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ALJ HOLDS THAT INSURANCE PAYMENTS TO CAPTIVE INSURANCE COMPANY ARE NOT DEDUCTIBLE

By Michael J. Hilkin

In *Matter of Stewart's Shops Corp.*, DTA No. 825745 (N.Y.S. Div. of Tax App., Mar. 10, 2016), a New York State Administrative Law Judge concluded that a corporation operating a convenience store chain could not deduct on its New York corporate franchise tax returns the insurance payments that it made to its wholly owned captive insurance company because such payments would not qualify as valid insurance premiums under federal income tax law.

Facts. Stewart's Shops Corp. ("Stewart's Shops") owns and operates over 300 convenience stores in New York and Vermont. In the face of increasing insurance costs for its operations, Stewart's Shops started self-insuring certain of its risks in 1992. Subsequently, in late 2003 to early 2004, Stewart's Shops decided to create a captive insurance company, Black Ridge Insurance Corp. ("BRIC"), to insure some of its self-insured risks. BRIC received authorization to operate as a captive insurance company licensed by the New York State Insurance Department ("Insurance Department") and provided Stewart's Shops coverage for: (1) losses incurred within the threshold deductible amounts and in excess of the maximum losses covered by its outstanding policies with third-party insurance companies; (2) its self-insured risks and claims from periods before the formation of BRIC ("loss portfolio transfer"); and (3) other risks, including pollution, identity theft, and crime, for which it did not have any insurance at the time of the formation of BRIC.

In the months prior to the formation of BRIC, William Dake, Stewart's Shops' President, engaged in discussions with the Insurance Department's captive insurance group. Mr. Dake testified that, as a result of these discussions, he understood that insurance payments paid to a New York captive insurance company would be deductible for New York corporate franchise tax purposes and believed that Stewart's Shops could not create a stable captive insurance company "without deducting the payments made to BRIC." However, an Insurance Department representative involved in the discussions with Mr. Dake testified that he could not recall representing that the payments were deductible.

BRIC filed annual statements with the Insurance Department and was never contacted by the Insurance Department with any concerns

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about the annual statements. BRIC also paid New York insurance company franchise tax on the insurance payments from Stewart's Shops. In response to a 2004 tax refund claim from BRIC related to payments received for the loss portfolio transfer coverage, in 2005 the Department issued a letter stating that such payments were properly classified as taxable "premiums" for New York insurance company franchise tax purposes.

In 2010 and 2011, the New York State Department of Taxation and Finance audited BRIC and Stewart's Shops. The Department concluded that BRIC was subject to the insurance company franchise tax and could not be included in Stewart's Shops' combined corporate franchise tax returns because BRIC was an insurance corporation. Nonetheless, the Department also disallowed Stewart's Shops' deductions for insurance payments to BRIC, concluding that such payments would not be allowable deductions for federal income tax purposes. During the audit, Stewart's Shops had conceded that, for federal income tax purposes, the insurance contracts between it and BRIC did not qualify as insurance contracts, and that payments made on such contracts did not constitute insurance premiums.

The Law. New York's corporate franchise tax is calculated based on a corporation's entire net income ("ENI"), and ENI is defined by New York tax law as being "presumably the same as" a corporation's federal taxable income. Tax Law § 208(9). While New York calculates taxable ENI by making numerous adjustments and modifications to the federal taxable income amount, no such adjustments were relevant to Stewart's Shops' insurance payments to BRIC.

The Decision. Based on the language of Tax Law § 208(9), the Department argued that Stewart's Shops' insurance payments were not deductible for New York corporate franchise tax because such payments were not deductible for federal income tax purposes. Stewart's Shops, on the other hand, argued that the term "presumably" in Tax Law § 208(9) allows a departure from federal taxable income when accounting for Stewart's Shops' insurance payments to BRIC, and that such a departure is justified, in part because of the legislative history of New York's captive insurance law, which was designed to increase the number of captive insurance companies operating in the State.

The ALJ decided the first issue in the Department's favor, citing case law stating that "[f]ederal law controls for the purpose of defining 'entire net income'" unless there is a specific state departure. *Matter of Dreyfus Special Income Fund, Inc. v. N.Y.S. Tax Comm'n*, 126 A.D.2d 368, 372 (3d Dep't 1987), *aff'd* 72 N.Y.2d 874 (1988). The ALJ rejected Stewart's Shops' claim that New York Tax Law amendments requiring certain captive insurance companies to be included in a New York corporate franchise tax combined return affected such analysis and further concluded that Tax Law § 208(9) did not contain any ambiguity necessitating an examination of the legislative history of New York's captive insurance law.

The ALJ stated that ..."payments from a parent to a wholly-owned captive do not qualify as deductible insurance premiums because the arrangement lacks risk shifting and risk distribution."

Although Stewart's Shops had conceded during audit that its insurance payments to BRIC did not constitute insurance premiums for federal income tax purposes, the ALJ nonetheless conducted an independent analysis of federal law and reached the same conclusion. Specifically, the ALJ identified four criteria in determining the existence of insurance for federal income tax purposes: (1) the arrangement must involve insurable risk; (2) the arrangement must meet commonly accepted notions of insurance; (3) the arrangement must shift the risk of loss to the insurer; and (4) the insurer must distribute the risks among its policyholders. While the ALJ concluded that Stewart's Shops satisfied the first two criteria, she also determined that the insurance arrangements with BRIC did not shift the risk of loss or distribute risks among policyholders. The ALJ stated that numerous federal tax cases on the issue had a "common thread," in that "payments from a parent to a wholly-owned captive do not qualify as deductible insurance premiums because the arrangement lacks risk shifting and risk distribution."

The ALJ also rejected Stewart's Shops' claim that the Department was estopped from denying the deductibility of the insurance payments. The ALJ explained that the record did not support a conclusion that the Insurance Department made any representation related to the deductibility of insurance payments by Stewart's Shops to BRIC, and that the Department's letter to BRIC classifying insurance payments as premiums for New York insurance company franchise tax purposes had no bearing on the classification of such payments for federal income tax or New York corporate franchise tax purposes. However, the ALJ waived penalties in part because she found Stewart's Shops' reliance on such letter from the Department on the payments classification under the Insurance Law to be reasonable.

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Additional Insights

The *Stewart's Shops* decision is notable because there is no prior New York precedent examining the deductibility of insurance payments to a captive insurance company. The decision suggests that the deductibility of insurance payments to captive insurance companies for New York corporate franchise tax purposes will generally depend on whether such insurance payments are properly classified as insurance premiums under federal income tax law. However, as decisions from New York ALJs are not precedential, additional guidance from the New York State Tax Tribunal may be necessary to bring further clarity to taxpayers.

TRIBUNAL HOLDS THAT FURNISHING OF RETAIL STORE PRICING INFORMATION IS SUBJECT TO SALES TAX

By Irwin M. Slomka

In two related decisions, the Tax Appeals Tribunal has upheld the imposition of sales tax on the furnishing of retail grocery store pricing information, rejecting arguments made by the vendor and one of the vendor's clients that the information services qualified for the sales tax exclusion for information that is "personal and individual in nature." *Matter of RetailData, LLC*, DTA No. 825334 (N.Y.S. Tax App. Trib., Mar. 3, 2016); *Matter of Wegmans Food Markets, Inc.*, DTA No. 825347 (N.Y.S. Tax App. Trib., Mar. 10, 2016). The Tribunal decisions make clear that where the source of the information being furnished is readily accessible to the general public – even if the information is not obtained from a common data base nor substantially incorporated into reports furnished to others – the "personal and individual" exclusion does not apply.

The decisions relate to the same underlying services, the taxability of which was challenged by RetailData, LLC (the service provider) and by Wegmans Food Markets, Inc. ("Wegmans"), a supermarket chain and RetailData's largest New York client. RetailData provides price checking services for grocery and retail establishments throughout the United States, including New York State. RetailData principally conducts what are known as "competitive price audits" for its clients. This involves collecting pricing information on specified retail products – usually, comparable private label products – sold in a competitor's stores at specified locations. The pricing data is then validated and transmitted to clients electronically or in printed form. The information is obtained from publicly available sources, *i.e.*, the prices of goods on display on sales floors and shelves in competitors' stores. This data is used by RetailData's clients, such as Wegmans, for their own pricing and marketing strategies. The pricing reports furnished by RetailData to one client were never sold to another client.

The Department assessed sales tax against RetailData for failing to collect and remit sales tax for the period June 1, 2005 through May 31, 2011, on the grounds that the company was providing a taxable information service. In a separate case involving the same services, Wegmans was assessed sales tax on the amounts it paid to RetailData for those services for the overlapping period June 1, 2007 through February 28, 2010. RetailData and Wegmans brought separate challenges to the assessments.

ALJ Decision. An information service is not taxable if it (i) is personal and individual in nature to each client and (ii) is not or may not be substantially incorporated into reports furnished to other clients. Tax Law § 1105(c)(1). In two separate decisions issued by two different Administrative Law Judges (discussed in the March 2015 issue of *New York Tax Insights*), the ALJs held that the information services purchased by Wegmans from RetailData were not "personal and individual" in nature and therefore were subject to sales tax pursuant to Tax Law § 1105(c)(1). Neither taxpayer disputed that what was being furnished was an "information" service, so the only issue was whether the purchased information was "personal and individual in nature." The ALJs concluded that it is the source of the information that determines whether the information qualifies for the "personal and individual" exclusion, and it did not matter that the information did not come from a common database, government database, or a published database. These appeals followed.

The Tribunal held that in order to qualify for the "personal and individual" exclusion, the information must be "uniquely personal."

Tribunal Decision. RetailData and Wegmans made essentially the same arguments before the Tribunal as they did before the ALJs, the thrust of which was that each report being furnished was tailored to a client's specific needs and was therefore never substantially incorporated into reports furnished to others, and that the information being provided in those reports was not derived from a common database, a governmental database, or a published database and was therefore "personal and individual" to each client.

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The Tribunal affirmed both decisions, holding that the information being provided was not "personal and individual in nature" under Tax Law § 1105(c)(1). While noting that tax exclusions are to be strictly interpreted in the taxpayer's favor, the Tribunal also pointed out that the burden of proof still rested with the taxpayer to establish entitlement to the exclusion, concluding that the taxpayers' burden of proof was not met. The Tribunal held that in order to qualify for the "personal and individual" exclusion, the information must be "uniquely personal," citing *Matter of Allstate Ins. Co. v. State Tax Comm'n*, 115 A.D.2d 831, 834 (3d Dep't 1985), *aff'd*, 67 N.Y.2d 999 (1986). Since the information being furnished – the price of products on the shelves of supermarkets open to the public – was not "uniquely personal," it did not qualify for the exclusion. The fact that no two reports are likely to be the same because they were customized for each client did not change this conclusion.

The Tribunal also rejected the argument that whether information qualifies for the "personal and individual" exclusion depends on whether it is obtained from a common database, a government database, or a published database, factors which had been cited in other decisions involving information services. According to the Tribunal, the information *did* come from a "common source" that was not confidential and was widely accessible – non-confidential pricing information obtained from the shelves of competitor supermarkets that were open to the public, citing *Matter of ADP Automotive Claims v. Tax App*. Trib., 188 A.D.2d 245 (3d Dep't 1993) (upholding the imposition of sales tax on the furnishing of cost estimates for automobile repairs using information obtained from widely circulated publications). The Tribunal rejected the taxpayers' claim that only information taken from publicly accessible electronic databases or published bulletins ran afoul of the "personal or individual" exclusion.

Additional Insights

Unless reversed on appeal, these two Tribunal decisions establish a narrow interpretation of the "personal and individual" exclusion from taxable information services. Under the holdings in these two decisions, so long as the source of the information being furnished is publicly available, it does not matter that it was not obtained from a common database, or that it was not substantially incorporated into reports furnished to other clients. Although there is considerable case law holding that the provision of information obtained from a publicly accessible common database does not qualify as personal and individual, these two decisions extend the disqualifying publicly accessible database criteria to include any source of publicly available information.

In that regard, *Matter of RetailData* and *Matter of Wegmans* are potentially important cases that may have a significant impact on the taxation of information services in New York State.

Although not discussed in the decisions, the Department should only be entitled to collect the sales tax once with respect to the information services furnished by RetailData to Wegmans.

RECEPTION SERVICES HELD NOT SUBJECT TO SALES TAX AS "PROTECTIVE AND DETECTIVE" SERVICES

By Hollis L. Hyans

The New York State Tax Appeals Tribunal reversed the determination of an Administrative Law Judge and held that reception services, even though provided by a security service business in conjunction with clearly taxable security guard services, are not subject to sales tax as "protective and detective services." *Matter of AlliedBarton Security Services LLC*, DTA Nos. 825169 & 825690-825693 (N.Y.S. Tax App. Trib., Feb. 16, 2016). This decision, the first issued by the Tribunal that analyzes what are and are not "protective and detective services" in many years, provides needed clarity and may require the Department to rethink the broad application it has been urging for application of the tax on protective and detective services.

Facts. AlliedBarton is primarily engaged in providing security services to business clients, including financial institutions. Its security officers are designed to serve as a deterrent to potential criminal activity and provide a safe and secure workplace. They require special training and a license under New York's Security Licensing Law, set forth in Articles 7 and 7-A of the General Business Law and the regulations promulgated thereunder. AlliedBarton hires security officers by recruiting people interested in law enforcement, including students of criminal justice, former police officers, and military personnel, and subjects them to a thorough background check. They are provided with cell phones and handcuffs, and in some cases with firearms. Services provided by security officers gave rise to approximately 95% of AlliedBarton's revenue. AlliedBarton also provides certain of its clients with receptionists, whose duties included greeting, screening, and processing visitors, and, on occasion, informing unexpected visitors that they could not enter. If such visitors refuse to leave,

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the security officers, and not the receptionists, have the responsibility of dealing with the situation. The receptionists do not require state licensing, have no handcuffs or weapons, wear different uniforms from those worn by security guards, and are recruited from people with hotel, airport, or concierge/receptionist backgrounds. While security guards occasionally perform the duties of a receptionist, receptionists never perform the duties of a security guard.

AlliedBarton's clients also included two private entities that AlliedBarton claimed were acting as agents of governmental entities – the Metropolitan Transit Authority and the City of New York Department of Citywide Administrative Services, respectively – which AlliedBarton treated as exempt from sales tax. However, the record did not contain any Forms ST-122, the *Exempt Purchase Certificate for an Agent of a New York Governmental Entity*, or any Forms DTF-122, *Certification of Agency Appointment by a New York Governmental Entity*, which were required under the Department's Publication 765, effective July 1, 2005.

Issue and ALJ Decision: AlliedBarton collected and remitted sales tax on the 95% of its receipts that arose from providing security officers, but it took the position that its receptionist services, for which it was separately compensated, were not "protective and detective services" subject to tax under Tax Law 1105(c)(8). On audit, the Department disagreed, and assessed sales tax on the receipts for the reception services, and also denied any exemption for the sales that were treated as having been made to exempt agencies.

The ALJ agreed, finding that the reception services were part of the taxable security services, and that the inquiry must focus on "'the service in its entirety, as opposed to reviewing the service by components,'" citing *Matter of SSOV '81, Ltd.*, DTA Nos. 810966 & 810967 (N.Y.S. Tax App. Trib., Jan. 19, 1995). The ALJ also found that AlliedBarton did not qualify for exemption for sales to the two clients it claimed were agents for state entities, because it had not submitted properly completed exemption certificates nor otherwise established that the sales were to governmental entities that were exempt from tax.

Tribunal Decision. First, the Tribunal reviewed the facts, and found significant differences between the security officer services and the reception services, noting that both the qualifications for the jobs and the duties performed were completely different. While acknowledging that some duties by the receptionists could be considered protective in nature, the Tribunal concluded that the services "are really more of a hybrid." The issue therefore turned not on a factual determination, but on a question of statutory interpretation: whether the term "protective and detective services" in Tax Law § 1105(c)(8) includes such a hybrid service. In making the determination, the Tribunal reiterated that, since the issue is the imposition of a tax, the "statute cannot be read to allow the government to tax anything more than the clear terms of the statute allow," and that there is no reason to defer to the expertise of the state agency.

The Tribunal then determined that ... the statute was intended to cover services such as those provided by AlliedBarton's security officers, but not the services performed by the receptionists....

The Tribunal then determined that, while there is no definition of protective or detective services in the Tax Law, a consideration of the types of services listed as examples, such as alarm systems, detective agencies, and patrol and watchman services, indicated that the statute was intended to cover services such as those provided by AlliedBarton's security officers, but not the services performed by the receptionists such as checking a visitor's identification and issuing passes to enter facilities. It also cited to *Compass Adjusters & Investigators v. Comm'r of Taxation & Fin. of State of N.Y.*, 197 A.D.2d 38, 41 (3d Dep't 1994), in which the Appellate Division found that, since there was no definition of "detective services" in the Tax Law, the court should look to the definition of "private investigator" in GBL § 71(1). The court in *Compass Adjusters* concluded that services requiring a private investigator's license were taxable as detective services, while services for which no private investigator's license was required were not subject to tax. In *AlliedBarton*, the Tribunal similarly found that the language in GBL § 71(2), referencing such activities as "watch, guard or patrol agency," was consistent with and appropriate to use to interpret Tax Law § 1105(c)(8), and that the duties performed by the receptionists were not covered by the statute.

The Tribunal also disagreed with the ALJ's refusal to separately analyze the two components of AlliedBarton's service. The Tribunal found that the security services were on occasion provided without receptionist services, and that even when they were provided together they were separately invoiced, so that the analysis in *Matter of SSOV*, which dealt with

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an attempt to separate out parts of a nontaxable dating service into separate taxable components, did not apply.

However, the Tribunal did sustain the ALJ's decision denying the claimed exemptions, finding that the guidance issued by the Department in May 2005 required vendors to provide Forms ST-122, including copies of Forms DTF-122, and that there was no evidence of any such forms, which would entitle AlliedBarton to a presumption of exemption, or of any other clear evidence to overcome the presumption of taxability.

Additional Insights

The decision in *AlliedBarton* is consistent with the earlier interpretation of the tax on detective and protective services by the Appellate Division in *Compass Adjusters*, which also equated the services taxable under Tax Law § 1105(c)(8) to those covered by GBL § 71(1). It is also a clear indication of the long-held view of both the Tribunal and the courts that the statutory language is the ultimate guidance, and that language imposing a tax must be narrowly interpreted in favor of taxpayers and cannot be expanded by the Department. This reminder may be particularly useful in the area of detective and protective services, where no precedential decision interpreting the scope of Tax Law § 1105(c)(8) has been issued for many years, and where, in the absence of precedential guidance, the Department has recently taken a much more expansive view of the reach of the statute. Last year, in an *Advisory Opinion*, TSB-A-15(16)S (N.Y.S. Dep't of Taxation & Fin., May 7, 2015), the Department took the position that cloud-based "fraud management services," described as services offered to merchants accepting credit cards to analyze and identify risks based on parameters provided by the merchants were subject to sales tax as detective and protective services. The Advisory Opinion did not discuss *Compass Adjusters*, GBL § 71(2), or indeed any other case or statutory support for its conclusions. In light of the distinct narrowing of the scope of the Tax Law § 1105(c)(8) by the Tribunal in *AlliedBarton*, the continued validity of the Department's position in this Advisory Opinion is questionable.

TRIBUNAL AFFIRMS DECISION DENYING SALES TAX REFUND OF AMOUNTS NOT YET REFUNDED TO CUSTOMERS

By Hollis L. Hyans

The New York State Tax Appeals Tribunal has affirmed the decision of an Administrative Law Judge denying sales tax refunds of over $100 million because the vendor had not complied with the statutory requirement that the amount in issue must first be refunded to customers. *Matter of New Cingular Wireless PCS LLC*, DTA No. 825318 (N.Y.S. Tax App. Trib., Feb. 16, 2016). The Tribunal also affirmed the ALJ's separate decision denying the company's motion to reopen the record.

Background. In order to resolve litigation claiming that New Cingular Wireless, now known as AT&T Mobility ("ATTM"), improperly collected and remitted sales tax on charges for Internet access, ATTM entered into a class action settlement agreeing to reimburse its customers, including New York customers, for the overcollected tax by filing refund claims for their benefit. The agreement involved the creation of an escrow account to receive sales tax refunded by the states, with those funds to be distributed to the customers by an escrow agent under court supervision. In states like New York that require a vendor to refund the overcollected tax to its customers prior to receiving a refund from the state, ATTM agreed to fund a pre-refund escrow fund. However, before claiming the refund, ATTM did not make any payments to the pre-refund escrow fund with respect to the overcollected New York sales tax.

The ALJ had determined that since ATTM had not repaid the tax to its customers, it could not obtain a refund because it failed to satisfy Tax Law § 1139(a), which provides that "[n]o refund or credit shall be made to any person of tax which he collected from a customer until he shall first establish to the satisfaction of the tax commission, under such regulations as it may prescribe, that he has repaid such tax to the customer."

A month after the ALJ decision, in August 2014, ATTM filed a motion to reopen the record or for reargument, claiming that it had not previously funded the New York escrow account because the Department had informed it that the refund claim would nonetheless be denied on other grounds; that it subsequently did fund the New York escrow account; and that it could submit evidence establishing that the account had indeed

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been funded. The ALJ denied the motion, noting that the Tribunal's Rules of Practice and Procedure only allow the record to be reopened for newly discovered evidence and that this evidence was not newly discovered but had not been in existence at the time of the original hearing.

Tribunal Decision. The Tribunal affirmed the ALJ on both grounds. First, it agreed that the record cannot be reopened for the admission of evidence that was not in existence at the time of the original hearing and only was created afterwards. It rejected ATTM's assertion that the Tribunal had "inherent authority" to reopen the record when there has been a change in circumstances, finding there was simply no basis in the governing statute and rules to reopen the record, and that reopening would be contrary to the Tribunal's "mission to provide a fair and efficient hearing system which…must be both defined and final."

[T]he Tribunal found that the language of Tax Law § 1139 unambiguously requires actual repayment or reimbursement to customers before a vendor may receive a refund....

On the merits of ATTM's refund claim, the Tribunal found that the language of Tax Law § 1139 unambiguously requires actual repayment or reimbursement to customers before a vendor may receive a refund, and that the various agreements among the parties, while they might constitute a legally binding promise to pay, did not satisfy the statutory language. The Tribunal explicitly noted that it was not addressing the question of whether funding of the escrow account would be sufficient to satisfy the repayment requirement since, given its denial of the motion to reopen, "there is no evidence in the record of any such escrow account funding." The Tribunal also agreed with the ALJ that the contrary decision by the New Jersey Tax Court in *New Cingular Wireless PCS, LLC v. Director, Division of Taxation*, 28 N.J. Tax 1 (2014) is distinguishable, due to differences between the New Jersey and New York statutes and the lack of any New Jersey regulations on point, where New York's regulations strongly support the payment requirement.

Additional Insights

There is no doubt that the New York sales and use tax statute, like those in many states, contains a clear requirement that customers must be repaid before a vendor can obtain a refund. This can result in a significant hardship to vendors when a potential refund is large and there is no guarantee that the state will agree a refund is due, and the $100 million at issue in *New Cingular Wireless* would be particularly daunting. Other state Departments of Revenue, in states with similar statutes, have, on occasion, been willing to work with vendors to create mechanisms to ensure no unjust enrichment to the vendor, but no enormous out-of-pocket expenses either, such as "unconditional promise to pay" agreements entered into between vendors and customers requiring the customers to be paid during the time period between the Department agreeing the refund claim is valid and actually issuing the payment to the vendor. Neither the ALJ nor the Tribunal was satisfied with any of the documents executed by ATTM and its customers and, due to the failure to fund the escrow account before the initial hearing (which ATTM claimed was based on informal advice from the Department that it wouldn't have mattered) and the Tribunal's sustaining the ALJ's determination not to reopen the record, it is impossible to know what impact funding the escrow account might have had.

At press time it is not yet known whether ATTM will appeal to the Appellate Division.

ALJ ISSUES DECISIONS ON THE TAXATION OF UNAUTHORIZED INSURANCE CORPORATIONS

By Irwin M. Slomka

Three recent decisions by an Administrative Law Judge address the sometimes confusing rules on how New York State taxes insurance companies that have nexus with the State but that nonetheless do not conduct an insurance business in the State. *Matter of Bayerische Beamtenkrankenkasse AG*, DTA No. 824762 (N.Y.S. Div. of Tax App., Mar. 3, 2016); *Matter of Landschaftliche Brandkasse Hanover*, DTA No. 825517 (N.Y.S. Div. of Tax App., Mar. 3, 2016); and *Matter of AXA Versicherung AG*, DTA No. 825518 (N.Y.S. Div. of Tax App., Mar. 3, 2016). In *Matter of Bayerische and Matter of Landschaftliche*, the ALJ held that foreign non-life insurance companies whose sole connection with New York State was ownership of interests in real estate partnerships that conducted business in the State were subject to the Article 33 tax under Tax Law § 1501 (which is imposed on the highest of four alternative bases, including on allocated net income) and that the Department's application of an alternative apportionment formula was reasonable. In

Matter of AXA Versicherung, the ALJ concluded that the petitioner, the significant majority of the receipts of which were from providing non-life insurance, nonetheless constituted a life insurance corporation, which meant that it was entitled to the limitation on tax under Tax Law § 1505(a)(2).

Facts. The facts in *Matter of Bayerische* and *Matter of Landschaftliche* were straightforward. The cases both involved German non-life insurance companies that did not conduct an insurance business in the United States. As such, they were not authorized by the New York Superintendent of Insurance (now known as the Superintendent of Financial Services) to transact an insurance business in New York and were considered "unauthorized insurance corporations" under the Tax Law. The insurance companies' activities in the United States and New York were limited to holding two interests in partnerships which owned and managed real property, some of which were located in New York State.

Since none of the income subject to apportionment ... was from premiums, and since the statutory formula was heavily weighted based on premiums, the ALJ found the Department had a "substantial basis" for rejecting it under these facts.

Both insurance companies filed New York State non-life insurance corporation tax returns and paid the minimum tax for the years 2006 and 2007. Following an examination of the New York State partnership tax returns of the partnerships in which they were partners, the Department assessed additional tax against the insurance companies, first by subjecting them to tax under Tax Law § 1501 (which is imposed on the highest of four alternative bases, in this case the highest being on allocated net income) and then by exercising the Department's discretionary authority to disregard the prescribed allocation formula (which is based on weighted premiums and wages factors), and substituting a single receipts factor based on their distributive share of receipts from the partnerships.

Statutory Argument. The insurance companies made two alternative arguments. First, they maintained that the statute should be interpreted so that Tax Law § 1502-a – which limits the tax for *authorized* non-life insurance corporations to the tax that would be due on direct premiums – applied to them, even though they were *unauthorized* insurance corporations. The insurance corporations had no direct premiums in the State, so they took the position that only the minimum tax should apply.

The ALJ rejected this argument, holding that he could not ignore the express terms of § 1502-a, which clearly only applied to *authorized* non-life insurers. Therefore, the ALJ held that the insurance corporations were subject to the § 1501 tax based on their allocated entire net income and were not covered by the § 1502-a "in lieu of" premiums tax limitations.

Alternative Apportionment Argument. In the alternative, the insurers argued that even if they were properly subject to tax under § 1501, the statutory allocation method (based on premiums and wages) should apply, not, as the Department asserted, an alternative single factor method based on receipts from the partnerships.

Tax Law § 1504(a) provides that an insurance corporation's entire net income is apportioned based on a two-factor allocation percentage, the first factor being the ratio of New York State premiums to total premiums, and the second factor being the ratio of New York State employee wages to total wages, with the premiums factor more heavily weighted at 90%. The Department declined to apply this formula and invoked Tax Law § 1504(d), which permits the Department to adjust the statutory formula in order to properly reflect income. Thus, rather than applying the zero allocation percentage as reported, the Department applied an alternative apportionment based on the ratio of the insurers' distributive share of New York receipts from the partnerships to their distributive share of total receipts from the partnerships, which was approximately 69%.

The ALJ acknowledged that, as the party seeking to deviate from the statutory formula, the Department must not only show that the statutory formula did not properly reflect the taxpayer's New York income and activity, but also that the Department's proposed alternative formula did. Since none of the income subject to apportionment – specifically, the partnership income – was from premiums, and since the statutory formula was heavily weighted based on premiums, the ALJ found the Department had a "substantial basis" for rejecting it under these facts. According to the ALJ, "since *unauthorized* insurance corporations . . . may . . . have no premium-based income, application of a premium-based allocation formula to non-premium-based entire net income would be, at best, inconsistent."

The ALJ also found the Department's application of a single factor receipts-based apportionment formula was reasonable under the facts. The ALJ noted that while this resulted in more than 2/3 of the insurers' entire net income being apportioned to New York, as non-U.S. corporations their entire net income did not include their worldwide income, and the majority of their income subject to apportionment arose from the partnerships' New York real estate activity and income. Apportioning that income by a single factor receipts-based formula attributable to those partnerships was, according to the ALJ, clearly reasonable under the facts.

Life Insurance Corporation Decision. In *Matter of AXA Versicherung AG*, the same ALJ addressed a different threshold question for the tax years 2006 and 2007 – whether a different German insurer constituted a life insurance corporation for New York insurance tax purposes where the substantial majority of the insurer's premiums were from the furnishing of non-life insurance, although it did receive some reinsurance premiums relating to life insurance. The ALJ held that the insurer should be classified as a *life* insurance corporation because it engaged in a life insurance business, albeit outside the State, through reinsurance. Therefore, under the Department's pre-2012 policy regarding unauthorized life insurance corporations, the ALJ held that the deficiency should be cancelled and that the Department should refund the minimum taxes previously paid by the insurer.

Additional Insights

The ALJ's affirmance of the Department's rejection of the statutory apportionment formula was based principally on the fact that the formula is almost entirely based on premiums and the insurers were not being taxed on premiums. However, the alternative method used gave no weight to the fact that the premiums earned by the insurers outside the State were undoubtedly the source for their ability to invest in the partnerships that generated most of the insurers' income subject to apportionment, and therefore it could reasonably be argued that those premiums should have been reflected in the apportionment formula. Moreover, if the unauthorized insurers were instead U.S. corporations so that their apportionable income *did* include premiums earned outside the State, the ALJ's rationale for disregarding the statutory formula would not seem to apply, resulting in potentially divergent treatment of U.S. and foreign insurers. In any event, if the Department believes that the statutory formula should not apply to unauthorized non-life insurers, the more appropriate remedy would be through legislation to change the formula to more accurately reflect income and activity in the State.

INSIGHTS IN BRIEF

On Remand, ALJ Adheres to Original Decision that SUNY Professor's Distribution from a Rollover IRA Does Not Qualify for State Pension Exclusion

After remand from the New York State Tax Appeals Tribunal, an Administrative Law Judge has again held that a retired SUNY professor's distribution from a rollover IRA did not qualify for the 100% exclusion from the personal income tax for pensions paid to State employees. *Matter of Peter and Marguerite Kane*, DTA No. 824767 (N.Y.S. Div. of Tax App., Mar. 3, 2016). In response to the Tribunal's direction to more completely address the question of how the rollover of an otherwise qualifying SUNY pension into an IRA changed the nature of the taxpayer's pension, the ALJ reviewed the basis for the statutory exemption for New York State employee pension income in Tax Law § 612(c)(3)(i) and 20 NYCRR 112.3(c)(1), and analyzed at length the different treatment of IRAs from that of state pension funds, including the maximum control and flexibility allowed under IRAs, significantly different regulatory requirements, and the lack of any direct contribution of the funds by the State, to reach the conclusion that distributions from an IRA were not entitled to the exemption.

Advisory Opinion Issued on How Resale Certificates May be Used by a Canadian Vendor

The New York State Department of Taxation and Finance has concluded that a Canadian vendor that registers as a vendor for sales tax purposes may issue resale certificates to its suppliers to avoid paying tax on purchases of materials it intends to resell. *Advisory Opinion*, TSB-A-16(4)S (N.Y.S. Dep't of Taxation & Fin., Feb. 22, 2016). The Petitioner seeking advice is a Canadian contractor, operating only in Canada but purchasing raw materials from vendors both inside and outside New York, which it then resells to an affiliate in New York, retaining ownership of the raw materials during at least part of the time the materials are in New York. The Department concluded that, in order to provide a valid resale certificate to its vendors, the Petitioner must first register for sales tax purposes, and then can purchase materials for resale without paying tax if the sales meet all the other necessary criteria.

Website Monitoring Service Treated as a Nontaxable Information Service

The Department of Taxation and Finance determined that a company's web traffic monitoring service was an information service not subject to sales tax because the information was personal or individual in nature and was not substantially incorporated in reports furnished to others. *Advisory Opinion*, TSB-A-16(3)S (N.Y.S. Dep't of Taxation & Fin., Feb. 22, 2016). The company embedded its software on the customer's website in order to gather information about visitors to the site. The fact that the company also made available to its customers anonymized data showing traffic patterns for similar websites at no additional charge did not cause the web traffic monitoring service to be a taxable information service because the provision of the anonymized data was a *de minimis* and incidental part of the overall information service provided.

ALJ Holds That Retroactive Volume Discount Does Not Reduce Sales Tax on Prior Sales

A New York State Administrative Law Judge rejected a company's attempt to apply a volume discount retroactively to sales on which the full purchase price had already been paid and held that the discount did not reduce the sales tax due on those prior sales. *Matter of Prima Asphalt Concrete, Inc.*, DTA Nos. 826279 & 826280 (N.Y.S. Div. of Tax App., Feb. 25, 2016). The ALJ found that the clear intent behind the statute and regulations was to impose sales tax at the time of transfer of title and possession. Therefore, it is the incidence and rate of the sales tax at the time of transfer and title and possession that controls. Allowing a volume discount to be applied at any time to reduce sales tax, sometimes years after the sale, was found to be untenable.

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