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‘MarketShare’ Acknowledges Challenge of Distinguishing Consulting, Information Services, and Software

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For many years, we have periodically reminded readers of this column of the uncertainties encountered in deciding whether transactions in the “knowledge” industry are subject to New York sales tax, a tax that was originally designed to tax the sales of tangible personal property. Nevertheless, as the world marches into the third decade of widely available electronic resources, distinguishing among consulting services, information services, and the provision of software, and then applying the differing sales tax rules to them, becomes only more difficult. The recent administrative law judge determination in *MarketShare Partners*, DTA No. 828562 (N.Y. Div. Tax App., Dec. 3, 2020) provides a rich text for those trying to classify a business as fitting into one of these categories.

N.Y. Tax Law §1105(a) generally imposes sales tax on the sale of “tangible personal property,” which, under §1101(b)(6), includes “pre-written computer software … regardless of the medium by means of which such software is conveyed ….” Services are subject to sales tax only to the extent set forth in the statute. §§1105(c)(1) and (9) generally impose sales tax on “information services.” The law provides an exception in the case of “information which is personal or individual in nature and which is not or may not be substantially incorporated in reports furnished to other persons.” Consulting services are not specified as taxable, and, therefore, are not taxable.

In determining whether a sale constitutes an information service, the courts formulated what is referred to as the “primary function” principle. The leading case in the area, *SSOV ‘81 Ltd. d/b/a People Resources*, DTA Nos. 810966, 810967 (N.Y. Tax App. Trib., Jan. 19, 1995), concerned an operation that was referred to as a “social club,” but which was effectively a dating service. “Members” could view résumés and video recordings of other members, and invite them to meet. The Tribunal in *People Resources* held that the providing of information as part of the service did not alone cause the service to become a taxable information service. Quoting *People Resources*, the ALJ in MarketShare noted that a primary function analysis “focuses on the service in its entirety, as opposed to reviewing the service by components or by the means in which the service is effectuated,” to determine whether or not that service is subject to sales tax. The ALJ in *MarketShare* contrasted the *People Resources* decision with *Principal Connections*, DTA No. 818212 (N.Y. Tax App. Trib., Feb. 12, 2004), which concerned a rental real estate listing service. The Tribunal in *Principal Connections* determined that, even though the purpose of the service was ultimately to connect renters with apartments, the primary function of the service was to provide information (listings).

Applying the primary function principle, the ALJ in MarketShare considered the appropriate sales tax classification for three of petitioner's lines of business: (1) advertising services; (2) media company services; and (3) white paper services. (The parties agreed that a fourth line of business was the taxable sale of software.)

MarketShare's advertising services involved assisting clients with their marketing strategies. These services involved determining what information to access, gathering both client-specific and general market data, undertaking the requested analysis, and presenting the concluding "insights" to the client both live and electronically. A material component of this service was the provision of web-based software by which the client could review the analysis that MarketShare undertook and even run its own analyses. Several of the contracts even expressly stated that MarketShare was a provider of "software-as-a-service" to its clients. However, under a primary function analysis, the ALJ determined that "the information is still just one component of a larger service of providing the customer with the advice and guidance necessary to allow the customer to make the transition to analytic marketing." Specifically, the ALJ focused on the fact that MarketShare assisted the client in developing the very questions that MarketShare sought to answer; that MarketShare presented recommendations to the client; and that the relationship with the client continued after the relevant analysis had been completed.

The parties apparently stipulated that the advertising services were not the provision of software. Had the parties not agreed on that point, and had the Division of Taxation tried to make the case that the primary function of the advertising service was the provision of software, perhaps the outcome would have differed. Additionally, the ALJ noted in dicta that, although he concluded that the advertising services were consulting services, if he had instead concluded that they were information services, they would not be eligible for the personal-or-individual-in-nature exception. His determination largely relied on the recent Wegmans case, *Wegmans Food Markets v. Tax Appeals Tribunal of N.Y.*, 33 N.Y.3d 587 (2019), which disallowed the use of the exception where the relevant data was largely drawn from publicly available sources—the shelves of supermarket competitors to the petitioner in that matter, which were not personal to that petitioner.

MarketShare's media company services were essentially the same as its advertising services, except that the clients for these services were media companies serving advertisers, rather than advertisers themselves. Unsurprisingly, with an exception discussed below, the ALJ likewise concluded that the media company services were consulting services, not subject to sales tax. However, one contract at issue in the case contained a much more limited scope of work than the others, which scope was essentially to provide certain software and support. The ALJ determined that this contract was a taxable information service. Significantly, the fact that different contracts under the same line of business could result in different sales tax treatments only underscores the complexity and closeness of some of determinations on these issues.

The white paper services were the provision of reports that "provide[d] information about the effectiveness of different types of media." According to petitioner, the process for creating a white paper was essentially identical to the process of the advertising services or the media company services, except that the end product was a report rather than a presentation of insights and related provision of software. The ALJ determined that the white paper services were taxable information services (unlike the advertising services and the media company services). The ALJ stated that petitioner had not produced sufficient evidence to show that the production of the white papers contained the kind of client-specific data collection and analysis that went into the advertising services and the media company services. That this determina-

tion may have come down to an evidentiary issue is another demonstration of the closeness of decisions in this area.

In all three instances, the ALJ's determination seems to be a close call or perhaps came down to an evidentiary issue, meaning that it could have shifted given another fact or two in the other direction. Because some of the holdings in the determination may have turned on stipulated facts, or a failure to meet an evidentiary burden, future cases on similar facts could come out differently.

This lack of clarity in the law puts every company in this industry in a delicate situation. On one hand, if a company is not required to impose and collect sales tax, but because of the law's uncertainty, elects to collect tax, the company will necessarily be "overcharging" its customers. If a company's competitors decide not to charge tax, the company may lose substantial business. On the other hand, a possibly devastating decision would be a company not collecting sales tax—thinking it was not obligated to do so—only to find itself later owing an assessment covering many years of unpaid sales taxes plus interest. The taxpayer in *MarketShare* was faced with a possible liability of over $1,000,000. Moreover, since the sales tax is a "trust fund" tax, the principals of a company can be held personally liable for the tax, even if the company is organized as a corporation or LLC. See N.Y. Tax Law §§1131(1) and 1133(a)(1)(1). In addition, due to frequent changes to businesses in this industry, it may not be possible to rely on a ruling from the Department of Taxation and Finance as to whether a particular transaction is or is not subject to tax, even if one could be obtained in the first place.

For these reasons, we often refer to sales tax issues as "bet the company" cases, since the risks of being wrong are so catastrophic. Companies in these industries need to plan carefully in order to decide on the best approach.

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