REPORT #607

TAX SECTION

New York State Bar Association

Committee on Sales, Property and Miscellaneous Taxes

Comments on Governor's Budget Bill S.2459/A.3659
to Amend the Sales Tax Law

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April 4, 1989

FEDERAL EXPRESS

William F. Collins, Esq.
Deputy Commissioner and Counsel
New York State Department of Taxation and Finance
State Campus – Building #9
Albany, New York 12227

Re: <u>1989 Budget Billes</u>

Dear Deputy Commissioner Collins:

At the request of William L. Burke, New York State Bar Association Tax Section Chair, I am forwarding to you herewith Comments on Governor's Budget Bill S.2459/A.3659 to Amend the Sales Tax Law.

Time constraints prevented consideration of these commence by the full Executive committee of the Tax Section and their adoption as a formal report. The Comments have, however, been approved by Administrative Committee of the Tax Section.

With best Regards,

Sincerely,

E. Parker Brown, II

EJP:CR
Enclosures
cc: Hon. Ralph J. Marino
Hon. Mel Miller
Hon. Tarki Lombardi
Hon. Roy Goodman
Hon. Saul Wepren
Deab Fuelihan
Abraham M. Lackman

bcc: William L. Burke, Esq.
Arthur A. Feder, Esq.
James M. Peaslee, Esq.
John A. Corry, Esq.

NEW YORK STATE BAR ASSOCIATION

TAX SECTION REPORT #607

LETTER TO WILLIAM F. COLLINS DATED APRIL 4, 1989 RELATING TO PROPOSED
NEW YORK STATE 1989 BUDGET BILL S. 2459/A.3659 (SALES TAXES).

NEW YORK STATE BAR ASSOCIATION TAX SECTION

Committee on Sales, Property and Miscellaneous Taxes

Comments on Governor's Budget Bill S.2459/A.3659 to Amend the Sales Tax Law*

This proposed legislation is designed to amend New York's sales tax law in several different areas. New provisions would be added pertaining to promoters of entertainment events; the law relating to compensating use taxation of catalogs and other promotional material would be changed; the use tax on building components assembled out of state would be clarified; the definition of the term “vendor” would be expanded; the taxation of floor coverings and their installation would be simplified; the services of furnishing cable television and music would be taxed for the first time; and the sales tax on admission charges would be expanded.

A. Entertainment Promoters

In 1978, following investigation by a State Tax Commissioner's Special Task Force on Tax Compliance by Flea Markets and Other Temporary Shows, New York's sales tax law was amended by adding the terms “show” and “promoter” and by placing special responsibilities on any person included within the definition of a show promoter. L. 1978, ch. 609. In general

* These comments were prepared by E. Parker Brown, II. Helpful suggestions were contributed by Robert E. Brown, Michael A. Pearl, Robert Plautz, Arthur R. Rosen and Marvin Rosenthal.

terms, a “show” is any flea market, craft show, antique show or the like, and a “promoter” is any person who directly or indirectly rents, leases or grants a license to use space to a person for the display and sale of tangible personal property or services subject to tax at more than three shows during a calendar year. Tax Law § 1131(6) and (5). A show promoter is required to notify the Commissioner of Taxation and Finance of an upcoming show, obtain a permit, prohibit participation in shows by unregistered vendors, and file reports with the Commissioner. Tax Law §§ 1134(b) and 1136(f). See also 20 NYCRR 533.1(b), and, e.g., TSB-A-86(32) and (33)S (State Tax Commission, Sept. 3, 1986). Failure to comply with the law can result in revocation of a show promoter's existing permits, denial of permits prospectively, and criminal prosecution for a misdemeanor. Tax Law §§ 1134(b) and 1817(f).

Budget bill S.2459/A.3659 (hereinafter “S.2459”) would introduce into the sales tax law parallel provisions regarding an “entertainment event” and an “entertainment promoter” in an effort to improve tax collection on tax free sales of shirts, hats, recordings, programs and the like by unregistered vendors at rock concerts, wrestling exhibitions, tractor pulls and similar performances scheduled on an occasional basis. See

Governor's Memorandum in Support (hereinafter “Bill Memorandum”), p. 12. An “entertainment event” is defined to include “concerts, athletic contests or exhibitions and other similar forms of entertainment, irrespective of both the kind of facility where such event is held and whether such event has an admission charge subject to tax, where the person or persons performing at such event do not perform on a regular, systematic or recurring basis at the same location.” S.2459 § 2. (The Tax Commissioner would be empowered to make rules defining “regular, systematic or recurring” and would be empowered to limit the reach of the term “entertainment event” by prescribing that the facility where such an event is held must have a certain attendance capacity. Id.) The definition of “entertainment promoter” is similar to that of “show promoter”, but there is no exclusion in the present bill for three or fewer events, and an effort has been made to expand the description of relationships between promoters and vendors.

Why limit reporting and enforcement responsibilities to promoters of events “where the person or persons performing ... do not perform on a regular, systematic or recurring basis at the same location”? The answer is apparently to be found in the Bill Memorandum, p. 12, as follows:

> Events such as professional or amateur sports with a scheduled season at the same location (Shea Stadium, Yankee Stadium, Rich Stadium, Madison Square Garden, RPI Fieldhouse, Glens Falls Civic Center, etc.) or cultural or theatrical events held at various sites across the State (performing arts centers, Broadway theaters, etc.) do not usually have the kinds of transient vendors that require stringent monitoring. However, certain kinds of events frequently do have transient vendors which require close scrutiny.

The Bill Memorandum acknowledges that “[t]he same facility may be the site for different events, only some of which would come within the scope of this proposal.” Bill Memorandum, p. 12. Thus, as the by-product of an effort to monitor more effectively transient vendors at “certain kinds of events”, wholly legitimate and conscientious facility owners would be forced to comply with a new set of enforcement and reporting requirements. Additionally, the conscientious facility owner would be put in the position of having to make what might be a difficult determination -- upon pain of stiff civil sanctions and possible prosecution for a misdemeanor -- as to whether persons perform at a facility with sufficient regularity to fall outside the definition of an entertainment event.

If the bill is correctly understood, Syracuse University would be an entertainment promoter when it sponsors an exhibition by the Harlem Globe Trotters, who do not regularly perform in Syracuse's domed stadium, but would not be an entertainment promoter when the schools own basketball team plays in the Dome. The case has not been made for such disparate treatment, and the justification for the regulatory tangle which would come with it is not apparent. We suggest a better approach is not to make reporting and enforcement requirements turn on such subjective assessments and instead focus on requiring reporting and enforcement in all cases, with suitable blanket exemptions or other procedures for a one-time registration of vendors for recurring events at the same location.

Turning to some of the specifics of the proposal, going beyond the parallel definition of “show promoter”, “entertainment promoter” includes “any person who has any management responsibility with respect to ... a vendor making ... sales at ... an event.” S.2459 § 2. Presumably this means a manager on the staff of a facility owner or perhaps a management firm employed by a facility owner, but it could be read to mean a vendor employee having management responsibility over the vendor's sales activities. The entertainment promoter must notify the Commissioner of Taxation and Finance 20 days prior to an event, and the Commissioner is to issue an “entertainment promoter certificate” within 10 days of receipt of this notification. S.2459 § 4. These time periods are longer than those relating to show promotions (10 and 5 days) and seem sensible.

Any entertainment promoter who willfully authorizes an entertainment vendor without first requiring such vendor to obtain a certificate of authority or who willfully fails to obtain an entertainment promoter certificate would be guilty of a misdemeanor. S.2459 § 10. On a technical level the proposed language is somewhat awkward. The penalty should be imposed upon an entertainment promoter who willfully authorizes an entertainment vendor to do something (e.g. make sales on the premises), not simply upon an entertainment promoter who willfully authorizes an entertainment vendor.

This criminal penalty goes further than the comparable misdemeanor involving show promoters. Show promoters violate Tax Law Section 1817(f) when they willfully fail to file a notice of show or willfully rent space, etc. for a show or operate a show without a permit, whereas S.2459 would compel the entertainment promoter to police the entertainment vendors by requiring the vendors to obtain certificates of authority. The more extensive criminal penalty seems justified in light of the fact that the conduct must be willful.

More questionable is the civil penalty, S.2459 § 9, which does not seem to have a counterpart in the law relating to show promoters. An entertainment promoter who authorizes an entertainment vendor to make taxable sales of tangible personal property at an entertainment event when such vendor is not registered with the Tax Department would be subject to a penalty of not more than $10,000 with respect to each event. Id. Strict liability here is unwarranted. At a minimum the penalty should apply to an entertainment promoter who “knowingly” authorizes the specified conduct; arguably the modifier “willfully” should be employed. Additionally, the large size of the penalty leaves too much to the discretion of the Tax Commissioner, permitting a ruinous fine for a minor infraction.

The provisions of S.2459 relating to entertainment events would appear to have only modest revenue implications, especially in the short run. Accordingly, this area might be better dealt with later in the Session after the budget is approved. In any event the proposed effective date of June 1, 1989 is too soon to allow orderly rulemaking, preparation of forms, and education of the public.

If further consideration is given to this topic, the Tax Section stands ready to assist.

B. Catalogs and Promotional Material

In a 1976 tax appeal, Matter of Ford Motor Company (S.T.C. Sept. 15, 1976) (CCH Transfer Binder para. 99-990t), the State Tax Commission found that Ford had had promotional brochures, booklets, posters and the like printed and collated outside New York and shipped by the independent companies doing the collating by mail or common carrier from Michigan to Ford franchised dealerships in New York. The Commission further found that Ford, which received no payment for the promotional materials, exercised no dominion and control over the materials in New York and the Commission concluded that, in consequence, there was no taxable use of the materials within the meaning of Tax Law Section 1110. In 1978 the Appellate Division, Third

Department, decided a similar case, Matter of Bennett Brothers, Inc. v. State Tax Commission, 62 A.D.2d 614 (3rd Dep't. 1978), the same way, citing Ford. Thereafter the Commission issued a policy memorandum stating that catalogs, promotional materials and other mailings sent by vendors free of charge directly to their customers within New York are exempt from tax when mailed or shipped by common carrier from outside New York. TSB-M-79(9)S (State Tax Commission, July 10, 1979). See also Matter of Sears Roebuck & Co. and Matter of Montgomery Ward & Co., Inc., State Tax Commission, Sept. 28, 1979.

As the Bill Memorandum, p. 13, indicates, this puts New York printers at a competitive disadvantage because New York vendors are encouraged to patronize out-of-state printers to avoid paying the sales tax that an in-state printer is required to collect on catalogs sent by it to in-state addresses. However, one person assisting in these comments makes the point that this disadvantage may not have been “severe” (as described in the Bill Memorandum) because the Bennett Brothers holding has been consistent with virtually every ruling by other states' courts on this issue so that New York printers have had a corresponding competitive advantage over the other printers in their home states.

While Ford and Bennett Brothers involved an interpretation of New York's statutory description of a “use” and were not decided on constitutional grounds, one infers that the Tax Department felt there were constitutional obstacles to simply broadening the (already broad) definition at Tax Law Section 1101(b)(7). What changes the picture is the United States Supreme Court's recent decision in D. H. Holmes Co., Ltd. v. McNamara, 108 S.Ct. 1619 (1988). This case concerned a Louisiana department store chain which had had catalogs designed in New York, printed in Atlanta, Boston, and Oklahoma City, and mailed by the printers to residents of Louisiana. Id. at 1621. Louisiana applied a use tax to the value of these catalogs and a dispute ensued. A unanimous Court brushed aside Holmes' Commerce Clause argument, holding that the four-part test in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977), had been satisfied. Holmes at 1623-1624. Furthermore, the Court distinguished National Bellas Hess, Inc. v. Department of Revenue of Illinois, 386 U.S. 753, 87 S.Ct. 1389, 18 L.Ed.2d 505 (1967), on the obvious ground that, unlike the National Bellas Hess company, Holmes had a significant economic presence (13 stores) in the state in question. Holmes at 1624.

With the green light provided by Holmes, S.2459 would expand New York's definition of a use by inserting the word “distribution”. S.2459 § 11. Thus, the term would be defined as “[t]he exercise of any right or power over tangible personal property by the purchaser thereof [including, but not limited to] the receiving, distribution, storage or any keeping or retention for any length of time, withdrawal from storage, any installation, any affixation to real or personal property, or any consumption of such property.” Given the explicit legislative history which would accompany the enactment of this amendment, the proposed one-word addition should be sufficient to reverse the Bennett Brothers result, and from a tax policy standpoint there is good reason to make this change.

One person contributing to these comments disagrees. In this person's view, the New York courts might still find that a company having promotional materials sent into New York by mail or common carrier lacked the “real control” over these items necessary to constitute a use. And the same person notes that the burden of the proposed tax on catalogs and other promotional materials mailed from out of state to New York residents will fall on those merchants having a New York nexus, i.e. the merchants already making substantial contributions to New York's economy through the sales they generate on which they collect New York sales tax, through the income and property taxes they pay, and through the jobs they create in their stores and other New York facilities. The proposed tax, in this view, will widen the competitive advantage that non-nexus mail order firms -- against whom the tax could not be imposed -- enjoy over New York-based merchants. A partial response to this last point is that, via amendments proposed elsewhere in S.2459 and by supporting federal legislation to overturn National Bellas Hess, Governor Cuomo is attempting to end the mail order abuses presently occurring.

S.2459 contains two other proposals regarding promotional materials. S.2459 Section 12 would add a comprehensive definition of “promotional materials” encompassing, inter alia, envelopes and personalized materials, which are presently taxed regardless of ultimate destination. S.2459 Section 13 codifies the present rule that promotional materials mailed etc. to customers or prospective customers outside the state for use outside the state area are exempt from sales and use tax, c.f. Tax Law § 1119(a)(2), and specifies that services with respect to mailing lists are exempt if they are performed on or directly in conjunction with exempt promotional materials. All of these proposed amendments are desirable.

One technical question needs to be asked. Company A has a promotional flyer printed in New York. Company B, by arrangement with A, has a New York mail house insert A's flyer with B's monthly statements, a certain percentage of which are mailed to out-of-state addresses. Is it absolutely clear -- as it should be -- that A's flyer is mailed “by or on behalf of [a vendor] or other [person] to [its] customers or prospective customers.”?

C. Building Components

Matter of Morton Buildings, Inc. v. Chu, 126 A.D.2d 828 (3rd Dep't. 1987), aff'd mem., 70 N.Y.2d 725 (1987), exposed a lacuna in the state's compensating use tax, which S.2459 proposes to remedy. Morton was an Illinois firm engaged in the manufacture, sale and erection of pre-engineered timberframe, metal-sheathed buildings for agricultural and commercial use. Morton purchased raw materials in bulk and stored them outside New York, shipped building components to customers in New York, and constructed buildings on land prepared by the customer. No sales tax was collected because Morton received certificates of capital improvement from its customers.

The State Tax Commission ruled that a use tax was due on the cost of the raw materials bought outside New York but used in building components in New York. The courts, taking an unexpected interest in the metaphysical, found that Morton did not "use" the raw materials within New York "because when petitioner manufactured the raw materials into building components it changed their identity." 126 A.D.2d at 829. As the Bill Memorandum, p. 15, notes, it was the manufactured products (i.e. the components) which Morton used in this state, and Morton had not purchased the components, as such, at retail as required by Tax Law Section 1110(A).

Further details on this are ably set out in the Bill Memorandum and -- in light of the modest impact of the proposal -- do not warrant further discussion. S.2459 Section 14 appropriately plugs the loophole created by Morton and should be enacted.

D. Definition of “Vendor”

S.2459 Sections 15-18 attempt, in part, to extend the Tax Department's authority to obligate national mail order firms to register as vendors and collect and pay over New York tax on sales to New York residents. In other words, the proposed amendments seek to enlarge New York's definition of a “vendor” to the maximum extent allowed by the National Bellas Hess decision. Additionally, portions of these proposed amendments relating to advertising other than by catalog are intended in part to compel businesses in states bordering New York, which exploit the New York market by attracting New York customers, to, collect New York's use tax. Because of time constraints on these comments, this very large and familiar topic will have to receive abbreviated treatment. Readers' knowledge of the basics of the issue will be assumed.

In light of the uncertain prospects for passage of federal legislation overturning National Bellas Hess, see, e.g., “Rep. Brooks Will Not Push Mail Order Sales Proposals Without Strong Lobby Effort”, BNA Daily Tax Report, Mar. 14, 1989, p. G-2, we do not oppose New York's addressing this question at the state level. We note that action has already been taken or is being considered by numerous other states. See Bill Memorandum, p. 19, and Tax Notes. Oct. 12, 1987, p. 184.

In very general terms the bill would include within the definition of a “vendor”, among other persons, a person who solicits business by distribution of catalogs or other advertising matter "if such person has some additional connection with the state which satisfies the nexus requirement of the United States constitution" and by reason thereof makes sales to persons within the state of tangible personal property or services subject to use tax. S.2459 § 15. The bill then separately includes within the definition a person who makes sales of tangible personal property or services subject to use tax and who regularly or systematically delivers such property or services in New York by means other than the United States mail or common carrier, as well as a person who regularly and systematically <u>solicits</u> business in New York in any of a large number of specified ways. Among these ways are the distribution of catalogs, advertising flyers and the like; placement of outdoor advertising in New York; placement of ads with the print and broadcast media; and the use of all manner of modern telecommunication devices to reach New York consumers.

After setting forth the expanded definition of "vendor", the bill somewhat limits the sweep of the new provisions. To provide a concrete standard regarding deliveries, S.2459 specifies that a person shall be presumed to be regularly or systematically delivering property or services in New York if the cumulative total number of deliveries in the state by the person or its agent exceeded 12 during the last four quarterly sales tax periods, unless the person can demonstrate that this cannot reasonably be expected to happen again during the next succeeding four quarters. And the bill specifies that a person shall be presumed to be regularly or systematically soliciting business (by advertising and the like) if, for the immediately preceding four quarters, the cumulative total of the person's gross receipts from sales of property and services delivered in New York exceeds $300,000 and the person made more than 100 sales of property and services in New York, unless the person can demonstrate that this cannot reasonably be expected to happen again.

While we do not oppose New York's seeking to fill the gap left by Federal inaction in this area, we believe that any action taken by New York should be sensitive to both the present uncertainty that surrounds the extent to which National Bellas Hess and Miller Bros, v. Maryland, 374 U.S. 340 (1954) have been eroded by subsequent Supreme Court decisions and also the practical problems of tax administration in this area.* In our view, these considerations coalesce in favor of the legislation

*As to the current status of National Bellas Hess and Miller Bros., we note that the Bill Memorandum (p. 18-19) places considerable emphasis on the Holmes case, supra. That case, however, seems largely irrelevant to the pure mail order situation because Holmes had an entire chain of stores physically present within the state in question. Furthermore, in the more recent Supreme Court case involving Illinois' tax on telecommunications, Goldberg v. Sweet, _U.S._, 57 U.S.L.W. 4070 (Jan. 10, 1989), National Bellas Hess was cited without qualification as supportive of the opinion. We do not mean to reject the argument that, given the many advances in telecommunications since National Bellas Hess was decided, physical presence in the state must recede in significance when determining nexus and systematic exploitation of a market must increase in importance. But we believe that it should be recognized that the present state of the law in this area, and how and when it may develop, are still subject to uncertainties.

being drafted to reach only those cases where there are truly significant invasive marketing efforts and a degree of actual transactions that would involve enough potential revenues to help justify the burdens of both compliance and enforcement.

To that end, we suggest the following revisions in the Bill. First, the clause defining a vendor as a person who distributes catalogs or other advertising material and who has some additional connection with New York which satisfies the nexus requirement of the United States Constitution provides too uncertain a standard to be included in a statute and should be eliminated entirely. The $300,000/100 transaction presumption leaves uncertain the status of the merchant whose activity does not rise to these threshold amounts. A preferable approach here would be to drop the presumption and add a safe harbor provision covering merchants who fall below $300,000/100 transactions. And finally, the separate 13-delivery presumption seems far too low to be equated with regular or systematic exploitation of a market and inconsistent with the much higher $300,000/100 transaction standard. In light of this latter, more realistic, standard, the delivery presumption should be excluded altogether as unnecessary.

More thought also needs to be given to the portions of the presumption clauses which allow a merchant to demonstrate that activity in the next succeeding four quarters cannot reasonably be expected to rise above the thresholds. This is written as if the Commissioner would make such a determination at the same time the 13th delivery, for instance, takes place within four quarters. The reality, however, is that three or more past years will normally be under scrutiny in an audit. The “reasonable expectation” approach, consequently, would be an awkward standard to apply. Furthermore, the out-of-state merchant which makes hundreds of deliveries into New York within four quarters and then goes out of business would avoid the presumption because it could not reasonably be expected to exceed 12 deliveries in the next four quarters.

E. Floor Coverings

S.2459 Sections 19-21 would amend the definition of “capital improvement” at Tax Law Section 1101(b)(9) to provide that floor coverings, such as carpet or linoleum, do not constitute capital improvements to realty except when installed as the initial finished floor covering in new construction or in a new addition or total reconstruction of an existing building. The justification for this new rule is well described in the Bill Memorandum, p. 19-20. (For an illustration of the present, unsatisfactory, approach, see TSB-A-86(31)S (State Tax Commission, July 28, 1986)) These provisions, promoting consistency and certainty should be enacted.

F. Cable Television and Music

Portions of the budget bill relating to cable television and music, S.2459 §§ 22 and 23, are widely reported no longer to be under serious consideration by the Legislature. For this reason, comments will not be made.

G. Admissions

The centerpiece of proposals on admissions is a new tax on receipts from participatory sports such as bowling and skiing. This is widely reported to be “dead”. If the remainder of S.2459 Sections 24-34 is to be redrafted, comments could more usefully be made on the revision than on the present language.