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Title Abstracts and Public Documents Now Taxable

By: Joseph Lipari and Debra Silverman Herman

Over the past few weeks, lawyers in New York received some unpleasant news. Royal Abstract, Corporation Service Company and other title abstract and document retrieval service companies recently alerted clients that beginning September 1, 2010, New York Sales and Use Tax (“Sales Tax”)¹ will be collected on the delivery of certain title abstracts and document searches, such as good standing certificates, UCC and related lien searches, and zoning lot certifications (collectively, the “Documents”). This change was not required by any change to existing Sales Tax Law. Rather, it resulted from new administrative guidance issued by the New York Department of Taxation and Finance (the “Tax Department”) in July of this year, in the form of a Technical Services Bureau Memorandum (the “TSBM”).²

Technical Services Bureau Memoranda are regularly issued by the Tax Department to set forth its policy, often in connection with legislative changes. The TSBM was issued due to numerous unsettled questions concerning the taxation of information services. In doing so the TSBM purportedly “clarified” the Tax Department’s policy with respect to documents sold by private entities, and announced the Tax Depart-

ment’s change in policy with respect to the taxation of abstracts of title and risk management analysis reports.

What is a Taxable Information Service Under the Law and Sales Tax Regulations?

To put the issue in context, it is necessary to go over some background Sales Tax concepts. Although, in general, one thinks of the Sales Tax as applying to sales of tangible goods, the tax also applies to what are referred to as “enumerated services.” Section 1105 of the Tax Law imposes the Sales Tax on the receipts from such sales including information services³ and the furnishing of entertainment or information services delivered by telephony or telegraphy (only if the service would otherwise be taxable if it was furnished by printed, mimeographed or multigraphed matter or by duplicating written or printed matter in any other manner).⁴

The specific statutory language imposing the Sales Tax on information services provides in relevant part as follows:

The furnishing of information by printed, mimeographed or multigraphed matter or by duplicating written or printed matter in any other manner, including the services of collecting, compiling or analyzing information of any kind or nature and furnishing reports thereof to other persons . . .⁵ Examples of taxable information ser-

vices set forth in the Sales Tax Regulations include credit reports, tax or stock market advisory and analysis reports, product and marketing surveys, telephone listings and the printouts of computer searches (e.g., Lexis-Nexis database searches).⁶

An important exclusion from taxability exists for any service that “is personal or individual in nature and which is not or may not be substantially incorporated into reports furnished to other persons by the person who has collected, compiled or analyzed such information” (the “Personal and Individual Exemption”).⁷ The Sales Tax Regulations provide that a report submitted by a private detective agency to its clients and automobile insurance damage appraisals performed for insurance companies are personal and individual reports, the charge for which is not subject to Sales Tax.⁸ Information services provided exclusively orally,⁹ advertising services, and information services used by radio and television broadcasters in the dissemination of news are not subject to Sales Tax.¹⁰ Also, certain publications that constitute non-taxable periodicals and newspapers are exempt from Sales Tax.¹¹

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What is the Primary Function of the Service—Judicial Test for Information Services

The statutory phrase “furnishing of information” is sufficiently broad as to encompass an enormous number of activities. For example, letters and memoranda from lawyers to their clients clearly include the furnishing of information (at least we like to think so) but so far at least are not considered taxable. Over the years, the courts and administrative tribunals that have considered the breadth of the information services tax focus on the “primary function” of the service (the “Primary Function Test”) when determining whether any particular service is taxable as an information service.¹² For example, the New York Tax Appeals Tribunal has held that the primary function of a dating referral service is to assist individuals in finding a date, rather than the provision of information about the users of the service (e.g. favorite movie or email address). The Tax Appeals Tribunal recognized in reaching its decision that “the mere fact that information is being transferred will not create a taxable event.”¹³ The Tribunal also emphasized that the transaction should be viewed in its entirety, rather than dissected to find a taxable information service.¹⁴ Under this analysis, a lawyer’s letter to a client would be characterized as the provision of legal services rather than an information service.

In November of 2009, an Administrative Law Judge (“ALJ”)¹⁵, examined whether a service that electronically analyzed the risk of accepting a check constituted a taxable information service.¹⁶ The ALJ, applying the Primary Function Test, concluded that the primary function of the service was not to disseminate information, but rather was the provision of advice as to whether to accept a check as payment. More recently, in *Matter of Nerac, Inc.* (decided approximately one week after the Tax Department released the TSBM), a State ALJ examined whether a research and advisory firm providing technical, scientific and engineering research and tracking services was providing a tax-

able information service.¹⁷ The ALJ determined that the taxpayer was providing non-taxable consulting services¹⁸ because the service principally involved the giving of guidance and advice, based on analysis, with respect to a particular transaction.

Although the Tax Department historically applied the Primary Function Test when determining whether a service transaction is subject to Sales Tax, such analysis is notably absent from more recent rulings.¹⁹ As such, there is no clear basis for determining whether a service transaction is subject to Sales Tax.

The Memorandum—The Tax Department’s New Policy

In an attempt to bring clarity to this confused area, the newly issued TSBM broadly provides, as a general rule, that the furnishing of three types of information is a taxable information service: (1) information created or generated from a common database, or information that is widely accessible; (2) a report that uses or relies on statistical models or historical data; and, (3) gathering information from a variety of sources and recasting that information into a report (the “General Reports”). The TSBM appears to adopt the Primary Function Test, stating as follows:

Whether a service qualifies as an information service depends on its primary function. The fact that one element of a service is an information service does not mean that the service as a whole is taxable as an information service. The Tax Department will determine a service’s primary function based on an examination of the nature of the service being sold and what is being paid for by the purchaser. How the buyer subsequently uses the information purchased is not relevant to this inquiry. If a customer’s chief purpose in paying for a service is to receive information from that service, whether it is the price of a stock, the chain of ownership of real property, or *contact information for a person meeting certain qualifications*, the service as

whole qualifies as an information service. This result holds true even if the customer receives other benefits as a part of the service. (*emphasis added*)

Significantly, in the language quoted above, the Tax Department seeks to reverse the holding of the Tax Appeals Tribunal decision that establishes the Primary Function Test, by deeming “contact information for a person meeting certain qualifications” to be the primary function of the transaction, rather than the end result and true objective of the customer paying for such service—a date. The TSBM further enumerates approximately twenty-five types of services, including matching or networking services, college selection services, employment history reports, credit monitoring services, and survey results of, which it considers the “primary function” to be a taxable information service. Absent of course from this application of the “primary function” test, is any analysis of the primary function of the service itself. It seems extremely clear that the value that a college selection service provides is expertise and advice on the types of schools that would be suitable for a particular student. The fact that the service may supply the identical lists of schools to multiple students, should not recharacterize the primary nature of the transaction, and yet, under the Tax Department’s TSBM Sales Tax would be due.

Private Documents Sold By Private Entities

The application of the Sales Tax to title reports, good standing certificates, etc. is particularly unusual. On the one hand, since 2004 the Tax Department has treated the sale of public documents by private service providers as a taxable information service. As the TSBM explains, an Advisory Opinion issued to a single taxpayer (State Farm Mutual Automobile Insurance), in 2004, provided guidance to all taxpayers of the Tax Department’s interpretation of the law—namely, the Personal and Individual Exemption does not apply to information filed with a governmental agency as a

public record to which there is unlimited public access. Despite this guidance, the TSBM notes that a number of taxpayers have been relying on correspondence from the Tax Department that predates the 2004 Advisory Opinion, which expressly provides that the Tax Department would provide notification if the advice in the letter was reversed. Thus, one of the purposes of the TSBM is to notify all taxpayers that beginning on or after September 1st, 2010, sales of public records by private services providers is subject to Sales Tax.

There may very well be challenges to the Tax Department's position. The furnishing of data (including its compilation and organization) is being done by the government agency, not the title company or corporate service company. The private companies are simply arranging to pick up the information from the government and transmit it to the client. One would not think that a company that delivers newspapers or copies of printed materials from a publisher to a customer is engaged in an information service, it is engaged in a transportation service. Taxpayers considering bringing a challenge should take note that this argument, among others, was rejected by the New York Supreme Court Appellate Division when it examined whether the furnishing of New York State Department of Motor Vehicle records obtained by a private company and delivered to All State Insurance Company was a taxable information service.²⁰

Additionally, the Tax Department acknowledges that sales of public documents by governmental entities are not subject to Sales Tax by virtue of Section 1116(a)(1) of the Tax Law. However, this Section of the Sales Tax Law provides that sales by the State of New York, or any of its agencies instrumentalities, or political subdivisions, are excluded from Sales Tax only when the transaction involves services or property of a kind not ordinarily sold by private persons. If the private company is merely reselling documents it purchased from the government, it is difficult to understand how the sale of such documents to the private company is of a kind not ordinarily sold by private persons.

Abstracts of Title

The TSBM explains that to better reflect controlling judicial case law, the Tax Department is reversing its prior correspondence that indicated that sales of abstracts of title (condensed history of title to a particular piece of real estate) were not subject to Sales Tax. Therefore, on or after September 1, 2010, sales of an abstract of title to either a prospective purchaser of real property or to an attorney who uses the abstract in connection with an opinion of title are taxable information services. Notably, the TSBM concluded that a title search conducted by an attorney is exempt as the provision of legal services. While abstracts of title, do re-

flect raw data, and therefore represent the type of information the Sales Tax Law intended to be taxed as an information service, they are often used to prepare policies of title insurance. Difficult issues arise when the sale of the abstract is in connection with the sale of title insurance, since insurance is not subject to Sales Tax.

Conclusions

There may very well be challenges to the positions taken in the TSBM. Several state and local tax practitioners believe that the Tax Department's policies set forth in the TSBM (and in Advisory Opinions issued by the Tax Department over the past two years) are inconsistent with the principal test—the Primary Function Test—applied by the New York courts and administrative Tribunals when determining whether a service is a taxable information service.²¹ Nevertheless, for the foreseeable future, counsel and their clients should factor in additional closing and transactional costs with respect to their purchases of taxable Documents. Although the Tax Department should be commended for its efforts to add clarity to an area that has been gray for some time, it appears as though the TSBM raises additional legal and tax policy issues.

¹ N.Y. Tax Law §1101, et. seq. (Articles 27 and 28 of the Tax Law) the Sales and Compensating Use Tax Law [hereinafter collectively referred to as the "Sales Tax"].

² N.Y.S. Dept. of Tax'n & Fin., Office of Tax Policy Analysis, Taxpayer Guidance Division, TSB-M-10(7)S, *Sales and Compensating Use Tax Treatment of Certain Information Services*, July 19, 2010 [hereinafter the "TSBM"]. Although accurate on the date issued, subsequent changes in the law or regulations, judicial decisions, Tax Appeals decisions, or changes in Tax Department policies could affect the validity of the information set forth in the TSBM. Significantly, courts do not view Tax Department TSBMs as legal authority and afford greater weight to regulations that are promulgated in accordance with the State's Administrative Procedures Act. See *Matter of E. Randall Stuckless and Jennifer Olson*, DTA No. 819319, N.Y. Div. of Tax Appeals, Admin. Law Judge, July 8, 2004; *Matter of E. Randall Stuckless and Jennifer Olson*, DTA No. 81939, N.Y. Tax App. Trib., May 12, 2005; *Matter of E. Randall Stuckless and Jennifer Olson*, DTA No. 81939, N.Y. Tax App. Trib., Order on Motion For Reargument, Dec. 15, 2005; *Matter of E. Randall Stuckless and Jennifer Olson*, DTA No. 81939, N.Y. Tax App. Trib., Aug. 17, 2000.

³ N.Y. Tax Law §1105(c)(1). See also N.Y. Tax Law §1110(a) (imposing Use Tax on information services).

⁴ N.Y. Tax Law §1105(c)(9).

⁵ N.Y. Tax Law §1105(c)(1).

⁶ 20 N.Y.C.R.R. §527.3(a)(3).

⁷ *Id.*

⁸ 20 N.Y.C.R.R. §527.3(a)(3).

⁹ 20 N.Y.C.R.R. §527.3(b)(3).

¹⁰ N.Y. Tax Law §1105(c)(1).

¹¹ N.Y. Tax Law §1115(a)(5).

¹² *Matter of SSOV' 81 Ltd*, D/B/A People Resources, DTA No. 810966, N.Y. Tax App. Trib., Jan. 19, 1995.

¹³ *Id.*

¹⁴ *Id.*

¹⁵ Although ALJ decisions are not precedential (in contrast to Tribunal decisions), they are useful in indicating the analysis that the Tribunal or New York courts would apply upon their review of the matter.

¹⁶ *Matter of TeleCheck Services, Inc.*, DTA No. 822275, N.Y. Div. Tax App., Nov. 5, 2009.

¹⁷ *Matter of Nerac, Inc.*, DTA No. 822568, N.Y. Div. Tax App., July 28, 2009.

¹⁸ Consulting services are not subject to Sales Tax because such service is not an enumerated service under the Sales Tax Law.

¹⁹ *See e.g.*, N.Y. S. Dept. Tax'n & Fin., TSB-A-09(18)S, April 27, 2009 (involving information services). Over the past two years or so, the Tax Department has issued guidance primarily in the software context reversing conclusions reached in prior Advisory Opinions and finding a taxable sale of prewritten computer software versus a nontaxable sale of services. For example, compare the Advisory Opinion issued by the Tax Department to *Tower Innovative Learning Solutions*, TSB-A-06(5)S, Feb. 2, 2006 (concluding educational program delivered through the Internet is a nontaxable educational service), with the Advisory Opinions issued to *MindLeaders*, TSB-A-09(2)S, Jan. 21, 2009 and to *Skillsoft Corp.*, N.Y.S. Dept. Tax'n & Fin., TSB-A-09(3)S, Jan. 29, 2009 (concluding charges to use online learning materials are taxable sales of pre-written computer software).

²⁰ *Allstate Insurance Co. v. State Tax Commission*, 115 AD2d 831 (N.Y. App. Div. 1985), *aff'd* 67 NY2d 999 (1985) (ruling declaratory judgment relief is inappropriate because taxpayer did not exhaust administrative review remedies); *Matter of Hooper Holmes, Inc. v. Commissioner of Tax'n & Fin.*, 152 AD2d 871 (N.Y. App. Div. 1989)(ruling on merits that services are taxable information services).

²¹ *See, e.g.*, Michael W. McLoughlin & A. Sonali Carlson, *New York Issues Questionable Guidance On Taxation of Information Services*, State Tax Notes, Aug. 2, 2010.

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