

4 KEY TAKEAWAYS

NY Sales Tax on Cloud-Based Document Management Services

On May 20th, Kilpatrick tax partner [Jeff Reed](#) presented during a New York City Bar SALT Committee meeting. Jeff discussed the recent NetVoyage New York Division of Tax Appeals sales tax determination.

Here are four key takeaways from the presentation:

1

The NY Tax Department Continues to Take the Position that Services Provided Online are Taxable as Sales of Software

The Appellant in the case provides cloud-based document management services primarily to law firms and accounting firms. Customers using the service access and upload documents to a data room. The data room is a way to centrally store and manage documents relevant to a potential acquisition, litigation, or other large project involving multiple users. The New York tax department took the position that the document management services were taxable as sales of tangible personal property / canned software. Its position was based in part on a senior accountant describing the service as software and an audit questionnaire that described the service as SaaS.

2

The ALJ's Determination Focused on Several Factors

In agreeing with the tax department that the document management services were taxable as software, the administrative law judge ("ALJ") highlighted several things. First, customers use software to facilitate the service, which makes it taxable under a prior Tax Appeals Tribunal decision. Second, the platform has tools and features that provide functionality, which distinguishes the platform from raw data processing or storage. Third, the Appellant's contracts included sections consistent with software contracts. For these reasons, the ALJ concluded that the Appellant's services were taxable as sales of software.

3

There was a Bundling Issue, Because some Non-taxable Services were Included Along with the Taxable Document Management Services

In addition to the main document management service, the Appellant also offered several optional services that the parties agreed were non-taxable services, including implementation and training. However, those services were generally not separately itemized on invoices, such that the ALJ concluded that the bundling rule applied. Per the bundling rule, when a bundle of taxable property and nontaxable services are sold together for one charge, the entire charge is taxable.

4

Apportionment of User Charges was not Permitted Based on Inadequate Documentation

Users of the Appellant's document management services were located both in New York and in other states. The Appellant argued that therefore only a portion of the document management services were taxable in New York, arguing for per-user apportionment. The New York tax department and the ALJ seemed to agree with the Appellant on this principle as a theoretical matter. However, the Appellant did not obtain statements from customers providing a breakdown of users located in NY and out of NY, and did not provide any documentation concerning customer usage at the hearing. As such, the ALJ concluded that the Appellant failed to prove that it is entitled to apportionment of its customers' fees. Therefore, 100% of the invoices at issue were taxable in NY without the benefit of apportionment.