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Sale of Security Services to Property Manager for NYC Housing Authority Held Exempt from Sales Tax

By Kara M. Kraman

A New York State Administrative Law Judge held that the sale of security services by a vendor to a property manager that managed various apartment buildings for the New York City Housing Authority ("NYCHA") was exempt from sales tax both because the property manager was acting as an agent for NYCHA and because such purchases were sales for resale. *Matter of Garrison Protective Services, Inc.*, DTA No. 826738 (N.Y.S. Div. of Tax App., July 6, 2017).

Facts. Garrison Protective Services ("Garrison") provided security guard services to Grenadier Realty Corporation ("Manager"), as well as to several other entities. Manager contracted with NYCHA to manage various apartment buildings located in New York City. The contract described Manager as an "independent contractor." Pursuant to the terms of the contract, Manager agreed to provide management services that included, among other things, rent collection, inspection and maintenance, and security services. Manager was expressly authorized by the contract to hire a private security firm to provide the security services. In addition, the contract between Manager and NYCHA required Manager to perform its duties under the contract in accordance with the directions of appropriate NYCHA personnel, and to use a request for proposals ("RFP") "to ensure the best possible price for the [NYCHA]" before procuring third-party services.

Garrison did not collect sales tax on its sale of security services to Manager because it understood that Manager was acting as an agent for NYCHA. Subsequently, the Department audited Garrison and assessed sales tax on its sale of security services to Manager, as well as its sales to certain other entities.

Law. Under New York law, the provision of security services is subject to sales and use tax. Tax Law § 1105(c)(8). However, purchases made by New York State government agencies are exempt

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from tax. Tax Law § 1116(a)(1). In addition, purchases made by any person for resale are also exempt from tax. Pursuant to New York State Department of Taxation and Finance Publication 765 (May 2005), a vendor may establish that a sale to a private entity is not taxable because that entity is acting as an agent for a New York State agency by procuring both an Exempt Purchase Certificate for an Agent of a New York Governmental Agency (Form ST-122) and a Certification of Agency Appointment by a New York Governmental Agency (Form DTF-122).

The ALJ rejected the Department's argument that because the contract stated that Manager was an "independent contractor," it could not also be an "agent" . . . .

Decision. In this case, Garrison only obtained Form ST-122, but not Form DTF-122. Nevertheless, the ALJ held that the lack of both prescribed forms did not end the inquiry as to whether the sale was taxable, as nontaxability may be established through other evidence. As there was no dispute that direct purchases by NYCHA were not subject to sales tax, the ALJ focused his inquiry on whether Manager was acting as an "agent" for NYCHA.

Applying a commonly accepted definition of "agency" as a relationship whereby "one retains a degree of direction and control over another" (*Garcia v. Herald Tribune Fresh Air Fund, Inc.*, 51 A.D.2d 897 (1st Dep't, 1976)), the ALJ found that an agency relationship existed because the record clearly established that NYCHA had a fiduciary relationship with Manager, and exercised a high degree of direction and control over Manager's actions. The ALJ rejected the Department's argument that because the contract stated that Manager was an "independent contractor," it could not also be an "agent," holding that under established case law a finding that a person is an independent contractor does not preclude a finding of an agency relationship.

The ALJ also rejected the Department's argument that even if Manager was acting as an agent for NYCHA in general, Manager's purchase of security services was still subject to tax because it was ancillary to the main purpose of the contract, and therefore outside the scope of the agency relationship. The ALJ held that as the contract expressly provided that Manager would provide security services, those services were integral to the contract and not ancillary to its performance.

Although the issue does not appear to have been raised by the parties, in addition to finding that the sale of security services was exempt because Manager was acting as an agent of NYCHA, the ALJ also held that the sale was not taxable as a sale for resale. The ALJ found that the security services were resold as such, and that it was NYCHA, an exempt government agency, and not Manager that was the ultimate consumer of the security services.

Additional Insights

Although the agency issue seems straightforward, the ALJ's additional holding that the sale was also nontaxable as a sale for resale — an issue not raised by the parties — serves as a reminder that an ALJ has the ability to rule on legal issues that were not raised by either party. This rule also applies to the Tax Appeals Tribunal, which may rule on legal issues that were not raised by the parties or even raised in the proceeding before the ALJ, as discussed immediately below.

Tribunal Remands Sales Tax Appeal for Determination of Whether It Has Jurisdiction to Rule on Substantive Issues

By Michael J. Hilkin

Unilaterally raising an issue not addressed in the decision of the Administrative Law Judge or by either of the parties on appeal, the New York State Tax Appeals Tribunal remanded a case in order to develop the record as to whether the Division of Tax Appeals has jurisdiction to reach the substantive issue of whether a buyer of a business was liable for the seller's outstanding sales tax liability under bulk sales

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rules. *Matter of Khayer Kayumi*, DTA No. 825953 (N.Y.S. Tax App. Trib., July 14, 2017).

Facts. In early December 2010, Mr. Kayumi signed an agreement to purchase the business assets, inventory, accounts receivable and goodwill of a Popeye's Chicken & Biscuit restaurant in Brooklyn, New York. Under the terms of the sale, Mr. Kayumi agreed: (1) to make an initial down payment of $80,000, with the seller having the option of requesting that the check be made out to "New York State sales tax"; (2) to make another payment of $20,000, payable to a creditor of the seller, when the sale of the restaurant business closed; and (3) to pay the balance in 30 consecutive monthly payments of $2,000 to the seller. The agreement contained language acknowledging that the seller had a sales tax liability of at least $200,000, and the agreement was expressly conditioned upon the seller's payment of this obligation.

Mr. Kayumi delivered the $80,000 down payment check to Kevin Davis (a shareholder of the seller). Although the check was payable to "New York State sales tax," it was deposited into a business account under the name of "Platinum Properties." After learning in November 2013 that the check was not cashed appropriately, Mr. Kayumi filed a criminal complaint, which led to an indictment against Mr. Davis for unlawful deception and theft. Further, the subsequent $20,000 payment was made to a creditor of the seller other than the Department. Mr. Kayumi never made any of the monthly payments.

Meanwhile, on December 31, 2010, the Department received a Notification of Sale, Transfer or Assignment from Mr. Kayumi related to the sale of the restaurant, along with the agreement memorializing the sale. On January 3, 2011, the Department issued a notice of claim to Mr. Kayumi, advising him that he may be a purchaser of assets in a bulk sale and that there was a possible outstanding claim against the seller for sales and use taxes. Among other things, the notice advised Mr. Kayumi that he should place the entire amount for the purchase in an escrow fund for the purpose of satisfying any sales tax liabilities. On January 7, 2011, the Department sent a follow-up letter to Mr. Kayumi, asserting sales tax due on the transfer of tangible personal property included in the restaurant sale.

In March 2011, the Department issued one notice of determination to Mr. Kayumi assessing tax due in the amount of $160,000, representing the total purchase price of the restaurant, and another determination of almost $12,000, representing Mr. Kayumi's sales tax liability, interest, and penalties on the tangible personal property transferred in the restaurant sale.

[T]he Tribunal concluded that it had "no alternative but to remand for an additional determination" on the issue of whether Mr. Kayumi timely filed a request for conciliation with the BCMS.

In August 2013, Mr. Kayumi challenged the notices of determination by filing a request for conciliation conference with the Department's Bureau of Conciliation and Mediation Services ("BCMS"), but the BCMS issued a conciliation order later in the month dismissing the request as untimely. Thereafter, Mr. Kayumi filed a petition with the Division of Tax Appeals ("DTA"), which included a request that the BCMS timeliness of filing requirement be waived in the interests of justice, along with an assertion that he was a victim of poor professional advice and therefore should be allowed to either present his substantive case to the DTA or have his case referred back for a conference with the BCMS. In its answer, the Department affirmatively stated that the DTA lacked jurisdiction to review Mr. Kayumi's petition because Mr. Kayumi did not file a request for conciliation conference or a petition with the DTA within 90 days of the issuance of the notices of determination. The Tribunal found no further mention in the record of the apparently late-filed request for conciliation conference or of such late-filed request's potential effect on the DTA's jurisdiction in the matter.

ALJ Decision. The ALJ's decision did not address at all the issue of whether the DTA had jurisdiction to reach the substantive issues raised in Mr. Kayumi's petition. Instead, the ALJ ruled that Mr. Kayumi

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had failed to follow the requirement under Tax Law § 1141(c) that a purchaser of business assets in a bulk sale must: (1) provide the Department with 10 days' notice prior to taking possession of, or making payment for, the business assets that are the subject of the bulk sale; and (2) thereafter withhold payment of any consideration to the seller pending receipt from the Department of its claim for outstanding sales and use tax liabilities due from the seller. The ALJ upheld the $160,000 assessment because Mr. Kayumi's failure to comply with Tax Law § 1141(c) made him liable for the sales and use taxes owed by the seller of the restaurant business in an amount limited by the greater of the fair market value or the sales price of the business assets sold. Further, the ALJ found Mr. Kayumi liable for sales tax on the tangible assets transferred as part of the sale of the restaurant business.

Tribunal Decision. The Tribunal concluded that, based on the facts in the record, "it appears that [Mr. Kayumi] did not timely file a request for conciliation conference." The Tribunal stated that, in circumstances where it appears that a petitioner has failed to file a timely request for a conciliation conference with the BCMS, the DTA has jurisdiction to determine whether such request was, in fact, timely filed, but does not have the ability to overlook the issue of jurisdiction and consider the merits of the protest. As "there may be an explanation as to why" the issue of jurisdiction was not addressed in the ALJ's decision, the Tribunal concluded that it had "no alternative but to remand for an additional determination" on the issue of whether Mr. Kayumi timely filed a request for conciliation with the BCMS.

Additional Insights

Those who wish to challenge tax assessments in New York State must comply with the applicable deadlines to file an appropriate appeal. The jurisdiction of the DTA is statutorily defined, and both ALJs and the Tribunal have repeatedly confirmed that the DTA lacks jurisdiction "and is precluded from hearing the merits of [a] case if the petitioner fails to file within the statutory time limit, even by one day." *Matter of Papaye Restaurant, Inc.*, DTA No. 826418 (N.Y.S. Div. of Tax App., June 25, 2015) (citing *Matter of Charles Lukacks*, DTA No. 821248 (N.Y.S. Tax App. Trib., Nov. 8, 2007); *Matter of Sak Smoke Shop, Inc.*, DTA No. 010698 (N.Y.S. Tax App. Trib., Jan. 6, 1989)). This case highlights that the statutory limitations of the DTA's jurisdiction can be unilaterally raised by an ALJ or by the Tribunal at any time.

ALJ Cancels Penalties for Possession of Unstamped Cigarettes

By Irwin M. Slomka

In an interesting decision that vividly describes an actual seizure of unstamped cigarettes, but (more importantly) addresses questions of statutory interpretation of a penalty exemption under the cigarette and tobacco products tax, a New York State Administrative Law Judge held that an employee of a Native American-owned cigarette wholesaler was exempt from penalties for possessing or transporting unstamped cigarettes and cancelled the penalties. *Matter of Shawn E. Snyder*, DTA No. 825785 (N.Y.S. Div. of Tax App., June 22, 2017).

Facts. Shawn Snyder was employed by a Native American-owned tobacco wholesaler located on a Seneca Nation reservation in upstate New York. The wholesaler was regulated solely by the Seneca Nation of Indians, and was not licensed by the State of New York. On December 3, 2012, while delivering cigarettes for the wholesaler, Mr. Snyder was found to be in possession of unstamped cigarettes, which led to the imposition of the penalties.

The facts regarding the cigarettes sale in question, and the events that took place leading up to and following the seizure, are quite detailed. In essence, the tobacco wholesaler agreed to sell 150 cases of cigarettes to another Native American business for $164,000, and to "drop ship" them in the Ganienkeh territory in New York, considered by some to be a Native American nation. The cigarettes were manufactured by a Native American-owned tobacco company located in the state of Washington. There is no dispute that the cigarettes were unstamped.

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Neither the tobacco wholesaler nor the purchaser were licensed by or registered with the Department of Taxation and Finance as a cigarette agent or wholesaler.

On December 2, 2012, Mr. Snyder helped load the 150 sealed cases of cigarettes onto his truck at the wholesaler's warehouse. The following day, the New York State Police stopped Mr. Snyder's truck for failing to stop at a border checkpoint truck inspection station. The State Trooper issued a traffic summons, followed by the issuance of a vehicle examination report charging various vehicle safety violations unrelated to the cigarettes. Shortly thereafter, a State Trooper cut open a padlock on the back door of the truck and observed that the cigarettes did not bear tax stamps. Although not directly relevant to the decision, the ALJ appears to question the methods used by the State Police in connection with the inspection and seizure of the cigarettes, since Mr. Snyder also claimed his Fourth Amendment rights were violated by the search and seizure. Certain facts in the decision suggest that the Department's policy did not permit the seizure of unstamped cigarettes transported between Native American reservations.

On December 20, 2012, the Department issued a Notice of Determination asserting penalties against Mr. Snyder totaling nearly $1.3 million for possession of unstamped cigarettes in New York State, imposed at a rate of up to $150 per carton in excess of five cartons, and also seized the unstamped cigarettes. Separate notices were also issued to the wholesaler, tobacco manufacturer, and the purchaser. After a dispute regarding the timeliness of Mr. Snyder's protest was resolved, a hearing was held on the merits of the penalty notice.

The Law. Chapter 262 of the Laws of 2000 enacted various cigarette and tobacco tax civil and criminal enforcement provisions in order to deter the bootlegging of untaxed cigarettes and tobacco products. One of the enforcement provisions was a penalty for possession of unstamped or unlawfully stamped cigarettes in New York State, with a maximum of $150 per carton (in 2013, the penalty was increased to $600 per carton). At issue in this case was a provision that rendered the penalties inapplicable to "common or contract carriers . . . while engaged in lawfully transporting" unstamped cigarettes. The exemption also applied to any employees of the carrier "acting within the scope of his employment." Tax Law § 481 (2).

[T]he ALJ first concluded that neither the Tax Law nor the cigarette tax regulations require that a common carrier be licensed by New York State in order to qualify for the exemption.

Issue. As noted above, there was no dispute that the seized cigarettes were unstamped. Directly at issue was the scope of the exclusion from penalties for contract carriers and their employees, referred to in the decision as an "exemption." Mr. Snyder claimed that, as an employee of an exempt contract carrier, he was not subject to the penalties. The Department maintained that Mr. Snyder was not "lawfully transporting" the cigarettes because neither he nor his employer wholesaler were licensed by New York State, and so he did not qualify for exemption.

Decision. The ALJ held that Mr. Snyder qualified for the exemption. She first recited several principles of statutory construction, including that tax exemptions are strictly construed, but also that where the statutory language is clear, the plain meaning of the words must be used. Applying those principles, the ALJ first concluded that neither the Tax Law nor the cigarette tax regulations require that a common carrier be licensed by New York State in order to qualify for the exemption.

She also concluded that the requirement that the carrier or employee be "lawfully transporting" means that the carrier "is acting in a lawful manner," and not that it must be transporting stamped cigarettes. The ALJ noted that there must be unstamped cigarettes for the penalties to apply in the first place, suggesting that the exemption would have little meaning if transporting or possessing unstamped cigarettes rendered the exemption inapplicable. The ALJ held that since the wholesaler was a contact carrier engaged in lawfully transporting unstamped

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cigarettes, and Mr. Snyder was acting within the scope of his employment with the carrier, Mr. Snyder qualified for the exemption, and the penalties against him were cancelled.

Additional Insights

The ALJ's decision, which is subject to appeal by the Department, raises interesting questions regarding the meaning of the statutory phrase "lawfully transporting." The ALJ correctly concludes that the definition of a contract or common carrier does not require that the carrier be "licensed," but she provides little guidance regarding what the phrase "lawfully transporting," a condition for the exemption from penalties, actually means.

Although not discussed in the decision, the New York Public Health Law renders it "unlawful" for any person in the business of selling cigarettes to ship or cause to be shipped cigarettes to a destination in New York State unless the person to whom the cigarettes are shipped is "licensed as a cigarette tax agent or wholesale dealer" in New York State. Public Health Law § 1399-11(1). To be properly licensed or registered, the person's name must appear on a list published by the Department (which is maintained on the Department's website). None of the relevant parties in this case were so registered. The decision does not address whether the phrase "lawfully transporting" may actually refer to this requirement in the Public Health Law.

Department Issues Guidance Explaining New Tax on Ridesharing Services

By Hollis L. Hyans

The New York State Department of Taxation and Finance has issued guidance explaining the new statewide tax on ridesharing companies. *Advisory Opinion*, TSB-M-17(1)M, 1S (N.Y.S. Dep't of Taxation & Fin., June 23, 2017).

Ridesharing services, also known as transportation network companies ("TNCs"), such as Uber and Lyft, were for the first time authorized to operate anywhere in New York State under legislation (the "TNC Act") enacted this spring and effective as of June 29, 2017. (Chapters 59 (Part AAA) and 34, Laws 2017). Previously, they were only authorized to pick up passengers in New York City, under the City's Taxi & Limousine Commission supervision, and those rides were subject to an 8.875% combined State and City sales tax.

Article 29-B was added to the Tax Law, establishing a state tax assessment of 4% of the gross trip fare of every TNC trip that originates in New York State outside New York City and terminates anywhere in the State.

In conjunction with the new authorizing legislation, Article 29-B was added to the Tax Law, establishing a state tax assessment of 4% of the gross trip fare of every TNC trip that originates in New York State outside New York City and terminates anywhere in the State. The law also contains a presumption that every trip originating in the State outside the City is subject to the assessment, unless the contrary is established by the person responsible for the tax. Tax Law § 1293.

The TNC Act gives certain local governments and counties the ability to opt out, although so far no localities are identified as having opted out on the website of the Department of Motor Vehicles.

TNCs will be required to file quarterly returns, and the Commissioner is authorized to require returns to be filed at shorter intervals if necessary. The first return will cover the period June 29, 2017 through September 30, 2017, and is due on October 30, 2017. Every TNC will be required to establish an online account and file returns using the Department's web filing application. Recordkeeping requirements have also been enacted, requiring TNCs to keep records of all trips, including records showing amounts paid, when trips occurred, and where they originated and terminated. Charges for rideshare services that are subject to the TNC assessment are excluded from New York State and local sales taxes.

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INSIGHTS IN BRIEF

Department Concludes that Tickets for Charity Softball Game Are Taxable

The New York State Department of Taxation and Finance has found that ticket sales for a charity softball game played at a stadium owned by a minor league baseball team are subject to New York sales tax. *Advisory Opinion*, TSB-A-17(8)S (N.Y.S. Dep't of Taxation & Fin., June 21, 2017). Although the nonprofit organization that rented the facility for the game is an exempt organization for sales tax purposes, and generally would not be required to collect sales tax on admission charges, these charges were found to be taxable because the game was played to benefit the nonprofit organization itself, not for the benefit of an elementary or secondary school, and the statute specifically limits the exemption to proceeds that exclusively benefit an elementary or secondary school. Tax Law § 1116(d)(2)(A), 20 NYCRR § 527.10(e). In addition, the petitioner had collected sales tax on the admission charges, so it would have been required to remit those taxes to the Department even if the game had been found nontaxable.

MTA Employee Subject to "Frivolous Petition" Penalty

An employee of the MTA New York City Transit system who claimed that he was not subject to New York State and City income tax on his wages was held by a New York State Administrative Law Judge to be subject to tax on his wages. *Matter of Reginald Marthone*, DTA No. 827279 (N.Y.S. Div. of Tax App., June 29, 2017). The ALJ also imposed a $500 "frivolous petition" penalty against the taxpayer, concluding that his position before the Division of Tax Appeals that his wages were not includable in his taxable income was a frivolous position meriting the penalty.

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