

SALT to taste

State and Local Tax Items of Interest – February 13, 2009

Distance Learning Charges Subject to Tax

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The New York State Department of Taxation and Finance recently issued an opinion stating that charges for on-line continuing education courses are subject to sales tax as a taxable software sale. While the taxpayer's course includes well-defined learning objectives mapped to certification requirements, interactive simulations and exercises, and an evaluation of whether or not the objectives were accomplished, the absence of interactive human instruction was a significant factor in concluding that the sale was a taxable software sale rather than a nontaxable distance learning course. In addition, the taxpayer provided live non-automated academic support for an additional fee which was marketed as a "mentoring" service.

In 2006, the Department came to a different conclusion when it issued a ruling to a similar service provider. In 2006, the Department held that the Internet-based distance learning course was a nontaxable service because the taxpayer provided significant non-automated academic support at no extra charge. While not directly stated, the implication is that the distance learning course recently held to be taxable may have been regarded as nontaxable if the mentoring service was provided at no additional charge.

Recommendation

In the absence of pricing, market competition and other business reasons, the obvious take-away from the recent ruling is a recommendation that mentoring and live, interactive academic support services be bundled with the charge for the "canned" educational course (i.e., priced and invoiced as one product).

This ruling appears to be one which could be challenged on the basis that the "true object" of the transaction is an educational course for the purpose of certification and not a software sale. If the true object of the transaction is a nontaxable learning course, the fact that it is provided through software arguably does not change the underlying nature of the transaction.

A true object position could be supported by an analysis of the underlying contract wherein the service is characterized as an education certification course rather than a sale of software. The contract could state that the course is not a license or sale of software; a fact which could be emphasized by avoiding open licenses which allow re-use of the educational course by the same individual in favor of contracts allowing one-time access to the course material.

The Dow Lohnes Difference

We understand that price barriers, competitors' practices and other legitimate business reasons could outweigh the tax benefit achieved through bundling, resulting in a less-than-optimal choice between lower taxes and compromised operational strategies. In addition, the Department has not clearly defined how much interaction is needed in order to achieve a nontaxable position, leaving educational institutions at risk for changes in administrative policy or other developments beyond the taxpayer's control.

Dow Lohnes PLLC has many trade association contacts and a large education client base which could potentially be leveraged to retract the ruling or obtain further clarification from the Department in an effort to minimize application of the ruling. This industry-based knowledge, when combined with the sales tax expertise of Dow Lohnes Price Tax Consulting Group LLC, provides maximum leverage to our education clients. Please contact Michael Goldstein to discuss what actions may be taken on behalf of the industry or your institution.

Taxation of Electronic Libraries

Our next issue of *SALT to taste* will focus on the impact of the New York ruling on the taxability of electronic library services. If you received this newsletter courtesy of a friend or associate, we encourage you to contact us directly to be added to our distribution list so you won't miss the upcoming edition of interest to educational institutions.

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