Sales Tax in New York State: A Year in Review

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In this article, the authors sum up 2015 and some of New York state's more interesting — and entertaining — tax developments from the year, including the surprising sales and use tax exemption on private planes and luxury boats, which took effect in June.

Private planes . . . yachts . . . hotels . . . exotic dancers. A teaser for the latest James Bond film? Actually, believe it or not, those are teasers from the past year in New York state's sales and use tax law. Add in some interesting developments in the always tricky realms of cloud computing and information services and you've got what amounted to an interesting year for sales tax in New York. This article will look back at some of the highlights.

2015 Budget: A Break for Boats, Planes, and Tax Planning Structures

Purchasers and owners of private airplanes and luxury boats got an early Christmas present from the New York State Legislature in its enacted 2015 budget. As part of the budget's revenue and tax package, the Legislature did away with sales and use tax altogether on "general aviation" airplanes. The budget act also extended a slightly less generous but still significant tax break to purchasers and owners of high-priced boats, limiting sales tax to the first $230,000 of the purchase price and allowing boats purchased out of state to be used in New York waters for up to 90 days without triggering use tax. Interestingly, those two tax breaks were part of the same budget bill that proposed antiabuse provisions designed to crack down on the creative use of related entities to avoid or defer taxes on *other* types of high-priced items such as artwork — oddly enough, the same planning structures sometimes employed for planes and boats! As explained below, the tax breaks were enacted, but the Legislature ultimately voted down the proposed antiabuse amendments.

Effective September 1, sales, leases, or uses of "general aviation aircraft" in New York are no longer subject to sales and use tax.[1] That exemption joined the one already on the books for "commercial aircraft," effectively eliminating tax on all types of aircraft other than military aircraft, unmanned aircraft, and drones. The exemption also covers property affixed to a plane, including built-in furniture, fixtures, entertainment systems, and controls.[2] That includes property *later* purchased and installed, as long as the property is necessary for the "equipping" of the plane or for its "normal operation."

As for boats, the new rules took effect on June 1, capping the taxable base on the purchase price (or value for use tax) for all "vessels" at $230,000.[3] Any amount in excess of that threshold is exempt from tax. The $230,000 cap also applies to long-term (one year or longer) leases of vessels, which, like motor vehicles, are subject to tax upfront on the full value of all lease payments.[4] Finally, the new rules also make it possible for limited use of a boat in New York without triggering a taxable "use." Under the old rules, a boat purchased out of state by a resident was generally subject to tax upon entering the state, but under the new rules, a taxable use for a vessel does not occur until the earliest of (1) the boat's use in New York for 90 consecutive days; (2) the date the boat is required to be registered with the Department of Motor Vehicles (also 90 days); or (3) the actual date of registration.[5]

While effective lobbying appeared be the key to getting those big-ticket breaks across the goal line, the State Department of Taxation and Finance was not as fortunate with its own package of sales tax amendments, which would have eliminated some tax planning techniques designed to avoid or at least defer sales tax on big-ticket items, including artwork. The proposed legislation, which was not enacted in

[1]N.Y. Tax Law section 1115(a)(21-a).
[2]*See* TSB-M-15(3)S.
[3]*See* TSB-M-15(2)S.
[4]N.Y. Tax Law section 1111(i)(A).
[5]N.Y. Tax Law section 1118(13).

the 2015 budget but continues to be discussed in the context of future budgeting, would have:

- disregarded any transactions between a single-member limited liability company (SMLLC) and its sole member, treating the SMLLC and its sole member as one person for sales tax purposes, including transactions such as a lease of property purchased tax free by the SMLLC, ostensibly for resale, to its member;
- required that tax on all leases of property between affiliated entities be collected and remitted upfront at the inception of the lease, rather than as payments are made;
- restricted the use tax exemption applicable to property purchased out of state by a nonresident entity to those entities that have been doing business outside the state for at least six months before the purchase; and
- imposed tax on currently exempt corporate transactions involving the transfer of tangible personal property — including corporate and partnership liquidating distributions and initial contributions of property in exchange for stock — if the parties were affiliated (with the exception of statutory mergers).

Although those provisions were intended to address specific planning techniques to avoid or defer sales tax by the use of related entities, the measures likely would have affected many standard business structures and common transactions between related corporations. Being too broad likely contributed to the measures' failure to pass in the Legislature. However, it's possible that the department will soon introduce new, more narrowly tailored measures, so be on the lookout for that.

Cloud Computing . . . Gets Cloudier?

Several rulings in the cloud computing realm this year added to the still-growing collection of authority in that murky area, but it's hard to say they added any clarity.

The most surprising development in 2015 to folks like us who have been closely following the cloud computing issue came in the form of an advisory opinion issued to a company providing "Internet infrastructure for businesses."[6] The company in that case charged an hourly fee for customers to remotely access the company's computer hardware infrastructure, including servers, high-powered processors, and their operating systems. The service's benefit to the customer lay in the ability to run the customer's own software applications and computer functions (for example, data analysis functions, intranet software, and e-commerce programs) on computer hardware more powerful than the customer's own infrastructure.

The advisory opinion distinguished the company's remotely hosted service from the numerous instances in which the department found that cloud-based services allowing customers access to and use of remotely hosted software (commonly referred to as software as a service, or SaaS) constituted a taxable license to use prewritten software rather than a nontaxable service carried out by the provider. In this case, the department concluded that the primary purpose of the service was to give the customer remote access to computer *hardware* — or, specifically, "access to computing power — a specific array of a processor, memory, and storage." And according to the opinion, "providing a customer with computing power is not one of the services made taxable by the Tax Law."

We follow the logic here, at least regarding charges for infrastructure as a service (IaaS) not constituting a license to use otherwise taxable software. What is somewhat troubling, though, is the analysis that is *missing* from the opinion. Specifically, if access to remotely hosted software can be deemed to be a "license to use" tangible personal property (prewritten software), why wouldn't the department analyze whether remote access to computer *hardware* could represent a similar "license"? We doubt the conclusion would have changed had the department engaged in that analysis — rather than bluntly concluding that access to "computing power" isn't an enumerated service. However, the department *would* have been obligated to reference authorities that we think call into question whether SaaS indeed represents a taxable license of the software as opposed to the provision of a service. For example, the regulations governing licenses and other transfers of possession provide the following example:

> A corporation contracts with a computer center for access time on the computer center's equipment through the use of a terminal located in the corporation's office. The terminal is connected to the computer by telephone. The corporation's access to the computer through the terminal is not deemed to be a transfer of possession of the computer subject to tax.[7]

That example alone could have supported the conclusion that the IaaS in the department's opinion was not subject to tax. It's difficult to reconcile that view of remote access to hardware, which involves no "transfer of possession," with the concept expressed in numerous SaaS determinations since 2008 that customers who pay a SaaS provider for the ability to log onto and use hosted software are paying for a "transfer of possession" of that software sufficient to constitute a taxable license.

Another cloud computing opinion from this year — this one involving a company offering an online "hub" for facilitating drop-shipment transactions between e-commerce retailers and manufacturers/suppliers — also raised some questions.[8] The department found that even though the "Drop Shipment Manager" (DSM) service offered by the petitioner had elements of telecommunication, "message switching,"

[6]TSB-A-15(2)S.

[7]20 NYCRR section 526.7(e)(5).

[8]*See* TSB-A-15(20)S.

and information reporting, its primary purpose was essentially a nontaxable data processing service. The DSM service connected retailers and suppliers, and it allowed shipping and order information to be sent, translated, and monitored by the two. The service provider used (and passed on the charges to customers for) electronic data interchange (EDI) networks to facilitate some of the data exchange between the parties.

But wait a second . . . is that the *same* EDI held to constitute taxable "telegraph service" in *Easylink Services International Inc. v. New York State Tax Appeal Tribunal*,[9] a case that involved a similar business-to-business messaging? The department distinguished the service here from that in *Easylink*, noting that the transmission of data was the primary function in *Easylink*, while the "drop-shipment" service in the opinion involved significantly more than simply transmitting data between the parties.

Information Services: The World as a 'Common Database'?

New York's tax on the sale of "information services" has always produced fodder for debate. 2015 was no different, with a pair of administrative law judge determinations issued to a supermarket chain and a company that provided supermarkets with "competitive price audits" to keep tabs on the supermarket chain's competition. The issue in both *Matter of Wegmans Food Markets Inc.*[10] and *Matter of RetailData LLC*[11] was whether those competitive pricing audits constituted a taxable information service subject to tax under N.Y. Tax Law section 1105(c)(1). Although that statute broadly taxes the "furnishing of information," including the services of "collecting, compiling, or analyzing information" and producing reports, it excludes information that is "personal or individual in nature and which is not or may not be substantially incorporated in reports furnished to others." The "personal and individual" exclusion has long been analyzed based on what is known as the "common database" rule — meaning that even if no two customers would get the same report, if the report contains data from a database maintained by the vendor, or from an online or published database, it cannot meet the "personal and individual" prong.[12]

In the *Wegmans/RetailData* cases, supermarkets and other customers hired RetailData to conduct in-person field audits of the customers' competitors to continually glean their pricing strategies. The field inspectors personally inspect the prices on all types of items requested by the customer, and that pricing information is analyzed and reported to the customer. The operative question in the *Wegmans/RetailData* cases was whether the personally observed pricing information and analysis constituted information culled from a "common database." The ALJ in both cases ruled that the information at the heart of RetailData's service is "compiled from a widely available public source, stores open to the public"; thus, the company's audits could not meet the "personal and individual" test.

The decision suggests a fairly expansive view of what constitutes a common database. Essentially, anything publicly observable could be considered derived from a database. Does that mean, say, a meteorological report containing physical observations and analysis of the weather is an "information service" containing information from a common database — that being nature?

Oh, wait, the department already tried taxing weather reports as an information service, but that didn't fly! In fact, it resulted in a specific exemption for meteorological reports and caused then-Gov. George Pataki to accuse the department of vastly overextending the definition of information services in general, amounting to "taxation by administrative fiat."[13] The *Wegmans* case may be a closer call, but it's still a bit troubling. We'll likely have a final answer on the case next year, since it is under appeal.

Nite Moves Part II: The Taxability of Exotic Dance Revisited

Sometimes, persistence pays off. That was at least partially true for the owners of Nite Moves, an upstate New York establishment offering nude and semi-nude exotic dancing, who went to court for a second round of litigation over whether the club's admissions charges and charges for private dances were subject to tax and, that second time, partially prevailed. In *Matter of 677 New Loudon Corp.*,[14] an ALJ found that at least the admission charges to the club were not taxable admissions to a "place of amusement" under N.Y. Tax Law section 1105(f), but rather qualified for the exclusion for admissions to "dramatic or musical arts performances" (which include choreographed dance). The judge, however, did not find the same regarding the club's separate charges for private, one-on-one dances.

The holding on admission charges is the opposite of that arising in prior litigation over the same club — litigation that made its way all the way to New York's highest court,[15]

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[9]101 AD3d 1180 (3d Dep't 2012).

[10]*Matter of Wegmans Food Markets Inc.*, No. 825347 (N.Y. Div. Tax App. 2015).

[11]*Matter of RetailData LLC*, No. 825334 (N.Y. Div. Tax App. 2015).

[12]*See., e.g.*, *Matter of Twin Coast Newspapers v. State Tax Comm'n*, 101 A.D.2d 977 (3d Dep't 1984), *appeal dismissed*, 64 N.Y.2d 874; *Matter of ADP Collision Estimating Services Inc.* (Tax Appeals Tribunal, Aug. 8, 1991), *confirmed sub nom,* 188 A.D.2d 245, *lv. denied*, 82 N.Y.2d 655.

[13]*See* Governor's message, L. 1995, c. 373 (Aug. 2, 1995).

[14]*Matter of 677 New Loudon Corp. d/b/a Nite Moves*, No. 824333. (N.Y. Div. Tax App. 2015).

[15]*See Matter of 677 New Loudon Corp. d/b/a Nite Moves* (Tax Appeals Tribunal, Apr. 14, 2010), *confirmed* 85 AD3d 1341 (3d Dep't 2011), *aff'd* 19 NY2d 1058 (2012), *cert. denied* 134 SCt 422 (2013).

not to mention onto Comedy Central's *The Colbert Report*.[16] After the New York Court of Appeals confirmed that lap dances, pole dances, and private dances did not constitute choreographed dance performances, rendering the club's charges for admission and private dances taxable, the club was audited by the department for a second time and decided to re-litigate. This time, Nite Moves offered testimony from a new list of witnesses, including a cultural anthropologist and dance scholar, a ballet dancer and choreographer, a dance instructor, an entertainment critic, a gymnast and national pole-dancing champion, and dancers from the club itself — all testifying as to the "art" of exotic dancing. This time, an ALJ held that the charges for admission were exempt from tax as charges to a choreographed dance performance, relying on the new and presumably better volume of evidence presented by the taxpayer the second time around. Not so for charges for private dances, however, which the judge found to be focused on physical contact and not elements of music and performance. Such charges (the biggest revenue source for the club) were held to be taxable admissions to a "place of amusement" and not admissions to a "dramatic or musical arts performance."

Retailers' Membership Discount Programs: Are Programs Like Amazon Prime Taxable?

An advisory opinion issued to an affiliate of an online retailer — one that sounds an awful lot like Amazon.com Inc. — confirmed the department's view that an annual membership fee entitling members to benefits such as discounts on products, free or reduced shipping charges on purchased products, access to a free streaming video service, and access to an e-book lending library was subject to tax.[17]

The petitioner operated the membership program for an affiliated company that made the actual online sales of products and provided the video streaming service. The department compared the membership's discount pricing and shipping benefits to memberships offered by large bricks-and-mortar retail stores (for example, Costco Wholesale Corp.), which the department has deemed a method of "prepayment" for the retailer's otherwise taxable merchandise.[18] The advisory opinion acknowledged that things like e-books and streamed video services might not be taxable on their own, but that because the petitioner's membership fee also entitled members to special member pricing on purchases of otherwise taxable tangible property and free or discounted shipping on that property, the entire annual fee represented "a prepayment for a taxable item" and was thus subject to sales tax on the full price. That the entity administering the membership program was separate from the affiliated entity actually making the underlying sales of taxable property did not change the analysis, according to the opinion.

Hotel Occupancy: Converted College Dorm Is Not a 'Hotel'

While the taxability of short-term apartment and room rentals by companies such as Airbnb Inc. continued to make headlines in 2015, the department, without much fanfare, issued an advisory opinion confirming that a converted New York City college dorm providing temporary housing to traveling students completing study programs or internships was not a hotel for sales and use tax purposes.[19] The lodging offered by the petitioner was available only to students and those completing internships, not to the general public, and rooms could not be rented for less than 30 days. Although guests did not sign a lease that would render the lodging a nontaxable rental of real property rather than a charge for occupancy, the department found that the facility still could not be considered a hotel subject to New York state and city sales tax on "hotel occupancy."

That was primarily because the converted dorm facility — although offering lodging for transient guests — did not provide services customary to a hotel, such as linen or maid service, food service, a concierge, and the like. The regulations define a hotel as a building or portion of a building "regularly used or kept open for the lodging of guests," noting that a property falls under the definition if the following apply:

- sleeping accommodations are provided for the lodging of paying occupants on a regular basis;
- typical occupants are transients or travelers;
- housekeeping, linen, or other customary hotel services are provided for occupants; and
- the relationship between the operator of the establishment and the occupant is that of an innkeeper and guest, not that of a landlord and tenant (for example, the occupant does not have an exclusive right or privilege regarding any particular room or rooms, but instead merely has an agreement for the use or possession of the room or rooms).[20]

The ruling noted that only the third prong above was not met, suggesting all other elements for a hotel may have been present.

Conclusion

One thing you can say about sales and use tax in New York state: It's rarely boring, at least for practitioners like us. We couldn't catalog every relevant sales and use tax development for the year (now that *would* be boring!), but we thought these would be of interest. ☆

[16] *The Colbert Report* (Comedy Central television broadcast Nov. 8, 2012).

[17] TSB-A-15(15)S.

[18] *See, e.g.*, *Costco Wholesale Corp.*, TSB-A-92(66)S.

[19] *See* TSB-A-15(11)S.

[20] 20 NYCRR section 527.9(b)(1).