

NEW YORK TAX INSIGHTS

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NEW YORK RELEASES COMPREHENSIVE REVISIONS TO DRAFT APPORTIONMENT REGULATIONS

By [Irwin M. Slomka](#) and [Kara M. Kraman](#)

The New York State Department of Taxation and Finance has released revisions to its draft business corporate franchise tax regulations interpreting the general rules in Tax Law § 210-A for computing the business apportionment factor under New York State corporate tax reform, which went into effect in 2015. The revisions, if promulgated, will impact many businesses, including those in the financial services industry. *Draft Apportionment Rules, Part 4* (N.Y.S. Dep't of Taxation & Fin., released July 18, 2019). The new draft comes just two weeks after the Department released other draft regulation revisions relating to digital products and other services and other business receipts.

The latest revisions are extensive in scope, and include both changes to provisions in the previous draft version and the addition of some entirely new provisions. Some of the more notable changes and additions are summarized below:

Business receipts. The latest draft changes the definition of “business receipts” includable in the apportionment factor, so that the term now includes receipts from unusual events that are not received in the regular course of the taxpayer’s business. This would be a departure from both the long-standing Article 9-A practice – which, for example, excluded from the factor receipts from sales of capital assets or from sales outside the ordinary course of the taxpayer’s business – and from the earlier version of the draft regulation, which specifically excluded receipts from unusual events.

Marked to market financial instruments. “Qualified financial instruments” (“QFIs”), which are prescribed financial instruments marked to market by the taxpayer, qualify for the election to use an 8% fixed apportionment method. The new draft rule provides that securities held by a dealer that meet one of the exceptions from being marked to market for federal income tax purposes under IRC § 475(b)(1) – such as securities held for investment – will *not* be considered marked to market for apportionment purposes and, thus, will not be considered QFIs eligible for the 8% election, even where the dealer has not identified the securities for purposes of the marked to market exception under IRC § 475(b)(2). The result of this new draft rule would appear to be that a corporation could have securities that are actually marked to market

for federal income tax purposes, but that do not qualify as QFIs for Article 9-A purposes. As a result, a securities dealer having marked to market income for both federal and Article 9-A purposes may be required to source that income in the apportionment factor under the prescribed customer sourcing methods.

Broker-dealer sourcing. Various categories of receipts of registered broker-dealers are subject to special sourcing rules. A new rule provides that the term “registered broker or dealer” does *not* include any corporation that is merely a partner or member in a broker-dealer entity but is not itself a registered broker or dealer.

Discretionary adjustments. The new draft now specifies that the party seeking to vary the apportionment factor bears the burden of proof to demonstrate by “clear and convincing evidence” that the standard formula does not result in a proper reflection of the taxpayer’s business income or business capital in the State, and that the application of the standard formula attributes income or capital to the State that is “out of all proportion” to the business transacted by the taxpayer in the State. The earlier version permitted a discretionary adjustment whenever the factor did not “properly reflect” income or capital. The draft contains new examples involving financial services, including one involving a corporation with 95% of its income consisting of dividends and net gains from investments in stock, and 5% consisting of fees for investment advisory services. The example concludes that a discretionary adjustment would be made to include the otherwise excluded dividends and net gains in the apportionment factor in order to properly reflect the taxpayer’s business income in the State.

Credit card processing services. Receipts received by credit card processors for authorizing, clearing, and settlement are sourced to where the processor’s customer accesses the processor’s network, with receipts not specifically addressed by statute sourced to New York based on an average of (i) 8% (roughly based on New York’s share of U.S. GDP) and (ii) the percentage of customer “access points” in New York out of all of its access points in the United States. The draft contains a new sourcing method applicable to third-party processors, including receipts from volume-based activities, where the processor cannot identify the access points. In that case, the draft provides for sourcing to New York the processor’s other receipts based on the average of (i) 8% and (ii) the percentage of customers with “billing addresses” in the State.

The draft regulations also contain new rules for apportioning interest income and net gains from asset-backed securities and other government

agency debt, interest income, and net gains from corporate bonds, brokerage commission receipts, and net interest income from federal funds.

The Department is seeking comments by October 18, 2019. While the draft regulations contain helpful guidance, they cannot be relied upon by taxpayers until they are adopted, although the Department has not provided a timetable for their adoption. The New York City Department of Finance has indicated on its Business Corporation Tax FAQ page that it intends to issue rules that correspond to the regulations issued by New York State under Article 9-A where the underlying statutes correspond, and that corporations *can* rely on draft regulations posted on New York State’s website until such time as the City issues its regulations.

THIRD DEPARTMENT CONFIRMS HOLDING THAT ELEVATOR PURCHASES ARE SUBJECT TO SALES AND USE TAX

By [Hollis L. Hyans](#)

The Appellate Division, Third Department, has confirmed the decision of the New York State Tax Appeals Tribunal that an elevator installation company was liable for sales and use tax on the elevator products that it purchased for sale and installation, along with services and maintenance sales related to the elevators. *Zuckerman v. Tax Appeals Trib.*, No. 526059, 2019 NY Slip Op. 05602 (3d Dep’t, July 11, 2019). The court agreed with the Tribunal that the petitioner company had failed to demonstrate that all of the elevator products purchased and installed qualified for the statutory exemption applicable to medical equipment and prosthetic devices.

Facts. The petitioners included Titan Elevator & Lifts LLC (“Titan”) and its principals, Shari Zuckerman and Michael Zuckerman. Titan is a New York limited liability company engaged in the business of installing and servicing small elevators and dumbwaiters for use in homes and small business locations. It was not registered as a sales tax vendor in New York and had not paid sales tax on any of its purchases or collected tax from any of its customers. The Department audited Titan for the period December 1, 2003 through November 30, 2009, and repeatedly requested records for that entire period, but received complete records only for 2007. Despite

recognizing that 2007 might not be a representative year, the Department treated that year as the “test period” to perform the audit because it was the only year for which Titan had purchase and sales invoice records.

The Department examined Titan’s 2007 sales invoices and expense purchases and extrapolated from those records to calculate tax due for the entire audit period on Titan’s purchases of materials used in the installation of elevators and on service and maintenance of elevators. The auditor also reviewed letters, purportedly from Titan’s customers, stating that the customers had purchased and installed the elevators “for medical purposes in order to create accessibility in the home.” The Department disregarded these letters as unreliable. The Department assessed tax on sales of service and maintenance of elevators and dumbwaiters, and tax on purchases of elevators and dumbwaiters from manufacturers, and imposed penalties.

[B]ecause Titan had failed to produce the requested documents . . . it was “wholly appropriate for the Department to utilize an indirect audit methodology.”

Tax Law and decisions below. Sales of tangible personal property, and certain sales of tangible personal property installation and maintenance services, are generally subject to sales and use tax unless a statutory exemption applies. Tax Law §§ 1105(a), (c)(3), 1110(a), 1115. Titan argued that its purchases and sales were exempt from sales and use tax, either as “medical equipment” and “supplies” used “to correct or alleviate physical incapacity,” or as “[p]rosthentic aids.” Tax Law § 1115(a)(3), (4). Department regulations state that in order to qualify for the medical equipment exemption, the equipment in question “must be primarily and customarily used for medical purposes and not be generally useful in the absence of illness, injury or physical incapacity.” 20 NYCRR 528.4(e)(2). Similar requirements also apply to the exemption for prosthetic devices. 20 NYCRR 528.5(b)(1).

Titan and its principals challenged the assessment, both on the grounds that an estimation method should not have been used and that it was entitled to an exemption. After a hearing was held, the Administrative Law Judge (ALJ) concluded that the Department had properly assessed sales and use tax on the purchases of materials to install elevators and on Titan’s sales of installation and maintenance services related to such elevators, because Titan had failed to meet its burden to

demonstrate an exemption. The Tribunal affirmed the ALJ determination in all respects, finding that Titan had failed to demonstrate that the elevators were “primarily and customarily used for medical purposes and [are] not” merely “*generally useful* in the absence of illness, injury, or physical incapacity,” as required by 20 NYCRR 528.4(e)(2), and held that the law does not permit the exemption simply because the elevator was designed for use by a person with a disability, but requires evidence that the elevator is “primarily and customarily” used for such purposes. It also found that the use of the estimation method was proper because the Department had repeatedly requested complete books and records for the entire period, but never received complete records.

Appellate Division decision. The court confirmed the Tribunal’s decision in all respects. Dealing first with Titan’s objection to the indirect audit methodology used by the Department, the court found that, because Titan had failed to produce the requested documents — including a general ledger, merchandise purchase invoices, sales invoices, exemption documents supporting nontaxable sales, and a cash receipts journal — it was “wholly appropriate for the Department to utilize an indirect audit methodology.”

The court then rejected Titan’s claim that it was entitled to the medical equipment or prosthetic device exemption. The burden was on Titan to prove its entitlement to an exemption, and the court found Titan had failed to meet that burden. It found Titan’s reliance on a Department publication regarding the use of elevators to be “misguided,” since the publication exempted elevators used as a prosthetic device by an individual with a disability that were installed in a residence, and the record showed that not all the elevators were installed in residences, nor were they designed as prosthetic devices for any particular person, and the Department’s investigation showed that one of the elevators installed for disabled individuals at a country club was also used by individuals without disabilities. The court found that letters from customers introduced by Titan to support its position were of “minimal value,” since they were undated, contained the exact same language, did not explain the individual’s disability, and, in one case, contained changes that the writer of the letter denied making.

The court also upheld the imposition of penalties, concluding that Titan relied solely on a claim of having acted in good faith, quoting *Shuai Yin v. State Dep’t of Taxation & Fin.*, 151 A.D.3d 1497, 1501 (3d Dep’t, 2017), for the proposition that “[n]either ignorance of the law nor the good faith advancement of a reasonable legal

theory constitutes reasonable cause in the absence of the taxpayer's efforts to ascertain the proper tax liability.”

Titan was unable to establish that its elevators were not only designed for persons with disabilities, but also were compliant with the statutory and regulatory requirements that the elevators be used “primarily and customarily” by persons with disabilities to qualify as medical equipment or prosthetic aids.

ADDITIONAL INSIGHTS

In the sales tax area, strict compliance with the statutes and regulations is generally required. Here, Titan was unable to establish that its elevators were not only designed for persons with disabilities, but also were compliant with the statutory and regulatory requirements that the elevators be used “primarily and customarily” by persons with disabilities to qualify as medical equipment or prosthetic aids. While that can be a difficult burden — at the ALJ hearing, one of Titan’s principals testified that Titan was not the “elevator police,” tracking the use of every elevator it installed — the statute does require the vendor to demonstrate the “primary and customary use,” and any supporting documents sought by a vendor from its customers must be accurate and convincing to the Department and to the ultimate trier of facts, who will look behind the written statements.

TRIBUNAL UPHOLDS TAX DEPARTMENT’S DENIAL OF SALES TAX EXEMPTION ON HOTEL DEVELOPER’S EXCESS PURCHASES FOR IDA PROJECT

By [Irwin M. Slomka](#)

The New York State Tax Appeals Tribunal has affirmed a determination that a hotel developer, acting as a designated agent of a New York State industrial development agency (“IDA”), was not entitled to a sales and use tax exemption for purchases it made to construct

a hotel at a cost in excess of the amounts it had estimated in its application for IDA tax benefits. *Matter of Jefferson Hotel Associates LLC*, DTA No. 827618 (N.Y.S. Tax App. Trib., June 27, 2019). The Tribunal’s decision makes clear that a developer that incurs costs beyond the estimates in its IDA application must amend its application in order to claim the excess sales tax exemption amounts.

Background. In June 2012, Jefferson Hotel Associates LLC (“Jefferson Associates”) applied for financial assistance through an upstate New York IDA to construct a hotel in Monroe County, New York. As is common for IDA projects, the application sought a real property tax abatement, a mortgage recording tax exemption and, as relevant to the dispute, a sales and use tax exemption.

The application required that Jefferson Associates estimate the costs of construction to determine the amount of the anticipated sales tax exemption. Jefferson Associates provided the IDA with an estimated sales tax benefit of approximately \$223,000. The IDA accepted the application, approving the appointment of Jefferson Associates as the IDA’s agent for purposes of the hotel project and issuing a letter authorizing Jefferson Associates to make purchases free of sales tax. That letter also stated that the “[t]otal costs of the project cannot exceed the project costs” that Jefferson Associates estimated in its IDA application.

The IDA agent letter was thereafter extended twice (in December 2012 and February 2014), with each extension containing the same \$223,000 estimated sales tax exemption amount. Subsequently, Jefferson Associates filed with the Department of Taxation and Finance reports of IDA sales tax exemptions, but now reported a total sales tax exemption of approximately \$253,000, about \$30,000 more than it had previously estimated.

In February 2015, the IDA issued a Demand Letter to Jefferson Associates seeking repayment of the excess \$30,000 in sales tax. Subsequently, in November 2015, the Department itself issued a Notice and Demand seeking payment of the \$30,000, plus interest. Jefferson Associates paid the amount sought and, following the Department’s denial of its refund request, filed a Petition with the Division of Tax Appeals.

Relevant statutory amendments. Directly relevant to the dispute were amendments to the New York General Municipal Law, effective March 28, 2013, that significantly changed the way IDAs could allow sales tax exemption benefits. Under those amendments, IDAs were now required to recapture sales tax exemption benefits “in excess of the amounts authorized” and to remit those

amounts to the Department. In addition, the amendments authorized the Department to assess tax, penalties, and interest if the excess amounts were not paid over to the IDA. The new law applied to any amendment of a project made on or after March 28, 2013, that involved “additional funds or benefits.” Gen. Mun. Law § 875. The developer argued that the new law was inapplicable because there were no amendments of the hotel project after March 28, 2013, and that, even if the new law did apply, it did not limit the sales tax exemption to the estimate in its application.

The Tribunal . . . noted that each of the IDA letters stated that the total project costs “cannot exceed” the estimated project costs, and found that it was reasonable to limit the benefit to the estimated sales tax exemption amount.

ALJ determination. An ALJ held that the excess sales tax amount was properly subject to repayment and that the new law applied because the February 2014 project extension was an amendment that conferred additional benefits after the effective date of the new law. The ALJ also concluded that the extensions of the sales tax exemption letter issued by the IDA, made after March 28, 2013, specifically identified the lower \$223,000 exemption amount, which capped the allowable exemption amount.

Tribunal decision. The Tribunal affirmed the ALJ determination in its entirety. It noted that each of the IDA letters stated that the total project costs “cannot exceed” the estimated project costs, and found that it was reasonable to limit the benefit to the estimated sales tax exemption amount. It also concluded that the new law that imposed the limitation was applicable, finding that the extension of the developer’s IDA agency appointment through June 30, 2014, was “an amendment . . . involving additional funds or benefits” to the hotel project under the new law.

ADDITIONAL INSIGHTS

The developer had pointed out that limiting the sales tax exemption was inconsistent with the IDA’s broad authorization for the developer to make all necessary purchases for the project. However, the Tribunal noted that the 2013 amendments to the General Municipal Law were put in place to enable the IDA to control the costs of a project. The Tribunal also stated that the developer’s

recourse would have been to “amend the [IDA] project,” which the developer did not do. The Tribunal found that the 2014 extension of the IDA agency was “an amendment . . . involving additional funds or benefits,” with the alleged “benefit” being the extension of the time for the developer to make purchases free of sales tax. The decision does not address whether the legislative history for the General Municipal Law amendments indicated an intent to treat an extension of an IDA project as an “additional benefit” within the meaning of the new law.

INSIGHTS IN BRIEF

ALJ UPHOLDS DENIAL OF PERSONAL INCOME TAX DEDUCTIONS

A New York State ALJ has found that an individual taxpayer failed to establish that he was entitled to the itemized deductions that he claimed for charitable contributions, job expenses for cleaning suits he wore to work, commuting, and for gambling expenses for nonwinning lottery tickets. *Matter of Abraham Massil*, DTA No. 828399 (N.Y.S. Div. of Tax App., July 11, 2019). With regard to the job expenses for commuting and dry cleaning, the ALJ found that commuting costs between home and office are “simply not deductible,” and that Mr. Massil failed to make the necessary demonstration that the dry cleaning expenses were for clothing that was required for or essential to his employment and could not be used for general wear. The deduction for the gambling expenses of nonwinning lottery tickets was disallowed because a “casual gambler” such as Mr. Massil, who was not engaged in gambling as a trade or business, is not permitted under federal or New York State law to reduce adjusted gross income by gambling losses and expenses.

ALJ FINDS PETITIONER FAILED TO PROVE CHANGE OF DOMICILE

An ALJ has rejected a doctor’s claim that he had changed his domicile from New York to Michigan when he accepted a position as Chief of Neurology with the Veterans Administration in Iron Mountain, Michigan, finding that the doctor had failed to make the necessary demonstration of a subjective intent to abandon his historic New York domicile and establish a new domicile in Michigan. *Matter of Jeremiah H. & Jung J. Yim*, DTA No. 827687 (N.Y.S. Div. of Tax App., June 27, 2019). The ALJ found that, to the contrary, the testimony of the petitioner — who appeared *pro se* — established that his sole motivation for moving was to earn enough money to support his family, that he left New York with only a backpack and continued to keep all his significant belongings in New York, and that he returned from Michigan to New York at the end of his two-

year employment contract. Therefore, the ALJ found no evidence that the petitioner had intended to make Michigan his permanent home “with the ‘range of sentiment, feeling and permanent association’ which indicate the establishment of a new domicile.”

TAXPAYER BILL OF RIGHTS HELD INAPPLICABLE TO TAXPAYER’S TIME-BARRED REFUND CLAIM

An ALJ rejected as untimely a tobacco distributor’s tobacco products tax refund claim where the application was made in December 2010, more than two years after the tax had been paid for the periods June 2006 through May 2007, beyond the refund limitation period. *Matter of Core-Mark*

Midcontinent, Inc., DTA No. 827490 (N.Y.S. Div. of Tax App., July 11, 2019). The ALJ also rejected the taxpayer’s alternative claim for relief under the statutory Taxpayer Bill of Rights, which requires that the Department disclose to the taxpayer any overpayments of tax discovered during the course of an audit. The ALJ found that the taxpayer did not prove that the Department had discovered any tax overpayments while the statute of limitations was still open, and noted that the taxpayer’s refund claim did not state the amount of the claimed overpayment or provide any other detail regarding the claims.

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Clorox Products Manufacturing, Co. v. New Jersey (NJ App. Div. 2008)

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Former CFO of Fortune 500 Co. v. New York (NYS Div. of Tax App. 2017)

frog design, inc. v. New York (NYS Tax App. Trib. 2015)

Hallmark Marketing Corp. v. New York (NYS Tax App. Trib. 2007)

Kohl's Department Stores, Inc. v. Virginia (VA Sup. Ct. 2018)

Lorillard Licensing Co. v. New Jersey (NJ App. Div. 2015)

Lorillard Tobacco Co. v. New Jersey (NJ Tax Ct. 2019)

MeadWestvaco Corp. v. Illinois (U.S. 2008)

Meredith Corp. v. New York (NY App. Div. 2012)

Nerac, Inc. v. New York (NYS Div. of Tax App. 2010)

Rent-A-Center, Inc. & Subsidiaries v. Oregon (OR Tax Ct. 2015)

Reynolds Innovations Inc. v. Massachusetts (MA App. Tax Bd. 2016)

Reynolds Metals Co. v. Michigan (MI Ct. of App. 2012)

Scioto Insurance Co. v. Oklahoma (OK Sup. Ct. 2012)

Thomson Reuters Inc. v. Michigan (MI Ct. of App. 2014)

United Parcel Service General Svcs. v. New Jersey (NJ Sup. Ct. 2014)

Wendy's International, Inc. v. Illinois (IL App. Ct. 2013)

Wendy's International, Inc. v. Virginia (VA Cir. Ct. 2012)

Whirlpool Properties, Inc. v. New Jersey (NJ Sup. Ct. 2011)

W.R. Grace & Co.-Conn. v. Massachusetts (MA App. Tax Bd. 2009)

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