with CRS operators on numerous occasions. According to Mr. Schiff, during the periods in issue, monthly fixed charges were set out in all contracts. However, travel agencies were not concerned with those charges because of the discounts allowed.

52. Isabel Pascoe has been an employee of the Galileo organization since 1993 and currently holds the position of Senior Manager for Business Planning for Apollo. Her initial duties included evaluating and pricing individual deals with travel agencies and assisting the sales department in finalizing those deals. Ms. Pascoe is now responsible for overseeing all deals with travel agencies and approving deals up to a certain level before the subscriber services

agreements are finalized. Ms. Pascoe testified regarding petitioners' economic considerations when negotiating a subscriber services agreement with a travel agency.

53. The key factors for petitioners were to determine what products and services the travel agency wanted, a target level of bookings, and whether to give financial incentives to the travel agency. Rack rates were not relevant to petitioners in their contract negotiations with travel agencies. Petitioners' rack rates were based on historical amounts, and would most likely change only if their competitors' rates changed. According to Ms. Pascoe, the principal reasons that petitioners continued to designate monthly fixed charges in their contracts were because it was industry practice to do so and because the monthly fixed charge was a marketing tool that helped the subscriber to better value what it was receiving. As a general rule, the more equipment a travel agency required, the greater its target bookings requirement. That is because it was assumed that the more equipment used by a travel agency, the more service demands the travel agency would place on petitioners. For example, it would be expected that an increase in the number of computer terminals used by a travel agency would result in an increased number of "hits" made to the computer reservations system, as well as increased training and other support costs to petitioners.

54. In theory, the monthly fixed charge was supposed to allow petitioners to recover their costs for servicing subscribers. This included the costs of creating and maintaining a data center, networks, and infrastructure, manning a help desk, training, maintaining a sales staff, supplier expenses, and the costs of the equipment provided to subscribers. According to Ms. Pascoe, computer equipment represented only 5 to 10 percent of Apollo's total operating costs.

55. During the first tax period, as noted above, Galileo owned and operated the computer reservations system. Under the standard pricing contracts, subscribers paid Galileo the net monthly fixed charges. When a subscriber booked a reservation through the Galileo CRS, the airline (or other travel provider) paid the subscriber a commission for generating the reservation. Under a separate contract between Galileo and each airline, the airline paid Galileo a booking fee for processing and housing the reservation in the database. Pursuant to the productivity-based contracts, subscribers receiving a 100% credit, did not pay monthly fixed charges to Galileo. However, those subscribers receiving a credit of between 60% and 100%, paid the appropriate amount of the monthly fixed charges to Galileo. As under the standard pricing contracts, the airline paid the subscriber a commission for generating a reservation and paid Galileo a booking fee. In instances where a subscriber failed to meet the bookings required under its productivity-based contract, it paid shortfall charges to Galileo.

56. In the second tax period, as noted above, as a result of restructuring, Apollo took over for Galileo in contracting with travel agencies and providing connectivity to the computer reservations system database. The database continued to be owned and operated by Galileo. Under the standard pricing contracts, subscribers paid Apollo the net monthly fixed charges. When a subscriber booked a reservation through the computer reservations system, the airline paid the subscriber a commission for generating the reservation. Under separate contracts between Galileo and each airline, the airline paid Galileo a booking fee for processing and housing the reservation in the database. Under the distributor sales and services agreement between Galileo and Apollo, Galileo paid Apollo a distribution fee based on a percentage of the booking fee received by Galileo from the airline.

Pursuant to the productivity-based contracts, subscribers receiving a 100% credit, did not pay monthly fixed charges to Apollo. However, those subscribers receiving a credit of between 60% and 100%, paid the appropriate amount of the monthly fixed charges to Apollo. As under the standard pricing contracts, the airline paid the subscriber a commission for generating a reservation, and paid Galileo a booking fee. Galileo paid Apollo a distribution fee based on a percentage of the booking fee received by Galileo from the airline. In instances where a subscriber failed to meet the bookings required pursuant to its productivity-based contract, it paid shortfall charges to Apollo.

57. In accordance with the terms of their standard pricing and productivity-based contracts, petitioners demanded and collected liquidated damages from their subscribers.

58. For the first tax period, Galileo collected and remitted to the Division \$504,061.00 in New York State and local sales tax. This amount was based on the actual payments made by subscribers located in New York State under the standard pricing contracts. For the second tax period, Apollo collected and remitted to the Division \$281,006.00 in New York State and local sales tax. This amount was also based on the actual cash payments made by subscribers located in New York State under the standard pricing contracts. Neither Galileo nor Apollo collected and remitted sales tax on the monthly fixed charges set out in the productivity-based contracts since there was no cash payments made by the subscribers. Sales tax was collected and remitted on the shortfall charges.

59. For the prior tax period commencing March 31, 1988 through February 25, 1991, the Division audited the sales and use tax returns filed by Covia, the predecessor to Galileo. The Division accepted Covia's reporting position that taxable receipts with respect to the standard

pricing contracts were limited to the monthly fixed charges actually paid to Covia by the subscribers.

60. Following an audit of Galileo's sales and use tax returns for the first period, the Division issued to Galileo a Notice of Determination (L-019512471) ("first Notice of Determination") dated May 29, 2001, which notice assessed additional sales and use tax in the amount of \$549,867.37, plus interest, for the period March 1, 1991 through November 30, 1993.¹⁰ The first Notice of Determination consisted of additional sales tax found to be due by the Division in the following three areas: (1) variable sales charges (which are not in issue in this case); (2) monthly fixed charges from the standard pricing contracts; and (3) monthly fixed charges from the productivity-based contracts.

61. Of the total sales tax assessed in the first Notice of Determination, \$261,879.01 relates to monthly fixed charges under the standard pricing contracts, and \$258,670.27 relates to monthly fixed charges under the productivity-based contracts. Both amounts were computed by projecting error rates, 10.6670% and 10.5363% for the standard pricing contracts and the productivity-based contracts, respectively, - - calculated using the agreed-upon test period month of March 1993 - - against sales figures provided by Galileo and accepted by the Division.

62. Following an audit of Apollo's sales and use tax returns for the second tax period, the Division issued to Apollo a Notice of Determination (L-019512472) ("second Notice of Determination"), dated May 29, 2001, which notice assessed additional sales and use taxes in the amount of \$1,548,237.00, plus interest, for the period September 1, 1993 through February 29,

¹⁰ During the course of the audit, Covia Corporation (Galileo) executed a total of 20 consents extending the period of limitations for the purpose of allowing the sales and use tax asserted as due for the period March 1, 1991 through November 30, 1993 to be determined at any time on or before June 20, 2001.

1996.¹¹ The second Notice of Determination consisted of additional sales tax found to be due by the Division in the following three areas: (1) variable sales charges (which are not in issue in this case); (2) monthly fixed charges from the standard pricing contracts; and (3) monthly fixed charges from the productivity-based contracts.

63. Of the total sales tax assessed in the second Notice of Determination, \$260,551.20 relates to monthly fixed charges under the standard pricing contracts, and \$1,254,113.00 relates to monthly fixed charges under the productivity-based contracts. Both amounts were computed by using a straight line projection based on the amount of additional sales tax computed by the Division as due (i.e., \$8,685.04 and \$41,803.76, in additional sales tax due for the standard pricing contracts and the productivity-based contracts, respectively) for the agreed-upon test period month of September 1995. The straight line projection computation involved multiplying the additional sales tax computed by the Division for the test period month of September 1995 by 30 (the number of months comprising the tax periods ended November 30, 1993 through February 29, 1996).

64. During the audit of the second tax period, the auditor sent a two-page Sales Tax Examination Questionnaire containing 15 questions to Apollo. Scott Milnes, Tax Manager of Apollo, prepared Apollo's responses to that questionnaire. Question number 2 on the questionnaire asks "[w]hat type of products or services does your company sell or provide?" In response, Mr. Milnes wrote "[l]ease computer equipment & software for use with a computer reservation system."

¹¹ During the course of the second audit, Covia Corporation / Apollo Travel Services executed a total of 17 consents extending the period of limitations for the purpose of allowing the sales and use tax asserted as due for the period September 1, 1993 through February 29, 1996 to be determined at any time on or before June 20, 2001.

65. On February 24, 1998, Apollo filed for an Advisory Opinion (Petition No. S980224D) raising the following two issues. (1) Whether Apollo leases computer equipment to its subscribers pursuant to its productivity-based contracts and therefore may purchase the computer equipment exempt from tax for resale. Alternatively, whether Apollo is the consumer of the computer equipment transferred to the subscribers as an incident to, and to facilitate, the performance and delivery of the travel reservation booking and ticketing services and, therefore, is subject to use tax on the purchase of the equipment. (2) Whether Apollo's subscribers are required to pay sales tax on the full amount, or any portion, of the fixed monthly charges appearing in their contracts with Apollo.

66. On December 30, 1998, the Division issued an Advisory Opinion (TSB-A-98[89]S) to Apollo setting forth its conclusions concerning the two issues raised by Apollo in the Petition for Advisory Opinion. With respect to issue number 1, the advisory opinion stated that two sections of the productivity-based contract indicate that Apollo is leasing hardware, including computer equipment, to its subscribers. The advisory opinion concluded that the leasing of the computer equipment constitutes a "sale, selling or purchase" in accordance with Tax Law § 1101(b)(5). Therefore, when Apollo purchases the computer equipment, it is considered a purchase for resale and does not constitute a retail sale of tangible personal property subject to sales tax as provided by Tax Law §§1104(b)(4) and 1105(a). With respect to issue number 2, the advisory opinion stated that the credit allowed by Apollo against the monthly fixed charges is based on the number of bookings made by a subscriber through the computer reservations system, and Apollo receives payments from Galileo, with respect to these bookings. The advisory opinion concluded that the credits against the monthly fixed charges were a component of the taxable

receipt based on Tax Law § 1101(b)(3) and the same legal reasons articulated in the advisory opinion issued to *Planetarium Travels, Inc.* (TSB-A-93[42]S). The advisory opinion issued to *Planetarium Travels, Inc.* (TSB-A-93[42]S) concluded that the travel agency was “not receiving a true discount or a credit but [was] actually having a third party pay a part of its obligation to [the computer reservations system operator] on its behalf.” The advisory opinion went on to state that “[c]onsequently, in accordance with Section 1101(b)(3) of the Tax Law the amount of credit which [the travel agency] receives from [the computer reservations system operator] is not deductible when computing the sales tax.”

67. Based on the conclusions reached in the Advisory Opinion issued to *Apollo Travel Services Partnership* (TSB-A-98[89]S), the Division issued the notices of determination at issue.

68. At the hearing, petitioners submitted into evidence a report and a supplemental report prepared by Richard W. Genetelli, a Certified Public Accountant and the founder and principal owner of the Genetelli Consulting Group, which specializes in state and local tax matters. Mr. Genetelli testified at the hearing concerning his findings in those reports. Mr. Genetelli was accepted as an expert in accounting.

69. Mr. Genetelli analyzed petitioners’ financial data for the periods in issue. He testified that petitioners’ subscriber fees from travel agencies represented only a small percentage of petitioners’ total income. Galileo’s subscriber fees represented 13.55%, 12.28% and 8.99%, respectively, of its total income for 1991, 1992 and 1993 (nine months), respectively. While Apollo’s subscriber fees comprised 8.99%, 4.61%, 3.87% and 3.44%, respectively, of its total income for 1993 (three months), 1994, 1995 and 1996, respectively.

70. According to the United States Bureau of Labor Statistics, the cost of personal computers and workstations decreased approximately 50 percent between December 1992 and December 1995.

71. Galileo and the Division agree that if it is ultimately determined that Galileo did not lease tangible personal property to subscribers under the standard pricing and/or the productivity-based contracts during the first tax period, then Galileo owes use tax in the following principal amounts: \$151,379.18 under the standard pricing contracts and \$149,573.47 under the productivity-based contracts.

72. Apollo and the Division agree that if it is ultimately determined that Apollo did not lease tangible personal property to subscribers under the standard pricing and/or the productivity-based contracts during the second tax period, then Apollo owes use tax in the following principal amounts: \$48,424.25 under the standard pricing contracts and \$233,112.13 under the productivity-based contracts.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

In her determination, the Administrative Law Judge recited applicable provisions of the Tax Law and regulations regarding the imposition of tax on the retail sale of tangible personal property. The Administrative Law Judge concluded that under both the standard pricing contracts and the productivity-based contracts in effect during the period at issue herein, petitioners were leasing and licensing computer equipment and software. In making her determination, the Administrative Law Judge relied on specific provisions in each type of contract as well as the manner in which petitioners billed subscribers. The Administrative Law Judge held that the separate listing of equipment in the invoices supported a finding that a lease

of tangible personal property was occurring. Noting that under Tax Law § 1101(b)(5) a “sale” includes leases or licenses to use or consume tangible personal property, the Administrative Law Judge concluded that petitioners’ leasing and licensing of tangible personal property was a sale of tangible personal property.

The Administrative Law Judge disagreed with petitioners’ argument that the equipment provided to the subscribers was a trivial element of the contracts and, therefore, not subject to tax. The Administrative Law Judge found that either a computer terminal or a personal computer, loaded with proprietary software, was necessary to access petitioners’ computer reservations system. The Administrative Law Judge noted that despite the fact that subscribers could use their own computer equipment, petitioners admitted that they furnished computer equipment to nearly all of their subscribers. The Administrative Law Judge found a correlation between the monthly fixed charges and the equipment furnished. The Administrative Law Judge noted that the monthly fixed charges would increase if the amount of equipment furnished to the subscriber increased and would decrease if pieces of equipment were surrendered. In addition, the Administrative Law Judge observed that while petitioners issued invoices to those subscribers who used their own equipment, no charges were stated on those invoices.

The Administrative Law Judge found that the monthly fixed charges set forth in petitioners’ standard pricing and productivity-based contracts were solely for the leasing and licensing of that tangible personal property and that petitioners engaged in mixed cash and barter transactions with their subscribers under both types of contracts. The Administrative Law Judge concluded that when the subscribers generated bookings, they gave something of value to petitioners for the lease of the equipment. Therefore, after analyzing how travel agents were

able to use target bookings to offset their charges under each type of contract, the Administrative Law Judge held that the monthly fixed charges set forth in petitioners' standard pricing and productivity-based contracts were receipts subject to sales tax.

ARGUMENTS ON EXCEPTION

On exception, petitioners argue that under the "true object" test, they were primarily providing a non-taxable connectivity service and were not leasing computer equipment (Petitioners' brief, p. 17). As a result, petitioners contend that no portion of the monthly fixed charges set forth in the standard pricing and the productivity-based contracts is taxable. Petitioners maintain that in the case of the productivity based contracts, there is no lease or rental because no consideration was paid for the use of equipment. Petitioners allege that despite the use of the terms "lease" and "license" in the subscriber agreements, that should not preclude a finding that the substance of the agreements was the furnishing of connectivity.

Petitioners seek to distinguish *Matter of C.I.D. Refuse Serv.* (Tax Appeals Tribunal, August 31, 1995). Petitioners claim that the taxpayer in *C.I.D.* provided a specific rental charge for each item on its customer invoices while petitioners only had a total monthly fixed charge for all the items shown on the invoices. Petitioners insist that their business was not leasing hardware and software but providing connectivity to petitioners' CRS system. Petitioners argue that the true object test is applicable to determining whether the transaction is subject to tax. Petitioners maintain that the Administrative Law Judge erred in holding that the monthly fixed charges were solely for the leasing and licensing of tangible personal property. Petitioners rely on *Quotron Sys. v. Comptroller* (287 Md 178, 411 A2d 439) as relevant to distinguishing the true object of their transactions with travel agencies.

Petitioners maintain that if they did lease computer equipment for monthly fixed charges, they properly collected and remitted tax on the discounted amounts paid by their subscribers. Petitioners assert that discounts were provided to generate additional bookings and petitioners and the travel agent subscribers did not engage in barter transactions. Petitioners assert that if they did lease computer equipment and software to travel agencies, the Division may only tax the true price paid for the equipment and not a hypothetical “sticker price” that was never charged to or received from the travel agencies (Petitioners’ brief, p. 27).

Petitioners seek to distinguish the transactions undertaken in *Matter of House of Lloyd* (Tax Appeals Tribunal, November 13, 1998) where hostesses provided services to the company and received merchandise as their compensation. Petitioners argue that any services that the travel agencies provided in generating bookings were “paid” to the travel providers in exchange for commission income (Petitioners’ brief, p. 26).

Alternatively, petitioners argue that if they were leasing computer hardware and software to subscribers in exchange for rental payments, then the subscriber agreements were not solely for equipment leasing and, as the designated monthly charges exceeded the fair rental value of the equipment furnished, only the portion of such charges that represented the fair rental value of the equipment should be subject to tax.

In opposition to petitioners’ exception, the Division argues that the Administrative Law Judge correctly determined that under both the standard pricing contracts and productivity-based contracts, petitioners were leasing and licensing computer equipment and software to their subscribers. Further, the Division believes that the Administrative Law Judge correctly

determined that the monthly fixed charges under both types of contracts were receipts subject to sales tax.

The Division maintains that petitioners leased tangible personal property to travel agents, as evidenced by the language of the contracts themselves and by petitioners' admissions in other court proceedings. Further, the Division asserts that as petitioners collected tax on the monthly charges that were paid, they must have also believed that the agreements were taxable leases of tangible personal property.

The Division points out that petitioners' monthly invoices enumerated the equipment leased and the charges therefor, consistent with the terms of the leases. The Division asserts that there is little to distinguish petitioners from the taxpayers in *C.I.D.*, where it was held that there was a lease of tangible personal property. The Division maintains that tangible personal property need not be the predominant element in a bundled transaction in order for the receipt to be taxable; rather, it is only where the tangible personal property transferred is a trivial element of the transaction that no sale is deemed to occur. The Division argues here that the tangible personal property forms a significant part of the transaction and is, therefore, taxable. The Division believes that *Quotron* does not control the outcome here and the Division provides the argument that the facts in *Quotron* are significantly different from those in the instant proceeding.

The Division asserts that the charge on which the tax should be based should not be reduced by the credits given to travel agents for reservations booked nor adjusted to the fair rental value of the tangible personal property leased. The Division urges that the placement of reservations by travel agents is a form of consideration. The Division posits that the fixed

monthly charge was an incentive for travel agents to place additional reservations through petitioners' system. The credits given, argues the Division, are not a reduction in price (i.e., discount) but an acknowledgment of a barter transaction, with the consideration for the equipment having taken on a different form. The Division maintains that the productivity-based contracts are no different than the standard pricing contracts in that the shortfall penalty was a substitute means of obtaining consideration for the lease of the tangible personal property.

OPINION

Tax Law § 1105(a) imposes a tax on receipts from the retail sale of tangible personal property and a "sale" is broadly defined as any transaction in which there is a transfer of title or possession, or both, of tangible personal property for a consideration, including an exchange or barter, rental, lease or license to use or consume (Tax Law § 1101[b][5]). Despite petitioners' arguments to the contrary, it appears clear that under both the standard pricing contracts and productivity-based contracts, petitioners were leasing or licensing tangible personal property to their subscribers. Not only did these contracts specify that equipment was being leased and computer software licensed but the contracts also specified the pieces of hardware being provided and the monthly fixed charges therefor. Additionally, petitioners installed the computer equipment at the subscribers' locations and those subscribers operated the equipment furnished. The subscribers could use the computer equipment to connect to the computer reservations system as well as to prepare and print correspondence and bills and to maintain records. The subscribers were required to return the furnished equipment to petitioners at the termination of the contract, to insure the equipment furnished and to assume liability for any loss or damage to the equipment.

The Administrative Law Judge correctly found a correlation between the monthly fixed charges and the equipment furnished, with the monthly fixed charges increasing or decreasing based on the amount of equipment furnished to the subscriber. Perhaps most telling, invoices issued to those subscribers who used their own equipment had no monthly fixed charge stated on those invoices.

As noted above, a “sale” is defined as any transaction in which there is a transfer of title or possession, or both, of tangible personal property for a consideration. 20 NYCRR 526.7(b) defines consideration as including “monetary consideration, exchange, barter, the rendering of any service or any agreement therefor.” 20 NYCRR 526.7(d) provides the following definition of barter or exchange: “the transfer of tangible personal property . . . to a person in consideration for tangible personal property or services received is a ‘sale’ under the Tax Law.”

Despite petitioners’ arguments that they did not lease tangible personal property to their subscribers, the Division accurately points out that petitioners collected and remitted tax on the monthly charge they collected. Thus, even petitioners must have believed, at the time, that such charges were subject to tax.

The crux of petitioners’ argument is that despite the monthly fixed charges stated in the agreements, the travel agents only paid the full amount of such charges (or a penalty amount) if they failed to generate their target bookings in the prior month. As the Administrative Law Judge noted, petitioners’ marketing strategy provided the subscribers with incentives to generate bookings. The Administrative Law Judge found that generating bookings in lieu of paying fixed monthly charges due under the standard pricing contracts was consideration given to petitioners by their subscribers for leasing the equipment in their possession. We agree. Although the

productivity-based contracts were subject to different terms, the effect of the subscribers meeting their target bookings was no different than under the standard pricing contracts. As the Administrative Law Judge noted:

[p]etitioners used the monthly fixed charges as a marketing tool to help the subscriber value what it would be receiving under the contract - - the equipment - - in exchange for making the required number of bookings. This marketing strategy gave the potential subscriber an additional incentive to make bookings. There was very limited negotiation of the target bookings level. As part of petitioners' pricing strategy, the target bookings requirement was set at a level that discouraged the potential subscriber from obtaining more equipment than was reasonably necessary for its business. Clearly, both parties placed a value on the target bookings when they negotiated the productivity-based contract (Determination, conclusion of law "H").

Even though subscribers might have been entitled to a credit of 100% to be applied to the monthly fixed charges for the following month, the correlation between the monthly fixed charges and the target bookings was clearly stated in the contract. If the subscriber failed to achieve the target bookings level, the following month neither the monthly fixed charges nor the credit applied and, instead, the subscriber was required to pay shortfall charges.

Under either type of contract, by making the required number of bookings (i.e., target bookings) each month the subscribers either obtained a reduction of their monthly fixed charge for equipment or did not have to pay any monthly fixed charge for the equipment. Petitioners, in turn, received revenue through booking fees and distribution fees. Although petitioners and their subscribers did not directly trade equipment for services, petitioners established a plan whereby travel agents, using petitioners' equipment to achieve a minimal level of bookings, could cause the travel providers to subsidize the cost of their equipment rental in the form of increased booking fees to Galileo and distribution fees to Apollo. However, this was not a discount in the

price of the equipment rental, as argued by petitioners, because absent the sustained level of bookings, the cost of leasing the equipment increased as provided in the respective agreements.

We find no authority for petitioners' argument that tax is due, if at all, only on the fair rental value of the equipment and software. Instead, we agree with the Administrative Law Judge that tax is due on the monthly fixed charges as set forth in the respective contracts.

The Administrative Law Judge, by her thorough analysis of the issues presented to her, has correctly applied the relevant law to the facts of this case and we affirm her determination for the reasons set forth therein.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Galileo International Partnership is denied;
2. The exception of Apollo Galileo USA Partnership is denied;
3. The determination of the Administrative Law Judge is affirmed;
4. The petition of Galileo International Partnership is denied;
5. The petition of Apollo Galileo USA Partnership is denied; and
6. The notices of determination dated May 29, 2001 are sustained.

DATED: Troy, New York
March 24, 2005

/s/Donald C. DeWitt
Donald C. DeWitt
President

/s/Carroll R. Jenkins
Carroll R. Jenkins
Commissioner