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Expert Analysis

NY Tax Minutes: Amazon, Congestion Pricing, GILTI Guidance

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The past month was a busy one for New York tax updates, but don't worry, we have the highlights, and, as always, we're delivering the month's news in a way that's made for New Yorkers. Fast.

This month, we cover Amazon's breakup with New York City; the state's new congestion surcharge pricing; recent state guidance on the treatment of repatriation and global intangible low-taxed income; and we highlight several new and noteworthy cases involving New York taxes.

The Headlines

Amazon and New York City Call It Quits

We could lead this story with a headline straight out of Us Weekly. "Split!" "It's Over!" "Amazon tells New York, 'We're Done!'"

After Amazon.com Inc. was enticed with a package of $3 billion of performance-based tax incentives to announce the opening of a new corporate office in Long Island City, the company immediately faced tough

questions and criticisms from several New York politicians about the merits of offering tax breaks to a trillion-dollar company. And, apparently, Amazon wasn't feeling the love, as on Feb. 14, 2019 — Valentine's Day no less — Amazon announced that it was dumping New York.

Amazon posted on its internal blog[1] that "for Amazon, the commitment to build a new headquarters requires positive collaborative relationships with state and local elected officials who will be supportive over the long term." And Amazon wasn't getting the warm and fuzzies from New York, noting that "a number of state and local politicians have made it clear that they oppose our presence and will not work with us to build the type of relationships that are required to go forward with the project we and many others envisioned in Long Island City."

As we detailed in our original report on the deal, we supported the idea of Amazon coming to New York but questioned the need to offer billions of dollars in incentives to convince a company to move to a city with one of the country's most talented workforces, a top global reputation, and other major industries already in place. But we also noted that if the projected benefits came to fruition — i.e., 40,000 high-paying jobs and over $25 billion in tax revenue — a 9 to 1 payout on the original incentives was probably a good deal. We're now left only with finger pointing, as Gov. Andrew Cuomo (a vocal supporter of the deal) has blamed the Democrat-controlled New York Senate for the breakup and believes the senate should be held accountable for the lost economic opportunity. During an interview with public radio station WAMC, Gov. Cuomo called the collapse of the Amazon deal "the greatest tragedy that I have seen since I have been in government." No one said relationships were easy.

New York State Provides Single Day Notice for Congestion Surcharge

Both of your authors commute regularly between New York City airports and our firm's midtown office, so we know the frustration of sitting in bumper-to-

bumper, rush hour traffic. And, now, starting Feb. 2, 2019, we'll get to pay a little more for the pleasure of watching walkers and cyclists rush by our taxis at the speed of light.

The New York state congestion surcharge[2] was first enacted on April 1, 2018, with collection of the surcharge scheduled to begin on Jan. 1, 2019. Collections were delayed, however, due to a temporary restraining order filed in Taxifleet Management LLC, et al. v. State of New York.[3] But on Jan. 31, 2019, the New York State Supreme Court lifted the temporary restraining order, and on Feb. 1, 2019, the Department of Taxation and Finance issued important notice N-19-2,[4] announcing that "all persons subject to the surcharge must begin to collect the surcharge from passengers beginning at 12:01 a.m. on Saturday, Feb. 2, 2019. All persons who will be responsible for the collection and payment of the surcharge on more than one trip in any calendar month must also register with the department."

According to the Tax Department's original technical memorandum, TSB-M-18(1)CS,[5] "the congestion surcharge is an amount that is added to the charge for transportation that: both begins and ends in New York state, and that begins in, ends in, or passes through the area of New York City in the borough of Manhattan, south of and excluding 96th Street (an area known as the 'congestion zone')." The surcharge applies to transportation in vehicles that carry people for-hire, including taxis; "green cabs;" limousines; black cars; livery vehicles; rideshare/transportation network company vehicles; and pool vehicles.

The surcharge does not apply to transportation provided in connection with funerals; transportation provided by buses; transportation provided by school districts; transportation administered by the Metropolitan Transportation Authority; or transportation by ambulance or ambulette. Additional information on the surcharge is available on the state's website,[6] and on Feb. 12, 2019, the state readopted, as an emergency measure, an amendment to the state's sales and use and other miscellaneous tax regulations to add a subchapter on

the new congestion surcharge.[7]

The surcharge is intended to fund future subway improvements and operations. And with an extra $2.75 added to each taxi, Uber, or Lyft ride, the subway will certainly need the improvements as it deals with increased numbers of cheapskates like your authors tired of sitting in traffic.

President Trump and Gov. Cuomo Meet to Discuss State and Local Tax Deduction Cap

On Feb. 12, 2019, President Donald Trump and New York state Governor Andrew Cuomo met to discuss the impacts of the federal Tax Cuts and Jobs Act, of which the two men have very different outlooks.

The “SALT summit,” as it was dubbed, came in the wake of Gov. Cuomo and New York Comptroller Thomas P. DiNapoli’s Feb. 4, 2019, update on state revenues,[8] in which state politicians noted a significant decline in personal income tax revenue over December and January. The reductions were seen in both the withholding component, which largely comes from current wages, and the estimated payment component, which mostly reflects nonwage income. Estimated payments, for example, are $2.3 billion below forecast. The governor and comptroller have attributed the decline to the federal tax legislation's elimination of full state and local tax deductibility, which they argue disproportionately impacts New York and other predominantly Democratic states. Gov. Cuomo continued this message during his meeting with President Trump.

In an interview with WCBS 880, previewing his meeting with Trump, Gov. Cuomo said of the SALT cap, “[I]t has to be turned around. Congress is going to be persistent. I'm organizing governors all across the nation. I've been briefing congressional members. And the president understands it. The president previously said that he was open to a change. He suggested he was open to a change here, also. Because he understands, you hurt New York,

you hurt California, you're hurting the economic engines of the nation."

Prior to the meeting, Trump had told reporters that he was "open to thinking about" revising the SALT deduction cap. At the meeting, however, it appears the president mostly touted the benefits of the TCJA. According to Deputy Press Secretary Judd Deere, Trump talked about the "positive impacts of the Tax Cuts and Jobs Act on the American economy, and the president listened to the governor's concerns regarding" the SALT deduction cap. Which is code for the SALT deduction cap staying in place for the foreseeable future.

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 New York County Supreme Court ruling, granting a nonprofit's request for a property tax exemption; we review a taxpayer's failed attempt to clearly and convincingly prove his change of domicile from New York to Connecticut and we applaud an administrative law judge's decision to cancel a sales and use tax assessment based on the Audit Division's lack of a rational basis.

New York Supreme Court Finds Taxpayer Entitled to Property Tax Exemption for Nonprofit Educational Headquarters

On Jan. 8, 2019, the New York County Supreme Court issued an order in Alliance v. New York City Tax Commission,[9] granting the Drug Policy Alliance's, or DPA's, petition to review the New York City Department of Finance's denial of its real property tax exemption under Real Property Tax Law Section 420-a(1)(a).

According to the court's ruling, DPA's purpose is to "operate exclusively for charitable and educational purposes, including but not limited to conducting research and educating the public about medical, scientific and sociological

effects of drugs and developments in the drug laws." DPA is exempt from federal income tax and also exempt from New York state and city sales and use taxes.

In June 2011, DPA purchased its New York City headquarters and applied for exemption from New York City real estate taxes pursuant to Section 420-a(1)(a), specifying its exempt purpose as "educational." The Department of Finance then denied DPA's application with a one-sentence ruling, stating that "[a]dvocacy of a cause does not qualify as an exempt purpose for property tax exemption." The New York City Tax Commission upheld the denial.

In overturning the denial of DPA's claim for exemption, the New York County Supreme Court first noted several procedural issues with the Tax Commission's review of the case, including a failure to allow DPA to cross-examine the director of the Department of Finance (which constituted a denial of due process) and the Tax Commission's failure to limit its review to only those facts entered into the hearing record.

The court then specifically ruled that under Section 420-a(1)(a)'s two-part test for real property tax exemptions, DPA qualified for an exemption. First, DPA met the organizational prong of the test, which requires that the property at issue be owned by a nonprofit organization "organized [or conducted] exclusively for one or a combination of the enumerated exempt purposes." Second, DPA met the property use prong of the test by using its property "exclusively for one or more of the exempt purposes." According to the court, "DPA's activities fall within its exclusive or primary purposes of 'charitable, educational, moral, or mental improvement of men, women, and children,' which are available free of charge to the public and for the public benefit." The court therefore directed the Department of Finance to grant DPA's property tax exemption.

New York Administrative Law Judge Denies Taxpayer's Claim of Connecticut Domicile

In Matter of McManus,[10] a New York state administrative law judge, or ALJ, from the Division of Tax Appeals denied an individual's personal income tax petition, finding that the Audit Division had properly determined that the taxpayer was a domiciliary of New York state during the tax year at issue.

The case included some convoluted filing history, but like most domicile determinations, the decision turned on whether the party alleging the change of domicile (in this case, the taxpayer) met his burden to show by “clear and convincing evidence” that he intended to form a new permanent home away from New York and in Connecticut. After reviewing the entire record, the ALJ determined that the taxpayer had not given up his New York domicile and had not acquired a new domicile in Connecticut as of the year in issue.

So what factors worked for and against the taxpayer? The taxpayer, who represented himself before the ALJ, owned a significant home in Connecticut, where he kept his family albums, yearbooks, passports, vehicle titles, birth certificates and other family “heirlooms.” Score one for the taxpayer.

But the taxpayer also owned a home in Bronxville, New York, where his children continued to attend school (practitioner sidebar: where one’s children are enrolled in school is often a significant factor in New York state domicile cases).

Additionally, much of the taxpayer’s employment was in New York City, which also didn’t help, and the taxpayer continued to vote in New York state, registered his automobiles in New York, and belonged to New York state country clubs. Lastly, based on the auditor’s day count schedules, which referenced credit card statements, flight records, EZPass statements and cell phone records, the taxpayer was in New York for 156 days and in Connecticut for 146 days during the year at issue.

Thus, although the taxpayer’s more substantial (and sentimentally important)

home appeared to be located in Connecticut, the ALJ held that "[t]he record clearly shows that petitioner's life remained centered in Bronxville, New York, during the year at issue." And because there was "no evidence that petitioner took any steps to sever his relationship with his New York domicile," the ALJ held that the taxpayer had "failed to carry his burden of proving by clear and convincing evidence that he intended to change his domicile from New York State to Connecticut."

One other point of note from the determination is that when the ALJ asked the taxpayer for the date on which he changed his domicile to Connecticut, the taxpayer "gave a protracted vague response." Practitioner sidebar No. 2: It is crucial in domicile cases for taxpayer's to have a clear date in mind as to their claimed change of residency.

New York ALJ Cancels Auditor's Use of Indirect Methodology in Sales and Use Tax Audit

For the second time in the last four months, we've seen taxpayers prevail in cases involving indirect sales tax audit methodologies. This time, in Matter of Taveras,[11] an ALJ reviewed and cancelled a sales and use tax assessment issued against the owner of a convenience store.

The relevant background of the audit is that in June 2013, a tax technician within the Audit Division sent a letter to the taxpayer saying that the business was under audit. The audit was apparently triggered by a discrepancy between information received from the business's suppliers and the business's sales tax reports. The initial letter included a statement of proposed audit changes (the precursor to a formal assessment), along with the auditor's work papers. In other words, the letter read along the lines of, "Hey, we're starting an audit. Now we're done. Your bill is attached!"

The case was then eventually reassigned from the original tax technician to a field auditor who sent another letter to the business in November 2013, asking

the business to respond “as to how the matter will be resolved.” In April 2014, the division issued its formal assessment to the taxpayer.

As highlighted by the ALJ, the audit log did not indicate anywhere that the auditors had actually reviewed any information provided by the taxpayer. Specifically, at the end of the log, the ALJ found “an area to account for time spent on the audit,” and noted that the number “0.00” was indicated in each column. The log then listed the total number of hours worked on the file as “0.00.”

As explained by the ALJ, New York Tax Law Section 1138(a)(1) allows auditors to, if necessary, estimate a sales tax liability on “the basis of external indices.” But the Audit Division may only rely on external indices if the taxpayer’s own, internal records are inadequate. And to determine the adequacy of a taxpayer’s records, the Audit Division must first make an explicit request for the records, and second, thoroughly examine the books and records for the entire audit period. In this case, although the ALJ found that the Audit Division did explicitly request records, the “audit log [did] not reflect what documents were received or examined.” And since “the division has not established that it thoroughly examined the documentation submitted by petitioner,” the ALJ “determined that the division did not follow the steps required in order to estimate sales tax due using an indirect audit methodology.” Accordingly, the ALJ cancelled the assessment as it lacked a rational basis.

Other Guidance

New York State Tax Department Issues GILTI Guidance

On Feb. 8, 2019, the New York State Tax Department issued two technical memoranda addressing the treatment of repatriation and global intangible low-taxed income, or GILTI, for both businesses and individuals.[12]

The federal Tax Cuts and Jobs Act created new provisions in the Internal Revenue Code, addressing income earned from overseas operations, including mandatory deemed repatriation income ("net IRC Section 965 amounts") and GILTI.

For individual taxpayers, the Tax Department has now advised that full-year residents must include their net Section 965 amounts and GILTI in their federal adjusted gross income and, consequently, New York taxable income. The net Section 965 amount is included in federal adjusted gross income regardless of whether taxpayers elect to defer the payment of the federal tax. For nonresidents and part-year residents, the net Section 965 amounts and GILTI are treated as income from an intangible and, as such, are sourced to New York if the last day of the tax year of the foreign corporation that generated the income occurred during a resident period. For nonresidents and part-year residents where the last day of the tax year of the foreign corporation that generated the income occurred in a nonresident period, the net Section 965 amount or GILTI is sourced to New York only if the stock of the foreign corporation was used in a trade or business in New York state.

For corporate taxpayers, the Tax Department's memorandum lays out New York's tax treatment of net Section 965 amounts and GILTI for different entity types, including exempt organizations, insurance corporations, New York C corporations and New York S corporations.

For New York C corporations, Section 965(a) inclusion amounts are generally considered gross exempt controlled foreign corporation, or CFC, income under Article 9-A and deducted from entire net income when computing business income. The Section 965(a) inclusion amount is not included in the numerator or denominator of the business apportionment factor. Net GILTI income, which is the GILTI recognized under Section 951A, less the allowable Section 250(a)(1)(B)(i) deduction, is included in entire net income under Article 9-A, and, according to the state's memorandum, if the stock of a foreign corporation that generates GILTI is business capital, net GILTI income

needs factor representation in the business apportionment factor in order to properly reflect the taxpayer's business income and capital in the state. The Tax Department has determined that such net GILTI income must be included in the denominator but not the numerator of the business apportionment factor. Taxpayers should report this amount in the "everywhere" column of the discretionary adjustment line of Part 6 of Form CT-3 or Form CT-3-A and attach a statement to the return indicating the GILTI amounts included apportionment schedule. In other words, New York will include the net GILTI amount but allow factor relief.

As reported in last month's column, the governor's executive budget proposed establishing a statutory sourcing rule for GILTI that would require net GILTI to be included in the denominator of the apportionment factor, with zero in the numerator. This treatment would mirror the Tax Department's recent technical guidance.

New York City Department of Finance Issues Guidance on Allocation of Service Receipts for Unincorporated Business Tax

In a recent letter ruling,[13] the New York City Department of Finance reminded unincorporated business taxpayers that in determining the fraction of a taxpayer's receipts earned within and outside New York City, the unincorporated business tax, or UBT, generally treats the source of service receipts to be the location where the services are performed.[14] The ruling goes on to instruct taxpayers that "a reasonable attempt to match the receipts to the time spent in the City earning those receipts should be made." And that "[i]f work for a particular client is split between the City and outside the City, you should allocate the receipts for that client based on the proportion of time spent in the City. Finally, "if different tasks performed by the same [taxpayer] are billed at different rates, the amount to be allocated to the City can be calculated separately, based on the time spent in the City to accomplish the various tasks." This guidance appears to agree with our experiences on audit, which show that time cards or employee hour reports are often the best

evidence when attempting to allocate service receipts under the UBT.

New York City Department of Finance Determines Karaoke Room Rental Amounts Not Deductible From Base Rent for Commercial Rent Tax

One of New York City's most surprising (and least known) taxes is the commercial rent tax, or CRT, which is imposed on tenants who occupy or use certain properties south of 96 Street in Manhattan for the use of a trade, business, profession or commercial activity. In a recent letter ruling,[15] the New York City Department of Finance addressed whether a karaoke business could reduce its taxable base rent by the amounts received from customers for the hourly rental of the individual karaoke rooms.

Under Section 11-701(7) of the New York City Administrative Code, certain amounts of rent received from subtenants can be deducted from base rent. But according to the Department of Finance, the karaoke business could not deduct its room rental charges as (1) the individual karaoke rooms were not used for the purposes of carrying on or exercising any trade, business, profession, vocation or commercial activity and (2) "the hourly rental of the karaoke room did not create a common law landlord/tenant relationship.

Accordingly, the taxpayer did not meet the criteria of any of the deductions from base rent found under the CRT statute.

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[1] https://blog.aboutamazon.com/company-news/update-on-plans-for-new-york-city-headquarters

[2] Tax Law Article 29-C.

[3] Taxifleet Management LLC, et al. v. State of New York

[4] Notice N-19-2, https://www.tax.ny.gov/pdf/notices/n19-2.pdf.

[5] Technical Memorandum, TSB-M-18(1)CS, https://www.tax.ny.gov/pdf/memos/cs/m18-1cs.pdf.

[6] https://www.tax.ny.gov/bus/cs/csidx.htm#agents.

[7] https://www.tax.ny.gov/pdf/rulemaking/feb1219/congestionsurcharge/text.pdf

[8] https://www.governor.ny.gov/sites/governor.ny.gov/files/atoms/files/SALT_Revenue_PP.pdf

[9] Alliance v. New York City Tax Commission, No. 103827/2012, 2019 WL 647510 (N.Y. Sup. Ct. Jan. 08, 2019).

[10] Matter of McManus, DTA No. 827116, https://www.dta.ny.gov/pdf/determinations/827116.det.pdf.

[11] Matter of Taveras, DTA No. 828051, https://www.dta.ny.gov/pdf/determinations/828051.det.pdf.

[12] Technical Memoranda for businesses, https://www.tax.ny.gov/pdf/2019/corp/m19-1c.pdf, and individuals, https://www.tax.ny.gov/pdf/2019/inc/m19-1I.pdf.

[13] https://www1.nyc.gov/assets/finance/downloads/pdf/redacted-letter-rulings/ubt/redacted-18-4986-ubt.pdf.

[14] NYC Code Sec. 11-508(c)(3).

[15] https://www1.nyc.gov/assets/finance/downloads/pdf/redacted-letter-rulings/crt/redacted-18-4988-crt.pdf.