

STATE OF NEW YORK
DIVISION OF TAX APPEALS

In the Matter of the Petition
of
IT WORKS MARKETING, INC.

DETERMINATION
DTA NO. 829134

for Revision of a Determination or for Refund of Sales and
Use Taxes under Articles 28 and 29 of the Tax Law for the
Period December 1, 2011 through August 31, 2014.

Petitioner, It Works Marketing, Inc., filed a petition for revision of a determination or for refund of sales and use taxes under articles 28 and 29 of the Tax Law for the period December 1, 2011 through August 31, 2014.

A hearing was commenced before James P. Connolly, Administrative Law Judge, by videoconference via CISCO webex, on January 19, 2021, and continued to conclusion on March 25, 2021, with all briefs to be submitted by July 1, 2021, which date began the six-month period for issuance of this determination. Petitioner appeared by Whiteman Osterman and Hanna, LLP (Scott D. Shimick, Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (Melanie Spaulding, Esq., of counsel). This matter was reassigned to Donna M. Gardiner, Administrative Law Judge, pursuant to the authority of section 3000.15 (f) of the Rules of Practice and Procedure of the Tax Appeals Tribunal, who renders the following determination.

ISSUES

I. Whether subscriptions to eSuite are taxable as transfers of pre-written computer software pursuant to Tax Law § 1105 (a).

II. Whether the furnishing of eSuite information reports is taxable as an information service pursuant to Tax Law § 1105 (c) (1).

FINDINGS OF FACT

The parties executed a stipulation of facts containing eight numbered paragraphs, which facts have been incorporated into the findings below.

1. On or about August 11, 2014, the Division of Taxation (Division) commenced a sales and use tax audit of petitioner, It Works Marketing, Inc.

2. Petitioner is a multilevel marketing company that sells health and beauty products to consumers on a global basis through network marketing channels. The network marketing arrangements generally consist of a company selling directly to the end customer via e-commerce and paying a commission to a distributor/independent sales agent (DIA or distributor) for referring the customer to the company. Petitioner's primary revenue is from the sale of health and beauty products.

3. DIAs recruit new customers and other DIAs. Upon enrollment, DIAs enter the It Works! Distributor Agreement (Agreement), which incorporates the It Works! United States Statement of Policies and Procedures (Policies). The Policies provide that eSuite is available to DIAs, but that the information contained therein is confidential and proprietary and is to be used solely to develop the DIAs business of selling petitioner's products.

4. DIAs receive commissions and bonuses based on their personal sales and their downline activity. DIAs recruit additional distributors to be part of their network. Each distributor directly under a DIA represents a "leg" for the DIA. The top distributor in each leg is on the first "level" of the DIA. Each generation below that first level is an additional level. Each of the legs, including all of the levels, constitutes a DIA's downline.

5. DIAs earn compensation through several key incentives. The key compensation incentives are the Fast Start bonus, the Rank and Level bonus, the Leadership Level bonus and the Diamond bonus. The quickest bonuses that DIAs can obtain are called Fast Start bonuses. A DIA that buys a business builder kit, as defined in the applicable compensation plan, enrolls two new loyal customers, and meets the minimum Bonus Volume becomes Fast Start bonus qualified. If a DIA enrolls a new distributor and that distributor becomes Fast Start qualified, the DIA receives a Fast Start bonus.

6. Bonus Volume is the assigned value of a product for the purposes of qualification and calculation of bonuses and commissions. This Bonus Volume is a value assigned by petitioner.

7. DIAs also earn Rank and Level bonuses. A commission qualified DIA earns a ten percent commission on all Bonus Volume from levels 1 and 2. To become commission qualified, a DIA needs a minimum of 80 Bonus Volume in auto shipments and at least 150 Personal Bonus Volume for the month.

8. DIAs can receive bonuses for additional levels if they reach advanced ranks. All commission qualified DIAs are at least at the level of distributor. The next level is Executive, which requires two qualified legs. Executive status provides a five percent commission on level 3 Bonus Volume. By obtaining three qualified legs and 2,000 Group Volume, a DIA reaches Ruby status, which provides the DIA with a five percent commission on level 4 Bonus Volume. Group Volume is the Personal Bonus Volume of the DIA and each of their downline distributors.

9. If two of those qualified legs are headed by Ruby or higher status distributors and the DIA has at least 5,000 Group Volume, then that DIA has reached Emerald status. This status allows for a five percent Bonus Volume on level 5 and an Emerald bonus of two percent on level 6 and lower.

10. Beyond Emerald status, DIAs can achieve the rank of Diamond and higher. This entitles DIAs to Leadership Level bonuses. To increase from Emerald status to Diamond, one of the legs must increase to an Emerald leg and the Group Volume must be at least 8,000. This Diamond status entitles DIAs to an additional category of compensation which is the Leadership Level bonus. A Diamond status DIA earns two percent on all Personal Gross Bonus Volume in the DIA's first Generation.

11. Personal Group Bonus Volume is the Personal Bonus Volume of a DIA plus the Personal Bonus Volume of every distributor through the level Diamond or higher-level distributor ends in a particular leg.

12. Personal Bonus Volume is the Bonus Volume from the DIA's personal orders and all the personally enrolled loyal and retail customers of the DIA.

13. A generation is all the distributors in the downline, stopping at the first Diamond or higher distributor in each leg.

14. As the status increases to Double Diamond, Triple Diamond, Presidential Diamond and Ambassador Diamond, the Leadership Level bonuses provide extra compensation for the second, third, fourth and fifth Generations, respectively.

15. Another important compensation incentive is the Diamond bonus. With the Diamond bonus, Diamond-level DIAs can earn up to \$150.00 for each new qualifying distributor personally enrolled by the DIA.

16. In addition to these key incentives, petitioner provides DIAs with a number of other incentives. DIAs can earn product rewards, which entitle distributors to buy products at discounted prices. DIAs can earn a rebate credit, which provides them credits for additional

product purchases. Additionally, petitioner provides short-term incentives for seasonal sales or product promotions.

17. As indicated by the above-mentioned incentives, growth and management of a DIA's downline are keys to maximizing compensation. Petitioner offers DIAs a web-based service, called eSuite, to help the DIAs in promoting product sales and downline growth and management.

18. DIAs recruit new customers, as well as other distributors, and can earn commissions on sales to their personally enrolled customers as well as the customers enrolled by their downlines and customer acquisitions. DIAs can enroll new customers and downline distributors through: (i) the company's website; (ii) the enrolling DIA's replicated website; (iii) the enrolling DIA's paid eSuite services; or (iv) through customer service.

19. There are two versions of eSuite services. The free version of eSuite is access to a web page where the DIA can place and move orders and redeem rebate credits, view news and product/promotional updates and view a snapshot of their volumes and limited performance overview.

20. The paid version of eSuite services, which is free for the first 30 days, provides the same services listed above plus it allows the DIA to enroll new customers and other DIAs and access to: (i) personalized commission reports; (ii) personalized reports detailing the DIA's downline transactions (including volume and geography); (iii) the open items necessary to reach elevated rankings; (iv) a replicated website; (v) training videos; (vi) limited messaging and calendar features; and (vii) access to a mobile application (mobile app).

21. The replicated website is retained by the DIA, even after cancellation of the paid version of eSuite and whether the cancellation occurs after the first free month or at a later time.

Thus, the replicated website essentially is part of the free version of eSuite. The limited messaging and calendar features were discontinued because they were not used by the subscribers. Additionally, the training videos are intended to be videos for beginning DIAs, as the content is geared toward the DIA's first month of being a distributor. The videos are also free and available on many channels outside of eSuite.

22. The subscription to eSuite provides DIAs with detailed confidential financial reports about their commissions and how their downline is performing as well as what is needed to achieve their next elevated ranking. The reports enable the DIAs to make informed business decisions to grow and enhance their business.

23. Revenues from sSuite subscriptions generally comprise about three percent of petitioner's annual revenues. For 2012, 2013 and 2014, the eSuite global revenues were approximately \$5.8 million, \$15 million and \$17.8 million, respectively.

24. Subscribers to eSuite are provided with a replicated website for their use as distributors. The replicated website is a reproduction of the corporate website; merely an additional page to the petitioner's website where DIAs can add their photo and a brief statement about themselves. There is no other functionality or manipulation of the website. The website is hosted by petitioner and remains under its uniform resource location (url). After the free first month of the paid version of eSuite, a DIA can cancel without having paid for the service, yet maintain the replicated website moving forward.

25. The mobile app is free to download. Use of the mobile app is restricted to paid subscribers of eSuite. The mobile app does not provide any functionality that is not available on the website.

26. The paid version of eSuite provides the ability to run 30 different personalized reports. The reports are the result of data processing and back-office services continuously performed on behalf of the DIAs. Each of the reports is run on demand based on real time information from petitioner.

27. As DIAs move up ranks from Ruby to Emerald to Diamond, their commissions grow because the commissions reach a lower level in their downline. Additionally, as the status increases from Diamond to Double Diamond, Triple Diamond, Presidential Diamond and Ambassador Diamond, the Leadership Level bonuses provide extra compensation for the first, second, third, fourth and fifth generations, respectively. DIAs can earn hundreds of dollars through Fast Start bonuses and Diamond bonuses. Using the personalized reports, a DIA can strategize placement of new orders and new distributors to maximize these incentives.

28. As set forth in finding of fact 26, the subscription to eSuite allows a DIA to generate 30 different reports. These reports will be divided into two groups for ease of reference. The first group of reports are monthly commissions reports, weekly commissions reports, volumes reports, product rewards reports, distributor by location reports, promo code reports, leads reports, retail customer reports, fast start qualification reports, perk points reports, personally enrolled team reports, promotion status reports, volume total by leg reports and Diamond bonuses reports. These reports can be run on demand by the DIAs, using data collected in real time. These reports cannot be shared, are confidential and cannot be viewed by any other DIAs. These reports do not incorporate the reports of any other DIA.

29. The next group of reports do incorporate data from other DIA reports within each report. These reports are first time rank achieved reports, genealogy reports, organization details reports, volume total by distributor reports, leadership level qualification reports, leadership level

qualification by period reports, downline activity reports, downline orders reports, downline auto-shipments reports, qualified legs by level reports, levels detail reports, steps to success reports, enhanced leadership reports, tree view reports, organization view reports and organization explorer reports.

30. Although each of the 30 reports is provided to only one DIA, some of the reports, as indicated in finding of fact 29, contain sales data of downline distributors. The reports of the downline distributors can include certain sales figures and other data that appear in the upline DIA's report. However, for these reports to incorporate the same data points, the reports would have to be generated simultaneously.

31. Because of the compensation structure, sales generated by a downline distributor have a different meaning to the downline distributor than they do to the upline DIA. Thus, some data points may be incorporated if reports are run simultaneously, but the reports themselves remain distinct. No reports are replicated or incorporated into reports of other subscribers.

32. As an example, petitioner chose a random sample of its subscribers in an effort to demonstrate any overlap in reports. Petitioner used reports of a distributor named Amy with a rank of Double Diamond and two other DIAs within her organization: Jenny, a distributor and Jacquelin who is a Ruby. The theoretical overlap between Amy and her direct distributor, Jenny was 0.8%. The theoretical overlap between Amy and her downline Ruby, Jacquelin, was 3.9%. There was no overlap between Jenny and Jacquelin.

33. The minimal degree of potential overlap appears to be a result of the horizontal nature of DIA organizations.

34. The Division's auditor was assigned to this case in August of 2014. In preparation for the audit, he sent an appointment letter with multiple enclosures that included an information

document request (IDR) to petitioner's representative along with a responsible person questionnaire and sales tax examination questionnaire. The IDR requested sales tax returns, Federal income tax returns, New York State corporation tax returns, general ledger, and sales invoices, among other information.

35. The auditor first met with petitioner's representative on October 13, 2014. At that meeting, the auditor reviewed certain documents provided and he requested additional documentation. A future meeting was scheduled for June of 2015.

36. In April of 2015, petitioner's representative contacted the auditor to explain that petitioner hired a tax manager, Ronald Kaley, who would represent petitioner through the audit process moving forward.

37. The second audit appointment took place on June 15, 2015. Documents were provided and reviewed. The auditor continued to request additional documentation that he needed. The auditor and Mr. Kaley worked together throughout the audit. There was communication back and forth through the entirety of the audit process.

38. The Division's audit focused on whether the sales of eSuite software were subject to sales tax as sales of taxable pre-written computer software. The auditor reviewed, among other things, petitioner's accounting books and records, including, but not limited to, invoices, website, product lists, exempt sales and other documentation provided by petitioner. The auditor reviewed petitioner's sales records in detail and determined that they were adequate. At no point during the audit was the auditor provided any of the 30 reports that can be generated by subscribers with the paid version of eSuite.

39. The Division issued two notices of determination to petitioner; assessment number L-047404298, dated October 27, 2017, for the sales tax quarter December 1, 2012 through

February 28, 2013, and assessment number L-047404359, dated October 27, 2017, for the period December 1, 2012 through August 31, 2014.

40. Petitioner filed a request for a conciliation conference at the Bureau of Conciliation and Mediation Services. The conciliation order, CMS No. 301175, dated October 5, 2018, cancelled assessment number L-047404298 and recomputed assessment number L-047404359. The outstanding amount of tax due pursuant to assessment number L-047404359 is now \$78,011.22, plus penalties and interest as stipulated by the parties.

41. Petitioner thereafter filed a timely petition with the Division of Tax Appeals on December 28, 2018.

42. At the hearing, the Division presented the testimony of the auditor who explained the audit. In his opinion, the auditor stated that the eSuite software was both petitioner's back office and its replicated website. The auditor explained that the back office controls all of the information and data in order for DIAs to receive their commissions and make their sales. The auditor explained that this service went well beyond just reports. He testified that his understanding of the eSuite software was that it had functionality. He explained that based upon petitioner's multilevel marketing scheme, a DIA who was not making sales to meet quota could manipulate that data by where the sales were input as well as when sales were made. The auditor noted that the software has messaging capability as well as training videos.

43. In addressing eSuite's ability to enroll new customers, the auditor testified that the paid version allows information to be entered for new customers and their DIAs. With respect to the personal commission reports, the auditor stated that a DIA can review reports of the people in their downline; detailed reports of online transactions, volume and geographies. Based on his understanding, the auditor stated that if someone below a DIA is not going to make their quota,

the DIA can take their own sale and assign it to the downline person so that it benefits that person to hit their quota and for them to make their commission.

44. With respect to its replicated website, the auditor explained that it is a website where you input your information, your name and your address and the website generates a report that allows you to determine your individual sales.

45. Petitioner presented the testimony of Jerry Ogle at the hearing. Mr. Ogle is both the Chief Financial Officer and Chief Operating Officer of petitioner. He explained the entirety of petitioner's eSuite product. He explained the difference between the free and paid versions of eSuite. He also outlined petitioner's business and explained the role of DIAs and how they attain the ranks and levels and how commissions are paid and how subscribers to eSuite use it to track their commissions and maximize productivity.

CONCLUSIONS OF LAW

A. At the outset, it is necessary to address petitioner's contention that the assessment at issue lacks a rational basis. Specifically, petitioner contends that the auditor did not have an adequate understanding of the eSuite subscription service. Petitioner argues that the auditor failed to properly investigate petitioner and the subscription service. This argument is completely without merit.

It is well settled that a presumption of correctness attaches to a properly issued statutory notice issued by the Division and the taxpayer bears the burden to prove that the assessment is incorrect (*see Matter of Hotel Depot, Inc.*, Tax Appeals Tribunal, January 24, 2020, citing *Matter of Darman Bldg. Supply Corp. v Mattox*, 106 AD3d 1150 [3d Dept 2013]; *Matter of Blodnick v New York State Tax Commn.*, 124 AD2d 437 [3d Dept 1986], *appeal dismissed* 69 NY2d 608 [1987]).

Petitioner argues that the audit lacked a rational basis because the auditor did not properly investigate nor specifically request certain documentation from petitioner, i.e., the 30 reports that subscribers to the paid version of eSuite can generate. The Division made its information document request and met with petitioner's tax director multiple times. The Division asked for documents to prove petitioner's contention that the sales at issue were of nontaxable information services. Petitioner failed to provide the personalized reports until the formal hearing in this matter. If the auditor failed to understand the scope of the eSuite subscription, the fault lies wholly upon petitioner who failed to present on audit the documentation that it provided at the hearing. Although petitioner may disagree with the Division's conclusion as to what is being sold, that does not make the Division's audit, and the subsequent issuance of the notice, irrational.

B. Tax Law § 1105 (a) imposes a sales tax on the retail sale of tangible personal property, which is defined to include pre-written computer software (*see* Tax Law §§ 1101 [b] [6]; 1105 [a]). Tax Law § 1101 (b) (14) defines pre-written computer software as software which is not "designed and developed by the author or other creator to the specifications of a specific purchaser." Tax Law § 1132 (c) creates a presumption that all receipts for property or services subject to tax under subdivisions (a) through (d) of Tax Law § 1105 are subject to tax and the burden of proving the contrary is borne by the vendor or its customer (20 NYCRR 532.4 [a] [1]; [b] [1]).

Where the service being offered is an integrated service, it is to be taxed according to its primary function (*see Matter of SSOV '81 Ltd.*, Tax Appeals Tribunal, January 19, 1995). The Tax Appeals Tribunal (Tribunal) held that: "the analysis employed by the New York courts and the Tax Appeals Tribunal 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” (*id.*, citing *Matter of Building Contrs. Assoc. v Tully*, 87 AD2d 909 [3d Dept 1982] and *Matter of Woolworth Co.*, Tax Appeals Tribunal, December 1, 1994).

Petitioner argues that the eSuite subscription does not entitle the subscriber to any of the rights and benefits that would amount to a transfer of pre-written computer software.

Additionally, petitioner asserts that a subscription to eSuite does not entitle the subscriber to any functionality that would be deemed to equate to a transfer of the software. The Division disagrees and states that the eSuite product and its accompanying mobile app allows the distributor to direct the use of the software. The Division claims that the DIAs can download contact information, can use the software to search periods and names in the various reports and can enroll customers and new distributors. The Division argues that providing distributors with access and rights to use pre-written computer software constitutes the sale of pre-written computer software which is taxable.

In this case, petitioner distributes health and beauty products through network marketing channels. Petitioner enrolls distributors who, in turn, recruit distributors in order to sell its products. The DIAs compensation plan has been fully described above and the eSuite subscription is sold to DIAs to provide them with confidential financial reports that detail their personal commissions and their personal downline performance, as well as what is needed to get to their next elevated ranking. The reports enable the DIAs to make informed business decisions to grow and enhance their business. It is determined that the primary function of the eSuite subscription is the generation of these 30 reports. Although there are some features such as the mobile app, training videos, accessibility to the replicated website and limited messaging and calendar features, these are all incidental to the subscription’s main function which is the

generation of the reports. As such, it is concluded that the sales of the eSuite service are not taxable sales of pre-written computer software.

C. The next question is whether the subscription sales are taxable sales of an information service. Tax Law § 1105 (c) imposes sales and use tax on certain enumerated services, including the service of “[t]he 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” (Tax Law § 1105 [c] [1]). That section excludes from tax the sale 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” (*id*).

As it has been determined that the primary function of the subscription was the generation of the 30 reports, these reports constitute the furnishing of information and, as such, are deemed sales of an information service. Therefore, in order for petitioner to prevail, it must establish that the individual DIA reports are excluded from tax as personal or individual in nature, the contents of which are not or cannot be substantially incorporated in reports furnished to other DIAs.

The Court of Appeals addressed the scope of the personal or individual exclusion in *Matter of Wegmans Food Mkts., Inc. v Tax Appeals Trib. of the State of N.Y.* (33 NY3d 587 [2019]). The issue in *Wegmans* was whether the personal or individual exclusion applied to RetailData’s service of collecting pricing data from rival grocery stores specified by Wegmans. The Court of Appeals upheld the decision of the Tribunal that determined that the exclusion did not apply. The Tribunal held that the information RetailData furnished to Wegmans was not personal or individual in nature because it was collected from prices on supermarket shelves,

which are publicly available, widely-accessible and not confidential (*see Matter of Wegmans Food Mkts., Inc.*, Tax Appeals Tribunal, March 10, 2016, *annulled* 155 AD3d 1352 [3d Dept 2017], *revd* 33 NY3d 587 [2019]).

In this case, the information provided by the eSuite subscription is personal to the subscriber and is confidential. Petitioner maintains all the proprietary information that is used in the reports provided to subscribers. The information reports generated for subscribers are confidential, unique and individual to the DIAs. The reports are a key component in understanding and maximizing a distributor's compensation. The information contained within these reports aid DIAs in targeting specific areas of their downline to focus on growth and sales.

In order for these information reports to be excluded from tax, it must be determined whether the contents of the reports can be substantially incorporated into the reports of others. As discussed in the findings of fact, the reports are run in real time and there is a very small percentage of overlap. However, given that the reports are tailored to the growth and sales performance of the individual DIA, it is determined that any information that is included in another DIAs report is very minimal and cannot be considered substantial within the meaning and intent of the Tax Law. As such, the information reports are excluded from tax pursuant to Tax Law § 1105 (c) (1).

D. The petition of It Works Marketing, Inc., is granted and the notice of determination, assessment number L-047404359, dated October 27, 2017 is canceled.

DATED: Albany, New York
December 30, 2021

/s/ Donna M. Gardiner
ADMINISTRATIVE LAW JUDGE