New York State Bar Association
Tax Section
Comments on 2018-2019 New York State Executive Budget[1]

Tax #5 March 9, 2018

Introduction

This report on selected tax provisions of the 2018-2019 New York State Executive Budget (the "Budget Bill") was prepared by the Tax Section of the New York State Bar Association. It focuses on certain technical, administrative and conceptual issues raised by selected provisions of the Budget Bill with reference to the New York Tax Law (the "Tax Law") and identifies aspects we think should be clarified or reconsidered prior to adoption by the Legislature.

This report offers comments and recommendations on the following parts of the Budget Bill:

Part H: Extend the State of Limitations on Amended Tax Returns.

Part K: Allow Warrantless Tax Debt to be Assessed Against Unclaimed Funds.

Part M: Carried Interest Provision.

Part N: DTF Right to Appeal DTA Tribunal Decisions.

Part O: Clarify New York Residency Requirements for Tax Purposes.

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Part S: Defer Business Related Tax-Credit Claims.

Part T: Amend the Refund and Joint Liability Provisions of the Real Estate Transfer Tax.

Part X: Provide Responsible Person Sales Tax Relief for Minority LLC Owners.

Part AA: Impose an Internet Fairness Conformity Tax.

Discussion

I. Part H: Extend the State of Limitations on Amended Tax Returns

A. Current Law

The general period of limitations for assessment of tax is three years after the filing of a return. *See* Tax Law §§ 683(c), 1083(c), and City of New York Administrative Code § 11-1783(c). There are numerous exceptions that provide for extension of this time period in particular circumstances, such as where the return is fraudulent or where more than 25% of gross income is omitted, but the filing of an amended return is not currently one of them. *See In re George and Carol Bello*, N.Y. Tax App. Trib. Dkt No. 806543 (1993) (citing *Dowell v. Commissioner*, 68 T.C. 646, 649, *rev'd on other grounds*, 614 F.2d 1263 (1980), and then adopting the court's interpretation that the three-year statute of limitations runs from the filing of an original return, not from an amended return).

To claim a refund, an amended return must be filed three years from the filing of the original return, or two years from the payment of the tax, whichever is later. Tax Law §§ 687(a), 1087. The Department has authority to examine any and all aspects of an amended return to compute the correct tax for the year at issue. Unless limited by statute, the review is not necessarily restricted to consideration of the particular items of adjustment proposed in the refund claim, although the expiration of the limitation period may preclude assessment of a deficiency. *See e.g.*, *Bankers Trust Corp. v. New York City Dept. of Finance,* 750 N.Y.S.2d 29, 35-36 (1st Dep't 2002).

Where an erroneous refund has been paid, the refund is considered an underpayment of tax on the date made, and "an assessment of a deficiency arising out of an erroneous refund may be made at any time within two years from the making of the refund." This period is extended to five years if "it appears that any part of the refund was induced by fraud or misrepresentation of a material fact." Tax Law §§ 683(c)(5) and 1083(c)(5); City of New York Administrative Code § 11-1783(c)(5). The term "erroneous refund" generally means a refund that was issued as a result of a mathematical or clerical error made by an employee of the Department. *See* 20 NYCRR §§ 36.1(a) and 107.7(a).

B. Proposed Changes

Part H of the Budget Bill would amend the limitations on assessment provisions of Tax Law §§ 683(c) and 1083(c), and City of New York Administrative Code § 11-1783(c), to add the following paragraph:

> Except as otherwise provided in paragraph three of this subsection, or as otherwise provided in this section where a longer period of time may apply, if a taxpayer files an amended return, an assessment of tax (if not deemed to have been made upon the filing of the amended return), including recovery of a previously paid refund, attributable to a change or correction on the amended return from a prior return may be made at any time within three years after such amended return is filed.

The stated purpose for the extended period of limitations is to limit refund abuse:

> The Executive Budget will reduce refund abuse by extending the statute of limitations to three years after the filing date of the amended return, rather than three years after the original return filing date. Currently, taxpayers can file an amended return containing a refund request close to three years after the due date of their initial return, hampering the possibility of an audit and assessment by DTF.

FY 2019 Executive Budget Briefing Book, at 18.

C. Comments

Limitations on the assessment of tax serve an important purpose, as "public policy favors the effective, timely, and definitive collection of unpaid taxes." *In re King Center Corp.*, 573 B.R. 384, 398 (Bkrtcy. E.D.N.Y. 2017). As stated by the U.S. Supreme Court, tax "recomputations are immensely difficult or impossible when a long period has intervened." *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*, 88 392 U.S. 481, 503 (1968). Extension of the limitation period should only be made where a systemic problem exists under the existing period that hampers the government's ability to timely assess the tax. Otherwise, for the majority of taxpayers who file non-fraudulent amended returns, the additional lengthy period of limitations imposes additional burdens to maintain records, and fails to provide the closure necessary for financial reporting and business planning. Before broadly extending the period of limitations, these important policy considerations should be taken into account.

1. *Clarify the Meaning of "Attributable To"*

The proposed amendment limits the Department's ability to assess additional tax under the extended statute of limitations to assessments that are "attributable to a change or correction on the amended return." In this regard, we note that it is unclear what the phrase "attributable to" means. For example, if a corporate taxpayer files an amended return to change the composition of its combined group (i.e., to add or remove entities from the combined return), is the Department's ability to assess additional tax under the extended statute of limitations limited to only re-adjusting which affiliated entities should be in the combined group? Or could the Department also adjust the apportionment factors of the entities in the combined group on the grounds that a change to the group's apportionment is "attributable" to the change in the group composition reported by the taxpayer? The Tax Section encourages the legislature to clarify that the proposed amendment is intended to prevent the Department from opening the taxpayer's entire return for audit under the extended statute of limitations and to consider providing a definition of what it means for the Department's assessment to be "attributable to" a change on the amended return. Opening the entire return would unfairly burdens taxpayers who file amended returns to correct errors in favor of New York, or to claim refunds to which they are lawfully entitled. In other words, a taxpayer should not have to weigh the purpose of amending its return for a single issue against the possibility that data-intensive aspects of a return could be revisited years after the natural close of the statutory period.

2. *Absent Clarification, the Amendment May Discourage Taxpayers from Self-Correcting Erroneous Returns*

In general, there is no legal obligation to file an amended tax return, although a taxpayer is required to file an amended return to report Federal changes, corrections, and disallowances, or if the taxpayer has filed a Federal amended return. Tax Law § 659; 20 NYCRR §§ 159.2, 159.3. If the proposed amendment is not clarified to limit the scope of the Department's review and ability to assess additional tax under the extended statute of limitations, taxpayers may be discouraged from self-correcting returns (including to make adjustments in favor of the taxing authority) and filing claims for refund that are rightfully owed to the taxpayer. As noted above, taxpayers may fear that filing an amended return for a discrete issue could result in a burdensome audit related to other aspects of the return.

3. *The Amendment May Conflict with Sections 687(b) and 1087(b) of the Tax Law*

Absent clarification, the Tax Section is also concerned that the proposed statute would undo the protections provided in Tax Law §§ 687(b) and 1087(b). Those code sections provide that, if the taxpayer and the Department have entered into an agreement to extend the period for the assessment of additional tax (i.e., a waiver) and have done so within the period prescribed for the filing of a refund claim, then the period for filing a refund claim shall not expire prior to six months after the expiration of the waiver. While these provisions extend the period of limitations for the taxpayer to file a refund claim, they do not extend the period of limitations for assessment. Accordingly, under existing law, when taxpayers avail themselves of their right to file a claim for refund pursuant to section 687(b) or 1087(b), the Department is permitted to defend against the refund claim, but cannot open the entire return up for review and assessment of additional tax.

Sections 687(b) and 1087(b) were designed to give taxpayers sufficient time to raise claims for credit or refund as a means to offset assessments of additional tax asserted by the Department near the end of the limitations period for filing such claims. We believe this is a laudable policy goal and are concerned that the proposed amendments to sections 683(c) and 1083(c) would be in conflict with the protections provided under sections 687(b) and 1087(b). Specifically, if the "attributable to" language in the proposed amendment is not clarified to limit the scope of the Department's ability to assess additional tax under the extended statute of limitations, it may give the Department the right to audit other aspects of an amended return filed pursuant to sections 687(b) and 1087(b), which is precisely what those sections were designed to prohibit. At a minimum, the proposed amendments should be clarified to provide that the Department cannot avail itself of the additional time to audit an amended return if such return was filed during the extended six month period provided for in sections 687(b) and 1087(b).

4. *The Proposed Amendment Should be Modified to Provide for a Shorter Extension of the Statute of Limitations*

A three-year extension of the statute of limitations could be viewed as extensive. While some states have adopted a three-year extension of the statute of limitations in the context of amended returns, *see* Conn. Gen. Stat. § 12-733(e); Md. Code Ann. Tax-Gen. § 13-1101(d), other states have adopted much shorter (e.g., six month to one year) extensions. *See e.g.*, Ga. Code Ann. § 48-2-49(e); Kan. Stat. Ann. § 79-3230(a). We note that a shorter six-month extension of the statute of limitations would parallel the six-month extension of time that is granted to taxpayers to seek offsets of assessments issued by the Department as a result of an audit conducted pursuant to a waiver issued by the taxpayer (discussed above).

Alternatively, the proposed legislation could be narrowed to conform to the Internal Revenue Code, which provides for a limited extension in the case of amended returns filed within the 60-day period ending on the day on which the statute of limitations would otherwise expire. For those amended returns, the IRS has an additional 60 days to assess additional tax. IRC § 6501(c)(7). Enacting a similar provision would address the legislature's concern that some taxpayers attempt to hamper the ability of the Department to assess additional tax by filing an amended return just before the statute of limitations expires. As this group of amended returns is most likely to be problematic, the extension provision could be limited to them. We note, however, that while the Internal Revenue Service has only 60 days to assess additional tax when an amended return is filed within the 60-day period ending on the day on which the statute of limitations would otherwise expire, it has two years to recover erroneously issued refunds. The Department also has two years to recover erroneously issued refunds, but it, unlike the Internal Revenue Service, is limited to recovering erroneous refunds that were issued as a result of a mathematical or clerical error by an employee of the Department.

II. Part K: Allow Warrantless Tax Debt to Be Assessed Against Unclaimed Funds

Part K allows the Department to share information with the State Comptroller to satisfy past-due tax liabilities with unclaimed funds without the necessity of filing a tax warrant. As stated in the Memorandum in Support of the Budget Bill, "secrecy statutes in the Tax Law prevent the Commissioner from sharing debtor/taxpayer information with the Comptroller when warrants have not been filed," therefore the change "is needed so the Commissioner has authorization to share taxpayer information with the Comptroller regarding unwarranted fixed and final debts so the debts can be satisfied, in whole or in part, with unclaimed funds."

A. Current Law

Currently, the Commissioner and Comptroller share information regarding warranted fixed and final debts, which results in the Commissioner routinely applying a taxpayer's unclaimed funds to fixed and final warranted tax debt. Thus, this proposal provides the Department with a modified tool to enforce the collection of past-due liabilities.

B. Proposed Change

Part K of the Budget Bill would allow the Department to share information with the State Comptroller regarding fixed and final unwarranted debts of taxpayers for purposes of collecting unclaimed funds from the Comptroller, who serves as the custodian of the funds, to satisfy the taxpayers' past-due liabilities.

The authorization is limited to the release of information regarding fixed and final unwarranted debts of taxpayers for purposes of collecting unclaimed funds from the Comptroller to satisfy fixed and final unwarranted debts owed by taxpayers. The phrase "unwarranted debt" is defined as "past-due tax liabilities, including unpaid tax, interest and penalty, that the commissioner is required by law to collect and that have become fixed and final such that the taxpayer no longer has any right to administrative or judicial review and a warrant has not been filed." And, "taxpayer" is defined as "any individual, corporation, partnership, limited liability partnership or company, partner, member, manager, sole proprietorship, estate, trust, fiduciary or entity, who or which has been identified as owing taxes to the state." The term "unclaimed funds" is not defined in the legislation.

The State Comptroller would be required to keep all information obtained from the Department confidential.

C. Comments

The Tax Section commends the Budget Bill's proposal to allow the Commissioner to share information with the State Comptroller to facilitate the collection of taxpayers' past-due liabilities from unclaimed funds, without the need to file a tax warrant. Without this authority, the Commissioner would continue to be required to file a public tax warrant with the appropriate county clerk's office and the Department of State prior to the undertaking of any enforcement action with respect to unclaimed funds. Publicly filed tax warrants can impose harms and burdens on taxpayers that may not be necessary to effectively enforce the state's tax laws. These include negatively affecting the taxpayer's credit report, causing an increase to the taxpayer's insurance premiums rates, and jeopardizing employment opportunities with employers that conduct credit checks as part of the hiring process. By allowing the Department to share information with the Comptroller regarding fixed and final unwarranted debts of taxpayers, the Department will be permitted to engage in a routine and productive tax collection technique without creating unnecessary burdens and hardships for taxpayers.

The Tax Section has previously issued reports acknowledging the many benefits from the Department's warrantless wage garnishment, which also permits the Department to engage in a routine collection action, without the necessity of filing a tax warrant.

While we commend this legislation, we note the following technical comments. First, we believe the title of the provision could be changed to better describe the provision and parties involved. The proposed title is “Information sharing with the Comptroller regarding unclaimed funds.” An alternative option is “Information sharing with the State Comptroller regarding tax debt for collection of unclaimed funds.” (Similarly, the word "State" should also be added throughout the statute before the term Comptroller).

Second, the term "taxpayer" is defined to include generally an entity or person "who or which has been identified as <u>owing taxes</u> to the state" (emphasis added). This language seems overbroad. We suggest that the language be revised to apply solely to an entity or person "who or which has been identified as owing <u>past-due tax liabilities</u> to the state" (emphasis added).

Third, the term “unclaimed funds” is not currently defined in the legislation. We believe it should be defined to provide clarity, such as “unclaimed funds under New York’s Abandoned Property Law.” Furthermore, in this regard, the Memorandum in Support cites to general common law and case law as the basis for the Comptroller to satisfy debt owed to the State with unclaimed funds of a debtor/taxpayer. Specifically, the Memorandum in Support states that "common law and case law authorize and permit the Comptroller to satisfy debt owed to the State with unclaimed funds of a debtor/taxpayer when 1) a debt is owed; 2) the debtor/taxpayer received notice of the debt; and, 3) the debtor/taxpayer no longer has any right to administrative or judicial review of the debt.”

Presumably the common law doctrine being referred to is the Comptroller's common law right to offset any valid claim or debt owed to the State against a claimant who is due money under the Comptroller's control, even if the setoff is unrelated to the state's debt to that claimant. Or, stated differently, if a claimant is owed money by a state agency but also owes money to the same or another state agency, the Comptroller may subtract and withhold the money owed to the state from the money owed by the state, thereby facilitating the collection by the state of the money it is due. *See, e.g.*, *Suburban Restoration Co., Inc. v. Office of the State Comptroller*, 2012 NY Slip Op 07022 (3rd Dep't).

The Tax Section is concerned that there is no written agreement between the Department and the State Comptroller that addresses the enforcement of delinquent tax liabilities through unclaimed funds. For example, the procedures for identifying unclaimed funds, provisions addressing certifications that the funds are unclaimed (i.e., proper notice has been provided to the claimant), and/or procedures for transferring the funds so the funds can be applied to satisfy past-due unpaid tax liabilities. It is our understanding that the current unclaimed funds program against warranted debt has generated substantial returns, through both automated funds offsets and manual exceptions (i.e., unclaimed funds primarily related to intangible property). Under current federal and state debtor protection laws, the Department cannot reach by levy to pay tax debts a tax debtor's social security payments, public assistance payments, veteran's benefits, unemployment insurance, child support and workers compensation payments. If the Department levies a bank account containing exempt funds, there is a procedure available for the owner of the account to claim an exemption for the exempt funds. *See* CPLR § 5222-a. Consideration should be given to the fact that unclaimed funds in New York can include bank accounts. Also, in the case of decedents, there is a possibility that the unclaimed funds no longer belong to the named claimant decedent, but rather are the property of the decedent's beneficiaries. Federal and state debtor protection laws should not be violated as a result of this enforcement action. In this regard, we think it is instructive to look at the written agreements required under Tax Law § 171 relating to the enforcement of delinquent tax liabilities through the suspension of drivers' licenses (Tax Law § 171-v) , enforcement of delinquent state tax liabilities through the suspension of eligibility for STAR exemptions (Tax Law § 171-y) and various provisions relating to the Commissioner's authority to credit any overpayments of taxpayers against outstanding debts owed to a state agency (Tax Law § 171-f) or to New York City (Tax Law § 171-l).

Upon being turned over to the Comptroller, abandoned property does not become the property of the State; instead the State assumes its care and custody in a special fund for the benefit of those entitled to receive it, and any person who can prove his or her right to such property is entitled to have it paid over to him or her at any time. The Tax Section is concerned that once the State Comptroller transfers the unclaimed funds to the Commissioner, there is no public record that a claimant ever had unclaimed funds. Presumably, the State Comptroller could be required to maintain a public list that details the names of claimants for which it transferred unclaimed funds to the Department to satisfy past-due tax liabilities. However, the legislation at issue is necessary precisely because the Commissioner is unable to disclose unwarranted tax debt of taxpayers due to taxpayer secrecy provisions. Indeed, the provision requires that the Comptroller keep all of the information confidential. Thus, no public record would be available to notify claimants of unwarranted debts that their unclaimed funds were transferred to the Department to satisfy such debts.

III. Carried Interest Provision

A. Current Law

The Tax Law has no special provisions dealing with income from a carried interest. In general, partnership income that is taxed to the partners has the same character in the hands of the partners as it had in the hands of the partnership regardless of how the partner acquired his or her partnership interest. For example, partnership investment income, including long-term capital gains, flows through to the partners and is treated the same in their hands even if one or more partners acquired their partnership interest in exchange for services rendered to the partnership or to other partners.[2]

A carried interest is an interest in a partnership that is disproportionately high relative to the partner's capital contribution. It is common for the organizers of an investment partnership to contribute a small amount of the partnership's capital but to receive a much higher interest in partnership profits. Arguably, this disproportionate interest is received in exchange for services rendered in organizing and/or operating the partnership. Nevertheless, New York State, mirroring the federal income tax treatment, has treated income from a carried interest just like any other partnership income that is taxed to the partners. Until the enactment of the federal Tax Cuts and Jobs Act of 2017 ("TCJA"), the Internal Revenue Code contained no special provisions for carried interest income and the Internal Revenue Service treated the income as retaining the character that it had in the hands of the partnership. The TCJA amended section 1061 of Internal Revenue Code to provide, in general, that a partner who received a partnership interest in connection with the performance of substantial services would not treat long-term capital gains realized by the partnership as long-term capital gains unless the property sold by the partnership had been held by the partnership for more than three years. Section 1061 does not treat carried interest income as income received in exchange for services or as business income; its only effect is to convert what otherwise might have been long-term capital gains to short-term capital gains.

[2] References to partnerships and partners include limited liability companies and their members to the extent that they are treated as partnerships and partners for income purposes.

B. Proposed Changes

Part M of the Budget Bill would add a new section 44 to the Tax Law and would amend sections 208.6(a), 617(b), and 632(b) to change the treatment of carried interest income. The Memorandum in Support of the Budget Bill explains that the provisions are intended to "close the carried interest loophole" by treating carried interest income as income from a trade or business and not as capital gains. One consequence of this recharacterization would be that carried interest income would be taxable to a nonresident of New York to the extent that the partnership's income was attributable to New York sources. In addition, the Budget Bill would impose a 17% "carried interest fairness fee" on a portion of carried interest income that, in the words of the Memorandum, "would remain in effect until federal law is amended to treat the provision of investment management services for federal tax purposes substantially the same as under this legislation." The provisions of the Budget Bill would take effect only upon the enactment of similar legislation by Connecticut, New Jersey, Massachusetts, and Pennsylvania.

C. Comments

The Tax Section takes no position with respect to whether carried interest income should be treated as business income or should be given favorable tax treatment.

The Budget Bill applies the new regime to income that a partner is deemed to have received from "investment management services." Section 44 defines this phrase as including investment advice regarding the purchase or sale of securities as defined in section 475(c)(2) of the Internal Revenue Code, real estate held for rental or investment, and certain partnership interests, including managing, acquiring, or disposing of such assets, arranging financing with respect to the acquisition of such assets, and related activities.

The operative provision of section 44 indicates that a partner who performs investment management services for a partnership will not be treated as a partner with respect to the partner's distributive share of income, gain, loss, and deduction, including guaranteed payments, "that is in excess of the amounts such distributive share would have been if the partner had performed no investment management services for the partnership." That excess amount will be treated as a business receipt for services and for purposes of the personal income tax as income attributable to a trade, business, profession, or occupation. Similar provisions would apply to an S corporation shareholder. An exception would be provided for certain real estate businesses. A partner or shareholder will not be deemed to be providing investment management services if at least 80% of the average fair market value of the partnership's assets consists of real estate held for rental or investment.

It may be difficult to determine whether a partner received all or part of a partnership interest in exchange for investment management services. It does not automatically follow that an interest that is disproportionate to a partner's capital contribution is received in exchange for investment management services or, for that matter for any services. For example, the organizers of a partnership might be willing to give a particularly prestigious individual a disproportionately high partnership interest because the person's name might enhance the partnership's reputation or ability to attract other investors or otherwise assist in relations with private or public organizations. Other partners might simply strike a hard bargain and succeed in negotiating for a partnership interest that is disproportionately high relative to their capital contributions.

The new regime applies to income received by a partner for services performed by that partner. As written, it would not apply to income received by a partner who received a partnership interest as a gift from a person who performed services for the partnership (e.g., the service provider's spouse or children).

Section 44(c) provides for "an additional tax, referred to as the 'carried interest fairness fee.'" This fee is equal to 17% of the amount treated as business income under section 44(b). This fee will remain in effect until "federal legislation has been enacted that treats the provision of investment management services for federal tax purposes substantially the same as provided in this section." It is not clear what kind of federal legislation would be needed to result in a termination of the fee. The bill converts investment income to business income. If Congress wanted to completely eliminate favorable treatment for capital gains realized by partnerships that had partners with carried interests, it could do so by expanding on the approach taken by the TCJA and simply providing that all long-term capital gains realized by a partnership will be treated as short-term capital gains to the extent that they are passed through to carried interests. That would eliminate any federal preference for carried interest income, but it would not treat that income as business income as the New York statute does. It would still be investment income for other purposes of the federal tax laws. That would not result in treatment "substantially the same as provided" in the New York law.

The carried interest provisions take effect only if Connecticut, New Jersey, Massachusetts, and Pennsylvania all adopt legislation "having substantially the same effect as this act." It is unclear what this phrase means. In the unlikely event that all four states adopt some kind of legislation dealing with carried interest income, they could take different approaches. They could recharacterize carried interest income as business income but not impose a punitive "fairness fee," or they could impose a "fee" that was much lower than New York's fee.

IV. Part N: DTF Right to Appeal DTA Tribunal Decisions

A. Current Law

The statute that created the Division of Tax Appeals within the Department of Taxation and Finance has, since its enactment in 1986, provided a mechanism for taxpayers to appeal adverse decisions rendered by the Tax Appeals Tribunal (the "Tribunal"); such appeals are made to Supreme Court, Appellate Division (Third Department) under a specially modified procedure under Article 78 of the Civil Procedure Law and Rules. The Department, however, has been provided no such appeal opportunity and thus decisions of the Tribunal in which the taxpayer prevails are final. Consequently, inasmuch as Tribunal decisions are precedential, the Department has occasionally resorted to seeking legislative changes to substantive Tax Law provisions when it has believed the law should be different than as interpreted by the Tribunal.

B. Proposed Changes

Part N of the Budget Bill would modify the Tax Law by providing the Department with the same appeal rights as currently afforded taxpayers.

C. Comments

From the time that the original Division of Tax Appeals legislation was being developed in the early 1980s through as recently as 2009, the Tax Section has supported placing the Department on equal footing with taxpayers in the context of appeal rights. This position was based on two important considerations. First, unlike the former State Tax Commission, which exercised adjudicative as well as administrative and regulatory functions, the Tribunal is an independent, adjudicative body. Thus, whereas there was no need for a right of appeal when the State Tax Commission (i.e., the Department) made its own final determinations of tax cases (because it had ultimate control of such determinations), each litigant before the independent Tribunal should have the right to appeal. Such a procedure would be consistent with the procedure at the United States Tax Court, which permits the Internal Revenue Service to appeal adverse United States Tax Court decisions. *See* NYSBA Report #382, "Need For and Feasibility of a New York Tax Tribunal (Jan. 4, 1983); *see also* Letter from Erika W. Nijenhuis, Chair, Tax Section, NYSBA to Hon. David A. Paterson, Governor, New York State (Apr. 24, 2009).

Second, the Tax Section's historic support for granting the Department a right to appeal an adverse Tribunal decision was based on the belief that in cases where (a) the degree of the persuasiveness of the adverse parties' positions are approximately equal and (b) only one party can appeal further, a decision-making body will tend to rule against the party that has the opportunity to pursue such an appeal. This seems to be especially true when broad questions, such as Constitutional issues, are being decided. The Tax Section's concern has been that this will create the perception, whether valid or not, that the system lacks fairness because the Tribunal will decide close cases involving important tax principles against taxpayers. The Tax Section sees no reason why these considerations do not remain valid.

With the passage of time, however, some members of the Tax Section have come to believe that the existing process for adjudicating tax disputes before the Division of Tax Appeals has worked well and that the prohibition on the Department appealing adverse Tribunal decisions should not be changed. The primary concern of these members is that granting the Department an appeal right would create undue burdens on taxpayers that are not justified by the reasons asserted for granting the appeal right.

By the time a taxpayer's case has reached the Tribunal, the taxpayer (whether an individual or a corporation) will typically have gone through several stages of administrative proceedings, including an audit by the Department, a protest before the Department's Bureau of Conciliation and Mediation Services, and a hearing before an administrative law judge at the Division of Tax Appeals. These proceedings frequently take years to resolve and often require taxpayers to expend significant resources. If the proposed amendment is adopted, the Department would have the power to extend the litigation process beyond these proceedings, not just to the New York State Supreme Court, Appellate Division, Third Department, but potentially to the New York State Court of Appeals. Those Tax Section members who oppose granting the Department an appeal right are concerned that a large segment of the taxpayer community will be unable to endure an extended litigation process due to financial, time or other resource constraints, or even because the taxpayer does not have the psychological stamina to proceed.

In this regard, the potential imbalance in "staying power" between the government and taxpayers should be considered, as should the legislative history behind the 1986 legislation creating the Tribunal. That legislative history makes it clear that the Tribunal was created primarily to benefit taxpayers by, among other thing, establishing an independent adjudicative body and providing for a "rapid" system for resolving tax dispute. *See* Memorandum of State Executive Department, L.1986, c.282 at 2898-2899 (July 19, 1986). Permitting the Department to extend litigation beyond the Tribunal arguably goes against the purpose of the 1986 legislation.

In light of the above, those Tax Section members opposing the appeal right question whether the justifications set forth in the Memorandum in Support of the Article VII Legislation justify changing the current system. According to the Memorandum in Support, the Department should be granted the right to appeal adverse Tribunal decisions because "[j]udicial review presents the quickest and most efficient method of reaching finality: in the absence of judicial review, the Department's only recourse is to seek legislation to reverse significant Tribunal decisions with which the Department disagreed as a matter of law." Those Tax Section members who do not support providing the Department with the proposed appeal right find the assertion that judicial review is quicker and more efficient to be dubious. The judicial appeal process can take years to complete, whereas the Department has routinely succeeded in quickly persuading the legislature to adopt legislation—often retroactive in nature—to overturn Tribunal decisions with which it disagrees.[3] The Department has also been successful in overturning, through legislation, adverse decisions of the very judicial courts that it now says it must be permitted to appeal to for redress when the Tribunal issues a decision with which it disagrees.[4]

We also note that the Department has successfully utilized the Tribunal's rehearing process to convince the Tribunal to overturn its own decisions. The rehearing process permits a party to a proceeding before the Tribunal, including the Department, to file a motion with the Tribunal to reargue its case. In recent times, the Department has used the rehearing process to demonstrate to the Tribunal that its original decision misapprehended important issues of fact or law.[5] Currently, the Department has moved to reargue the two September 2017 decisions regarding the non-discrimination clause of the United State-Germany 1989 Tax Treaty that are referenced in the Memorandum in Support as further support for permitting the Department to appeal adverse Tribunal decisions. In this regard, the Memorandum in Support inaccurately

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[3] Recent examples include legislation to retroactively overturn the Tribunal's decisions in *Matter of Baum*, Tax Appeals Trib. (Feb. 12, 2009) and *Matter of Weber*, Tax Appeals Trib. (Aug. 25, 2016).

[4] *See, e.g.*, *Tenn. Gas Pipeline v. Urbach*, 96 N.Y.2d 124 (2001).

[5] *See e.g.*, *Matter of Gaied*, Tax Appeals Trib. (June 16, 2011).

states that "judicial review is the only avenue for seeking reversal of [these] adverse opinion[s]."

While the majority of the Tax Section supports granting the Department an appeal right, it also acknowledges the validity of the concerns of those who believe that providing such an appeal right will impose an undue burden on taxpayers, especially those with limited resources and/or limited tax amounts at issue in a particular case. Several approaches to addressing these concerns have been raised since the early 1980s. Among the proposals (some of which are not mutually exclusive of some others) that should be considered are:

1. Provide the Division of Taxation the right to seek leave to appeal from the Appellate Division, Third Department, based on specified criteria (i.e., the Division would need permission from the Third Department before being permitted to proceed with the appeal).

2. Require the Department to reimburse the taxpayer's reasonable litigation costs if the Department is unsuccessful in its appeal.

3. Provide that the Attorney General must approve of the Division of Taxation's request to appeal and provide written justification as to why: (1) an appeal is in the best interest of the State; and (2) imposing the litigation burden on the particular taxpayer is warranted.

4. Provide a mechanism by which the Division of Taxation may move the Tax Appeals Tribunal to render its decision non-precedential (similar to "unpublished decisions" in many states), rather than appeal.

5. Provide that the Division of Taxation may appeal an adverse Tax Appeals Tribunal decision only where either the dollar amount at issue exceeds a certain threshold and/or the taxpayer's net worth exceeds a certain threshold.

It is important to note that virtually all of these approaches would require a change to the current Article 78 principles and procedures since Article 78 is the codification of the common law proceedings for mandamus, prohibition, and certiorari, which are proceedings against the government since if the Division of Taxation has the right to undertake an appeal, the situation would be one where the government is proceeding against a taxpayer. We believe that these present mere "mechanical" issues that can be addressed by relatively simple legislation.

V. Part O: Clarify New York Residency Requirements for Tax Purposes

The Budget Bill proposes to amend the definition of a New York State and New York City "resident individual" under Tax Law §§ 605(b)(1)(B) and 1305(a) for personal income tax purposes.

A. Current Law

In addition to most individuals domiciled in the state, the Tax Law currently defines a "resident individual" to include someone "***who is not domiciled in this state but*** maintains a permanent place of abode in this state [city] and spends in the aggregate more than one hundred eighty-three days of the taxable year in this state [city]."[6] This is commonly referred to as the "statutory residency" test. The highlighted language was the subject of a 2015 Order from New York's Division of Tax Appeals in *Matter of Sobotka*.[7] In *Sobotka*, an Administrative Law Judge determined that days spent in New York during the part of a tax year when the taxpayer was domiciled in New York could not be counted toward the 183-day limit found in Tax Law §§ 605(b)(1)(B) and 1305(a)(2).

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[6] Tax Law §§ 605(b)(1)(B) and 1305(a)(2). Other than the geographic descriptors, the language in the Tax Law sections applicable to state and city statutory residency is identical.

The underlying bases for this ruling were (1) the plain language in Tax Law §§ 605(b)(1)(B) and 1305(a)(2) stating that statutory residency test applies only to an individual "who is not domiciled in the state" and (2) the legislative history of a 1922 amendment to the Tax Law section defining resident individuals (Tax Law former §350(7)).

The Department claimed it has historically counted all days an individual is present in New York during a given tax year—regardless of whether that individual is a part-year domiciliary of New York—to determine whether that individual is a statutory resident. In the *Sbotka* decision, the Division of Tax Appeals held that the Department's interpretation was inconsistent with the language of the statute and was not supported by the legislative history.

B. Proposed Changes

The Budget Bill proposes two changes to Tax Law §§ 605(b)(1)(B) and 1305(a)(2). First, it eliminates the language highlighted above, ridding the statute of the requirement that an individual not be domiciled in the state [city] to meet the definition of a statutory resident. Second, it adds language stating that an individual who meets the two-pronged requirement of statutory residency (maintenance of a permanent place of abode plus more than 183 days spent in New York) is a resident individual "whether or not domiciled in this state for any portion of the taxable year."

The Budget Bill would make these changes effective prospectively and retroactively to all taxable years for which the statute of limitations for seeking a refund or assessing additional tax is still open.

[7] *Matter of Sobotka*, New York Division of Tax Appeals, Administrative Law Judge (DTA No. 826286), August 20, 2015.

C. Comments

The Court of Appeals has twice held (in *Gaied v. N.Y. Tax Appeals Tribunal* and *Tamagni v. Tax Appeals Tribunal of the State of New York*[8]) that the legislative history of the statutory residency provision was to tax as residents those individuals who "for all intents and purposes" were residents of New York State, but claimed domicile elsewhere. While we take no position on whether the Legislature should amend the Tax Law's statutory residency provisions to reject the analysis of the administrative law judge in *Sobotka*, we note that the proposed amendment would have the effect of taxing individuals as full-year residents of New York when they are "for all intents and purposes" only part-year residents.

Such results would, arguably, also be inconsistent with the Court of Appeals decision in *Gaied*. In *Gaied*, the Court of Appeals noted that "[t]he legislative history of the statute, to prevent tax evasion by New York residents, as well as the regulations, support the view that in order for a taxpayer to have maintained a permanent place of abode in New York, the taxpayer must, himself, have *a residential interest* in the property." The proposed law change here would do nothing to address this issue. In the above example, the proposed law change would result in Iris being taxed as a full-year resident, despite the fact that she did not, under the Court of Appeals decision in *Gaied*, have a "residential interest" in her New York property for nearly half of the year.

It is also worth noting that, in recent years, there have been bills introduced that would ameliorate the impact of the statutory residency rules for taxpayers in circumstances similar to the taxpayer in *Matter of Barker*.[9] In *Barker,* the Department applied the statutory residency

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[8] *Tamagni v. Tax Appeals Tribunal of the State of New York,* 695 N.E.2d 1125 (N.Y. 1998).

[9] *Matter of Barker,* Division of Tax Appeals, N.Y. Tax Appeals Tribunal (Docket No. 822324), January 13, 2011.

test mechanically, taxing Connecticut domiciliary Mr. Barker as a New York State resident. Though Mr. Barker spent well over 183 days in New York State, only about 15-20 days each summer were actually spent at his Hamptons abode, and the remainder were days spent in New York City where Mr. Barker worked as an investment banker, but had no living quarters whatsoever.

The Memorandum in Support of Part O of the Budget Bill suggests that the proposed amendment is needed to ensure that individuals are taxed if they are, "for all intents and purposes," residents of New York. If the Legislature is going to amend the definition of a statutory resident to address the *Sobotka* decision, it ought to consider a comprehensive revision to the statutory residency provisions so that taxpayers who clearly do not meet the "for all intents and purposes" test do not get caught up in the statutory resident net.

Some might argue that the Legislature could achieve both the original intent of the statutory-resident rules and avoid the possibility of untoward results, by drafting a proposed change that is more consistent with the "for all intents and purposes" test. For instance, the Legislature could adopt a pro-rated day count test for statutory residency to be applied to individuals who are domiciled in New York for less than all of the year in question. As applied to the Iris example, such a test might have allowed Iris to spend up to 90 days in New York during the non-domiciliary part of the tax year (July 5–December 31) before she became a statutory resident for that part of the tax year.

Finally, the changes proposed in Part O of the Budget Bill take effect immediately and apply to all tax years for which a statute of limitations for seeking a refund or assessing additional tax is still open. Absent compelling circumstances, changes to longstanding statutes should not be made retroactively applicable. Here, the only rationale for retroactive application would seem to be generating additional tax revenue, which is not, alone, a compelling justification. We appreciate the goal of revenue protection. But, retroactively-effective legislation, in addition to being susceptible to Constitutional challenges, is almost never good policy. Inasmuch as the current law fully comports with the legislative history of the current law, and the specific provision in question was tested by an August 2015 Division of Tax Appeals case that the Department chose not to appeal, retroactive application would not be good policy in this instance.

VI. Part S: Defer Business Related Tax-Credit Claims

A. Current Law

There is no current law, but a similar deferral regime was in effect for taxable years beginning on or after January 1, 2010 and ending on or before December 31, 2012. We note that the prior deferral of tax credits survived a constitutional challenge.[10]

B. Proposed Changes

Under Part S of the Budget Bill, taxpayers would be required to defer the use and refund of certain business tax credits in excess of $2 million in taxable years beginning on or after January 1, 2018 and ending on or before December 31, 2020. The Budget Bill provides a formula to proportionately reduce each credit by a specified fraction with the result that the taxpayers are only able to use up to $2 million of credits in each taxable year. The total amount of credits deferred under the Budget Bill would be paid back to taxpayers (without interest) over tax years 2021, 2022 and 2023. The timing and amount of the repayment would depend on whether the credits are refundable or non-refundable under the current law. The credits subject to deferral would be expanded from those covered under the prior deferral

[10] *Empire Gen Holdings, Inc. v. Governor of NY*, 967 N.Y.S.2d 919 (Sup. Ct. Albany Cty. June 25, 2013).

regime and, would include brownfields, low-income housing, and historic tax credits, among others.

C. Comments

Some of the tax credits that would be subject to the deferral are used to finance real estate developments across the state and function as an alternative to government issued bonds. We note that the proposed deferral of the tax credits would create uncertainty regarding the viability of tax credits as a financing tool and likely decreases their value, resulting in higher borrowing costs.

VII. Part T: Amend the Refund and Joint Liability Provisions of the Real Estate Transfer Tax

A. Current Law

Under section 1412 of the Tax Law, grantors and grantees claiming to have erroneously paid real estate transfer taxes are allowed to file a refund claim within two years from the date of payment. An additional tax is imposed under section 1402-a on the conveyance of residential real property for consideration of $1 million or more ("the mansion tax"). The mansion tax is imposed on the grantee, but if the grantee is exempt from the tax, the grantor becomes liable for the tax.

B. Proposed Changes

Part T of the Budget Bill would extend the statute of limitations to three years for the filing of a refund claim. The bill would also make the grantor liable for the mansion tax when the grantee fails to pay the tax (not just when the grantee is tax exempt). If the grantor becomes liable, the grantor and grantee would be jointly and severally liable for the tax.

C. Comments

The extension of the statute of limitations to file refund claims to three years is commendable. We believe that the three year refund period promotes fairness to taxpayers by putting the taxpayer and the Department on equal footing (because the Department has three years to assess additional tax). It also promotes procedural uniformity across the various other taxes, thus helping eliminate inadvertent mistakes by taxpayers regarding the timeliness of their refund claim.

We note, however, that the period for refund claims with respect to real property transfers pursuant to Articles 31-a through 31-G remains two years. For consistency purposes, we recommend that the statute of limitations under these Articles also be extended to three years.[11]

VIII. Part X: Provide Responsible Person Sales Tax Relief for Minority LLC Owners

A. Current Law

Section 1131(1) of the Tax Law defines the "persons required to collect tax" for New York State sales tax purposes. The provision imposes absolute liability for unpaid sales taxes of a partnership upon any member of the partnership without regard to whether the member is a general partner or a limited partner. The same clause also imposes absolute liability for unpaid sales taxes of a limited liability company upon any member of the limited liability company without regard to whether the member had any involvement in the financial affairs or management of the business. Unlike the liability imposed on directors, officers, employees or

[11] We note that New York City's statutes of limitations to request refunds of various local taxes is one year, whereas the statutes of limitations for audit purposes is three years. See, e.g., NYC Admin Code §§ 11-2108, 11-2116 (Real Property Transfer Tax); NYC Admin Code §§ 11-2507, 11-2517 (Hotel Room Occupancy Tax). We recommend that the legislature addresses the discrepancy between the statutes of limitation and extend the time to claim a refund to three years.

managers, there is no requirement that the partner or member be "under a duty to act" for the business in complying with the sales tax laws in order to be held liable.

This "strict liability" language is inconsistent with all other "responsible person" provisions of federal and state tax law as they apply to other forms of doing business (*e.g.*, corporations) and other types of trust fund taxes (withholding taxes). In all other cases, the liability is imposed only on those persons with "a duty to act" in assuring compliance with the laws for collection and paying over the trust fund taxes (sales taxes and withholding taxes).

The absolute liability imposed by the law is also in direct conflict with other provisions of New York law intended to encourage investment in limited liability companies and limited partnerships by protecting passive investors from the liabilities of the business. *See* Limited Liability Company Law §609(a) and New York Partnership Law §§ 121-303.

In Report #1035 (July 22, 2003), the Tax Section of the New York State Bar Association recommended amendment of section 1131(1) to correct what we believed was the unintended effect of amendment of the law in 1994 when New York adopted legislation permitting the creation of limited liability companies. If read strictly, the law imposes personal liability for all unpaid sales taxes on limited partners of a limited partnership and members of a limited liability company even if the limited partner or LLC member was merely a passive investor having no role in the operations of the business.

Since that report was published, there have been several legislative efforts to amend the law to remove the absolute liability provisions. In 2011, a departmental bill from the Department recommended an amendment to section 1131(1) to eliminate the language imposing absolute liability. However, after that effort stalled in the legislature, the Department issued Technical Memorandum TSB-M-11(17)S (Sept. 19, 2011) to provide some administrative relief from the harsh effects of the law. The TSB allows a limited partner or LLC member with less than a 50% ownership interest and who did not have a "duty to act" in assuring compliance with the sales tax laws, to settle his or her sales tax liability under the law by paying a percentage of the sales taxes owed (inclusive of statutory interest) equal to his or her percentage ownership in the business.

In 2015, Assemblyman Daniel Farrell, Chair of the New York State Assembly Ways and Means Committee., introduced Assembly Bill #1983, which proposed to amend the "responsible person" provisions of the sales tax law to make changes consistent with the recommendations made in Tax Section Report #1035. The bill was identical to the language drafted by the Department in 2011. The Tax Section submitted informal comments on Assembly Bill #1983 in which we agreed with the proposed language amending section 1131(1) to remove the absolute liability provisions. However, we objected to certain other provisions in the bill creating new and onerous registration reporting requirements as well as a provision doubling the statute of limitation for liability (from three years to six years) for anyone failing to comply with those reporting requirements. Our objections noted that the earlier (2011) Department concerns regarding identification of responsible persons likely no longer existed as a result of new questionnaires then being used by the Department to obtain responsible person information when a business registers to become a vendor for the collection of sales taxes. Assembly Bill 1983 was referred to the Assembly Ways & Means Committee, but never moved forward.

B. Proposed Changes

The Budget Bill would amend section 1133(a)(2) of the Tax Law to essentially codify the Departmental policy set forth in TSB-M-11(17)S. That TSB has, as described above, provided some measure of relief to limited partners of a limited partnership and members of a limited liability company from the imposition of absolute liability for sales tax delinquencies owed by the partnership or limited liability company. Under that TSB, the limited partner or member may settle his or her sales tax liability by paying a percentage of the sales taxes owed (inclusive of statutory interest) equal to his or her percentage ownership in the business if the limited partner or member can demonstrate that he or she had a minority interest (less than 50%) in the business and had no "duty to act" in assuring compliance with the Tax Law. To qualify for relief, the Budget Bill adds the requirements that the person seeking relief cannot: (1) have acted on behalf of the limited partnership or limited liability company in complying with the sales tax laws; (2) have been convicted of a crime under the tax law; or (3) have a past-due tax liability. The Budget Bill does **not** propose any amendment to section 1131(1) to remove the "absolute liability" provisions that include within the definition of "persons required to collect tax" all partners in a limited partnership (including limited partners) and all members of a limited liability company even if they have no involvement in the financial affairs or management of the business.

C. Comments

While we have commended the Department for extending administrative relief to limited partners and limited liability members who, under a strict reading of the current language of section 1131(1), have been found to have absolute liability for sales taxes owed, we continue to take the position that the TSB relief does not go far enough to address the unfairness of the statute. We continue to believe that section 1131(1) needs to be amended to remove the absolute liability language. If the LLC member or limited partner is merely a passive investor without any involvement in the business, he or she should have no "responsible person" liability for unpaid sales taxes. Sales tax liabilities are potentially some of the largest of the trust fund liabilities and even a very small percentage ownership interest can result in very large liabilities owed even under the relief provisions of the TSB. As accurately described in the "Justification" of Assembly Bill 1983, "[t]he existing language of the state law that creates personal liability in passive investors is not just grossly unfair, it could deter investment in New York State businesses."

While the codification of TSB-M-11(17)S would assure a permanency and an interpretive weight to the relief provision that does not currently exist in its form as a TSB-M (which is merely an informational statement of existing department policies and may be changed by the Department), it is disappointing that the Budget Bill does not seek to amend section 1131(1) and finally address the unfairness of imposing absolute liability for sales tax on mere investors in a business especially when there is no policy justification for the law, no consistency with similar federal or state "responsible person" provisions, and the law is in direct conflict with other provisions of New York law intended to limit liability of passive investors.

Furthermore, in contrast to the provisions of TSB-M-11(17) S, the Budget Bill adds the following requirements for relief:

> "[T]he commissioner may deny an application for relief to any such limited partner or member who the commissioner finds *has acted on behalf of such limited partnership or limited liability company in complying with any requirement of this article* or has been convicted of a crime provided in this chapter or *who has a past-due liability, as such term is defined in section one hundred seventy-one-v of this chapter."*
> (emphasis added).

We believe that the above wording creates some ambiguities. We do not believe that relief should be denied to a limited partner or limited liability company member who may become aware that there is a delinquency in the filing of sales tax returns or the payment of sales taxes by the business and attempts to intervene in some positive way to demand that the business become compliant with the Tax Law or make arrangements for payment of sales tax delinquencies. Under the above language, even a positive effort on the part of the limited partner or member to right the wrong could place them at risk for denial of relief. Perhaps a better way of expressing the above requirement would be:

> "has *acted on behalf of such limited partnership or limited liability company in* ***thwarting compliance*** *with any requirement of this article …."*

Similarly, the denial of relief to anyone "*who has a past-due liability, as such term is defined in section one hundred seventy-one-v of this chapter"* is overbroad and overly restrictive. Under section 171-v, the term "past-due liability" means "any tax liability or liabilities which have become fixed and final such that the taxpayer no longer has any right to administrative or judicial review." This means that any limited partner or member who owes even a single dollar of unpaid tax liability would not qualify.

This additional limitation represents a significant narrowing of the relief provided by TSB-M-11(17)S, though we understand it may be consistent with how the Department is currently administering the policy. In any event, while the Tax Section supports a more vigorous reworking of the statute to entirely remove the absolute liability language for LLC members and limited partners, we at a minimum recommend that the restriction on providing relief to individuals with other tax debts be reconsidered. In our view, the unfairness of holding minority, passive investors responsible for entity-level sales and use tax debts should be mitigated as a matter of good tax policy and administration.

IX. Part AA: Internet Fairness Conformity Tax

Part AA of the Budget Bill proposes (i) a major change to the way sales and use taxes would be collected for sales made through so-called "marketplace providers" and (ii) a system whereby persons not required to collect tax in New York would be required to submit certain reports to New York State and to purchasers.

The marketplace proposal would shift the burden of collecting sales tax from the retailer to a "marketplace provider" that "facilitates sales of tangible personal property." It also has the effect of increasing the reach of New York's authority to require the collection of sales tax on online sales made by out-of-State sellers through marketplace providers with New York State nexus. Additionally, it would shift responsibility for the collection of sales tax for sales by an in-State seller to the marketplace provider in regard to particular sales.

The reporting proposal would require sellers and marketplace providers who are not required to obtain a certificate of authority to submit information returns with respect to sales to New York purchasers to New York State, as well as annual statements of purchases with notices that sales tax may be due to the purchasers.

A. Current Law

1. *Marketplace Provider*

Under current law, the responsibility to collect and remit sales taxes on taxable in-State sales is limited to "vendors."[12] A vendor is defined as a person "making sales" that has a sufficient connection to New York State to require the vendor to collect and remit sales tax on sales to customers in the State.[13] In certain circumstances, an agent of the vendor can be treated as a "co-vendor," with joint responsibility for collecting and remitting the sales tax.[14] When sales tax is not collected by the vendor on a taxable sale, the purchaser is obligated to remit use tax with respect to the use of the purchased property.[15]

Because vendors are defined as the persons actually making sales, a party that merely facilitates a sale between a seller and a buyer through a physical or online marketplace forum is not a vendor and does not have tax collection responsibilities, even if such party has in-State nexus. The responsibility for collecting sales tax lies with the seller itself. Critically, an out-of-State seller that does not otherwise have nexus with New York does not create in-State nexus by selling goods through an online marketplace, and is not required to collect and remit sales tax on sales made through an online marketplace.[16] This does not relieve in-State purchasers from liability for use tax.[17] Use tax is generally acknowledged to be

[12] Tax Law §§ 1131(1), 1132(a)(1).

[13] Tax Law § 1101(b)(8).

[14] Tax Law § 1101(b)(8)(ii)(A).

[15] Tax Law § 1110.

[16] Tax Law §§ 1101(b)(8)(v)(A).

[17] Tax Law § 1110.

underreported.[18] Thus, in an effort to increase use tax compliance, in lieu of having purchasers compute the use tax on each individual purchase, New York offers a simplified method whereby residents can elect on their personal income tax return to pay an estimated aggregate use tax on all purchases costing less than $1,000 each, which estimate is based on the residents' taxable income.[19]

2. *Information Reporting*

Under current law, no information reporting requirements are imposed on sellers or on marketplace providers.

B. Proposed Changes

1. *Marketplace Provider*

Part AA of the Budget Bill would alter the structure of current law by placing the burden of collecting tax on sales facilitated through an online or physical marketplace on the "marketplace provider." Under the proposal, a "marketplace provider" is defined as any person who "facilitates a sale of tangible personal property" by a "marketplace seller." A marketplace provider facilitates sales when it (i) "provides the forum" in which, or by means of which, the sale takes place and (ii) such person or an affiliate of such person either collects the receipts paid by a customer to a marketplace seller for the sale of tangible personal property or contracts with a third party to collect such receipts. A "forum" includes an internet website, catalog or similar forum or a physical forum, such as a "shop, store, or booth." Importantly, a

[18] Memorandum in Support, Part AA (stating that the proposal will increase revenues by $80 million in 2019 and $159 million annually thereafter).

[19] Form IT201i, p. 26.

person who facilitates sales exclusively by means of the Internet is not a marketplace provider if its annual sales have been no more than one hundred million dollars for every calendar year after 2016. The proposal would take effect on September 1, 2018.

2. *Information Reporting*

Part AA of the Budget Bill would also require sellers and marketplace providers who are not required to obtain a certificate of authority to submit information returns to the Commissioner with respect to sales to New York purchasers, as well as annual statements of purchases with notices that sales tax may be due to the purchasers.

The first requirement applies to "non-collecting sellers" who are defined as persons who make sales of tangible personal property, are not required to obtain a certificate of authority in New York, and do not collect sales tax in regard to tangible personal property delivered to New York. A non-collecting seller is required, upon, request of the Commissioner, to provide to the Commissioner each New York purchaser's name and last known address, and the total of the non-collecting seller's receipts from purchases by the New York purchaser.

In addition, non-collecting sellers with receipts of five million dollars or more during the calendar year are required to file an annual information return with the Commissioner. The return must include the total of the non-collecting seller's receipts from sales of tangible personal property that are delivered to New York "together with such other information the Commissioner may prescribe." In addition, such non-collecting sellers are required to provide an annual statement of purchases to each New York purchaser for purchases of tangible personal property delivered to a location in New York. This document must include both a statement that sales or use tax was not collected and that the purchaser may be required to remit such tax directly to the Commissioner and a list of transactions entered into during the prior calendar year by the purchaser showing the date of each purchase, a description of the item purchased, and the amount paid for each item. Non-collecting sellers **over the $5 million threshold** are also required to prominently display a notice on all order forms and sales receipts (including screens that summarize the transaction prior to the completion of sale) stating that a purchaser may be required to submit tax directly to the State.

A separate requirement applies to "non-collecting marketplace providers," which are marketplace providers (as defined above, including the $100 million threshold embedded in the definition) who are not required to obtain a certificate of authority under the new requirements described above and who do not collect sales tax in regard to tangible personal property delivered to New York. Non-collecting marketplace providers are required to perform the requirements set forth above on behalf of a non-collecting seller for all sales they facilitate for such non-collecting sellers. Non-collecting marketplace providers are required to provide notice to each non-collecting seller for whom they facilitate sales of tangible personal property that states that the seller may be required to obtain a certificate of authority and informs the seller of information that the marketplace provider may provide to the Commissioner.

C. Comments

At the outset we note that the Supreme Court has issued a writ of certiorari in the matter of *South Dakota v. Wayfair, Inc.*, No. 17-494, in which South Dakota has asked the Supreme Court to reconsider the sales-tax only physical presence nexus requirement established by *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). The Supreme Court's ultimate determination in this matter has the potential to fundamentally change the underlying constitutional jurisprudence that has resulted in New York's inability to directly impose sales tax on Internet sales. The proposals in Section AA of the Budget Bill, which appear designed to navigate around the constitutional constraints, may no longer be necessary. Given the possibility of change in the underlying federal law, we note that this is an unusual juncture for New York to propose the significant new changes set forth in the Budget Bill. We suggest that consideration be given to the *Wayfair* matter in connection with review of the proposals in the Budget Bill.

1. *Marketplace Provider*

The proposed approach in the Budget Bill would significantly alter nationwide practices as to the party responsible for collecting sales tax on sales facilitated through third parties.[20] The proposal would impose significant compliance obligations and potential tax liabilities on marketplace providers, parties whose sole role in the transaction is to facilities sales between two unrelated parties, and who may not be in a position to make determinations as to taxability. Under the proposal, this designation of collection responsibility is mandatory—if a marketplace provider facilitates sales, the marketplace provider will be responsible for sales tax compliance for those sales.[21] The Tax Section expresses no opinion on this provision as a policy matter, although we note that it would represent a substantial change.

The shifting of responsibility for collecting tax from the marketplace seller to the marketplace provider under the proposal appears to have two major effects. First, with respect to sellers that already have nexus in New York, it would appear to relieve them of the

[20] For states with similar statutes, see Minnesota H.F. 1 (2017) and Washington H.B. 2163 (2017).

[21] Budget Bill Part AA § 2.

responsibility of collecting sales tax and shift that responsibility to the marketplace provider.[22] Second, it appears to provide a mechanism for the collection of sales tax for sales by sellers that do not have any nexus with the State. The marketplace provider would be responsible for collecting and remitting the tax on sales made by both in-State and out-of-State sellers.

i. Nexus

We have not identified any obvious constitutional infirmity in placing the responsibilities set forth in the Budget Bill on marketplace providers, so long as the marketplace provider meets the statutory and constitutional nexus requirements with the State. Indeed, it may be analogized to imposing a sales tax collection responsibility on in-State co-vendors (discussed below).[23] We do, however, recommend that the Tax Law make clear that only marketplace providers with nexus to New York are required to collect sales tax. At a minimum, the law should provide that marketplace providers must have "a connection with the state which satisfies the nexus requirement of the United States constitution."[24]

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[22] We note that under the proposal, in order to be relieved of responsibility for collecting sales tax, the seller must obtain a "completed certificate of collection" from the marketplace provider which states that the marketplace provider will collect the sales tax. Budget Bill Part AA § 3.

[23] *See*, *e.g.*, TSB-A-86(13)S (N.Y.S. Dep't of Taxation & Fin., Mar. 26, 1986) (ruling that a household appliance telephone ordering service is responsible for collecting and remitting sales tax as a co-vendor on sales made on behalf of out-of-state suppliers).

[24] We note that under the Budget Bill, marketplace sellers that have nexus with New York must ascertain whether the marketplace provider has nexus in order to determine which party will bear tax collection responsibilities. If the marketplace provider has nexus with New York, the marketplace seller will be relieved of sales tax collection responsibilities with respect to those sales that it makes through the marketplace provider. However, if the marketplace provider does not have nexus with New York, sales tax collection responsibilities for those sales will remain with the marketplace seller.

As described above, we note that these nexus requirements may change depending on the U.S. Supreme Court's determination in the *Wayfair* matter. Based on current law, in order to satisfy constitutional requirements to be required to collect and remit sales tax on behalf of New York, a marketplace provider would need to have a non-de minimis physical presence in New York, either directly or through *Scripto/Tyler Pipe*-type agency or representative nexus. In *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), which will be revisited in *Wayfair*, the U.S. Supreme Court reaffirmed its decision in *National Bellas Hess, Inc. v. Dep't of Revenue*, 386 U.S. 753 (1967) establishing a "bright-line" physical presence rule under the Commerce Clause; under this bright-line rule a state can compel those out-of-state mail order sellers having a physical presence in the state to collect its use taxes, but cannot impose a collection obligation on those who do no more than communicate with customers in the state by mail or common carrier as part of an interstate business. Accordingly, a marketplace provider would have nexus with the State only if it has a physical presence in the state, such as if personnel of the marketplace provider are physically present in the State on a regular or systematic basis. While in-state physical presence is a necessary predicate to nexus, such in-state presence need not be "substantial;" rather, it need only be demonstrably more than the slightest presence.[25] For example, it is unclear whether merely having a server in the State would meet this nexus standard.

Nexus can also be established through attribution from independent contractors or agents under the U.S. Supreme Court decisions in *Scripto* and *Tyler Pipe*. In *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960), the Supreme Court held that regular solicitation of sales by independent contractors (and not employees) was sufficient to establish a sales and use tax

[25] *National Geographic Soc. v. California Bd. Of Equalization*, 430 US 551 (1977); *Orvis Co. v. Tax Appeal*

collection obligation by an out of state corporation with no physical presence in the state. Indeed, the Supreme Court has stated that "the crucial factor governing nexus is whether the activities performed in [the] state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in [the] state for the sales.'"[26]

In view of the above precedent, and in the absence of direct precedent regarding marketplace providers, the Tax Section does not take a position on the required nexus where the marketplace seller does not itself have nexus with the State, but raises it as an issue that should be considered and addressed in the legislation, or else by regulation, and notes that any such guidance may need to be revisited in light of the final determination in *Wayfair*. We also acknowledge the decision of the New York State Court of Appeals in *Amazon.com, LLC v. New York State Department of Taxation and Finance*,[27] in which the court found substantial nexus in the absence of actual physical presence.

ii. Scope of Application

The proposed reporting requirements are limited to sales of personal property. We note that for purposes of New York's sales and use tax, personal property includes computer software,[28] therefore bringing within the ambit of the marketplace provider provisions those online marketplaces that sell software applications and computer games. Prior versions of

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Tribunal, 86 N.Y.2d 165 (1995).

[26] *Tyler Pipe Indus., Inc. v. Washington State*, 483 U.S. 232 (1987) (quoting *Tyler Pipe Indus. v. Dep't of Revenue*, 105 Wash.2d 318, 323 (1986)).

[27] 20 N.Y.3d 586 (2013).

[28] 1101(b)(6)

proposed marketplace reporting requirements would also have included sales of occupancies or admissions, which are no longer covered by the current proposal.[29]

Under the proposed definition, an entity is a "marketplace provider" only if it collects the receipts paid by a customer. We understand that there are "peer-to-peer" online marketplaces where the buyer has the ability to pay the seller directly, resulting in the marketplace provider not collecting such receipts. It appears that such sales are excluded from the application of this section, especially in light of the deletion of language that has been present in former marketplace reporting proposals that provided that the term "marketplace provider" included organizations that arrange for exchange of messages between customers and sellers.[30]

We also understand that there are companies that create and manage websites that are branded in the name of the selling business, and may provide the types of services identified in the definition of a "marketplace provider." For example, in addition to creating a website for the seller, such companies may also collect the receipts from the seller's customers through the website and remit them to the seller. If the intent of the proposal is to treat as a "marketplace provider" an entity that facilitates sales through a website address that is specific to a single business, rather than a website address that identifies a marketplace, then we recommend that the proposal make that clear.

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[29] See Part X, 1/19/15 Budget Bill.

[30] See Part X, 1/19/15 Budget Bill.

iii. Physical Marketplaces

In identifying the "forum" through which a marketplace provider facilitates a sale, the proposal also refers to a "shop, store, or booth" in addition to online marketplaces. We have struggled to identify a situation where a physical marketplace such as a store that does not already have tax collection responsibilities would meet the criteria specified in the statute.

We note that the exception for sellers that facilitate sales *exclusively* by means of the Internet applies only if the seller facilitated less than one hundred million dollars annually for every calendar year after 2016. We agree that the high threshold is appropriate here given the burden of compliance with the law. It is not clear to us why this exception would apply only to Internet websites and not to other retailers. For example, an Internet website that is under the threshold would immediately become a marketplace provider if it were to publish a catalogue.

iv. Other Matters

The Budget Bill states that generally a seller would be relieved from its duties to collect tax if it has received in good faith a properly completed certificate of collection from the marketplace provider certifying its compliance. It then goes on to provide that the Commission may (i) develop a contractual provision or approve a contractual provision developed by the marketplace provider which, if included in the contract, will have the same effect as the certificate of collection and (ii) provide by regulation or otherwise that inclusion of such provision in the publicly available agreement between the marketplace provider and the marketplace seller will have the same effect as the certificate of collection. We note that this provision differs from the rules applicable for other sales tax exemptions. For example, a certificate of exemption must be obtained from a non-profit organization; it is not sufficient to recite in the contract that the organization is non-profit. We are unclear as to the meaning and scope of the prong requiring inclusion of the contractual provision in a publicly available agreement and suggest that this be clarified. We are concerned that requiring public availability of the commercial contract, including sensitive business terms, may dissuade parties from using this provision.

We note that the Budget Bill states that the Department may provide by regulation or otherwise that a seller will be relieved of duty to collect tax for sales facilitated by a marketplace provider only if such marketplace provider is not on a list on the department's website of marketplace providers whose certificates of authority have been revoked at the commencement of the applicable quarterly period. We are concerned about the potential burden on sellers of needing to check this list on such a frequent basis and would suggest that an annual period be considered.

v. Co-Vendor Approach

One alternative to the Budget Bill's approach that could achieve the bill's apparent policy objectives would be to amend the law to permit a marketplace provider to be treated as a co-vendor under Tax Law § 1101(b)(8)(ii). Under existing law, the Department has the authority to treat any "salesman, representative, peddler or canvasser" as the seller's agent, and thus as jointly liable for collecting and remitting the sales tax.[31] By allowing the Commissioner to treat the marketplace provider as a co-vendor, the marketplace seller would remain the party primarily responsible for collecting and remitting the tax, but where the Commissioner determines it to would be efficient for administration of the tax, the marketplace

[31] Tax Law § 1101(b)(8)(ii).

provider could be held jointly responsible. Under this approach, whether or not a marketplace seller has New York nexus, the marketplace provider could be treated as responsible for collecting the sales tax upon reasonable notice by the Department.

2. *Information Reporting*

The proposed approach in the Budget Bill follows the general approach taken by Colorado in Colo. Rev. Stat. §39–21–112, which was the subject of litigation in *Direct Mktg. Assn. v. Brohl*, 814 F.3d 1129 (10th Cir. 2016), cert. denied, 580 U.S. 16-267. In that case the 10th Circuit held both that Colorado's law does not violate the dormant Commerce Clause because it does not discriminate against or unduly burden interstate commerce and that *Quill's* bright-line physical presence test did not extend beyond tax collection to information reporting. We note that the Budget Bill would expand the information reporting obligation not just to sellers but to marketplace providers; it has not been determined whether the rationale of *Direct Mktg. Assn.* would properly extend this obligation beyond sellers to marketplace providers as well.

i. Privacy Concerns

We have significant privacy concerns with the proposal in the Budget Bill. Under the proposal, the State would be entitled to request that each non-collecting seller or non-collecting marketplace provider furnish the Commissioner with a listing of the name of each New York purchaser and the total of the non-collecting seller's receipts from each purchaser. The mere fact that a purchaser has made a purchase from a particular website may be sensitive information that a purchaser may not want to disclose to the State. Similarly, in order for purchasers to obtain assistance from tax preparers in determining whether purchases are taxable (see below), they will need to share what may be sensitive information regarding the details of their purchases (even those of *de minimis* value) with their tax preparers.

ii. Purchasers

Under the proposal, the State would receive a listing with the name of each New York purchaser and the total of the non-collecting seller's receipts from each purchaser, but no information on the purchase itself or whether the purchase is taxable. This may result in a situation where the State makes inquiry of a purchaser with respect to potential tax due where the items purchased were not in fact taxable.

Similarly, the notice requirement applies to each sale of tangible personal property, whether taxable or not. The notices to the seller may accordingly be misleading: A seller would be required to submit a statement to a purchaser specifying that "the purchaser may be required to remit tax" even when the item sold to the purchaser is clearly not taxable.

For purchasers that use income estimates for computation of use tax as described above, the information provided on the notices will be irrelevant. Accordingly, consideration should be given to requiring the notices to explain the availability of this method so as to make purchasers aware that there is an alternative method to be used instead of adding up all purchases made and determining the taxability of each item.

iii. Notices

The requirement that repeated notices about use tax obligations be included by non-collecting sellers on all order forms, sales receipts, and screens summarizing transactions prior to completion seems to us to go too far. A single notice on the sales receipt and on the final screen commemorating the transaction would seem to suffice for this purpose.

With respect to the annual tax notice that must be provided by the marketplace provider to the seller, it is not clear to us why this should be, in the first instance, sent by mail. Email is the typical method of communication utilized by Internet vendors and the cost of mailing notices to sellers may be significant. We note that New York State does not send its own Forms 1099G by mail but instead delivers them by Internet download.[32]

[32] https://www.tax.ny.gov/pit/file/1099g.htm