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In this installment of The Endres Assessment, the authors discuss the unique sales tax compliance challenges facing the art industry in the post-*Wayfair* era and its broadened nexus standards.

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News that Christie's auction house in April agreed to pay $16.7 million to settle a New York sales tax investigation by the Manhattan district attorney likely sent a shudder through the world of art dealers doing business in New York state. We've previously written in these pages about New York's increased enforcement efforts regarding sales of art and luxury goods.[1] The Christie's case is yet another example of the unique sales tax compliance challenges facing the art industry in the post-*Wayfair* era and its broadened nexus standards.

In another less flashy development affecting the art industry (and potentially any other retailer in New York that ships goods), New York's Appellate Division in March issued a new decision attempting to define what qualifies as a "common carrier" as opposed to a "contract carrier" for sales tax purposes. This issue, which factored in another sales tax enforcement action in 2016 involving the prominent Gagosian Gallery, has long presented a problem for art dealers in determining the place of sale or "delivery" for sales tax purposes. We'll cover both of these developments in this article and review some lessons learned from each.

Christie's Conundrum

A Question of Nexus

The sales tax issue in Christie's case centered on nexus. According to documents released by the district attorney's office, several of the auction house's affiliated overseas entities failed to collect New York tax on sales made by those entities but delivered to New York. The $16.7 million represents sales tax, plus interest and penalties, that allegedly went uncollected between 2013 and 2017.[2] The transactions involved two divisions of Christie's: a U.K.-based entity that handled all the auction house's private sales, and various other overseas affiliates making sales under the Christie's tradename. In both cases, the DA

[1] Timothy P. Noonan and Joshua K. Lawrence, "The Art of Taxing Luxury Items in New York," *State Tax Notes*, July 9, 2018, p. 143.

[2] The payment is part of a deferred prosecution agreement, suspending any potential criminal prosecution in exchange for the payment and internal changes on the part of Christie's to ensure future compliance.

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asserted that the entities had established nexus with New York but failed to register and collect tax. The case offers interesting lessons on the role and importance of seeking outside tax guidance, but we will stick to the nexus and compliance issues here.

The DA's case did not involve Christie's New York-based operations — just overseas affiliates. Before 2013, private sales (that is, sales directly between an owner and a buyer, rather than at auction) were facilitated by individual affiliates. In 2013 Christie's consolidated all private sales activity so that all such sales would be invoiced by the U.K.-based Christie's Private Sales Ltd. But according to the DA's papers, Christie's global network of entities and personnel continued to participate in connecting buyers and sellers for private sales. For example, personnel from Christie's London affiliate and the New York City-based Christie's Inc. might collaborate to connect a London seller to a New York buyer. The sale would be invoiced by Christie's Private Sales regardless of where the deal was negotiated or who was involved. This even included sales at "pop-up" retail stores in New York. Yet, based on some internal (and later external) tax guidance, the U.K. entity did not register in New York or collect tax on sales to New York buyers.

Once this stance was questioned internally, an internal directive was issued in 2015 to begin collecting New York tax. However, rather than registering the U.K. entity at that point, the decision was made to collect sales tax, but run the collected tax through Christie's Inc. (the New York-based entity, which was already registered), even though the sales were made by the U.K. entity. The purpose, according to the DA, was to avoid opening the U.K. entity to a New York sales tax audit — which could be triggered by registering two years after sales had commenced.

In addition to the "U.K." private sales, the DA's case more generally involved sales made by Christie's foreign affiliates operating in nine different countries — none of which were registered to collect tax in New York during the period covered by the investigation. As alleged, the New York-based Christie's Inc. engaged in activities in New York that assisted the affiliates in maintaining their market in the state, including: referring customers to them, actual face-to-face solicitation of customers on behalf of the affiliates, and distributing catalogs and advertising on their behalf. With such assistance, the DA alleged, the foreign affiliates made roughly $189 million in New York sales between 2013 and 2017 on which they should have collected New York tax.

Lessons Learned

The nexus issues raised in the Christie's case have to some extent been eclipsed in relevance by the widespread adoption of economic nexus laws, including in New York, in the wake of the U.S. Supreme Court's 2018 decision in *South Dakota v. Wayfair*. For high-end dealers like Christie's, the sale of a single painting can create sales tax nexus under many states' new economic thresholds. But the case sheds light on the concept of "affiliate nexus" laws — a pre-*Wayfair* vehicle for reaching remote sellers — and confirms that New York for one has been active in continuing to enforce those rules.

In 2010 New York expanded its definition of a vendor so that an out-of-state entity that otherwise lacked any physical presence in the state could nonetheless be obligated to collect tax if it was affiliated with an *in-state* vendor that assisted in establishing and maintaining a market for the out-of-state entity's goods.[3] The threshold for "affiliation" is low under the statute (requiring only 5 percent of overlapping ownership between the entities themselves or their owners); and the "assistance provided by the in-state affiliate" can come in two forms: (1) the in-state entity uses the same "trademarks, service marks or trade names" as the out-of-state entity; or (2) the in-state entity "engages in activities in the state that inure to the benefit of the seller, in its development or maintenance of a market for its goods or services in the state."

Under this rubric, the overseas Christie's entities clearly met both prongs based on the DA's findings. First, all the entities involved operated under the "Christie's" trademark (owned by the New York-based Christie's Inc.). Secondly, according to the DA, all the entities benefited from Christie's Inc.'s activities in New York to "promote the development of a market for [the

[3] *See* N.Y. Tax Law section 1101(b)(8)(i)(I).

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foreign affiliates'] products or services in New York" (including referrals, solicitation and distribution of catalogs and advertising). More directly, and even without the "affiliate nexus" net, Christie's Private Sales Ltd. likely established nexus directly by virtue of sales at pop-up stores in New York.

Affiliate nexus laws like New York's were designed in part to address the (obviously pre-*Wayfair*) situation in which a brick-and-mortar business with clear physical presence and nexus could set up a dot-com operation outside the state and claim no obligation to collect tax on in-state sales by claiming no physical presence in the state. And with separate legal entities generally being respected as separate for nexus and other sales tax purposes, such a structure generally could work, unless the in-state entity clearly assisted in the out-of-state entity's sales activities (including soliciting sales, accepting product returns, and so forth).[4] In Christie's case, sufficient promotion and assistance by Christie's Inc. — as well as actual sales in New York as in the case of the pop-up stores — was deemed sufficient to create an obligation for the numerous foreign entities involved.

The Christie's case should serve as a cautionary tale in two respects. First, cases for which an argument can be made for purposeful tax evasion could end up with a criminal prosecution by the DA rather than a simple civil audit by the state Department of Taxation and Finance. New York state seems to be aggressively pursuing high-profile cases in which the taxpayer allegedly knowingly avoided its sales tax obligations.[5] Second, with the tax world so focused on the shift in the nexus rules caused by the *Wayfair* decision, practitioners shouldn't forget about the older nexus laws still on the books in most jurisdictions (affiliate nexus laws and click-through nexus laws).[6] If a taxpayer is planning on using a lack of nexus as a defense for noncompliance, the business has to also take into consideration these older nexus laws.

New York's Common Carrier Conundrum

It may lack the flash of an international auction house getting slapped with a multimillion-dollar tax bill, but a decision in March by New York's Appellate Division also has implications for art dealers and others who ship products from New York. *Matter of Dex Media v. Tax Appeals Tribunal*[7] reaffirmed the definition of what constitutes a "common carrier" for sales tax purposes — a question whose implications affect whether items shipped from New York to customers out of state, including valuable artwork, are in fact "delivered" in New York.

The Appellate Division held that some companies specializing in delivering Yellow Book phone directories for their publishers were not common carriers for sales tax purposes, but rather "contract carriers". This holding came as no surprise; the Appellate Division actually held the same position 10 years ago in *Matter of Yellow Book of N.Y. Inc. v. Commissioner of Taxation and Finance*.[8] But even now, with a second Appellate Division decision, the common carrier issue still represents a significant gray area for businesses in New York that ship goods out of state.

Common vs. Contract Carrier: Why Does It Matter?

New York's sales tax is a "destination tax," meaning that "[t]he point of delivery or point at which possession is transferred by the vendor to the purchaser, or the purchaser's designee," controls the taxability (that is, in which jurisdiction the sale occurs for sales tax purposes).[9] Simply put, it's physical delivery (not where title passes) that controls whether a sale is taxable in New York, and if so, at what rate.[10] New York's regulations stop short, however, when defining what constitutes "delivery" or a "transfer of possession" to the customer — particularly when the product is being shipped. Moreover, practical guidance on determining "place of delivery" is basically confined to a few

[4] *See, e.g.*, *Borders Online v. State Board of Equalization*, 129 Cal. App. 4th 1179 (1st Dist. 2005).

[5] *See, e.g.*, the complaint filed by the attorney general of the state of New York against B&H Foto & Electronics Corp.

[6] *See* N.Y. Tax Law sections 1101(b)(8)(i)(I) and 1101(b)(8)(vi).

[7] 180 A.D. 3d 1281 (3d Dep't 2020).

[8] 75 A.D. 3d 931 (3d Dep't 2010).

[9] 20 NYCRR section 525.2(a)(3).

[10] *See* 20 NYCRR section 526.7(e)(2). Different localities within New York impose different sales tax rates.

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advisory opinions from the Department of Taxation and Finance.[11]

For example, in *Crowe, Chizek & Co. LLC*,[12] the tax department explained that the place of delivery on purchased goods shipped from New York state depends on: (1) who hires the carrier (that is, the vendor or the purchaser); and (2) what type of carrier the goods are released to (that is, a common carrier or a "private" or contract carrier). According to the opinion, if the *vendor* arranges for and hires the carrier, the delivery occurs where the purchase is ultimately shipped (and if that's outside New York, then no New York tax is due).[13] This is true regardless of what type of carrier (common or contract) is hired. Things change, though, if the *purchaser* hires the shipper. In that case, according to the opinion, whether the delivery occurs in New York or not depends on the type of carrier hired. If the purchaser hires a *common carrier* (or a freight forwarder for international deliveries), the delivery occurs at the destination to which the material is ultimately shipped. But if the customer hires a *contract* or *private* carrier, the delivery occurs wherever the carrier picks up the property. If that's in New York, the delivery is then deemed to have occurred in New York to the purchaser's "agent" or "designee," and New York sales tax applies.

It may all sound nuanced and academic, but in our practice, we routinely witness the real-world problems this common-versus-contract carrier rule presents for New York-based businesses. The art industry is a prime example. Art galleries and auction houses have been grappling with New York's delivery rules for years, with the tax department taking the position, effectively, that any artwork sold in New York is *delivered* in New York for sales tax purposes if the purchaser arranges shipping. That is because the department (albeit not in any published guidance) has effectively adopted a position that all specialized art shippers are, by nature, contract carriers; and thus, anytime artwork is released to one in New York, the customer's agent or designee has taken possession in New York for sales tax purposes regardless of shipping destination.

In fact, the tax department's enforcement of that position was the impetus for a $4.2 million settlement paid by the prominent Gagosian Gallery in 2016 following an investigation by the New York attorney general's office.[14] According to the attorney general's statement at the time, the gallery had "sold and shipped" nearly $40 million in art that was technically "delivered" in New York even though it was shipped out of state: "When it turned over art to shipping companies that were not common carriers like UPS, FedEx or the U.S. Postal Service, but rather were contract carriers acting as the purchasers' agents, Gagosian should have collected and remitted sales tax."[15] We've seen the same approach taken by the department in other industries as well, including the sale and shipping of rare wines.

Common vs. Contract Carrier: What's the Difference?

Enter the *Dex Media* decision. Despite the implications of this issue, the only authority focused on the common-versus-contract carrier issue for *sales tax* purposes comes from a series of decisions on Yellow Book delivery companies — of which *Dex* is the most recent. The state tax law does not define common or contract carriers, nor do the sales and use tax regulations. The problem is that the common carrier definition emerging from the Yellow Book decisions provides little in the way of practical guidance. As the Appellate Division framed it:

> [T]he fundamental difference between a common carrier, like [the U.S. Postal Service] and a contract carrier is that the common carrier holds itself out to the public as a carrier, in such a manner as to incur liability if it were to refuse to carry for any individual who chose to employ its

[11] *See Crowe, Chizek & Co.*, TSB-A-08(53)S (Dec. 15, 2008); *see also Norman Levy Associates Inc.*, TSB-A-96(23)S (Apr. 22, 1996).

[12] TSB-A-08(53)S (Dec. 15, 2008).

[13] According to the opinion, this is true regardless of whether the purchaser may have "the option of determining the method (e.g., air ground, etc.) and urgency (e.g., overnight, weekends, regular, etc.) of delivery," or whether the vendor's shipping cost is passed through and included in the customer's sale price.

[14] *See* N.Y. State Office of the Attorney General, press release, "A.G. Schneiderman Announces $4.28 Million Settlement With International Art Dealer Gagosian Gallery for Failure to Collect and Remit New York Sales Tax" (July 19, 2016).

[15] *Id.*

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services. By contrast, a private or contract carrier is one that carries for some particular person under some particular arrangement, but makes no public profession that it will carry for all who apply, nor is it required to.[16]

This is the identical construct the Appellate Division stated 10 years earlier in *Matter of Yellow Book of N.Y. Inc. v. Commissioner of Taxation and Finance*, a case involving the same issue (and even one of the same delivery companies). The characterization is drawn from a body of common law on common carriers dating as far back as the late 1800s — mostly dealing with insurance and liability issues and having little to do with tax. Interestingly, just five years earlier, a New York administrative law judge in *Matter of Verizon Yellow Pages Co.*[17] had applied the same body of law to find some of the same Yellow Book delivery companies *did qualify* as common carriers.

The judge noted that "[t]he test of a common carrier is whether he holds himself out, either expressly or by a course of conduct, to carry persons or property for hire, so long as he has room, for all that may see fit to employ him, indifferently."[18] Even though the phone book delivery companies specialized in a product and worked under negotiated terms, that didn't negate the fact that they advertised and held themselves as open to carry that product for anyone who sought to hire them.

The tax department itself attempted to define more clearly the common-versus-contract distinction in 2015 by issuing its own (now retracted) guidance. In a sales tax bulletin called "Delivery Rules for New York Sales Tax,"[19] the department reiterated the common-versus-contract-carrier rule from *Crowe, Chizek* and previous advisory opinions and provided a definition of a common carrier, as one that:

- holds itself out to the public as one who will agree to carry (transport) personal property for all who apply;
- is required to carry for all who apply;
- agrees to carry for a specified standard rate of compensation; and
- makes deliveries under standard schedules.

While some of these criteria look familiar — reflecting the Yellow Book cases and the common law on which they relied — some do not. For example, neither *Dex Media* nor *Yellow Book of N.Y.* noted that a carrier must charge a "specified standard rate of compensation." In fact, in *Jackson Architectural Iron Works v. Hurlbut*[20] — one of the earliest authorities cited in the Yellow Book cases — the New York Court of Appeals stated not only that a common carrier can restrict its business to carrying a specific class of goods, but also that it is not bound to charge a standard tariff or fee.[21] Moreover, courts have noted that "the absence of regular schedules of operation or of definite terminals does not necessarily take a carrier out of the classification of a common carrier."[22]

This brings us back to specialized art shippers. New York has made its view clear that those shippers are not "like" FedEx, UPS, and the Postal Service and therefore must be the agent of whoever hires them. Many New York-based galleries and auction houses have wisely already shifted their shipping practices to address the issue — either by requiring all shipping to be arranged by the gallery or charging New York tax to any buyers arranging their own shipping. But without a statutory definition of common-versus-contract carriers, and with only *Dex Media* and its predecessors to rely on for the distinction, we're still not sure whether New York's one-size-fits-all position regarding art shippers is justified.

[16] *Matter of Dex Media*, 180 A.D. 3d 1281, citing *Matter of Yellow Book of N.Y. Inc. v. Commissioner of Taxation and Finance*, 75 AD3d 931 (3d Dep't 2010) (citing *Matter of Motor Haulage Co. v. Maltbie*, 293 NY 338, 354 (1944); *Stevenson & Co. v. Hartman*, 231 NY 378, 381 (1921); *Anderson v. Fidelity & Casualty Co. of New York*, 228 NY 475, 481 (1920); and *Allen v. Sackrider*, 37 NY at 342).

[17] Admin. Law Judge Determination (Apr. 7, 2005).

[18] *Matter of Verizon Yellow Pages Co.* (citing *Gerard & Hey v. Cattaraugus Tanning Co.*, 241 NY 413 [1926]).

[19] TB-ST-155 (Aug. 6, 2015).

[20] 158 N.Y. 34 (1899).

[21] According to the court, "The circumstance that the defendants had no regular tariff of charges for their work, but that a special price was fixed by agreement, does not change the [common carrier] relation. The necessity for a different charge in each case arises, of course, out of the difference in labor in handling articles of great bulk. The charge in each case may be proportioned to the risk assumed and commensurate with the carrier's responsibility as such." 158 NY at 37-38.

[22] *Olive Kent Park v. Moshassuck Transportation Co.*, 189 Misc. 864, 869 *aff'd* 274 AD 765 (1st Dep't 1948) (citing *Fidelity & Casualty Co. of N.Y.*, 228 NY 475).

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Conclusion

Art dealers and galleries must pay close attention to their sales tax compliance, especially in New York state. One sale of highly valuable art can create nexus under many state *Wayfair* rules. While this is not true in New York,[23] the Empire State has arguably the most aggressive slate of older nexus laws, including affiliate and click-through nexus rules that art vendors need to consider. New York also has perhaps the most confusing rules regarding the shipment of goods. And with the recent spate of criminal investigations, the stakes could not be higher. It has never been more important to have a purposeful and efficacious structure for completing sales of artwork. ■

[23] New York's economic nexus rule requires that both the dollar threshold ($500,000) and the transaction threshold (100 transactions) must be satisfied.

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