

New York State Department of Taxation and Finance
Office of Counsel
Advisory Opinion Unit

TSB-A-10(61)S
Sales Tax
December 17, 2010

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S100817A

Petitioner [REDACTED], requests an Advisory Opinion about whether three services it provides are subject to New York State and local sales and use taxes. We conclude that Advice Service P, as described in the petition, is an information service that is subject to State and local sales and use taxes, and Petitioner must collect tax on these services beginning September 1, 2010, if they are delivered in New York State. Advice Services R and V, as described, are not services subject to sales and use taxes.

Facts

Petitioner provides advice services to its financial institution clients about the pricing of certain financial products. Petitioner seeks advice on three services, known as [REDACTED] ("Advice Service P"), [REDACTED] (Advice Service R"), and [REDACTED] ("Advice Service V").

Advice Service P

Advice Service P provides advice to financial institution clients about the proper pricing of derivatives the clients are buying or selling on their own behalf or on behalf of the clients' customers. This service increases the transparency and accuracy in pricing options. Petitioner provides pricing advice for the widest possible range of instruments and underlying assets, including those trading based on: (1) foreign currency exchange rates; (2) interest rates; (3) equities; (4) commodities and energy; and (5) credit.

Petitioner performs its function with internally-developed valuation and risk management formulas, along with an internally-developed database. Petitioner constantly updates both the valuation and risk management formulas and the database. To do the updating, Petitioner maintains a large staff of quantitative analysts who are highly trained and have extensive backgrounds in financial modeling and with financial institutions, some with as many as 15 years' experience. [REDACTED] of the analysts have PhDs in Mathematics and Physics. In addition, Petitioner employs for these tasks [REDACTED] programmers, quality assurance engineers, database administrators, information technology experts, security experts, and graphic designers. Petitioner's Research and Development Department now consists of over [REDACTED] employees, many of whom hold Master's degrees.

Petitioner uses proprietary formulas developed by its principals and others who are highly educated in mathematics, finance, and physics. Petitioner's founder, who has been the company's President and CEO since its inception, has a PhD [REDACTED] and an MBA and Master of Science [REDACTED]. Prior to founding Petitioner, he was the [REDACTED]. Together with Petitioner's Chief Technology Officer, he developed a formula that was a substantial improvement on the existing mathematical models for pricing options. That early formula was the basis for Petitioner's development of the formulas it currently uses. Thereafter, Petitioner's several formulas were further developed by its CEO and his co-founder, who has a PhD [REDACTED]. With assistance from many mathematicians, they developed

Petitioner's advice system after dedicating years and many thousands of hours of research and development, a process that has continued without interruption.

The formulas and mathematical codes are constantly enhanced in terms of asset and instrument coverage, in order to reflect the market's ever-changing needs. The quality of the mathematical code is constantly checked and confirmed against actual trades from the market, which are aggregated to a database that includes [REDACTED] trades. Formulas are constantly being remodeled and improved. At any time in recent years, Petitioner has between [REDACTED] and [REDACTED] employees with degrees in mathematics or science who are dedicated to research and development.

The formulas consist of multiple pages of algorithms that take into account numerous variables and assigned weightings. The formulas are proprietary and highly confidential. They are not disclosed to any outsiders, nor is the possession or use of the formulas ever transferred to clients.

In addition to the proprietary and confidential formulas, Petitioner has created internally, and at great expense, a proprietary and confidential database. The information contained in the database has been collected, culled, maintained, improved, and developed over many years from both proprietary and public sources and is constantly updated. The updating is monitored by more than [REDACTED] employees daily. The information is purchased/gathered, checked/cleansed/ monitored, and combined, as described below:

- Purchased/Gathered -- Information is obtained from three primary sources. For exchange-traded commodities (e.g., energy products, precious metals, agriculture), information is obtained from commodity exchanges and market data vendors. The information is updated during the trading session and when available during after-market hours. In addition, settlements are obtained daily. For commodities traded over-the-counter, data are obtained from a network of brokers for swaps, differentials, volatilities, and skews for a wide range of products (e.g., oil and refined products, natural gas). In instances when data are not contributed, Petitioner internally derives the data points. For all markets, some information is obtained from data aggregators and vendors.
- Checked/Cleansed/Monitored - Petitioner runs the collected data through its internally-developed filters and monitors. Among the validity checks are a constantly functioning escalation and alerting system. These validation tests isolate for further review data registering outside pre-defined ranges, and review the consistency of data throughout a single day and across multiple days and the relationship between data points (e.g, volatility ask should exceed the bid). Events triggering an alert include, but are not limited to: (1) data contributor's price that falls outside of the average bid-ask spread; (2) data that differ by more than an established percentage from the previous value from the same provider; (3) a bid-ask spread that increases by more than a predefined amount or volatility resulting in a "zig zag" in pricing between short and long-term tenors (ordinarily, volatility is smooth). When an alert is triggered, Petitioner's Market Data Unit, staffed with [REDACTED] professionals, analyzes the issue. This review can permit use of the entirety of data that were reviewed, disallow all or some of the data, or result in the temporary or permanent suspension of this data source and replacement with data obtained from market makers and other participants on a regular or ad hoc basis.

- Combined – Incoming data arrive throughout the day from throughout the world. Information sources include options exchanges, market makers, brokers, data vendors, and other public and private sources. When analyzing incoming market data sources and combining them with Petitioner's market data, Petitioner uses internally developed methods and algorithms. In the process of introducing new data into its filtered pool, Petitioner weights the data, taking into consideration the parameters for the data (e.g., instrument/structure, maturity, liquidity), the time of day the data were received, and a variety of other subjective and objective criteria.

Petitioner maintains a help desk 24 hours per day, six days per week, which services its clients worldwide. The help desk's staff consists of [REDACTED] trained market and derivatives specialists who assist clients with questions about everything from inputting information to interpreting Petitioner's advice.

Petitioner sells its Advice Service P to large financial institutions located throughout the world. The institutions access the system remotely through the Internet. The institutions purchase their desired number of portals, allowing that number of users access to the service. Petitioner does not provide any of its clients with any tangible personal property or possession or control over its formulas, database, or software.

The advice provided to a client is unique to the derivatives being priced by the client. Further, the advice is specific to the time that the pricing occurs, because the pricing of those derivatives is determined by Petitioner's most recently updated version of the relevant proprietary formula, which is then applied to the most recently updated version of the proprietary database. Petitioner does not and cannot incorporate the information generated for one client into reports furnished to other persons. Advice previously provided is not useful in providing current advice to a client. Company does not maintain a library of advice it has provided and does not reference advice previously provided. Moreover, the information provided Petitioner by its clients is highly confidential. Neither the information received nor the results of any advice provided are shared with another client or used in providing advice to another client.

Advice Service R

Advice Service R is provided in addition to the other advice services offered by Petitioner, but it relies on the same proprietary formulas and database described above with reference to Advice Service P. This service provides advice to financial institutions that require an independent valuation or whose existing valuations have become stale or for other reasons are doubtful. This service is available for all types of financial products, including but not limited to derivatives. To receive this service, the financial institution submits specific information about its holdings in an agreed-upon electronic format, which is uploaded onto Petitioner's servers. Petitioner's experts then prepare valuations for each financial product in the client's portfolio, and generate an output in the form of a report in the agreed-upon format, which is then transmitted electronically to the client. These experts typically have many years of experience as a senior trader or head of a trading desk in the relevant field at leading financial institutions, and generally hold advanced degrees in mathematics or physics. Because the clients typically request assistance with complex financial products, Petitioner assigns an expert with many years of experience as the individual with primary responsibility for pricing the items in the portfolio. The advice provided is unique to the institution requesting the information, is not archived in a library, and cannot be reused.

Advice Service V

Advice Service V (Market-to-Market Data) is provided in addition to the other advice services offered by Petitioner, but it relies on the same proprietary formulas and database described above with reference to Advice Service P. As is true of all Petitioner's services, Advice Service V provides risk reference data for commodities, energy, equities, foreign exchange, and interest rates derivatives – here for Petitioner's most sophisticated clients. These clients consist of financial institutions with considerable expertise in the pricing of financial products of all kinds, including derivatives. Nevertheless, they recognize the Petitioner has greater expertise in determining the volatility of the prices of financial products. The advice is provided in an agreed-upon format and is transmitted electronically to the client. Accurate volatility coefficients are essential to accurately pricing a financial product, and their determination requires a subjective analysis in addition to a quantitative analysis. To provide this service, Petitioner may require numerous communications with the client, both by telephone and through the Internet.

Both Advice Services R and V involve customization, which may occur in both the customer's desired analysis ("output") and the information Petitioner requires to conduct the analysis ("input"). The services provided by Petitioner's experts vary with the financial product to be analyzed, whether a single security, a basket of securities, options, indices, commodities, debt issuances, foreign currencies, or swaps. In the case of a structured financial product, the customization may take the following forms:

- Petitioner's experts use their extensive industry experience to develop a strategy for valuing the structured product, including analyzing the term sheet describing the product to convert a single product to component parts for valuation purposes, determine the correlation between these components, and value the structured product as a whole.
- In circumstances when the client either requires revaluation of certain assets and/or instruments or requires Petitioner to generate data when data are either insufficient or unavailable, the experts must define the gap between the required and available information and develop the required market data and/or determine the adjustments to the formulae required to compensate for the limited information.
- Petitioner's experts conduct follow-up analysis relating to the generated valuations, and for Advice Service V, the generated data. At times, this requires the experts to re-check the entire valuation and/or data generation process. More often in conducting follow-up, the experts investigate a client's challenge of some aspect of the valuation (in the case of Advice Service R) or the generated output data (in the case of Advice Service V). For example, in the case of Advice Service R this can occur when a client claims that the financial product Petitioner priced at a certain dollar value receives an entirely different valuation by the buyer or seller of that product. The expert must then make necessary inquiries to understand how the client's counterparty generated its price and explain the discrepancies in the pricing results.

Petitioner asks whether its services are subject to State and Local sales and use taxes: (1) for periods through and including August 31, 2010; and (2) for periods on and after September 1, 2010.

Analysis

We conclude that Advice Service P is an information service subject to State and local sales and use taxes for periods on and after September 1, 2010. Advice Services R and V are not within the enumerated services subject to sales and use taxes.

Tax Law section 1105(c)(1) imposes sales tax on the receipts for the service of furnishing of information by printed matter, including the services of collecting, compiling, or analyzing information of any kind or nature and furnishing reports thereof to other persons, but excluding the furnishing of information that is personal or individual in nature and that is not or may not be substantially incorporated in reports furnished to other persons. With Advice Service P, Petitioner's information is obtained from a variety of sources, both public and private. This information is compiled into a database that is used, along with Petitioner's proprietary formulas, to provide advice to clients about the pricing of financial products. The analysis and results provided to clients are based, in part, on the information aggregated and collected by Petitioner. Consequently, Advice Service P is an information service subject to sales and use taxes. *See* Tax Law §1105(c)(1); 20 NYCRR § 527.3(a)(2).

The exclusion for information that is personal or individual in nature and that is not or may not be substantially incorporated in reports furnished to other persons does not apply to Advice Service P. The first criterion (information that is personal or individual in nature) is satisfied only by information that is uniquely personal or individual in nature. *See Matter of Allstate Ins. Co. v. Tax Comm'n of the State of New York*, 115 AD2d 831, (3d Dep't 1985); *aff'd* 67 NY2d 999 (1986); *Twin Coast Newspapers, Inc. v. State Tax Commission*, 101 AD2d 977 (3d Dep't 1984). It is the source of the information that controls whether the report prepared will meet the criteria of "personal and individual." *See Matter of ADP Automotive Claims Service Inc.*, Tax Appeals Tribunal, August 8, 1991. Information is not uniquely personal or individual in nature if it comes from a common source or a data repository that itself is not confidential. *See Matter of ADP Automotive Claims Service Inc. v Tax Appeals Tribunal*, 188 AD2d 245 (3rd Dep't 1993); *Rich Products Corporation v Chu*, 132 AD2d 175 (3d Dep't 1987); *Towne-Oller & Assoc. v State Tax Comm*, 120 AD2d 873 (3d Dep't 1986); *Alan/Anthony, Inc.*, TSB-A-92(51)S. With Advice Service P, the information provided to clients comes from a common database compiled by Petitioner. Moreover, the information in the database comes, at least in part, from public sources. Therefore, the information in the databases is not personal or individual in nature.

Furthermore, Advice Service P does not satisfy the second criterion of the exclusion. The information provided to Petitioner's clients is based on the same formulas and database. Consequently, the information provided to clients by definition can be substantially incorporated in reports furnished to others. *See Matter of Rich Products, supra*; *Twin Coast Newspapers, supra*. Even when the information provided to a client is customized in some manner, the information service would still be taxable if customized information is substantially derived from a common data source maintained by the information service provider. *See Matter of Rich Products, supra*; *Matter of Towne-Oller and Associates, supra*; *Economic Cycle Research Institute, Inc.*, TSB-A-97(42)S.

Beginning on September 1, 2010, the sale of a service the primary function of which is to provide risk management analysis reports is the sale of a taxable information service. *See Sales and Compensating Use Tax Treatment of Certain Information Services*, TSB-M-10(7)S. Petitioner's services are similar to the risk management services described in TSB-M-10(7)S. With Advice Service P, in order to arrive at the proper price for a client's financial products, Petitioner must necessarily analyze the risk and volatility inherent in that product. Accordingly, Advice Service P is subject to tax beginning on September 1, 2010.

