

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
DZ BANK	:	DETERMINATION
	:	DTA NO. 821251
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 April 1, 2000 through	:	
June 30, 2003.	:	

Petitioner, DZ Bank, filed a petition 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 April 1, 2000 through June 30, 2003.

A hearing was held before Thomas C. Sacca, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on April 11, 2007 at 10:30 A.M., with all briefs to be submitted by November 9, 2007, which date began the six-month period for the issuance of this determination. Petitioner appeared by KPMG LLP (Arthur C.E. Burkard, Esq., and Russell D. Levitt, Esq., of counsel). The Division of Taxation appeared by Daniel Smirlock, Esq. (Michael J. Hall, Esq., and James Della Porta, Esq., of counsel).

ISSUES

- I. Whether petitioner has established that its purchases of certain risk analysis and forecasting services from Moody's/KMV are not subject to the imposition of sales and use taxes.
- II. Whether the Division of Taxation is estopped from denying petitioner's claim for refund as a result of the Division's representations made during the audit of Moody's/KMV.

FINDINGS OF FACT

1. On January 12, 2004, petitioner, DZ Bank, filed a claim for credit or refund of sales and use taxes paid in the amount of \$171,843.66. Attached to the claim were purchase invoices from Moody's/KMV (KMV) which establish the amount of sales tax paid. The invoices indicate that petitioner had purchased the following products from KMV: Credit Monitor, Portfolio Manager, Private Firm Model and Credit Edge. According to the claim, KMV had been the subject of a sales tax audit by the State of New York, which had represented that certain products, including those listed on the purchase invoices, were not subject to the imposition of sales and use taxes.

2. By letter dated February 18, 2005, the Division of Taxation (Division) denied petitioner's claim for refund in full. The refund denial provided, in part, as follows:

Section 1105(c)(1) provides for the imposition of sales tax on information services, except where the information furnished is personal and individual in nature. Section 1105(a) of the Tax Law also provides for the imposition of sales tax on the sale of tangible personal property except as otherwise provided. The term "tangible personal property" is defined in Section 1101(b)(6) to include pre-written software.

The "KMV Subscription Agreement" provided in support of your refund application provides for the installation and use by the subscriber of pre-written software and databases, which include third party data obtained and redistributed by KMV, LLC, to evaluate credit facilities and investment portfolios. These services represent information services which are not personal and individual in nature. Since such services are taxable under Section 1105(c)(1) of the Tax Law, your refund application is denied in full.

3. KMV has the right to use and license others to use certain databases and software so as to incorporate its market and credit risk measurements and modeling capabilities into solutions that allow businesses to better manage market and credit exposures. Generally, KMV sells products to financial institutions that invest for their own account in securities, or whose business

or investment activities expose them to credit risk. Among the products it sells are Credit Monitor, Portfolio Manager, Private Firm Model and Credit Edge. KMV charges a fixed fee for each of these products.

4. Credit Monitor is a Windows based product which offers credit measures on nearly 25,000 global, publicly traded companies, and nearly 130 privately held companies. It allows portfolio managers to access and manage credit risk for investments in these public and private companies. KMV's EDF (Expected Default Frequency) credit measures are probabilities of default used by lenders and investors. A public firm's probability of default is determined based upon the market value of its assets, its volatility and its current capital structure. Customers have direct access to the credit measures, which are not processed or manipulated during the retrieval process. Credit Monitor is updated monthly.

5. Portfolio Manager is a Windows based product which provides numeric values for the risk parameters of investment portfolios. The numeric values are used by the customer to determine a dollar cost for the risk parameters of an investment portfolio. Portfolio Manager is updated monthly.

6. Private Firm Model is a credit-related service, whereby KMV evaluates the performance of credit models and provides analysis of internal rating system behavior. It is a Windows based product which uses market information to provide a detailed portrait of the future prospects of the sectors and regions of the global economy in which private companies operate. Private Firm Model is updated monthly.

7. Credit Edge is similar to Credit Monitor in that it offers KMV credit measures on thousands of publicly held companies. However, Credit Edge is a web-based product, is updated daily and is accessed on-line by KMV's customers.

8. Petitioner has been a subscriber to KMV's Credit Monitor, Portfolio Manager and Private Firm Model since December 31, 1999, pursuant to the executed KMV Subscription Agreement (Agreement). The Subscription Agreement provides that "KMV owns or has the right to use and license others to use certain Databases and Software" and that petitioner "wishes to use the Databases and Software for its internal business purposes." The definition portion of the agreement defines the following terms as follows:

(a) "'Data Vendors' shall mean third-party suppliers from whom KMV acquires data for the provision of services hereunder, as identified in Exhibit B hereto and as may be amended from time to time by notice from KMV to Subscriber."

(b) "'Databases' shall mean the databases identified in Exhibit A attached hereto, including all revisions, modifications, updates, and replacements thereto which may be provided to Subscriber hereunder." Exhibit A contained the databases Credit Monitor, Portfolio Manager and Private Firm Model.

(c) "'Service' shall mean the provision by KMV to Subscriber of the Software, the Databases,"

(d) "'Software' shall mean the computer programs described in Exhibit A attached hereto, in object code format only, including all corrections, modifications, and enhancements thereto, which may be provided to Subscriber hereunder."

9. Pursuant to the Agreement, petitioner was granted a nonexclusive, nontransferable license to install, access and use the software and databases solely for internal business purposes. KMV retained all property rights, including copyrights and trade secrets, in the databases and software. Petitioner was permitted to use the databases and software on an unlimited number of personal computers and local or wide area network file servers, so long as access to and use of

such computers and servers was restricted to petitioner's employees and all such computers and servers were installed in facilities controlled by petitioner. Petitioner was prohibited from allowing its customers, borrowers, consultants, independent contractors or agents to use the software or databases, or any information derived from them. It also could not, without the prior written consent of KMV, sell, transfer, assign, publish, distribute, disseminate, allow access to or convey any of the databases or software. KMV had the right under the Agreement to periodically inspect, at petitioner's location, the computer systems on which the databases and software were stored, processed and used for purposes of establishing compliance with the terms of the Agreement.

10. The Agreement further provided that in the event that either KMV or petitioner terminated the Agreement for any reason, petitioner was required to destroy or return to KMV any and all machine readable material containing the databases, and any and all related documentation, and expunge all data or information from the databases in its data storage facilities.

11. KMV obtained data from third-party suppliers to provide its services to petitioner. Exhibit B of the Agreement listed the data vendors as ASX Operations Pty Limited; Disclosure Incorporated, Primark Global Information Services; DRI/McGraw-Hill, a division of McGraw-Hill, Inc.; Interactive Data, Financial Times Information, a Pearson Company; Standard & Poor's Compustat and Global Vantage, a division of The McGraw-Hill Companies, Inc.; and Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc.

12. According to the Agreement, data obtained from the vendors included the following information about companies: accounting treatment, common equity, common shares outstanding, common/ordinary dividends, company name, country of incorporation, currency

name, debt in current liabilities, deferred taxes, equity value, issue description and par value, minority interest, operation income before depreciation, other liabilities, preferred dividends, preferred stock, price close monthly, retained earnings, sales, SIC code, Standard & Poor's Ratings Services ratings, statement date, total assets, total current liabilities, total liabilities, and total long-term debt.

13. The information that KMV purchased from the data vendors was incorporated into KMV's software that was sold to customers, such as petitioner. The third-party data obtained from the data vendors was licensed to KMV for redistribution to its subscribers. KMV relied on the third-party data in preparing and providing the databases to the subscribers. The availability of any third-party data to the subscribers ceased automatically if a data vendor terminated its relationship with KMV. The third-party data was updated monthly and incorporated into the software. The updated information could include most recent financial statements, new securities and new rating information. The software could be acquired from KMV by either CD-ROM or by secure web-site download. Petitioner chose to have the products and monthly updates of the products delivered by CD-ROM.

14. Pursuant to the General Provisions of the Agreement, the Agreement constituted the entire agreement of the parties, and excluded all representations, conditions, warranties and other terms not expressly stated therein. Furthermore, the Agreement could be modified only by a writing signed by the party to be charged.

15. As previously mentioned, Credit Edge is a product similar to Credit Monitor but is a web-based product, is updated daily and is accessed on-line by KMV's customers. Its use by petitioner was not governed by the Agreement. Credit Edge provided a credit risk analysis and forecasting service that was designed for analyzing and forecasting credit risk through an

interactive internet exchange. To access Credit Edge, petitioner was required to download software provided by KMV. Petitioner then entered private portfolio data online into KMV's web-site database. KMV then performed an analysis of petitioner's portfolio, and provided petitioner with a report forecasting the probability distribution of future default rates. These forecasts were used to analyze the credit risk exposure of petitioner from its business or investment activities. The report provided by Credit Edge dealt with analysis of credit risk from entities that may default on obligations to petitioner.

CONCLUSIONS OF LAW

A. Tax Law § 1105(a) imposes sales tax on “[t]he receipts from every retail sale of tangible personal property, except as otherwise provided in this article.” All sales of tangible personal property are presumptively subject to tax pursuant to Tax Law § 1132(c) until the “contrary is established.” Tax Law § 1101(b)(6) imposes a tax upon “pre-written computer software, whether sold as part of a package, as a separate component, or otherwise, and regardless of the medium by means of which such software is conveyed to a purchaser.”

B. In 1991, the Tax Law was amended by the addition of paragraph (14) to section 1101(b). That section, effective September 1, 1991, defines “pre-written computer software” as:

Pre-written computer software. Computer software (including pre-written upgrades thereof) which is not software designed and developed by the author or other creator to the specifications of a specific purchaser. The combining of two or more pre-written computer software programs or pre-written portions thereof does not cause the combination to be other than pre-written computer software. Pre-written software also includes software designed and developed by the author or other creator to the specifications of a specific purchaser when it is sold to a person other than such purchaser. Where a person modifies or enhances computer software of which such person is not the author or creator, such person shall be deemed to be the author or creator only of such person's modifications or enhancements. Pre-written software or a pre-written portion thereof that is

modified or enhanced to any degree, where such modification or enhancement is designed and developed to the specifications of a specific purchaser, remains pre-written software; provided, however, that where there is a reasonable, separately stated charge or an invoice or other statement of the price given to the purchaser for such modification or enhancement, such modification or enhancement shall not constitute pre-written computer software.

Following the enactment of Tax Law § 1101(b)(14), the Division issued TSB-M-93(3)S which stated that “References in the 1978 bulletin to exempt software are largely obsolete and should be disregarded.” As the Division stated therein, “the effect of this change in the Tax Law is to broaden the types of computer software that are subject to sales and use tax.” (*See Matter of Manufacturers and Traders Trust Company*, Tax Appeals Tribunal, September 23, 2004.)

C. Three of the products at issue, Credit Monitor, Portfolio Manager and Private Firm Model, were sold by KMV to petitioner pursuant to the KMV Agreement. The Agreement provided that KMV had the right to use and license others to use certain databases and software and that petitioner wished to use the databases and software for its internal business purposes. The Agreement granted petitioner a nonexclusive license to install, access and use KMV’s software and databases. The term software is defined in the Agreement as the “computer programs described in Exhibit A, including all corrections, modifications and enhancements thereto.” The Agreement defined databases as the “databases identified in Exhibit A, including all revisions, modifications, updates, and replacements thereto.” Exhibit A of the Agreement listed Credit Monitor, Portfolio Manager and Private Firm Model as the products obtained by petitioner from KMV.

Several other provisions of the Agreement indicate that the databases and software were installed and used on petitioner’s computer systems. Petitioner was permitted to use the databases and software on an unlimited number of computers and servers, provided the

computers were within the control of petitioner and the users were petitioner's employees. Petitioner could not sell, transfer, assign, publish, distribute, disseminate, allow access to or convey any of the databases or software without the prior written consent of KMV. KMV was given the right to inspect petitioner's computers to insure compliance with the provisions of the Agreement. Petitioner had the option of receiving the monthly updates by either downloading the update files from KMV's web site or receiving such files on CD-ROM. Petitioner elected to receive the update files by CD-ROM. Had the Agreement been terminated for any reason, petitioner was required to destroy or return to KMV any and all machine-readable material containing the databases and expunge all data or information from the databases in its storage facilities. In addition, the software and databases obtained by petitioner contained data compiled by KMV from third-party suppliers.

Taken as a whole, the Subscription Agreement between petitioner and KMV indicates that KMV was selling to petitioner pre-written software and databases that were installed on petitioner's computers and servers. Under these circumstances, petitioner purchased pre-written computer software as that term is defined in Tax Law § 1101(b)(14). As section 1105(a) imposes sales tax upon the sale of tangible personal property, and tangible personal property includes pre-written computer software pursuant to Tax Law § 1101(b)(6), petitioner is not entitled to a refund of the sales tax paid on its purchases of the products Credit Monitor, Portfolio Manager and Private Firm Model from KMV.

D. At hearing, petitioner attempted to establish through the testimony of its witness that the circumstances surrounding the purchase and use of the three products that were the subject of the Agreement were different from those described in the Agreement. Petitioner contends that it did download software from KMV via CD-ROM, but that the software was of no value in itself but

was necessary to access KMV's online services. Petitioner also contends that it received a password which enabled it to connect to KMV's internet service. Petitioner would then enter its private portfolio data or credit data online into KMV's server and receive a market risk analysis and/or credit risk analysis report. Petitioner contends that KMV's market risk analysis and credit risk analysis services as described were electronic financial consulting services. As these are not among the services enumerated as taxable under section 1105(c) of the Tax Law, no sales tax was due on the purchase of these services.

E. The credibility of witnesses is a "determination within the domain of the trier of the facts, the person who has the opportunity to view the witness first hand and evaluate the relevance and truthfulness of their testimony" (*Matter of Spallina*, Tax Appeals Tribunal, February 27, 1992). Credibility has two components: competency and veracity. "Opportunity and capacity to perceive combined with capacity to recollect and communicate constitute the ingredients of competency. The truthfulness of the witness determines his veracity" (*Matter of Impath, Inc.*, Tax Appeals Tribunal, January 8, 2004; *Matter of Avildsen*, Tax Appeals Tribunal, May 19, 1994).

After reviewing the testimony and evidence in the record, it is concluded that petitioner's witness's testimony was not credible. In particular petitioner's witness did not have the requisite competency to provide a basis for concluding that the terms of the Agreement between KMV and petitioner were anything other than that as provided by the Agreement itself. The witness was not a manual user of the products at issue. He was not involved in the process of obtaining the products from KMV, nor in the negotiations that led to the execution of the Agreement. His testimony was vague and conclusory on critical points, and was often elicited with leading questions. Under these circumstances, it is concluded that the Agreement must determine the

relationship between KMV and petitioner as to the sale and use of the products Credit Monitor, Portfolio Manager and Private Firm Model.

F. Petitioner cites two Division advisory opinions in support of its position herein (*The RiskMetric Group, LLC*, Advisory Opinion, January 21, 2000 [TSB-A-00(2)S]; *Deloitte & Touche LLP*, Advisory Opinion, December 3, 1999 [TSB-A-99(58)S]). Although such opinions are not precedential and are not in any way binding herein (*see* Tax Law § 171; 20 NYCRR 2376.4), the factual settings described in each of those advisory opinions present a much stronger case that the services described therein are not subject to sales tax. In contrast to the advisory opinions, where the taxpayer submits the relevant facts for consideration, petitioner herein bore the responsibility of establishing the relevant facts through the introduction of testimony or documentary evidence. Ultimately, the documentary evidence, specifically the Agreement, establishes facts contrary to the factual circumstances contained in the advisory opinions.

G. With regard to the Credit Edge product, petitioner has the burden of establishing that the purchase of this product is not subject to the imposition of sales and use tax (Tax Law § 1132[c]). Credit Edge is a product similar to Credit Monitor but is a web-based product, is updated daily and is accessed on-line by KMV's customers. Its use by petitioner was not governed by the Agreement. To access Credit Edge, petitioner was required to download software provided by KMV. Petitioner then entered private portfolio data online into KMV's web-site database. KMV then performed an analysis of petitioner's portfolio, and provided petitioner with a report forecasting the probability distribution of future default rates. Such service is, in effect, an electronic financial consulting service, which is not one of the services enumerated as taxable under section 1105(c) of the Tax Law. Therefore, petitioner is entitled to a refund of the sales tax paid on its purchases of the Credit Edge product.

H. Petitioner contends that the Division of Taxation should be estopped from denying its claim for refund as a result of the alleged representations made by the Division during its audit of KMV insofar as KMV reasonably relied on discussions had with the Division. Petitioner contends that the Division determined that the sales of the products at issue were not subject to the imposition of sales and use taxes. Petitioner claims third-party reliance to its detriment in relying upon the Division's alleged determination in that it has expended time and resources in pursuing this refund claim.

I. As a general proposition, unless there are exceptional facts which require its application to avoid a manifest injustice, the doctrine of estoppel does not apply to governmental acts (*Matter of Consolidated Rail Corp.*, Tax Appeals Tribunal, August 24, 1995, **confirmed** 231 AD2d 140, 660 NYS2d 549 [1997], **appeal dismissed** 91 NY2d 848, 667 NYS2d 683 [1997]; *Matter of Harry's Exxon Service Station*, Tax Appeals Tribunal, December 6, 1988). This proposition is considered especially strong where a taxing authority is involved, since public policy supports the enforcement of the Tax Law (*Matter of Glover Bottled Gas Corp.*, Tax Appeals Tribunal, September 27, 1990). The Tax Appeals Tribunal has developed a three-part test in order to determine whether to invoke an estoppel, to wit, (i) whether there was a right to rely on a representation made by the Division, (ii) whether there was such reliance and (iii) whether the reliance was to the detriment of the party who relied upon the representation (*see, Matter of Consolidated Rail Corp., supra.; Matter of Harry's Exxon Service Station, supra.*).

J. Initially it is noted that petitioner has failed to establish the exact nature of the representations made by the Division to KMV and the factual basis upon which such representations were made. In addition, petitioner has failed to establish that it had a right to rely upon the representations made by the Division; that there was such reliance; and, that the reliance

was to its detriment. It is noted that the representations were made to KMV, not petitioner, and that they were made to KMV after the period of the refund claim. Petitioner filed its refund claim on the basis of information it received from KMV, not the Division. Furthermore, the Division is not estopped from asserting tax due merely because it failed to assert tax due from the taxpayer on an earlier audit (*Matter of Sachs, New York, Inc. v. Tully*, 79 AD2d 1056, 435 NYS2d 172 [1981]; *Matter of Finserv Computers v. Tully*, 94 AD2d 197, 463 NYS2d 923 [1983] *affd* 61 NY2d 947, 475 NYS2d 279 [1983]). Since the Division would not be estopped from asserting tax due from KMV, and since petitioner's reliance claim derives from the KMV audit, it cannot claim that it detrimentally relied on representations made to KMV.

K. The petition of DZ Bank is granted to the extent indicated in Conclusion of Law G, but is in all other respects denied. The Division of Taxation is directed to issue to petitioner a refund of the sales tax paid on the purchases of the Credit Edge product. The Division of Taxation's Notice of Disallowance, dated February 18, 2005, as modified, is sustained.

DATED: Troy, New York
May 1, 2008

/s/ Thomas C. Sacca
ADMINISTRATIVE LAW JUDGE