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IMPORTANT CHANGES AT NYS AND NYC TAX AGENCIES

In June 2015, Jerry Boone was appointed as the new Commissioner of the New York State Department of Taxation and Finance. Commissioner Boone was most recently President of the New York State Civil Service Commission and New York State Department of Civil Service. He began his career in New York State government with the Attorney General's Office as an Assistant Attorney General, ultimately serving as the State's Solicitor General. In the private sector, he was corporate in-house counsel and risk compliance officer for a large casino and hospitality company. He replaces former Commissioner Thomas Mattox, who resigned earlier this year.

Glenn Newman has retired as President and Commissioner of the New York City Tax Appeals Tribunal and New York City Tax Commission, effective May 29, 2015. Mr. Newman thus ends 34 years of New York City public service, which included positions as Chief of the Tax and Bankruptcy Division of the New York City Law Department and as Deputy Commissioner of Audit and Enforcement for the New York City Department of Finance. Mr. Newman was the first City official to simultaneously head both the City Tax Appeals Tribunal and the Tax Commission. As we went to press, New York City Mayor De Blasio named Ellen E. Hoffman, currently a Commissioner at the City Tax Tribunal, to succeed Mr. Newman as President of the Tax Commission, subject to City Council confirmation. Ms. Hoffman has also been serving as Acting President of the City Tax Tribunal since Mr. Newman's retirement.

We extend our best wishes to Commissioner Boone and to former President and Commissioner Newman in their new endeavors.

COURT OF APPEALS UPHOLDS CONSTITUTIONALITY OF TAXING NONRESIDENTS ON GAIN FROM S CORPORATION STOCK SALE IN TWO SEPARATE DECISIONS

By Michael J. Hilkin

In *Burton v. New York State Dep't of Taxation and Fin. et al.*, N.Y. Decision No. 115, and *Caprio v. New York State Dep't of Taxation and Fin. et al.*, N.Y. Decision No. 116 (N.Y. July 1, 2015), the Court of Appeals rejected

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two separate challenges to the validity of a 2010 statutory amendment to Tax Law § 632(a)(2), which provided that gains recognized by a nonresident on the sale of S corporation stock may be treated as New York-source income when a transaction is treated as an asset sale under IRC § 338(h)(10) or payments are received from installment obligations under IRC § 453(h)(1)(A).

Background to the 2010 statutory amendment. In a 2009 decision, an Administrative Law Judge held that, under the Tax Law as it then existed, nonresident shareholders of an S corporation did not have New York-source income when they received payments pursuant to an installment obligation that had previously been received by the S corporation in exchange for its assets and subsequently distributed to such shareholders in exchange for their stock upon the corporation's liquidation. *Matter of Mintz*, DTA Nos. 821806 & 821807 (N.Y.S. Div. of Tax. App., June 4, 2009). Further, in *Matter of Baum*, DTA Nos. 820837 & 820838 (N.Y.S. Tax App. Trib. Feb. 12, 2009), the Tax Appeals Tribunal concluded that nonresident individuals who sold S corporation stock treated as a sale of assets for Federal income tax purposes pursuant to IRC § 338(h)(10) did not have New York-source income on their gain. It reasoned that the transaction was "a simple stock sale" and that the "fictitious deemed asset sale and the deemed distribution" under IRC § 338(h)(10) was not applicable in determining whether the nonresident shareholders were subject to New York income tax on the gain.

In August 2010, at the behest of the Department of Taxation and Finance, Tax Law § 632(a)(2) was amended (the "2010 Amendment") to specifically provide that gain recognized by a nonresident shareholder of an S corporation will be treated as New York-source income based on the S corporation's New York business allocation percentage for the year in which the assets were sold if such gain is related to a distribution of an installment obligation under IRC § 453(h)(1)(A) or a stock sale for which an IRC §338(h)(10) election had been made. The 2010 Amendment was made applicable to tax years beginning on or after January 1, 2007, representing the years that at the time were open for assessment or refund. The New York legislature characterized the 2010 Amendment as a "clarification," stating that the *Baum* and *Mintz* decisions "erroneously overturned the longstanding policies" of the Department. L. 2010, ch. 57, Part C, § 1 ("Legislative findings").

The Burton decision. A group of plaintiffs, including Mr. and Mrs. Burton, were Tennessee residents and shareholders in an S corporation incorporated in Tennessee that was doing business in New York. In 2007, the plaintiffs sold their stock, and the S corporation and the buyer made a joint election under IRC § 338(h)(10) to treat the transaction as an asset sale. While the S corporation reported a gain of over $88 million for Federal income tax purposes, the plaintiffs did not report or pay any New York State income taxes associated with the sale. The Department, relying on the 2010 Amendment, determined on audit that the gain constituted New York-source income, and the plaintiffs paid the tax, claimed a refund, and then brought a declaratory judgment action in court when the refund claim was denied.

The basis of the plaintiffs' action was that the sale of the stock was not taxable as New York-source income because Article 16, § 3 of the New York State Constitution provides that "intangible personal property within the state not employed in carrying on any business therein by the owner shall be deemed to be located at the domicile of the owner for purposes of taxation." The plaintiffs argued that this provision precluded taxation of gains from the sale of a nonresident's intangible personal property, including stock.

[G]ains recognized by a nonresident on the sale of S corporation stock may be treated as New York-source income when a transaction is treated as an asset sale . . . or payments are received from installment obligations . . . .

Upholding the trial court's decision (discussed in the February 2014 issue of *New York Tax Insights*), the Court of Appeals held that the 2010 Amendment did not violate the New York State Constitution because Article 16, section 3 did not bar the taxation of a nonresident's New York-source income earned from a stock sale. The Court of Appeals reasoned that, even if the plaintiffs' sale was treated as a stock sale rather than a deemed sale of assets consistent with IRC § 338(h)(10), Article 16, section 3 proscribed ad valorem and ownership/property-based taxes on nonresidents' intangible personal property but contained no language constraining the imposition of any other non-location based taxes, such as income taxes.

The Caprio decision. The plaintiffs, Mr. and Mrs. Caprio, were nonresidents of New York and were the sole shareholders of an S corporation doing business as TMC Services, Inc. ("TMC"), which derived a portion of its income from activities in New York. In 2007, the Caprios sold all of their shares in TMC for a base price of approximately $20 million, plus an additional payment of $500,000 in 2008, and received promissory notes from the buyer for the installment obligations. Just like the plaintiffs in *Burton*, the S corporation and the buyer made an IRC § 338(h)(10) election, but the Caprios also elected

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to report the gain from the deemed asset sale under the installment method, pursuant to IRC § 453(h)(1)(A), under which gain is generally recognized only when cash payments are actually received.

While the Caprios reported approximately $19 million in capital gains on their Federal income tax returns for 2007 and 2008, they took the position on their New York nonresident income tax returns that the payments were not taxable in New York because, under Tax Law §631(b)(2), gain from the sale of an intangible asset such as stock is not included in the taxable income of a nonresident unless the asset was employed in a trade or business in New York, and IRC § 453(h)(1)(A) classified the installment payments as payments for stock. Positions similar to that taken by the Caprios were subsequently upheld in the *Baum* and *Mintz* decisions, but after the 2010 Amendment became law, the Department issued Notices of Deficiency to the Caprios. The Caprios brought suit in the Supreme Court, New York's trial court, claiming that the retroactive application of the 2010 Amendment to the 2007 and 2008 years was unconstitutional under the Due Process Clauses of the United States and New York Constitutions.

Agreeing with the trial court and overturning the Appellate Division decision (discussed in the May 2014 issue of *New York Tax Insights*), the Court of Appeals concluded that the retroactive application of the 2010 Amendment was constitutional. As had the Appellate Division, the Court of Appeals applied a three-prong "balancing-of-equities" test for determining the constitutionality of retroactive tax laws, as outlined in *James Square Assocs. LP, et al. v. Mullen*, 21 N.Y.3d 233 (2013), which considers: (1) the taxpayer's forewarning of a change and the reasonableness of reliance on the old law; (2) the length of the period of retroactivity; and (3) the public purpose for retroactive application. While the Appellate Division found that all three of these factors indicated that the retroactive application of the 2010 Amendment was unconstitutional, the Court of Appeals reached the opposite conclusion. The Court of Appeals reasoned that the Caprios could not have reasonably relied on the law prior to the 2010 Amendment, because, as stated in the Legislative findings included with the 2010 Amendment, the Department had a long-standing policy at the time of the Caprios' transaction that was contrary to their position, and the *Baum* and *Mintz* decisions only subsequently—and temporarily—altered that policy. The Court of Appeals further concluded that the retroactive period for which the 2010 Amendment applied was not unfairly long and had a "compelling" public purpose because the 2010 Amendment was "curative" in nature and only applied to open tax years.

Additional Insights

Subsequent to the *Baum* and *Mintz* decisions, it had appeared that nonresident individuals could avoid New York income tax on gain from the sale of stock of an S corporation that was part of an installment sale or IRC § 338(h)(10) election. The 2010 Amendment, and now the *Burton* and *Caprio* decisions, eliminated such opportunities.

The *Caprio* decision at the Court of Appeals relied on the same three-prong "balancing-of-equities" test as the Appellate Division for determining the constitutionality of retroactive tax laws under the Due Process Clauses of the United States and New York Constitutions but undid the Appellate Division's taxpayer-friendly application of that test. While the Appellate Division had noted that there was no evidence of the Department's long-standing policy, other than a 2002 PowerPoint presentation made to Department auditors that had not been publicly distributed, the Court of Appeals found that the PowerPoint presentation and a 2006 Department publication (former Publication 88, unmentioned in the Appellate Division decision, but of which the Court of Appeals took judicial notice as a matter of public record), were sufficient evidence of a long-standing policy that was reinstated by a curative retroactive amendment to the Tax Law.

NYC TRIBUNAL UPHOLDS DENIAL OF UBT DEDUCTION FOR MANAGEMENT FEE PAID TO CORPORATE PARTNER

By Irwin M. Slomka

The New York City Tax Appeals Tribunal has held that an investment advisor partnership subject to the New York City unincorporated business tax ("UBT") must add back a management fee paid to its corporate general partner representing compensation for services of employees of the corporate partner who were also individual partners of the partnership. The decision further limits the exception in the UBT regulations to the add-back for compensation paid for services performed by a corporate partner's employees. *Matter of Tocqueville Asset Mgmt. L.P.*, TAT(E)10-37(UB) (N.Y.C. Tax App. Trib., May 29, 2015).

Facts. Tocqueville Asset Management L.P. ("Tocqueville") is an investment advisor limited partnership that conducts business in New York City and is subject to the UBT. Tocqueville has no employees of its own. All of its activities—the management of client investment portfolios and the performance of related research—are performed by the employees of its sole general partner, Tocqueville Management Corp. ("TMC"), an S corporation that also managed a related securities broker-dealer.

Tocqueville paid TMC an annual management fee based on TMC's expenses incurred to provide the services.

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Approximately two-thirds of TMC's expenses was compensation paid to its employees, many of whom were also limited partners in Tocqueville. Prior to 2005, the sole year in issue, those employees had been shareholders of TMC but, as a result of a restructuring, many of those individuals redeemed their shares and became limited partners in Tocqueville.

On its federal partnership return and UBT return for 2005, Tocqueville claimed deductions for the portion of TMC's operating expenses that related to the management fee Tocqueville paid to TMC. This included compensation paid by TMC to its own employees. TMC did not report the management fee as income on its own tax returns, but also did not deduct the related expenses, including the compensation paid to its employees.

[I]n determining whether a payment is a non-deductible payment to a partner, it is irrelevant that the person receiving payment was not performing the services in his or her capacity as a partner.

On audit, the Department of Finance disallowed Tocqueville's deduction for compensation paid (in the form of the management fee) to the TMC employees who were also limited partners in Tocqueville. The basis for the disallowance was the provision in the UBT law that disallows a deduction "for amounts paid or incurred to a proprietor or partner for services or for use of capital." Admin. Code § 11-507(3). This add-back has been the subject of considerable controversy for many years. From the time of the initial promulgation of the UBT regulations in 1985, the Department has permitted a carve-out to the add-back for amounts paid to a corporate partner "which reasonably represent the value of services provided the unincorporated business *by the employees of such partner*." 19 RCNY § 28-06(d)(1)(ii)(D) (emphasis added) (the "D Exception"). The regulation conditions deductibility on the payment being "included in that partner's gross income for Federal income tax purposes."

ALJ determination. At the administrative hearing, Tocqueville took the position that the UBT regulations do not require the add-back of payments to a corporate partner for the services of an employee who is also a partner in the taxpayer partnership. Thus, Tocqueville maintained that the management fee paid with respect to TMC's employee compensation was not a payment to a partner for services performed for the partnership and was properly deductible. The ALJ rejected this argument, holding that the management fees were compensation for services provided by partners in Tocqueville, and therefore they were not deductible. This appeal followed.

Tribunal decision. On appeal, the City Tribunal upheld the ALJ's determination in its entirety, holding that the add-back of the management fee was fully consistent with the UBT law. The Tribunal first addressed Tocqueville's claim that the payment qualified for the "D Exception" to the add-back in the UBT regulations, which (as discussed above) allows a deduction to the extent the payment to the corporate partner is for services provided by employees of the corporate partner. Tocqueville noted that the regulation was clear on its face and did not preclude the exception where the employees were also partners of the taxpayer. The Tribunal held that such an interpretation "produces a result directly at odds with the plain language" of the add-back statute and ignores another regulation, 19 RCNY § 28-06(d)(1)(ii)(A), which provides that, in determining whether a payment is a non-deductible payment to a partner, it is irrelevant that the person receiving payment was not performing the services in his or her capacity as a partner.

The City Tribunal found the case to be substantially identical to *Miller Tabak Hirsch & Co.*, TAT(E) 94-173(UB) (NYC Tax App. Trib., Mar. 30, 1999), where it had held that payments made to employees who were also partners in the taxpayer partnership were not deductible, regardless of the capacity in which the payments were received. The Tribunal also rejected Tocqueville's argument that 19 RCNY § 28-06(d)(1)(i)(B), which treats as a non-deductible payment to a partner payments made "to any person," i.e, a third party, for the services provided by a partner of the unincorporated business, was not enacted until 2007, after the year in issue, and therefore was inapplicable. The Tribunal held that the interpretation reflected in the regulation "was well established in judicial precedent prior to the Tax Year," citing to decisions in *Guttman Picture Frame Assocs. v. O'Cleireacain*, 209 A.D.2d 340 (1st Dep't 1994) and *Matter of AGS Specialist Partners*, TAT(E) 00-10(UB) (N.Y.C. Tax App. Trib., May 21, 2003) (both upholding the add-back of amounts paid to the officers of a corporate partner) and *Matter of Horowitz*, TAT(E) 99-3 (UB) (N.Y.C. Tax App. Trib., Sept. 1, 2005), *aff'd*, 41 A.D.3d 101 (1st Dep't 2007), *lv. denied*, 10 N.Y.3d 710 (2008) (holding that payments by a sole proprietor to third parties for his insurance and retirement plan were not deductible).

Additional Insights

Although it may be appealed to the New York courts, *Matter of Tocqueville* is another in a line of City Tribunal decisions limiting the exceptions to the add-back contained in the Department's regulations, only some of which have been appealed and upheld by the New York

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courts. The Tribunal correctly observed that the UBT law itself is clear that payments to a partner for services are not deductible. However, the Department long ago recognized that it would be unreasonable to require the add-back of all payments to a corporate partner. Since the "D Exception" regulation is silent on the effect of the corporate partner's employees also being limited partners of Tocqueville, it could also be reasonably concluded that the Department should be bound by its own regulation and the exception to the add-back allowed. At a minimum, the Department should give consideration to amending its UBT regulations to provide further clarity regarding the scope of the add-back exception.

TRIBUNAL AFFIRMS ALJ DECISION REJECTING INCREASE IN FOREIGN BANK'S ALLOCATION OF INCOME TO NEW YORK STATE

By Hollis L. Hyans

In *Matter of UniCredit S.p.A.*, DTA No. 824103 (N.Y.S. Tax App. Trib., May 19, 2015), the New York State Tax Appeals Tribunal affirmed the decision of an Administrative Law Judge and held that the Department of Taxation and Finance improperly applied a "scaling ratio" to reduce the amount of income that can be excluded from the numerator of a bank's New York allocation factors.

Facts. The petitioner, UniCredit, S.p.A, is a foreign bank with its home office in Milan, Italy. During 1999 and 2000, the years in issue, it did business in New York City as a United States branch of a foreign bank and was subject to tax under Article 32. During those years it maintained an international banking facility ("IBF"), which is a separate set of asset and liability accounts segregated on the books and records of the bank that establishes it. UniCredit's IBF received international deposits from, and engaged in international lending activities with, "foreign persons" as defined by statute. Tax Law § 1454(b)(2)(B). It maintained separate books and records for the IBF's operations.

Law Governing IBFs. An IBF allows a bank operating in the U.S. to provide banking services to foreign customers without being subject to certain federal regulations, and therefore provides an opportunity for the bank to better compete with offshore banks. New York, like some other states, enacted favorable tax treatment for income from IBFs to encourage banks with IBFs to locate in New York. A bank may elect to calculate the amount of its income taxable in New York—its "Allocated Taxable ENI"—by using one of two methods. The Income Modification Method allows a banking corporation to deduct the adjusted eligible net income of an IBF from its entire net income. The Formula Allocation Method, which was the method elected by Unicredit for the years in issue, removes the values attributable to the IBF's production of "eligible gross income" from the numerator of the allocation percentage, while leaving such factors in the denominator. Both were explicitly designed to provide a tax benefit to the income arising from business the IBF does with foreigners.

The Formula Allocation Method involves a deposits factor, a payroll factor, and a receipts factor. Tax Law § 1454(b)(2)(A); 20 NYCRR § 19-2.3(b). Unicredit subtracted from its deposits used to compute the deposits factor those for which the expenses were attributable to the production of "eligible gross income of the IBF." It did not include any amounts attributable to either interbranch transactions or to "non-effectively connected" income. Similarly, in computing its payroll factor, it subtracted as payroll expenses amounts attributable to the production of eligible gross income of its IBF.

On audit, the Department determined that certain items did not qualify for treatment as eligible gross income, and therefore were "ineligible gross income" pursuant to 20 NYCRR § 18-3.2(i). The Department then computed a fraction, known as the "scaling ratio" and described in the Department's regulations, 20 NYCRR § 18-3.9(b), to reduce the amount of deposits and wages excluded from Unicredit's allocation factors. Neither the definition of "ineligible gross income" nor the "scaling ratio" are statutory; both were created by the Department by regulation.

ALJ Decision. The ALJ agreed with UniCredit's argument that the Department incorrectly determined that UniCredit had "ineligible gross income" as to which expenses were attributable. The ALJ found that because UniCredit elected to apply the Formula Allocation Method, it was only required to allocate income to New York using sections 19-2 and 19-3 of the regulations, and the definition of ineligible gross income relied upon by the Department was contained in 20 NYCRR § 18-3.2, applicable to the Income Modification Method. The ALJ rejected the Department's argument that the definition in § 18-3.2 is incorporated by reference in § 19-2.3(b), noting that the regulation is "clear and unambiguous" on this point. He also found that accepting the Department's interpretation would require disregarding specific language in the statute, Tax Law § 1454(b)(2)(B), and in the regulation, 20 NYCRR § 19-2.3(d), requiring that, for purposes of the Formula Allocation Method, transactions between the IBF and its foreign branches not be considered. He also found the interpretation urged by the Department was in conflict with both the Department's guidance that "'[f]or purposes

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of computing the allocation percentages, in no event shall transactions between the taxpayer's IBF and its foreign branches be considered,'" as set forth in TSB-M-85(16)C (N.Y.S. Dep't of Taxation & Fin., Feb. 10, 1986), and with the Department's Audit Guidelines.

Tribunal Decision. On exception, the Department continued to argue that the language in 20 NYCRR § 18-3 regarding the concepts of ineligible income and the scaling factor should be applied to the Formula Allocation Method. It also continued to urge that the testimony of UniCredit's expert witness should be disregarded based on the expert's reliance on a decision of the New York City Tax Appeals Tribunal and based on its argument that the witness had a personal interest in the case because he had numerous clients who would benefit from a determination in favor of Unicredit.

[S]ince transactions between the IBF and foreign branches of its establishing banking corporation are not to be considered at all for purposes of the Formula Allocation Method, they cannot possibly produce ineligible income.

The Tribunal affirmed the ALJ's decision, agreeing that the provisions the Department was relying on did not apply to the Formula Allocation Method. It found that, since transactions between the IBF and foreign branches of its establishing banking corporation are not to be considered at all for purposes of the Formula Allocation Method, they cannot possibly produce ineligible income. The Tribunal, as had the ALJ, rejected the Department's argument that 20 NYCRR § 19-2.3(b) makes the definition of ineligible gross income, and the scaling ratio, applicable to the calculation of expenses attributable to the production of eligible income, finding those sections unrelated to expense attribution. The Tribunal also agreed with the ALJ's conclusion that the starting point for computing entire net income under Tax Law § 1453(a) is federal taxable income under Internal Revenue Code § 882 and that income or expenses from interbranch transactions are not included in the computation of federal taxable income or New York entire net income for 1999 or 2000. Therefore, ineligible gross income of the IBF cannot include interbranch income or expenses or non-effectively connected income, since neither one was income for purposes of the Formula Allocation Method.

The Tribunal also rejected the Department's challenge to the testimony of UniCredit's expert witness, noting that such testimony only related to additional calculations regarding UniCredit's deposits factor for 2000–testimony more factual in nature–and that his testimony was not relied on for the Tribunal's interrelation of the statute and regulations at issue.

Additional Insights

Both the ALJ and the Tax Appeals Tribunal carefully analyzed a complicated, technical statute and an equally technical set of regulations to determine whether the IBF had properly calculated its New York income. They both did so against the express background of a statutory scheme that, at the federal level, was designed to improve the competitive posture of U.S. banks in foreign commerce, and, at the state level, had been established to provide tax benefits in order to encourage the location of banks with IBFs in New York. While the Department's interpretations of its own regulations are generally respected by the Division of Tax Appeals and the Tribunal, here both the ALJ and the Tribunal found that the Department's attempt to import provisions applicable to one apportionment method to the determination of another method was not supported by the statute.

Now that corporate tax reform applies Article 9-A to all corporations, including banks, and has eliminated the separate tax on financial institutions, the IBF rules are no longer in effect.

CONVEYANCE OF CONDOMINIUM UNITS FROM LLC TO ITS MEMBERS QUALIFIES AS "MERE CHANGE OF IDENTITY OR FORM"

By Kara M. Kraman

The New York State Department of Taxation and Finance has issued an Advisory Opinion ruling that the conveyance of two master condominium units to the members of a limited liability company ("LLC") were exempt from real estate transfer tax ("RETT") because the conveyance was a "mere change of identity or form" in which the beneficial ownership of the property did not change. *Advisory Opinion*, TSB-A-15(2)R (N.Y.S. Dep't of Taxation & Fin., May 12, 2015).

The LLC acquired real property in New York City with the purpose of constructing a 40-story building and converting it into a condominium containing two "master units" upon substantial completion of the building. RETT was paid at the time the LLC acquired the property. The two members of the LLC contemplated that one master unit would consist of floors 23-40 on which for-sale condominiums would be

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built, and the other master unit would consist of floors 2-22, which would contain residential apartments for rent.

Under the LLC's operating agreement, the initial membership interests in the petitioner were allocated 63% and 37%, respectively, for the shared development costs, but each member was obligated to pay for 100% of the costs incurred for work done solely for the benefit of that member. Income, losses, deductions, appreciation, depreciation, and related expenditures attributable to each unit were allocated to the respective member. Losses and profits not related solely to a master unit were allocated to the members in accordance with their membership interests. On substantial completion of the building, the LLC would be liquidated, and the title to the master units would be conveyed to the respective members, with each member taking title to 100% of its master unit. The question presented was whether the conveyance to the members was exempt from the RETT.

Tax Law § 1402(a) imposes RETT on each conveyance of real property or interest therein located in the State. However, conveyances that "effectuate a mere change of identity or form of ownership or organization where there is no change in beneficial ownership" are exempt from the RETT. Tax Law § 1405(b)(6).

The Department ruled that the conversion of the building to a condominium and the resulting conveyance of title to the master units from the LLC to the two members would constitute a mere change of identity or form of ownership as long as each member's ownership percentage in the condominium after the conveyances was the same as each member's respective ownership allocation in the LLC's operating agreement before the conveyances. In so ruling, the Department cited to other Advisory Opinions in which it had similarly ruled that a conversion of a building into condominium units and the subsequent conveyance of title to those units from an LLC to its respective members was exempt from RETT because the conveyances constituted a "mere change of identity or form."

Additional Insights

In this instance, the Department ruled that conveyances of real property were exempt as mere changes of identity or form because there would be no change in "beneficial ownership" before and after the conveyance if the members' ownership percentage in the condominium was the same as the members' ownership allocation in the LLC. Although the term "beneficial ownership" is not defined in the statute, the Advisory Opinion confirms the general rule that in determining whether the beneficial ownership has changed, one looks to whether a taxpayer's percentage interest in the property has changed. This bright-line approach is supported by the regulations relating to the "mere change of identity or form" exemption (20 NYCRR § 575.10) and provides a practical and straightforward way to determine whether a transaction qualifies for the exemption.

INSIGHTS IN BRIEF

State Rules That Interest on Installment Note from Stock Sale is Not New York-Source Income

Interest paid to a non-resident individual pursuant to an installment note received from the individual's sale of stock in a New York S corporation is not income from property employed in a trade or business carried on in New York and is not subject to New York State personal income tax. *Advisory Opinion*, TSB-A-15(5)I (N.Y.S. Dep't of Taxation & Fin., May 29, 2015). However, if the conditions of Tax Law § 631(b)(1)(A)(1) are met (the S corporation owns New York realty having a fair market value of at least 50% of the value of all the assets of the C corporation owned for at least two years before the stock sale), a portion of the gain included in the principal payments on the installment note would be attributable to the real property and would be considered New York-source income subject to tax by the nonresident individual.

A §186-e Resale Certificate Lacking a Certificate of Authority Number Does Not Rebut the Presumption of Taxability

A telecommunications carrier subject to the § 186-e telecommunications excise tax that makes sales to a foreign carrier and accepts a resale certificate (Form CT-120) from the carrier lacking a New York State Certificate of Authority ("COA") number cannot rely on the resale certificate to rebut the presumption of taxability with respect to those sales. *Advisory Opinion*, TSB-A-15(3)C, TSB-A-15(4)I (N.Y.S. Dep't of Taxation & Fin., Mar. 12, 2015) (released June 2015). According to the Advisory Opinion, the taxpayer telecommunications carrier can still attempt to prove, through a refund claim or on audit, that the sales to the foreign carrier are for resale. The Department advised the carrier to collect the tax from any purchaser that does not have a COA, since the purchaser can seek a credit to the extent it can show that the purchase was for resale.

ALJ Finds Admission Charges of Adult Club Not Subject to Sales and Use Tax

In *Matter of 677 New Loudon Corporation d/b/a Nite Moves*, DTA Nos. 824333, 824334 and 824335 (N.Y.S. Div. of Tax App., May 21, 2015), a New York State Administrative Law Judge found that the door admission charges of an adult club were not subject to tax, concluding that they were charges for admission to choreographed performances which are excluded from tax under Tax Law § 1105(f)(1). Although the Department

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had argued that the case was controlled by an earlier decision of the Court of Appeals involving the same club and finding the charges taxable, *Matter of 677 New Loudon Corp. d/b/a Nite Moves*, 19 N.Y. 3d 1058 (2012), the ALJ found that the club's evidentiary presentations in the new case, including testimony by experts who this time had actually viewed videos or live presentations of the dances, overcame the failure of proof in the earlier case and established that the performances were choreographed. However, the ALJ found that admission charges for private dances were taxable, because the club failed to demonstrate that the private dances were choreographed dance, due to significant differences between the stage performances and the private dances, and the fact that the expert witnesses had only viewed videos of private dances staged by the club's employees, which conflicted with the description of such dances described by both the Department's auditor who visited the club and by the club's owner.

Department Rules that Internet Drop Shipment Service Is Not Subject to Sales and Use Tax

In an *Advisory Opinion,* TSB-A-15(20)S (N.Y.S. Dep't of Taxation & Fin., May 26, 2015), the New York State Department of Taxation and Finance has ruled that a Drop Ship Master ("DSM") service provided to major retailers in the Internet retail industry is the provision of a nontaxable service and not the provision of taxable "telephony and telegraphy." The DSM service involved connecting e-commerce retailers, called "Merchants," with third-party manufacturers and distributors, called "Suppliers," who fulfill Merchants' customer orders. While the DSM service included receiving, processing, translating, and relaying order and inventory-related data between the parties, the primary value of the service was found to be the processing of the messages. The Department distinguished the result from that in *Matter of Easylink Servs, Intl., Inc. v. New York State Tax Appeals Trib.*, 101 A.D.3d 1180 (3rd Dep't 2012), concluding that in *Easylink* the primary function of the service at issue was the transmission of messages, while the primary function of the DSM service was the data processing aspect.

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ABB v. Missouri
Albany International Corp. v. Wisconsin
Allied-Signal, Inc. v. New Jersey
AE Outfitters Retail v. Indiana
American Power Conversion Corp. v. Rhode Island
Astoria Financial v. New York City
Citicorp v. California
Citicorp v. Maryland
Clorox v. New Jersey
Colgate Palmolive Co. v. California
Consolidated Freightways v. California
Container Corp. v. California
Crestron v. New Jersey
Current, Inc. v. California
Deluxe Corp. v. California
DIRECTV, Inc. v. Indiana
DIRECTV, Inc. v. New Jersey
Dow Chemical Company v. Illinois
DuPont v. Michigan
EchoStar v. New York
Express, Inc. v. New York
Farmer Bros. v. California
frog design, inc. v. New York
General Motors v. Denver
GMRI, Inc. (Red Lobster, Olive Garden) v. California
GTE v. Kentucky
Hair Club of America v. New York
Hallmark v. New York
Hercules Inc. v. Illinois
Hercules Inc. v. Kansas
Hercules Inc. v. Maryland
Hercules Inc. v. Minnesota
Hoechst Celanese v. California
Home Depot v. California
Hunt-Wesson Inc. v. California
IGT v. New Jersey
Intel Corp. v. New Mexico
Kohl's v. Indiana
Kroger v. Colorado
Lorillard Licensing Company v. New Jersey
Lorillard Tobacco Co. v. Michigan
McGraw-Hill, Inc. v. New York
MCI Airsignal, Inc. v. California
McLane v. Colorado
Mead v. Illinois
Meredith v. New York
Nabisco v. Oregon
National Med, Inc. v. Modesto
Nerac, Inc. v. New York
NewChannels Corp. v. New York
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Osram v. Pennsylvania
Panhandle Eastern Pipeline Co. v. Kansas
Pier 39 v. San Francisco
Powerex Corp. v. Oregon
Rent-A-Center v. Oregon
Reynolds Metals Company v. Michigan
Reynolds Metals Company v. New York
R.J. Reynolds Tobacco Co. v. New York
San Francisco Giants v. San Francisco
Science Applications International Corporation v. Maryland
Scioto Insurance Company v. Oklahoma
Sears, Roebuck and Co. v. New York
Shell Oil Company v. California
Sherwin-Williams v. Massachusetts
Sparks Nugget v. Nevada
Sprint/Boost v. Los Angeles
Tate & Lyle v. Alabama
Thomson Reuters v. Michigan
Toys "R" Us-NYTEX, Inc. v. New York City
Union Carbide Corp. v. North Carolina
United States Tobacco v. California
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USV Pharmaceutical Corp. v. New York
USX Corp. v. Kentucky
Verizon Yellow Pages v. New York
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Whirlpool Properties v. New Jersey
W.R. Grace & Co.—Conn. v. Massachusetts
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