

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition :
of :
CATALYST REPOSITORY SYSTEMS, INC. : **DECISION**
 : **DTA NO. 826545**
for Revision of a Deficiency or for Refund of Corporation :
Franchise Tax under Article 9-A of the Tax Law for the :
Period January 1, 2008 through December 31, 2010. :
:

The Division of Taxation (Division) filed an exception to the determination of the Administrative Law Judge issued on August 24, 2017. The Division appeared by Amanda Hiller, Esq. (Clifford M. Peterson, Esq., of counsel). Petitioner appeared by Hutton & Solomon LLP (Stephen L. Solomon, Esq., and Kenneth I. Moore, Esq., of counsel).

The Division filed a brief in support of its exception. Petitioner filed a brief in opposition. The Division filed a reply brief. Oral argument was heard on January 24, 2019, in New York, New York, which date began the six-month period for issuance of this decision.

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

ISSUES

I. Whether the receipts at issue are properly classified as receipts derived from the performance of services, pursuant to Tax Law former § 210 (3) (a) (2) (B), or as other business receipts, pursuant to Tax Law former § 210 (3) (a) (2) (D).

II. Whether, upon determining the proper classification of the receipts at issue, any portion thereof is properly allocable to New York.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge, except that we have modified findings of fact 1, 6, 7, 9, 12, 14, 16, 18 and 23 to more accurately reflect the record. We have not restated the Administrative Law Judge's findings of fact 36 and 37 as those findings summarize the parties' arguments below. We have made an additional finding of fact, numbered 36 herein. The Administrative Law Judge's findings of fact, the modified findings of fact and the additional finding of fact appear below.

1. Petitioner, Catalyst Repository Systems, Inc., is a Colorado based electronic data and document repository corporation that provides litigation support to its clients. Its genesis began in the 1990s as a unit within a law firm and in 2000, it was spun off as a separate company.

2. Petitioner filed form CT-3 (general business corporation franchise tax return) and form CT-3M/4M (general business corporation MTA surcharge return) for each of the tax years ending December 31, 2008, December 31, 2009 and December 31, 2010 (audit period) upon which it computed a business allocation percentage (BAP) in the amount of zero. In computing its BAP, petitioner treated its receipts as arising from services, and determined that such services were performed entirely in Colorado.

3. For each tax year, petitioner reported that its highest tax base was the fixed dollar minimum tax base and, as such, it reported a tax liability of \$25.00.

4. Petitioner subsequently filed amended forms CT-3 and forms CT-3M/4M to report changes to its federal taxable income for the tax years ending December 31, 2009 and December 31, 2010. The federal returns were amended to claim a deduction pursuant to Internal Revenue Code (IRC) (26 USC) § 199 on the basis that its gross receipts from its customers'

access to petitioner's software while connected to the internet are substantively similar to receipts from software that can be purchased or downloaded from a seller.

5. By a letter dated March 9, 2012, the Division informed petitioner that it was reviewing its corporation franchise tax filings for the audit period. This review included an examination of petitioner's BAP, which became the focus of the audit.

6. Petitioner provides its clients with the use of its system, which includes its proprietary software in order to acquire, store, sort, filter, organize and ultimately find and retrieve the documents its clients require, typically in response to demands for discovery arising through litigation, governmental requests or regulatory inquiries. In addition, petitioner's technical personnel may provide services to clients. The charges for such services are not at issue.

7. Petitioner licenses the use of its system. Each license is for a designated case, on a month-to-month basis, and may be terminated at will by either party. The license does not convey any ownership rights to any software or any of the storage or operating facilities being used. Petitioner does not sell any information or tangible personal property to its clients. Rather, the client provides data to be hosted by petitioner and uses petitioner's system for the purpose of searching, analyzing, reviewing and retrieving its own data.

8. The process begins when petitioner is provided with legal and other documents from its clients, which have been provided to petitioner for processing and loading into petitioner's platform. Petitioner then tags and organizes the data at its Colorado headquarters, where its computer servers and storage facilities are located. Clients from around the world utilize the internet to access the Colorado system in order to process, search, sort, filter, organize and retrieve the data they require.

9. Petitioner does not sell or provide data to its clients, but rather its clients provide the data to be managed. Petitioner offers secure storage, language translation, project management, application support, network support, training, consulting, uploading, conversion, numbering, special formatting, exporting and delivery all as part of its standard agreement with its clients. All of petitioner's facilities are located in Colorado. With minor exceptions, all of petitioner's employees are in Colorado. During the course of the audit, petitioner was asked what its customers received when they made a purchase. Petitioner responded that when a client contracts with petitioner, it does not physically get anything, but rather the client licenses software that is hosted in Colorado and gets a login and password to access that software.

10. Petitioner's system's "architecture" is a combination of petitioner's own computer code and third-party programs, stitched together and integrated into the system, which consists of hundreds of computer servers and storage devices all operating in tandem.

11. The third-party programs are licensed to petitioner for its use as a hosted service for its clients. These licenses cannot be re-licensed by petitioner to its clients, but can be accessed and used through petitioner's system as part of the hosted program.

12. Petitioner's servers used to host the software and data being accessed by the end users are located in Colorado and the services related to its data hosting activities are performed by its Colorado employees. These employees facilitate petitioner's business by developing the technology, monitoring and maintaining it, supporting and training clients to use it, and performing other support services as may be requested.

13. Petitioner enters into a master hosting and services agreement (Agreement) with each of its clients. Petitioner's fees are listed in a standard price sheet or within each Agreement and

these prices can vary from client to client, based generally on the volume of documents processed.

14. Petitioner's Agreements are standard and vary only between working with a direct end user client and a wholesale partner or reseller. Such a wholesale partner or reseller executes an "Alliance Partner" master hosting and service agreement to enable it to resell petitioner's product to end users.

15. Petitioner's retail and wholesale customers paid, in part, fees for what the Agreements identified as "Application Hosting." The Agreements define "Application Hosting" as making petitioner's applications available to its customers over the internet and the public telecommunication system.

16. Both the retail and wholesale Agreements grant to the customer "a non-exclusive, non-transferable limited right and license to use one or more Applications" The Agreements define "Application" as one or more of petitioner's software systems providing, among other things, document management, data sharing, collaboration, case, claim, deal and workflow facilities.

17. Petitioner charged its retail customers three types of "Hosting Fees," to wit: a "Site Setup Fee," a "Monthly User Access Fee," and a monthly "Variable Hosting Fee."

18. Site Setup Fees include provisioning the site on petitioner's servers, giving it a name and setting it up in the cases table and various databases. It also can include configuring the site for particulars about a case or matter by choosing certain fields, adding or deleting fields and other configurable options included in the software. All this work is performed by Colorado technicians and is technical in nature. The Site Setup Fees are not included in the receipts at issue.

19. The Monthly User Access Fee is priced based upon the number of users, while the Variable Hosting Fee varies based on the client's cumulative storage volume per matter, i.e., the volume of documents that they have given petitioner and loaded onto its servers.

20. Petitioner's retail invoices billed the Variable Hosting Fee as a Variable License Fee and billed the Monthly User Access Fee as the Base Monthly License Fee.

21. Petitioner charged its wholesale clients a monthly Base License Fee as well as a Variable Hosting Fee, which was billed as a Variable License Fee.

22. Wholesale customers were required to execute contracts with their end users that were substantially similar to the terms of the wholesale customers' Agreements with petitioner.

23. Petitioner's retail and wholesale customers also paid fees for "Services," which the Agreements defined as services other than Application Hosting and included document uploads, conversion, numbering, optical character recognition, special formatting, export, delivery, or any consulting. Each of these services are performed by petitioner's employees located in its Colorado offices. Fees for "Services" are not included in the receipts at issue.

24. Pricing is determined based on market conditions and on petitioner's published retail and wholesale price lists, subject to negotiation and change.

25. All data is maintained at co-location facilities rented by petitioner in the state of Colorado and all included and related services are provided in Colorado. Petitioner provides access to its servers to its clients, usually legal professionals from around the world, who use the internet to access their documents on petitioner's system in order to review documents, perform electronic discovery, query information, and other tasks.

26. The system is very labor intensive, as employees must make the system function, keep the system operating and secure, and assist clients in using the system and to optimize their

results. A large staff of employees perform a number of functions: system engineers, security people, code writers, account/project managers and, management and administrative staff. In addition, the system's architecture requires the building and maintenance of routers, servers, switches, hubs and other components required to make the system work.

27. During 2008, 2009 and 2010, petitioner's total payroll was \$6,026,065.00, \$7,505,532.00 and \$6,786,682.00, respectively. Of the total, petitioner's Colorado payroll amounted to \$4,904,919.71, \$5,860,080.07 and 6,541,913.72 for the same years, respectively. Petitioner employed 84 employees in Colorado during 2008, 85 in 2009, and 103 in 2010. During 2008 and 2009, petitioner had one employee in New York. In 2010, petitioner had four employees in New York. The New York employees mostly performed sales work for petitioner, except for a research scientist who was hired in the later part of 2010.

28. Petitioner's marketing brochure from 2010 provided, in pertinent part, that:

"Catalyst's secure, web-based systems help corporations and counsel manage electronic discovery and other complex legal matters. Our e-discovery platform helps clients save on e-discovery costs by reducing document populations and making reviewers more efficient. Our collaboration systems offer a central place to coordinate complex litigation or to connect counsel and clients. Both are delivered as web-based, hosted services via the Internet cloud. There is no hardware to purchase, no software to maintain and no technical staff to hire."

29. This same brochure also provided the following:

"We design our products with you in mind. You run our ediscovery systems from start to finish - from processing, through search, analysis, review and production. Administrators can set up users, identify and batch document populations, manage and track review teams and direct productions. Whenever you need additional support, our project managers and expert consultants are there to help."

30. The Division focused its audit on the "Monthly User Access Fees" and "Variable License Fees" from the retail price list and the "Base License Fees" and "Variable License Fees" from the wholesale price schedule. These fees are the receipts at issue.

31. Petitioner provided documents with revenue information for its New York customers for each of the tax years comprising the audit period. Using this information, the Division computed a receipts factor for each of the tax years at issue based upon the location of the customer.

32. On August 14, 2013, the Division issued to petitioner a notice of deficiency (L-039990114) asserting tax due of \$182,844.00, plus interest. Penalties were not asserted nor did the Division assert the MTA surcharge under Tax Law § 209-B.

33. Following a conciliation conference with the Division's Bureau of Conciliation and Mediation Services, a conciliation order sustaining the notice of deficiency was issued on July 11, 2014.

34. Petitioner timely filed a petition with the Division of Tax Appeals and this proceeding ensued. Thereafter, the Division filed an answer to the petition and an amended answer. The amended answer asserted an additional deficiency pursuant to Tax Law § 1089 (b) on the premise that the Division incorrectly computed petitioner's receipts factor for the 2010 tax year and asserted the MTA surcharge for all of the years that was not previously asserted.

35. The parties have stipulated that the notice of deficiency, exclusive of interest should be modified as follows:

Tax Year Ending	December 31, 2008	December 31, 2009	December 31, 2010	TOTAL
Amount Previously Asserted	\$72,666.00	\$65,854.00	\$44,324.00	\$182,844.00
Reduction in tax	\$0.00	\$15,292.00	\$0.00	\$15,292.00
Total tax due	\$72,666.00	\$50,562.00	\$44,324.00	\$167,552.00
MTA Surcharge	\$15,660.00	\$10,897.00	\$9,553.00	\$36,110.00
Revised Deficiency				\$203,662.00

36. At the hearing, petitioner's CEO, John Tredennick, described petitioner's business model as "software as a service." He further testified that software performs the various functions that petitioner's system provides to its clients.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge first noted that, during the years at issue, a corporation reported as its franchise tax liability the highest tax as computed under four bases, one of which was the entire net income base; that a portion of such entire net income base was the corporation's business income multiplied by its BAP; and that BAP equaled New York business receipts divided by total business receipts. The Administrative Law Judge observed that the present matter involves whether petitioner properly computed its BAP. Specifically, whether the receipts at issue are properly categorized as services or other business receipts (OBR) for BAP purposes and, ultimately, whether such receipts are properly sourced to New York.

After disposing of an issue regarding the proper standard of review that was raised by the Division below but not on exception, the Administrative Law Judge rejected the Division's contention that the term services as used in Tax Law former § 210 (3) (a) (2) is limited to services performed by humans. The Administrative Law Judge found that petitioner provides a litigation support service to its customers and, as such, the receipts at issue are from services. The Administrative Law Judge also rejected the Division's argument that its regulation at 20 NYCRR 4-4.3 (a) supports its statutory interpretation. Rather, the Administrative Law Judge found that the Division's construction of the regulation impermissibly expands the statute's meaning.

The Administrative Law Judge also found wanting the Division's contention that, as the receipts at issue provide customers with access to and use of petitioner's system, they result from

the licensing of intangible assets; and that, accordingly, such receipts are properly categorized as OBR and not services. The Administrative Law Judge found that petitioner's customers purchased not merely the right to access petitioner's system, but also the use of petitioner's technical personnel to manage electronic discovery and other complex matters. The Administrative Law Judge thus concluded that petitioner was a service provider.

Having determined that petitioner performed a service, the Administrative Law Judge turned to allocation. He observed that the Division's regulations generally require that receipts from services be allocated to the place of performance. The Administrative Law Judge found that the services in question were performed in Colorado "where petitioner's servers and computer infrastructure as well as the majority of petitioner's employees are located." Alternatively, even if the receipts are considered OBR, the Administrative Law Judge found that they are properly allocated to Colorado because they are earned by activities that occur in Colorado.

Finally, the Administrative Law Judge noted that the Tax Law was amended, effective in 2015, to provide for customer sourcing of receipts for services. The Administrative Law Judge noted that such a change would have been unnecessary if Tax Law former § 210 (3) (a) (2) was properly interpreted as the Division suggests.

ARGUMENTS ON EXCEPTION

The Division contends that the proper categorization of the receipts at issue is determined by the language of the Agreements entered into between petitioner and its customers. The Division's argument rests on the principle that where a taxpayer chooses to conduct business under a particular format, such taxpayer is bound by the tax consequences of that format. The Division notes that, according to those Agreements, petitioner's customers paid the licensing fees

for the right to access and use petitioner's software system or to sublicense such access and use. The Division further notes that the receipts at issue did not include any payment for "services" as that term is defined in the Agreements. The Division thus contends that the Administrative Law Judge erroneously analyzed the issue of the proper categorization of the licensing fees from the perspective of petitioner's customers. The Division also observes that petitioner claimed a deduction under the Internal Revenue Code that, according to the Division, is not available for receipts from the provision of services. Accordingly, the Division argues that the receipts at issue are payments for intangible assets and are properly categorized for allocation purposes as OBR.

The Division also contends that the licensing fees cannot qualify as receipts from services because the meaning of the term service must be understood from the ordinary understanding of that term as of the 1944 enactment of article 9-A. According to the Division, this means that a service must be performed by a person and may not be wholly automated in order to qualify as a service for allocation purposes. As it did below, the Division contends that this construction finds support in its regulations.

The Division acknowledges that petitioner's employees created and maintain petitioner's software system, but contends that this human element does not transform the grants of access to and use of its software system into a service.

The Division contends that its position that the receipts at issue are licensing fees properly categorized as intangible assets and thus OBR is consistent with its longstanding public position with respect to similar receipts. The Division cites advisory opinions reaching that conclusion under assertedly analogous facts.

The Division notes that OBR are allocated to the location where they are earned. The Division thus contends that the receipts at issue were earned at the location of the electronic devices of petitioner's customers and end users, the means by which such customers and end users gained access to petitioner's system. Further, in the absence of evidence as to the location of the end users, the Division contends that it was reasonable to presume that access was gained at the mailing address of the customer.

Alternatively, if the receipts at issue are deemed to be services, the Division contends that such services were performed when the end users accessed petitioner's platform. The Division likens petitioner's end users with listeners of radio broadcasts or viewers of television programs, the broadcast of which are deemed to be services under the Division's regulations. Since the regulations require the allocation of receipts from such broadcasts and programs according to the number of listeners or viewers, the Division reasons that petitioner's end users, like radio listeners or television viewers, received petitioner's service when they accessed it using an electronic device. Furthermore, the Division asserts, any service was performed by the software, an intangible; hence, the Colorado location of petitioner's employees is immaterial.

With respect to the 2015 changes to the Tax Law regarding apportionment, the Division argues that the change to mandate customer-based sourcing was consistent with the long-standing purpose of the receipts factor, which was to reflect the location of a taxpayer's customers.

Petitioner asserts that, historically, and continuing through the years at issue, the apportionment of services under article 9-A was based on the place of performance of those services. Petitioner further asserts that, other than a few specific exceptions, article 9-A did not move to market-based sourcing for receipts from services until 2015.

Petitioner contends that its receipts are from services performed by its system and by its employees in Colorado, who created, operate and maintain the system. Petitioner contends that the Administrative Law Judge rightly rejected the Division's argument that the receipts at issue could not be derived from services because they were performed by machines. Petitioner asserts that the relevant statute does not restrict the service receipts category to services performed by persons. Petitioner notes that, in any event, its employees provided a human element in the generation of the receipts at issue.

Alternatively, petitioner contends that if its receipts are deemed OBR, such receipts were earned in Colorado where its employees and facilities are located. More specifically, petitioner contends that the receipts at issue were earned by hosting its customers' data and by using its system to provide customers access to the data, which is stored in Colorado. Petitioner thus contends that the receipts were properly sourced to Colorado.

Petitioner asserts that the Division's reliance on advisory opinions is not appropriate because advisory opinions are not precedential. Even if they had precedential value, petitioner claims that the cited advisory opinions are factually distinguishable from the present matter.

Petitioner dismisses as irrelevant to the present matter its deduction under the Internal Revenue Code with respect to its gross receipts derived from its customers' access to its software.

OPINION

Article 9-A of the Tax Law imposes a franchise tax on all domestic and foreign corporations doing business, employing capital, owning or leasing property, or maintaining an office in New York State (Tax Law § 209 [1]). Corporations located or doing business within

the Metropolitan Commuter Transportation District are also subject to an additional surcharge tax (Tax Law § 209-B).

During the years at issue, New York corporate taxpayers reported as their article 9-A liability the greatest amount of tax due as computed by four different methods or bases (Tax Law former § 210 [1]).¹ Of these, the present matter concerns the entire net income (ENI) base (Tax Law former § 210 [1] [a]). Under the ENI base, a taxpayer allocated its total business income to New York by multiplying such income by its BAP (*see* Tax Law former §§ 208 [8], 210 [3]). The taxpayer also allocated its investment income to New York using its investment allocation percentage (*see* Tax Law §§ 208 [8], 210 [3] [b]).² Such allocation is intended to fairly reflect the corporate taxpayer's business activity in New York (*see* 20 NYCRR 4-6.1 [a]). The total of the taxpayer's allocated business and investment income was its ENI base, which was taxed at the applicable rate (Tax Law former § 210 [1] [a]).

During the period at issue, a taxpayer's BAP was calculated using a receipts factor (Tax Law former § 210 [3] [a] [10] [A] [ii]).³ To calculate its receipts factor, a taxpayer added its receipts from sales of tangible personal property shipped to points within the state; services performed within the state; rentals from properties situated, and royalties from the use of patents or copyrights, within the state; and all OBR earned within the state (Tax Law former § 210 [3]

¹ Comprehensive corporate tax reform, effective for taxable years commencing on or after January 1, 2015, has made significant changes in the computation of liability under article 9-A (*see* L 2014, ch 59).

² Petitioner reported no investment income during the years in question. This component of the ENI base is thus not relevant here.

³ Previously, the BAP had been calculated using three factors, i.e., receipts, property and payroll (*see* Tax Law former § 210 [3] [a] [1-4]). The BAP employed in the calculation of Metropolitan Commuter Transportation District surcharge tax continued to use three factors during the years at issue (*see* Tax Law former § 209-B [2]).

[a] [2] [A-D]). The taxpayer then divided that sum by its total of such receipts from both within and without the state (*id.*).

We must first determine whether the receipts at issue are properly classified as services for BAP purposes.⁴ If not, then they are considered OBR. As noted, the receipts are the “Monthly User Access Fee” (billed as “Base Monthly License Fee”) and “Variable License Fee” from the retail price list and the “Base License Fee” and “Variable License Fees” from the wholesale price schedule (*see* finding of fact 30). These are Application Hosting fees under the Agreements (*see* finding of fact 15). As such, the receipts at issue are for a “non-exclusive, non-transferable limited right and license” to use one or more of petitioner’s Applications (*id.*). Such Applications are defined in the Agreements as one or more of petitioner’s software systems providing, among other things, document management, data sharing, collaboration, case, claim, deal and workflow facilities (*see* finding of fact 16). Payment of the Application Hosting fees, i.e., the receipts at issue, thus provided petitioner’s customers and end users with the right to access and use petitioner’s system in order to search, analyze, review and retrieve their own previously uploaded documents (*see* findings of fact 7, 8 and 9).

Petitioner does not contest that the Agreements granted its customers a license to use the system. Moreover, there is nothing in the record to suggest that the Agreements did not accurately reflect the true nature of the transactions between petitioner and its customers. That is, petitioner’s clients paid the Application Hosting fees for the right to access the system. The Agreements make clear that such fees did not include “Services” or Site Setup fees as described in the Agreements (*see* finding of fact 18 and 23). Moreover, while the operation and

⁴ The other BAP receipts categories are not relevant here.

maintenance of petitioner's system is undoubtedly labor intensive (*see* finding of fact 26), we find that the employees who operated and maintained the system provided such services to petitioner and not to its customers. Further, any services rendered by employees to customers in connection with the provision of "Services" or Site Setup are not part of the receipts at issue.

As the form of the transactions reflects their substance, we need not consider the Division's argument that a taxpayer is bound by the form of an agreement even where the form does not reflect the parties' intent (*see e.g., Matter of Christian Salvesen, Inc.*, Tax Appeals Tribunal, April 2, 1998). Rather, in accordance with the terms of the Agreements, we find that the receipts at issue were paid for a license, an intangible asset (*see e.g.,* Black's Law Dictionary 134 [9th Ed 2009]; Treas Reg [26 CFR] § 1.167 [a]-3 [a]; Treas Reg [26 CFR] 1.482-4 [b] [4]; *see also ABKCO Indus. v Apple Films*, 39 NY2d 670 [1976] [license to promote a motion picture was intangible property]).

The word "services" is not defined in Tax Law former § 210 (3) (a) (2) (B). Accordingly, we must construe this word "according to 'its ordinary and accepted meaning at the time [of enactment]'" (*Gevorkyan v Judelson*, 29 NY3d 452, 459 [2017] citing *People v Eulo*, 63 NY2d 341, 354 [1984]). Such ordinary and accepted meaning does not include the provision of an intangible asset, such as a license.⁵ We find, therefore, that the receipts at issue were not from services for purposes of Tax Law former § 210 (3) (a) (2) (B).

In reaching his contrary conclusion, the Administrative Law Judge relied on *Matter of Capitol Cablevision Sys., Inc.* (Tax Appeals Tribunal, June 9, 1988), wherein we found that

⁵ We rely on the following definition of service in Black's Law Dictionary 1491 (9th Ed 2009): "The act of doing something useful for a person or a company, usu. for a fee." We believe that this definition is consistent with the common understanding of service at the time of the enactment of article 9-A (*see* L 1944, c 415).

“classification for corporation tax purposes is to be determined by the nature of the taxpayer’s business” and that “[t]he business must be viewed in its entirety and from the perspective of its customers.” The issue in *Capitol Cablevision*, however, was whether the petitioner there was principally engaged in the conduct of a transmission business and thus subject to tax under article 9 of the Tax Law and not article 9-A. Here, the issue is the classification of a corporation’s receipts for BAP purposes and our focus is properly on the transactions that resulted in those receipts and not on the corporation’s principal business activity. We thus find *Capitol Cablevision* inapposite to the present matter.

Although we conclude that the receipts at issue were not from services, we are mindful of the sophistication of petitioner’s system. Petitioner’s CEO referred to the Applications in his testimony as “software as a service” (*see* finding of fact 36). Given the system’s capabilities, this is an apt description. However, considering that the software performs the various functions that the system provides (*id.*), and that the use of the software is, after initial set up and instruction, and excepting for other “Services,” initiated and directed by the customers, we do not find that petitioner provided a service. Rather, we find that petitioner licensed the use of a technologically advanced tool to its customers and that the receipts from those licenses are properly classified as OBR for BAP purposes.

Having found that petitioner’s receipts are properly classified as OBR, we now turn to the question of whether such receipts are properly allocable to New York. Tax Law former § 210 (3) (a) (2) (D) provides that other business receipts must be allocated to the location where they are earned (*see also* 20 NYCRR 4-4.6 [a]). This means that the location of the work that resulted in the income is the location where the receipts must be allocated (*Matter of Siemens Corp. v Tax*

Appeals Trib., 89 NY2d 1020, 1022 [1997], *rearg denied* 90 NY2d 845 [1997] [interest income, classified as OBR, properly allocated based on the location of the work that resulted in the income]). Here, we find that virtually all of the work that resulted in the receipts at issue occurred in Colorado. That is, the development, monitoring and maintenance of petitioner's system, all occur at petitioner's Colorado location (*see* findings of fact 9 through 12). Accordingly, the receipts at issue may not be allocated to New York.

We have not followed the Division's conclusions on the sourcing of receipts from digital transactions as set forth in certain advisory opinions. Specifically, in *New York Mercantile Exchange* (TSB-A-99[16]C, April 7, 1999) and *Insurance Services Office, Inc.* (TSB-A-00[15]C, September 6, 2000), the petitioners sold digital access to data. In *Deloitte & Touche LLP* (TSB-A-02[3]C, April 18, 2002), the petitioner made digital sales of gift certificates, gift cards and other related products. In *Alvarez and Marsal* (TSB-A-11[8]C, July 12, 2011), the petitioner received fees from members of an exchange to allow the member to digitally access information and also received fees on completed transactions. In all four cases, the Division determined that the petitioners' receipts were properly classified as OBR and that such receipts were properly sourced at the location of the purchasers' electronic devices.⁶

The Division acknowledges that its advisory opinions are not precedential (*see* Tax Law § 171 [Twenty-fourth]), but asserts that they are persuasive authority given the similarity between the facts in the advisories and the facts herein. We find, however, that the cited advisory opinions are not persuasive because they offer no statutory or regulatory justification for the

⁶ The Division cited a fifth advisory opinion ([unnamed] TSB-A-11[1]C, December 28, 2010) that is not relevant to the present matter on the issue of allocation because it prescribes an allocation based on rules for banking corporations under former article 32.

conclusion that receipts for digital transactions as described in the opinions are properly sourced to the customer's location; they simply assert it (*see Matter of Kane*, Tax Appeals Tribunal, January 29, 2015 [advisory opinion is unpersuasive if no reason is given for the conclusion reached therein]). Given this lack of authority for the Division's position in the advisory opinions, we are constrained to follow the holding in *Matter of Siemens Corp. v Tax Appeals Trib.*

Corporate tax reform provisions, effective for taxable years commencing on or after January 1, 2015, also support our interpretation of Tax Law former § 210 (3) (a) (2) (D) herein. Such reforms include Tax Law § 210-A (10), which generally provides for customer sourcing of OBR, and Tax Law § 210-A (4), which expressly provides for customer sourcing of receipts from digital products, such as the receipts at issue. As the Administrative Law Judge noted, it is presumed that the corporate tax reform amendments affected a material change in the law (*see Matter of Stein*, 131 AD2d 68, 72 [2d Dept 1987], citing McKinney's Cons Laws of NY, Book 1, Statutes §§ 191, 193).

The Division has failed to overcome this presumption. As noted previously, the Division contends that the 2015 changes to mandate customer-based sourcing were consistent with the long-standing purpose of the receipts factor. According to the Division, this long-standing purpose was to reflect the location of a taxpayer's customers. The memorandum in support of the corporate tax reform legislation, however, appears to reflect the contrary position, as it describes customer sourcing in contrast to the then-current sourcing rules.⁷ The Division also

⁷ The memorandum in support of the amendment states that:
"New York's current sourcing rules fail to acknowledge the shift to a service-based economy. Companies that generate significant receipts from services can incur greater tax liability if they increase their activity in New York. This reform proposal would source a business's receipts to

finds support for its long-standing purpose argument in this Tribunal's decision in *Matter of Disney Enters., Inc. & Combined Subsidiaries* (Tax Appeals Tribunal, October 13, 2005, *confirmed* 40 AD3d 49 [3d Dept 2007], *affd* 10 NY3d 392 [2008]). There, in the course of a general discussion of the three factors comprising the BAP as then in effect, we stated that "the receipts factor reflects the location of the corporation's customers." Considering that the receipts factor was not at issue in *Disney*, we think it inappropriate to elevate this dicta to dogma as the Division suggests.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is denied;
2. The determination of the Administrative Law Judge is affirmed for the reasons stated herein;
3. The petition of Catalyst Repository Systems, Inc. is granted; and
4. The August 14, 2013 notice of deficiency, as modified by stipulation of the parties (*see* finding of fact 35), is canceled.

the location of its customers. This assigns income to various states based on where the customers are located and eliminates factors that would increase tax if a company increased its activity in New York. This removes a previous disincentive to locating in New York" (2014-2015 New York State Executive Budget, Revenue Article VII Legislation, Memorandum in Support, Part A).

DATED: Albany, New York
July 24, 2019

s/ Roberta Moseley Nero
Roberta Moseley Nero
President

/s/ Dierdre K. Scozzafava
Dierdre K. Scozzafava
Commissioner

/s/ Anthony Giardina
Anthony Giardina
Commissioner