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DRAFT BILL RELEASED IMPLEMENTING A NEW YORK STATE UNINCORPORATED BUSINESS TAX

By Kara M. Kraman

The New York State Department of Taxation and Finance has released a "discussion draft" of a bill that would implement a New York State unincorporated business tax ("UBT") as a way to mitigate the effects of the $10,000 cap on state and local tax deductions for certain non-wage income. *Unincorporated Business Tax, Bill Discussion Draft, Article 24-A* (released May 15, 2018). Although New York City imposes a UBT, there has not been a State-level UBT since 1981. The goal of the State UBT would be to shift non-deductible individual State income taxes to a deductible unincorporated business tax on pass-through entities, and to credit the value of the UBT paid by the business to the individual owners against their personal income taxes.

Overview of the Draft UBT

Imposition and Tax Rate. The draft bill would impose a 5% tax on the unincorporated business taxable income ("UBTI") of every partnership (including limited liability companies treated as partnerships) doing business in the State, effective for tax years commencing after 2018. The tax would be imposed on all partnerships regardless of the amount of their taxable income, but would not apply to S corporations, sole proprietorships, or single-member limited liability companies that are owned by individuals.

An entity's UBTI would be calculated by taking its unincorporated business net income, which is equal to its "federal ordinary business income" as described in IRC § 702(a)(8), with addbacks for guaranteed payments to partners and the State UBT deducted in computing federal ordinary income, and then applying a three-factor apportionment formula consisting of the partnership's property, payroll, and receipts within and without the State. A significant difference from the New York City UBT is that, as currently drafted, the State UBT would not explicitly exempt from the tax those partnerships whose activities are limited solely to trading for their own account or owning or managing real property for their own account.

Significantly, and unlike the receipts factor under Article 9-A, the UBT receipts factor would not employ market-based sourcing, but would instead generally source service receipts based on the office to which the partnership's employee performing the services is chiefly connected. The State UBT receipts factor also would not contain special registered broker-dealer sourcing provisions

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providing for the market-based sourcing of services. This could negatively impact New York–based broker-dealer partnerships whose customers are worldwide, but whose employees primarily work out of New York State.

The Department has indicated that it welcomes comments on several variations that it is considering, including whether the UBT should: (i) be made optional; (ii) only apply to partnerships with taxable income above a certain level; and/or (iii) also apply to S corporations and single member LLCs owned by individuals. In addition, although the draft bill would set the UBT rate at 5% — presumably based on a blend of the State personal income tax and Article 9-A tax rates — the Department has also indicated that it seeks feedback on whether the tax rate should be set higher or lower.

The credit would generally be equal to 93% of the individual or corporate partner's proportionate share of the partnership's UBT and could be used to offset the partner's personal income tax or Article 9-A tax liability, respectively.

Unincorporated Business Tax Credits

There would be three separate UBT credits. The first credit, called the Unincorporated Business Credit ("UBC"), would be available to a partnership that is also a partner in a lower-tier partnership for use against its State UBT liability. Any partnership that receives a distributive share of income from a lower-tier partnership that has itself paid UBT would claim the UBC credit to offset its own UBT liability. This is modeled after the City "UBT Paid Credit," and is intended to prevent the State from collecting the UBT twice on the same income.

The other two credits — one available to individual partners against their State personal income tax liability and the other available to corporate partners against their Article 9-A liability — are calculated in exactly the same way. The credit would generally be equal to 93% of the individual or corporate partner's proportionate share of the partnership's UBT and could be used to offset the partner's personal income tax or Article 9-A tax liability, respectively. Excess credits for any taxable year could be carried forward indefinitely.

In its comments on the draft bill, the Department notes that it chose the 93% "discount factor . . . to ensure revenue neutrality for the State." However, it is unclear how the Department arrived at this number, or whether it will in fact ensure revenue neutrality.

As a practical matter, limiting the credit to 93% likely would not fully compensate corporate partners subject to the 6.5% Article 9-A tax on income — which are unaffected by the federal limitation on itemized state and local tax deductions, but which would be bearing a portion of the State UBT through the partnership — for their share of the State UBT. This is because a corporation's distributive share of partnership income would not only be subject to the State UBT (at the partnership level), but would also be included in calculating the corporate partner's own Article 9-A liability, but without the partner receiving a credit that entirely offsets that liability. To its credit, the Department recognizes that using 93% may be an imperfect method of offsetting income tax liability, and has indicated that a method that adjusts the discount factor based on a partner's own individual tax rate is also under consideration.

It is also unlikely that the State UBT credits against New York income taxes would provide complete relief to a non-resident individual partner who must not only pay New York State income tax (on his or her distributive share of the partnership's income allocable to the State), but must also pay state income tax to his or her state of residence (on the individual's distributive share of unapportioned partnership income). In that case, the individual's state of residence may not allow a nonresident tax credit where the State UBT credit effectively eliminates all (or most of) the individual's New York State tax on that income. This is in contrast to cases in which the individual pays his or her New York State income tax directly. The draft State UBT would result in a tax increase in the individual's state of residence, even though the State UBT credit should substantially offset the individual's New York State income tax on the partnership income.

The Department states that its purpose in releasing the draft bill for discussion is to provide interested parties a chance to comment and provide feedback on both the general concept of a statewide UBT, and the proposed design and implementation details of this tax. It has asked that all such comments be submitted by email to federal.tax.response.comments@tax.ny.gov by July 16, 2018.

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UPDATE ON NEW YORK IMPACT OF FEDERAL TAX CUT AND JOBS ACT

By Irwin M. Slomka

It has been nearly six months since the enactment of the sweeping Federal Tax Cut and Jobs Act of 2017. With the New York State Legislature nearing the end of its current session, and having enacted limited legislative responses to the federal enactment, here is a summary of where things stand on key federal tax reform provisions and their effect on the New York State and City taxation of corporations, individuals, and pass-through entities:

Corporate Taxation

Interest expense limitation: Limitation of deduction for business interest to 30% of a taxpayer's "adjusted taxable income," subject to indefinite carryforward.

- *NYS/NYC Impact.* The federal interest expense limitation (including the carryforward) should apply for New York State and City tax purposes, since the starting point in computing entire net income is federal taxable income.
- *Open Questions*:
  - Since the New York State and City combined group is considered the "taxpayer" for many purposes, how will the 30% interest expense limitation apply in the case of a New York combined return that includes the corporation whose interest deduction is limited for federal purposes?
  - How should the carryforward be apportioned in the year applied — based on the corporation's apportionment in the year incurred or in the year applied?
  - How will the limitation affect the attribution of interest expense to exempt CFC income or investment income?

Immediate expensing: Immediate expensing for qualified property, through 100% bonus depreciation if placed in service between September 27, 2017 and January 1, 2023.

- *NYS/NYC Impact.* 100% bonus depreciation should not apply because the existing law had already decoupled from bonus depreciation under IRC § 168(k). Tax Law § 208(9)(b)(17); Admin. Code § 11- 652(8)(b)(16).

NOLs: Net operating losses arising after 2017 are limited to 80% of taxable income, with no carryback but with an indefinite carryforward.

- *NYS/NYC Impact*: The federal NOL limitation should not apply because, for tax years beginning after 2014, the New York State and New York City NOL is defined as the amount of a corporation's "business loss" multiplied by its apportionment factor. New York law expressly provides that the NOL deduction is not limited by the amount allowed for federal purposes under IRC § 172. Tax Law §210.1(a)(ix); Admin. Code § 11-654.1(3)(a). The carryback limitation and indefinite carryforward also should not apply, since New York law expressly provides NOLs may be carried back for three years and carried forward for up to 20 years. Tax Law § 210.1(a)(ix)(4); Admin. Code § 11-654.1(3)(d).

Since the New York State and City combined group is considered the "taxpayer" for many purposes, how will the 30% interest expense limitation apply in the case of a New York combined return that includes the corporation whose interest deduction is limited for federal purposes?

International Taxation

Repatriation transition tax: One-time repatriation transition tax on foreign-source income that was not previously taxed.

Undoubtedly, the most far-reaching federal changes are in the area of international taxation. In exchange for moving to a more business-friendly, quasi-territorial system of corporate taxation, the new federal tax law provides for a one-time repatriation of foreign income from controlled foreign corporations ("CFCs") in the transition year. This is effectuated in steps: first by increasing taxable income under IRC § 965(a) to take into account accumulated deferred income from CFCs as of December 31, 2017 (or as of November 2, 2017, whichever is greater); and second by then providing a deduction ("participation exemption") under IRC § 965(c) that results in a lower effective federal tax rate (either 15.5% or 8%) on that income. The taxpayer may elect to pay the resulting transition tax over eight years.

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- *NYS/NYC Impact*: The recently enacted New York State Budget Bill confirms that the one-time repatriated foreign income under IRC § 965 constitutes "exempt CFC income" for New York State and City corporate tax purposes. However, the federal deduction allowed under IRC § 965(c) must be added back. Tax Law § 208(9)(b)(23); Admin. Code § 11-652.5-a(b). In addition, under existing New York State and City law, corporations must either: (i) attribute interest expenses to the exempt income; or (ii) make a revocable election to reduce exempt income by 40%, which will have the effect of reducing the benefits of the exemption for CFC income. Reflecting the uncertainties of interest expense attribution, the Budget Bill provides that, in computing any underpayment of estimated tax for the transition year, no amount will be added to the tax for the portion of the underpayment relating to the attribution of interest expense or the 40% election.

- *Open Question*:

  - In light of the potentially significant impact of the attribution of interest expenses with respect to repatriated income qualifying as exempt CFC income, will the State and City tax departments permit less onerous indirect attribution methodologies for this one-time item?

<u>GILTI</u>: Inclusion in taxable income of Global Intangible Low-Taxed Income ("GILTI") from CFCs.

In general, the new GILTI provisions require a U.S. shareholder of a CFC to pay a minimum aggregate U.S. and foreign tax on its share of the CFC's earnings. This is carried out first by including the taxpayer's share of GILTI in its taxable income pursuant to new IRC § 951A, and then allowing a deduction of up to 50% of that amount plus any resulting Section 78 gross-up under IRC § 250, thereby resulting in a reduced federal effective tax rate on that income.

- *NYS/NYC Impact*. Unlike the one-time repatriation income discussed above, the GILTI inclusion likely does not qualify as "exempt CFC income" because that exemption only applies to additions to federal gross income pursuant to IRC § 951(a) (and the GILTI inclusion is instead pursuant to IRC § 951A). Therefore, it should be includable in entire net income. The deductions provided under IRC § 250 should also apply for New York purposes because they should not be subject to any specific add back. (Note: A State Senate proposal to classify GILTI as other exempt income was not enacted by the Legislature.)

- *Open Questions*:

  - Is the GILTI inclusion amount considered a dividend? If so, it may qualify as "exempt unitary corporation dividends" for New York State and City tax purposes. In order to qualify, however, the corporation that generates the income must be unitary with the taxpayer but cannot be included in the taxpayer's New York combined return. Tax Law § 208.6-a(c); Admin. Code § 11-652.5-a(c).

  - If GILTI is includable in the taxpayer's business income, should the non-U.S. apportionment factor(s) of the foreign corporations generating the income be used to fairly apportion that income?

In light of the potentially significant impact of the attribution of interest expenses with respect to repatriated income qualifying as exempt CFC income, will the State and City tax departments permit less onerous indirect attribution methodologies for this one-time item?

Individual Taxation

<u>Itemized deduction limitations</u>: Limitation of itemized deductions, particularly the $10,000 limitation for state and local taxes.

- *NYS/NYC Impact*. In an attempt to circumvent the federal limitations on the deductibility of state and local taxes, for years beginning after 2018, New York employers may annually elect to be subject to a new employer payroll tax ("Employer Compensation Expense Program"), converting the taxes to presumably deductible employer payroll taxes, and providing a tax credit to covered employees.

  The Budget Bill also authorized the creation of New York State–operated charitable funds to which individuals can make donations and claim a NYS tax credit for 85% of the donation made in the preceding year. Although the Governor had touted the donations as being deductible charitable contributions for federal income tax purposes, a just-released Treasury Department pronouncement strongly suggests that the IRS does not agree (and intends to issue proposed regulations to address this issue). *I.R.S. Notice* 2018-54 (May 23, 2018).

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In addition, beginning in 2018, New York residents will be entitled to claim itemized deductions for New York State and City personal income tax purposes as the law existed immediately prior to the enactment of federal tax reform (*i.e.*, allowing without limitation deductions for local *real property taxes*, but not state and local *income* taxes). The Budget Bill now also permits itemized deductions to be claimed for State and City purposes, even for individuals who claim the standard deduction for federal tax purposes.

The Tax Department is also considering a State unincorporated business tax, the purpose of which is to preserve the state and local tax deduction for non-wage income. The Tax Department has recently circulated a UBT "Bill Discussion Draft," and is seeking comments by July 16, 2018 (see article on page 1).

- *Open Questions*:
  - Will employers electing to be subject to the payroll tax be able to recoup the payroll tax costs by adjusting employee compensation?
  - Can an employer segregate into a separate payroll company those New York employees who would benefit from the election, and have the election only apply to the separate payroll company employer?

Pass-Through Entities

Qualified business income deduction: Non-corporate owners are entitled to a 20% deduction for qualified business income from a partnership, limited liability company treated as a partnership, S corporation or sole proprietorship under IRC § 199A.

- *NYS/NYC Impact*. Since the calculation of an individual's New York State and City taxable income starts with federal adjusted gross income, the 20% deduction should not flow through for State and City purposes.
- *Open Question*:
  - Can a taxpayer nonetheless claim the 20% deduction as a New York itemized deduction? Under existing New York law, the 20% deduction may qualify as a New York itemized deduction, and the law allows individuals who itemize their federal deductions a New York deduction for "the total amount of his or her deductions from federal adjusted gross income . . . as provided in the laws of the United States." Tax Law § 615(a).

In two recently-issued Technical Memoranda summarizing corporate tax and personal income tax changes enacted in the New York State Budget Bill, the Department states that it will be issuing future guidance on interest expense limitations, mandatory repatriation, and GILTI (for corporations), and on contributions to charitable gift fund accounts and decoupling from the IRC provisions (for individuals). *Technical Memorandum*, TSB-M-18(3)C and TSB-M-18(4)I (N.Y.S. Dep't of Taxation & Fin., May 25, 2018).

APPELLATE COURT HOLDS THAT NY RESIDENT DID NOT CHANGE HIS DOMICILE

By Hollis L. Hyans

The Appellate Division, Third Department, has confirmed the New York State Tax Appeals Tribunal's decision that a long-time New York State domiciliary failed to demonstrate that he had changed his domicile from New York to Florida in advance of recognizing a large gain on the sale of Florida property. *Campaniello v. N.Y. State Div. of Tax Appeals Trib.*, No. 524039, 2018 NY Slip Op. 03400 (3d Dep't, May 10, 2018).

Factual History. The petitioner, Mr. Campaniello, emigrated from Italy to New York in the 1960s. He established a successful retail furniture business in both New York and Florida, and opened a showroom in New York City in the 1970s. In 1979, he purchased a condominium apartment in the Bronx, where he lived with his wife and daughter. In 1981, he opened his first showroom in Miami, Florida, and purchased a condominium in Key Biscayne, Florida, where he would stay when conducting business in Florida. By 2007, he had acquired additional real estate holdings in New York, including two warehouses and co-op shares in a building in New York City, which he renovated and used to operate a second retail furniture showroom. During this same period, he also opened three additional retail furniture showrooms in Florida and acquired nine other residential and commercial properties in Florida. In November 2007, he sold one of his Florida properties for over $6.5 million, resulting in a long-term capital gain of approximately $5.3 million.

New York Filings. Through 2005, petitioner and his wife jointly filed New York State and City resident personal income tax returns, listing the Bronx condominium as their primary address. On December 7, 2007, less than one month after selling his Florida property, petitioner filed a New York nonresident and part-year resident personal

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income tax return for 2006, claiming the filing status of married filing separately and providing his Key Biscayne address. In October 2008, he filed a New York nonresident and part-year resident personal income tax return for 2007, reporting the capital gain from the November sale of the Florida property and indicating zero New York tax due. On both the 2006 and 2007 returns, the "no" box was checked in response to the question "Did you or your spouse maintain living quarters in NYS," although the 2006 return petition also listed the Bronx as both his county of residence and his school district. For both 2006 and 2007, his wife filed New York State and City resident personal income tax returns, as married filing separately, showing her primary address as the Bronx condominium.

Because of the narrow standard of review in the Appellate Division, which requires a Tribunal decision to be affirmed if it is "rationally based and supported by substantial evidence," the Third Department affirmed the Tribunal's decision . . . .

Audit and Decisions Below. In 2010, the Department of Taxation and Finance audited petitioner's 2007 return, and concluded that petitioner failed to establish that, as of 2007, he had abandoned his New York domicile and acquired a new Florida domicile. The Department issued a notice of deficiency assessing tax, interest, and penalty of over $725,000, which petitioner challenged before the Division of Tax Appeals.

The Administrative Law Judge upheld the Department's assessment, and the Tax Appeals Tribunal affirmed that decision. The Tribunal found that petitioner did not prove by clear and convincing evidence that he changed his domicile, relying on such facts as petitioner's retention of his historic home in New York City, in which his wife continued to reside and where he spent at least 169 days during the year. The Tribunal concluded that the fact that he had a Florida apartment for many years and spent more time in Florida than in New York was outweighed by his many New York City ties. The Tribunal also rejected petitioner's argument that the Tax Law unconstitutionally required a husband and spouse to have the same domicile, finding that while the regulations provide that "[g]enerally, the domicile of a husband and wife are the same," they also acknowledge that a husband and spouse may have separate domiciles if they are "separated in fact." 20 NYCRR § 105.20(d)(5)(i).

Third Department Decision. The Third Department confirmed the Tribunal's decision. It noted, first, that once a domicile is established — as was the case for petitioner here — it continues until the individual moves to a new location with the intention of making a new "fixed and permanent home" in the new location, and that the party seeking to establish a change in domicile bears the burden to prove the change by clear and convincing evidence.

Next, the court reviewed the petitioner's arguments, and noted that he did not contend that his domicile changed from New York to Florida on a date certain. Instead, he claimed that, over time, as his Florida business interests grew and he spent an increasing amount of time in Florida, he had effectively abandoned his New York domicile and established a new domicile in Florida by, at the latest, 2007. The court agreed that, "[w]ithout question," petitioner had demonstrated significant business ties to Florida, including his ownership and operation of four retail furniture showrooms and nine rental properties, and moving the personal belongings that were most important to him to Florida, such as his Ferrari and his sailboat. It also found that, if the ALJ and the Tribunal had made a contrary conclusion — that he had in fact changed his domicile — it "would not have been unreasonable."

However, the court concluded that there was no dispute that in 2007 the petitioner also maintained substantial contacts in New York, such as continuing to operate his New York furniture showroom, even though it was not as successful as his Florida showrooms, maintaining a warehouse and the administration and bookkeeping functions for his business in New York, continuing to see a New York doctor, and spending 169 days in New York. The court also found that the Tribunal "reasonably deferred" to the ALJ's finding that petitioner's testimony regarding his intent to change his domicile to Florida "lacked credibility."

Because of the narrow standard of review in the Appellate Division, which requires a Tribunal decision to be affirmed if it is "rationally based and supported by substantial evidence," the Third Department affirmed the Tribunal's decision, deferring to the Tribunal and the ALJ despite having found that the opposite result might also have been reasonable.

The court also sustained the assessment of the negligence penalty, noting the "misrepresentations" on petitioner's 2006 and 2007 returns that neither he nor his wife maintained living quarters in New York during these years, although his wife continued to live in the Bronx apartment and petitioner himself used that apartment, despite the claim by petitioner that these misrepresentations resulted from a mistake by his accountant. The court also dismissed in a footnote the petitioner's contention that the decision

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unconstitutionally limits the ability for him and his wife to "enjoy a marital relationship whereby they choose to 'live apart together,'" finding that there was nothing in the Tax Law or regulations that required a husband and wife to have the same domicile, and that it was the petitioner's own continued contacts with the State and his Bronx domicile that were the significant factors.

ADDITIONAL INSIGHTS

This case illustrates the difficulty faced by a long-time New York domiciliary in establishing a change of domicile, particularly without a defining event that can demonstrate a clear break with the historic home and the establishment of a new domicile. The law is clear that the party seeking to demonstrate a change in domicile must prove that change by clear and convincing evidence, and here both the ALJ and the Tribunal were not convinced that the petitioner had clearly demonstrated a change in domicile.

However, it does seem unusual for the court — after concluding that the facts supporting change of domicile were strong enough that, had the ALJ and the Tribunal reached the opposite decision, that too would have been reasonable and supported by substantial evidence — to nonetheless sustain the negligence penalty.

TRIBUNAL HOLDS TELECOM COMPANY IS SUBJECT TO SALES TAX ON PURCHASES OF ELECTRICITY

By Michael J. Hilkin

The New York State Tax Appeals Tribunal has upheld an Administrative Law Judge determination that a company was not entitled to a refund of sales tax paid on electricity used to power equipment necessary to provide telecommunications services and carry signals to its customers, rejecting the company's claim that the electricity was not subject to sales tax because it was a purchase for resale. *Matter of XO Commc'ns Servs., LLC*, DTA Nos. 826686 & 827014 (N.Y.S. Tax App. Trib., May 9, 2018).

Facts. XO Communications Services, LLC ("XO"), is a provider of intrastate, interstate, and international telecommunications services, including voice services, Internet services, optical services, and private data networks, to businesses, wholesalers, and governmental entities. XO maintains a number of central offices that house equipment used to provide telecommunications services, including voice switches that provide basic voice services, routers for voice and Internet services, and long-haul optical transport equipment to provide connectivity over a fiber optic network.

XO filed two refund claims, originally totaling over $1.1 million, seeking a refund of sales tax it paid on the electricity used to power the central office equipment that provided telecommunications services and carried signals to its customers. XO asserted that its purchase of electricity was a nontaxable purchase for resale, but the Department denied XO's claims.

Tax Law. New York State imposes sales tax on the receipts from every "retail sale of tangible personal property," Tax Law § 1105(a), and provides a purchase for resale exclusion within the statutory definition of "retail sale" for tangible personal property that constitutes a physical component part of services performed. Tax Law § 1101(b)(4). Under the regulations, the exclusion applies when a person in the course of business operations purchases tangible personal property for resale "either in the form in which purchased, or as a component part of other property or services." 20 NYCRR § 526.6(c)(1).

Separately, New York State imposes sales tax on the receipts from every "sale" of certain utilities, including electricity, "other than sales for resale." Tax Law § 1105(b). The regulation outlining the sales taxation of utility services, including electricity, discusses the sale for resale exclusion in Tax Law § 1105(b), stating that "[p]urchases of utility services by a utility for resale *as such* may be made without payment of the sales tax," but when the utility services are resold by the purchaser, it must collect sales tax on such sales. 20 NYCRR § 527.2(e) (emphasis added).

ALJ Decision. In briefs submitted to the ALJ, XO agreed that it could only be refunded the amount of tax paid for electricity used in its taxable services, and it provided a one-page chart recalculating its refund claim to be under $150,000. Nevertheless, relying in part on a sales tax decision issued by the Appellate Division in 2008, which rejected a sales tax refund claim by a predecessor entity to XO based on arguments similar to those made in the current case, the ALJ concluded that XO was not entitled to even its reduced refund claim. *See XO N.Y., Inc. v. Comm'r of Taxation & Fin.*, 51 A.D.3d 1154 (3d Dep't, 2008) (the "*XO* Appellate Division decision").

Tribunal Decision. While the Tribunal agreed with XO's position that the language in Tax Law § 1105(b) constitutes an exclusion from tax, rather than an exemption, and therefore must be construed "most strongly against the government and in favor of the taxpayer," the Tribunal

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nevertheless upheld the ALJ's determination that XO was not entitled to a refund of sales tax paid on electricity used to power its communications equipment.

While the Tribunal agreed with XO's position that the language in Tax Law § 1105(b) constitutes an exclusion from tax . . . construed "most strongly against the government and in favor of the taxpayer," the Tribunal nevertheless upheld the ALJ's determination that XO was not entitled to a refund of sales tax . . . .

The Tribunal first rejected XO's argument that its purchases of electricity qualified for the resale exclusion on the basis that the electricity was "tangible personal property" resold as a component part of the telecommunications services XO sold to its customers. Significant to the Tribunal's conclusion was the definition of tangible personal property in Tax Law § 1101(b)(6), which defines electricity as tangible personal property *only* for purposes of the sales tax on utilities imposed by Tax Law § 1105(b). In essence, this statutory limitation prevents electricity from being considered tangible personal property for purposes of the resale exclusion applicable to tangible personal property comprising a physical component part of services performed, as outlined in Tax Law § 1101(b)(4). According to the Tribunal, since Tax Law § 1105(b) makes no mention of a resale exclusion for utilities comprising a component part of property or services sold to a taxpayer's customers, no such exclusion exists. Thus, it found that the resale exclusion in Tax Law § 1105(b) is properly interpreted to apply only to resales of electricity "as such."

Relying on the *XO* Appellate Division decision, the Tribunal also rejected XO's argument that the imposition of sales tax on its electricity purchases would result in multiple taxation. According to the Tribunal, the *XO* Appellate Division decision stands for the proposition that there was nothing inherently improper about multiple taxation under XO's facts, and purchases made to produce or provide a product subject to sales tax are not automatically exempt from sales tax.

Finally, the Tribunal concluded that, even if XO would have been entitled to a resale exclusion for the electricity used to power the equipment used in providing telecommunications services, XO's evidence was insufficient to support the amount of its refund claim. XO agreed that the resale exclusion only applies to the services it provides that are subject to tax, and ultimately claimed the exclusion only for a percentage of the electricity used by its central offices, equal to the percentage of its revenue from services subject to tax. However, XO provided no evidence demonstrating that the percentage of sales in each service category correlated to the actual amount of electricity purchased to provide such services. Thus, the Tribunal agreed with the ALJ's determination that, even assuming that some of the electricity it purchased eventually flowed to its customers, the evidence provided by XO was insufficient to show how much electricity was purchased solely for resale.

ADDITIONAL INSIGHTS

As discussed in the December 2017 issue of New York Tax Insights, which examined the *Wegmans Food Markets, Inc. v. Tax Appeals Tribunal*, 155 A.D.3d 1352 (3d Dep't, 2017), New York Appellate Division case, New York courts have consistently held that ambiguities related to a statutory exclusion contained in a tax imposition statute must be construed in favor of the taxpayer and against the taxing authority. However, to take advantage of this principle, a petitioner must also be able to establish that an ambiguity actually exists. In this case, XO was able to establish that the resale exclusion in Tax Law § 1105(b) (applicable to sales of electricity) was an exclusion provision, and that ambiguities in the statute must be interpreted in its favor, but nevertheless it was unable to convince the Tribunal that any statutory ambiguity existed to overcome the guidance provided by Department regulations.

INSIGHTS IN BRIEF

CONVENIENCE FEE SUBJECT TO SALES TAX

The New York State Department of Taxation and Finance has issued an Advisory Opinion finding that a convenience fee charged by a club when credit cards are used to make purchases is subject to New York State and local sales tax. *Advisory Opinion*, TSB-A-18(1)S (N.Y.S. Dep't of Taxation & Fin., Apr. 12, 2018). The Department found that the convenience fee, which is charged by the vendor to "offset" the fee it must pay to process credit card payments, is, like other expenses incurred by a vendor in making sales, not deductible from its receipts and is therefore includible in taxable receipts. However, if a sale includes both taxable and nontaxable items that are separately itemized, sales tax need only be collected on the portion of the convenience fee attributable to the sale of the taxable items.

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“MERE CHANGE” ACQUISITION OF AN LLC INTEREST CAN BE AGGREGATED WITH AN ECONOMICALLY SUBSTANTIVE PURCHASE OF AN ECONOMIC INTEREST UNDER STATE TRANSFER TAX

Reversing an Administrative Law Judge determination involving the New York State real estate transfer tax, the New York State Tax Appeals Tribunal held that the Tax Department properly aggregated the grantee’s acquisition of a 55% membership interest in an LLC that owned real property in Manhattan, which qualified as a “mere change of identity or form” transaction, with the grantee’s economically substantive purchase of the remaining 45% LLC interest, thereby triggering the transfer tax to the extent of the 45% acquisition. *Matter of GKK 2 Herald LLC*, DTA No. 826402 (N.Y.S. Tax App. Trib., May 10, 2018). The Tribunal found that a mere change in form acquisition is a type of conveyance of an interest in real property that may be aggregated in determining whether a controlling interest has been transferred or acquired. The Tribunal declined to follow the Appellate Division, First Department decision involving the applicability of the New York City real property transfer tax to the same transaction, which upheld application of the federal “step transaction” doctrine as the basis for taxing the subject transfer. *GKK 2 Herald LLC v. City Tax Appeals Trib.*, 154 A.D.3d 213 (1st Dep’t, 2017).

U.S. News – Best Lawyers® BEST LAW FIRMS 2018

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Chambers USA 2017

- California: Tax
- Nationwide: Tax Controversy
- New York: Tax

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