NY Tax Minutes: Marketplace Sales Tax, Corp. Franchise Regs

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As we finalize this month’s column, it appears that budget season here in New York state has finally come to a close, with the governor and Legislature agreeing, on March 31, 2019, to a new $175 billion budget. The agreement came one day before the deadline for an on-time budget in order to meet the state’s next fiscal year, which begins April 1. In a March 31, 2019 press release,[1] Gov. Andrew Cuomo, Senate Majority Leader Andrea Stewart-Cousins and Assembly Speaker Carl Heastie announced a plan that includes:

- The passage of a permanent 2 percent property tax cap;
- The installation of electronic tolling devices on the perimeter of New York City’s “Central Business District,” defined as streets south of 60th Street in Manhattan;
- A progressive mansion tax on sales of residential properties valued at $25 million or above; and
- A new “consistent framework for the collection of required sales taxes by internet marketplace providers.”

Some other high profile proposals appear to have missed the cut, including:

- The state’s proposed new Cannabis Regulation and Taxation Act;[2] and
- A pied-a-terre tax on non-primary residence properties valued at $5 million or more.[3]

State politicians were still finalizing the budget details as we turned the calendar to April, so we'll have a complete recap of the tax provisions from the final budget in next month's column. This month, we discuss the New York State Department of Taxation and Finance's (premature?) decision to treat online marketplace providers as sales and use tax vendors; we review the Court of Appeals decision to dismiss a challenge to the state's resident credit provisions; and we outline the state's new draft corporation franchise tax regulations for domestic international sales corporations, or DISCs, real estate investment trusts, or REITs, and regulated investment companies, or RICs.

The Headlines

New York State Tax Department Classifies Online Marketplace Provider as Sales Tax Vendor

While we await the final details on the budget's new "consistent framework for the collection of required sales taxes by internet marketplace providers," it appears that the Tax Department may have already jumped the gun.

On March 7, 2019, the department issued a new sales and use tax advisory opinion,[4] stating that it is currently "within the discretion of the [c]ommissioner of [t]axation and [f]inance" to treat an online marketplace as a co-vendor of the independent software vendors operating on the market. The ruling goes on to treat the marketplace jointly liable for the necessary sales tax collection.

Like many marketplace providers, the petitioner in the state's advisory opinion, handled customer payments and delivery for all sales taking place on the marketplace. The marketplace provider then took a commission from each sale as consideration for its services. In this case, the petitioner also already calculated the appropriate amount of sales tax due on each transaction and remitted the tax directly to the department.

New York state's tax law requires certain "vendors" to collect and remit sales tax on taxable transactions. Included within the state's "vendor" definitions is a provision providing that:

... when in the opinion of the commissioner it is necessary for the efficient administration of this article to treat any salesman, representative, peddler or canvasser as the agent of the vendor, distributor, supervisor or employer ... for whom he solicits business, the commissioner may, in his discretion, treat such agent as the vendor jointly responsible with his principal, distributor, supervisor or employer for the collection and payment over of the tax.[5]

According to the state's new advisory opinion, "[t]his provision permits the [d]epartment to treat as vendors intermediaries that perform key acts in facilitating taxable sales by vendors."

The opinion goes on to note that treating the marketplace provider as a co-vendor in this instance both (1) relieves the independent software vendors of the need to register to collect tax and file returns, so long as the marketplace is complying with its duties as a vendor, thereby "reducing the administrative burden" on those vendors; and (2) improves the efficiency of sales tax administration, since the marketplace is already collecting the selling price from the customer, and "sales tax is to be collected when the sales price is collected."

As noted in our introduction, it appears that the state's new budget will finally adopt the governor's proposal to require marketplace providers to collect tax on certain sales that they facilitate (the governor's proposal failed to make it into the state's prior two fiscal year budgets). This means that the department's new advisory opinion may end up having a limited impact on tax policy.

But TSB-A-19(1)S is nevertheless an abrupt shift in the Tax Department's treatment of online marketplaces. In a footnote, the department acknowledges that its conclusion is "inconsistent with the outcome in TSB-A-99(49)S." Accordingly, "[t]hat [a]dvisory [o]pinion no longer reflects the [d]epartment's policy and should no longer be followed." This acknowledgement will hopefully prevent any overzealous auditors from attempting to assert sales tax liabilities on marketplace providers prior to the issuance of the state's advisory opinion.

A somewhat more troubling question, however, is why, with pending legislation, did the Tax Department feel it necessary to make such a sweeping change in its enforcement policy? No one is served by administrative fiat, and TSB-A-19(1)S appears to cause confusion and uncertainty at the exact time when the Legislature was working to enact new laws that would apply equally to all taxpayers. With it currently taking upward of two years for the department to issue its advisory opinions, we might have waiting another few weeks before releasing this one.

The Cases

Each month, we highlight new and noteworthy cases from New York State's Division of Tax Appeals and Tax Appeals Tribunal, along with any other cases involving New York taxes. This month, we highlight a Division of Tax Appeals ruling addressing the broker-dealer sourcing rules under the state's corporate franchise tax and also cover a New York State Appellate Division decision, which found that a taxpayer failed to meet his burden of proof in showing that he spent less than the requisite 183 days within New York state for purposes of the state's statutory residency test.

Division of Tax Appeals Rules That Investment Adviser Cannot Use Broker-Dealer Income Sourcing Rules

In Matter of BTG Pactual NY Corporation,[6] the Division of Tax Appeals addressed whether a New York corporation, which was the sole member of two single member limited liability companies, could use the broker-dealer customer-based sourcing rules when computing its business allocation percentage under the state's Article 9-A corporation franchise tax. The issue for the taxpayer was that only one of the two single member LLCs qualified as a registered broker-dealer, whereas the second LLC was registered as an investment adviser.

During the tax years at issue (2012 and 2013), former Section 210(3)(a)(9) of the tax law[7] allowed for customer-based sourcing of certain broker-dealer receipts, including brokerage commissions, margin interest, underwriting revenues, interest on certain loans to affiliated entities, account maintenance fees, and fees for management and advisory services. Other, non-broker-dealer, service providers were required to source their receipts based on the location where the actual services were performed (this changed in 2015 when the state switched to market-based sourcing for service receipts).

The petitioner's theory in Matter of BTG Pactual NY Corporation was that, as the sole member of two single-member LLCs, both of which were disregarded and deemed divisions under federal check-the-box regulations,[8] the petitioner became a deemed registered broker-dealer (since one of the LLCs was a broker-dealer) and could therefore use the broker-dealer sourcing rules for income from both LLCs.

There was no dispute in the case that as the sole member of the broker-dealer LLC, the petitioner properly sourced its receipts from that LLC using the broker-dealer sourcing rules. With regard to the non-broker-dealer LLC, however, the administrative law judge, or ALJ, held that the broker-dealer LLC's "status as a registered broker dealer cannot carryover to the non-broker-dealer receipts."

"Stated simply," the ALJ continued, "a disregarded entity that is not a registered broker-dealer is not disregarded under the check-the-box regulations in determining where its receipts are sourced for New York State franchise tax purposes." The ALJ's determination appears to match the Tax Department's recent informational guidance issued in NYT-G-17(2)C,[9] which, according to the ALJ, was issued after the petitioner's request for a hearing with the Division of Tax Appeals.

Affidavits Fail to Prove Taxpayer Spent Less Than 183 Days in New York

In Matter of Ruderman v. Tax Appeals Tribunal,[10] the Appellate Division, Third Department upheld a Tax Appeals Tribunal ruling, which found that a Florida domiciliary had failed to meet his evidentiary burden of establishing that he was not a statutory resident of New York for tax year 2007.

The taxpayer qualified as a Florida domiciliary, but, as an executive in the magazine publishing industry, he was required to make frequent trips between Florida and New York, while also maintaining an apartment in the state. Under New York state's Tax Law, anyone not domiciled in the state but who maintains a permanent place of abode and spends in excess of 183, full or part, days in the state, is deemed to qualify as a statutory resident.[11] And the state's "statutory residency" test mandates that taxpayers bear the burden of proof to show that they were not present in the state for more than 183 days.

The taxpayer in Ruderman failed to provide any documentary sources or diaries to substantiate his whereabouts during the tax year in question (not our recommendation for statutory residency audits; more on that below). Instead, he offered his own testimony and the affidavits of eight others in an attempt to show that many of the days attributed to him being in New York were based on evidence of purchases that were, in fact, made with credit cards that he had provided to family members and other individuals who were authorized to use them.

But according to the court, the affidavits suffered from “a general lack of detail,” and “in some instances, contradicted petitioner’s own testimony as to when he was purportedly in Florida.” Thus, despite the tribunal finding that the petitioner’s testimony was “forthright and honest,” the proof wasn’t there to show that the taxpayer was in New York for less than 183 days.

The Ruderman case underscores the importance of third-party documentation in statutory residency audits and appeals. The most common (and helpful) pieces of evidence usually come in the form of cellular call location records, travel records, credit card statements or third-party tracking data offered by companies such as Monaeo. Auditors, and the Division of Tax Appeals, will also often look for multiple sources of data to confirm a taxpayer’s location. And while there is no legal requirement to keep any one specific type of record, it’s clear from the Ruderman decision that general affidavits may not win the day.

Other Guidance

New York Proposes Revisions to Corporate Franchise Tax Regulations

In earlier columns, we’ve complemented the Tax Department for issuing detailed draft regulations expanding on the state’s 2015 corporate tax reforms. That trend continued this month with the state’s release of two new sets of proposed regulations — one for domestic international sales corporations, or DISCs,[12] and another for real estate investment trusts, or REITs, and regulated investment companies, or RICs[13]

The new DISC regulations would fall under a new 20 NYCRR 3-10.1, et. seq. The regulations first distinguish between “taxable DISCs” and “tax exempt DISCs.” According to the proposed new rules, a tax-exempt DISC is a DISC that:

1. Receives more than 5 percent of its gross receipts from the sale of inventory or other property that it purchased from its stockholders;

2. Receives more than 5 percent of its gross rentals from the rental of property that it purchased or leased from its stockholders; or

3. Receives more than 5 percent of its total receipts other than from sales or rentals from its stockholders.

A taxable DISC is any DISC that does not meet the requirements for exemption.

A tax exempt DISC has no filing requirement under Article 9-A, but its corporate stockholders may have filing requirements, and the proposed regulations lay out the filing requirements for stockholders of tax-exempt DISCs. Under the new rules, most distributions from a DISC are to be treated as business income, unless (1) the distributions come out of "other earnings and profits" under Internal Revenue Code Section 996 and (2) the stock of the DISC meets the state's definition of "investment capital." These distributions qualify as investment income. Finally, the new DISC regulations discuss combined and unitary reporting and the rules for treatment of DISC earnings and profits.

The new REIT and RIC regulations would fall under 20 NYCRR 3-11.1, et. seq. The regulations explain that any REITs or RICs subject to federal income tax, other than captive REITs and RICs, are subject to tax under article 9-A of the Tax Law. The tax is computed on the greater of the business income base or the fixed dollar minimum tax. The regulations go on to provide additional details regarding the computation of income and the apportionment rules for noncaptive REITs and noncaptive RICs, including the ability to annually elect a fixed percentage apportionment method that treats 8 percent of net income from qualified financial instruments as "New York receipts."

The department is asking for comments to the proposed regulations by June 19, 2019.[14]

Tax Department Issues New Guidance On Sales Tax Benefits for Industrial Development Agencies

The Tax Department recently provided industrial development agencies, or IDAs, in New York state with new, detailed guidance[15] relating to the provision of sales tax exemption benefits claimed by IDAs. Given the heightened scrutiny surrounding the provision of these benefits, the guidance should be welcome news for IDAs.

As governmental entities, IDAs, which are tasked with fostering economic development in specific localities, are exempt from paying sales and use tax on their purchases. But instead of making their own purchases, IDAs generally appoint developers or contractors as their agents, who then make purchases on the IDAs behalf. Purchases made by a properly appointed agent are deemed to be purchases made by the IDA and are also exempt from tax.

The Tax Department's recent bulletin includes instructions for how IDAs should appoint agents to receive their sales tax benefits, including the filing of Form ST-60, IDA Appointment of Project Operator or Agent for Sales Tax Purposes.[16] The bulletin also includes recordkeeping and reporting requirements, noting that if an IDA "fails to report the sales tax exemption benefits or make records available to the [d]epartment upon request, the IDA shall be prohibited from providing sales tax benefits until the IDA comes into compliance with all such requirements."

Finally, the bulletin notes that IDAs must recapture any state sales tax exemption benefits that were unauthorized or over the allotted benefits and remit the recaptured sales tax exemption benefits to the Tax Department using Form ST-65, IDA Report of Recaptured Sales and Use Tax Benefits.[17]

The bulletin also addresses agents' reporting requirements, including use of the proper exemption certificate, generally, Form ST-123, IDA Agent or Project Operator Exempt Purchase Certificate[18] and the need to annually file a Form ST-340, Annual Report of Sales and Use Tax Exemptions Claimed by Agent/Project Operator of Industrial Development Agency/Authority (IDA).[19]

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as legal advice.

[1] https://www.governor.ny.gov/news/governor-cuomo-and-legislative-leaders-announce-agreement-fy-2020-budget.

[2] https://www.hodgsonruss.com/newsroom-publications-10814.html.

[3] https://www.hodgsonruss.com/blogs-Noonans-Notes-Blog,new-yorks-potential-new-pied-a-terre.

[4] https://www.tax.ny.gov/pdf/advisory_opinions/sales/a19-1s.pdf.

[5] N.Y. Tax Law Section 1101(b)(8)(ii)(A).

[6] https://www.dta.ny.gov/pdf/determinations/827577.det.pdf.

[7] New York substantially reformed its corporate tax rules beginning in 2015.

[8] Treas. Reg. §§ 301.7701-1 to 301.7701-3.

[9] https://www.tax.ny.gov/pdf/guidances/corp/g17_2c.pdf.

[10] 2019 NY Slip Op 02392.

[11] N.Y. Tax Law § 605(b)(1)(B).

[12] https://www.tax.ny.gov/bus/ct/pending/draft-disc-3-21-19.pdf.

[13] https://www.tax.ny.gov/bus/ct/pending/draft-reic-ric-3-21-19.pdf.

[14] Comments can be submitted in writing to Kathleen D. O’Connell, Office of Counsel, Department of Taxation and Finance, W.A. Harriman Campus, Building 9, Room 200, Albany, NY 12227 or via email at tax.regulations@tax.ny.gov.

[15] https://www.tax.ny.gov/pubs_and_bulls/tg_bulletins/st/industrial_development_agencies_and_authorities.htm.

[16] https://www.tax.ny.gov/pdf/current_forms/st/st60_fill_in.pdf.

[17] https://www.tax.ny.gov/pdf/current_forms/st/st65_fill_in.pdf.

[18] https://www.tax.ny.gov/pdf/current_forms/st/st123_fill_in.pdf.

[19] https://www.tax.ny.gov/pdf/current_forms/st/st340_fill_in.pdf.