Report No. 1460

NEW YORK STATE BAR ASSOCIATION TAX SECTION

COMMENTS ON 2022-2023 NEW YORK STATE EXECUTIVE BUDGET

March 24, 2022

New York State Bar Association ("NYSBA") Tax Section

Comments on 2022-2023 New York State Executive Budget[1]

1. Introduction

This report on selected tax provisions of the 2022-2023 New York State Executive Budget (the "Budget Bill") was prepared by the Tax Section of the NYSBA (the "Tax Section"). 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, in some cases, recommendations on the following parts of the Budget Bill:

Part G: Establish a Permanent Rate for the Article 9-A MTA Surcharge

Part R: Require S-Corporation Conformity with Federal Return

Part S: Eliminate the Investment Tax Credit for Production of Master Tapes

Part V: Modernize Tax Law to Include the Vacation Rental Industry

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1 The principal drafters of this report were: Michelle Chionchio, Jack Trachtenberg, Christopher Doyle, Elizabeth Pascal, Paul Comeau and Raymond Freda. Helpful comments were received from Robert Cassanos, Peter Faber, Stephen B. Land, and Michael Schler. This report reflects solely the views of the NYSBA Tax Section and not those of its individual members, the NYSBA Executive Committee or House of Delegates, or any other party.

2. <u>Discussion</u>

I. Part G: Establish a Permanent Rate for the Article 9-A MTA Surcharge

A. Previous Law

The Metropolitan Business Tax Surcharge (the "MTA Surcharge") is a tax surcharge generally imposed on every corporation subject to the New York Franchise Tax under Tax Law § 209 (other than S Corps), for the privilege of exercising the corporation's corporate franchise, or of doing business, or of employing capital, or of owning or leasing property in a corporate or organized capacity, or of maintaining an office, or of deriving receipts from activity in the Metropolitan Commuter Transportation District (the "MCTD"), for all or any part of the corporation's tax year.[1]

Under current law and regulations, the Commissioner of Taxation and Finance is required to annually adjust the rate of the MTA Surcharge as necessary to ensure that the receipts attributable to the surcharge will meet and not exceed the financial projections for the state fiscal year that commences in the year for which the rate is to be set, as reflected in the enacted budget for the fiscal year commencing on the previous April 1.[2]

The increased yearly rates were necessary to create additional revenue in order to support the rising costs of the Metropolitan Transportation Authority. The previous yearly rates are as follows: 28% for 2016; 28.3% for 2017; 28.6% for 2018; 28.9% for 2019; 29.4% for 2020; and 30% for 2021 and beyond.

[1] Tax Law § 209-B; Tax Law §§ 183, 183-a, 184, 184-a, 186-a, 186-e, 189.

[2] Tax Law § 209-B(1)(f); 20 NYCCR 9-1.2(d).

B. Proposed Changes

The proposed changes in the Budget Bill would repeal the yearly variable rate and make the 30% surcharge rate permanent beginning in tax year 2023.[3] In addition, the MTA Surcharge on a combined report will include a surcharge on the fixed dollar minimum tax for each member of the combined group subject to the surcharge.[4]

C. Comments

This section analyzes certain potential benefits and detriments of this proposal on which the Tax Section takes no position.

The proposed changes to return the MTA surcharge to a permanent rate may be beneficial for several reasons. First, the return to a permanent rate would ease the annual burden on the Department of Taxation and Finance (the "Department") in determining a new rate and drafting emergency regulations and publishing guidance. By removing this burden from the Department, its resources will be preserved for rulemaking and regulatory activity designed to bring clarity to taxpayers on other tax matters.

Second, by establishing a permanent rate this proposal would provide taxpayers with the ability to better predict their annual New York State tax liabilities. Predictability of tax liabilities is important to taxpayers for purposes of budgeting and allocating resources, as well as for financial reporting purposes.

Third, the MTA Surcharge rate has risen every year since the enactment of the variable rate. Establishing a statutorily fixed rate of 30% will require future rate increases or decreases to be approved by the New York State Legislature, which typically determines tax rates and which is more accountable to the public.

[3] Budget Bill Part G § 1(a).

[4] *Id*.

On the other hand, changing the procedure for establishing the rate does not reduce the work involved in determining the appropriate rate, it just shifts it from the Department to other participants. In particular, the proposal to establish a fixed MTA Surcharge rate removes the Department's ability to annually adjust the rate as needed to ensure a proper funding of the MTA. Future rate increases will have to be sought through the legislative process, which may be more cumbersome and which may not be as responsive to the MTA's funding needs.

II. Part R: Require S-Corporation Conformity with Federal Return

A. Summary of Changes

Under the Article 9-A regime currently in place, corporations doing business in New York and which have elected to be taxed under Subchapter S of the Internal Revenue Code, could choose whether to elect S corporation status in New York. Corporations treated as S corporations for federal but not New York purposes (so-called "hybrid S corporations") were able to obtain tax advantages in certain situations. For example, shareholders could take advantage of New York's favorable treatment of investment income under the pre-2015 corporate tax regime and exempt income under the current corporate tax regime. It also provided a planning opportunity for nonresident shareholders, whereby the corporation paid tax to New York, with shareholders relieved of New York tax on distributions treated as dividends for New York tax purposes and potentially relieved of any obligation to file in New York.

On the other hand, the requirement of separate S elections for federal and New York purposes proved problematic for some corporations and their shareholders. Many out-of-state corporations and their tax preparers were caught unaware of the requirement to separately elect S corporation status in New York, often requiring them to get shareholders' and New York's permission to make the election retroactively. In addition, resident shareholders were sometimes unaware that a hybrid S corporation could prevent them from claiming resident credits for taxes paid to other state jurisdictions where S corporation status meant that the shareholders were subject to tax on income sourced to that state.

The 2007-2008 Budget Legislation added a provision mandating that a New York S corporation election will be deemed to have been made in that year "if the eligible S corporation's investment income for the current taxable year is more than 25 percent of its federal gross income for such year." This mandatory S election created a new and broader definition of "investment income" for this purpose, including a wider array of items of income than the then-existing Article 9-A definition of "income from investment capital." While the provision was designed to close perceived loopholes, it also resulted in disputes over the interpretation of the new "investment income" definition, as well as unintended consequences, such as an unusual gain from an asset sale pushing a hybrid corporation into the mandatory S election category.

The Governor's Executive Budgets for FYE 2018 and 2022 both proposed S corporation election conformity, but this provision was ultimately left out of the final enacted budgets for both years. The Executive Budget Bill for FY2023 once again proposes to require federal and New York conformity regarding S corporation elections.[5]

B. Comments

S corporation election conformity does, indeed, simplify certain aspects of the tax law and reduces the risks of uninformed shareholders or tax preparers either neglecting to make the separate New York S election or assuming that credits for taxes paid to other jurisdictions at the shareholder level will still be available in New York.[6] Indeed, the vast majority of states have adopted S corporation election conformity. Nevertheless, eliminating the option for hybrid S corporation status could have unintended consequences on certain businesses.

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[5] FY 2023 New York State Executive Budget Bill Part R § 660(i).

[6] Tax Law § 620(d).

First, a qualified manufacturing company that has elected federal S corporation status loses any advantage of locating in New York, undermining the incentive of the zero percent tax rate enacted with corporate tax reform.

Second, whereas a hybrid S corporation could capitalize its New York State tax credits (e.g., a film production credit) and monetize them strategically, such treatment would no longer be possible where the credits are passed to the shareholders and no longer "belong" to the corporation that earned them. A hybrid S corporation may have valued certain tax credits (particularly refundable credits) on the basis of their use by the corporation rather than the shareholder for purposes such as obtaining bank financing, seeking a buyer, or attracting investors. Eliminating the hybrid model could change the value of those credits once they are in the hands of shareholders, potentially undermining business plans based on corporate-level tax credits.

While some of the benefits of hybrid status may have been unintended by-products of the hybrid system itself, it is not clear that the benefits listed (or other similar benefits) were intended either to be eliminated or diminished in value. If not, consideration might be given to ameliorating the impact of conformity on certain corporate taxpayers, such as qualified New York manufacturers who may have relied on the hybrid option in deciding to locate in New York, or to existing corporations with carryover state tax credits that relied upon those credits being available at the corporate level, and that would be detrimentally effected by the elimination of the hybrid option.[7]

III. Part S: Eliminate the Investment Tax Credit for Production of Master Tapes

Part S of the Budget Bill eliminates the availability of the investment tax credit (the "ITC") for capital assets acquired and principally used by the taxpayer to create audio and visual recordings including films, television shows, commercials, and musical recordings, or to

[7] *See* Report No. 1449 – Report on Governor Cuomo's New York State FYE 2022 Executive Budget, New York State Bar Association, Tax Section (March 6, 2021) at 22-25.

duplicate such recordings for the purpose of rebroadcast in any medium. The ITC would be eliminated for both corporate taxpayers subject to tax under Article 9-A, and individual taxpayers subject to tax under Article 22.

A. Current Law

Tax Law Sections 210-B and 606 include provisions generally allowing taxpayers ITCs with respect to acquisitions of tangible property that:

i. Is depreciable under the Internal Revenue Code (the "Code");

ii. Has a useful life of four years or more;

iii. Is acquired by purchase within the meaning of Section 179 of the Code;

iv. Is located in New York; and

v. Is principally used by the taxpayer in the production of goods by manufacturing, processing, etc.[8]

The Department has ruled that a taxpayer's acquisition, including through self-creation, of master tapes is a credit-qualifying event.[9] Specifically, in TSB-A-06(5)C, the Department ruled that production of duplicate tapes using a master tape constitutes "processing" under the Tax Law for purposes of the ITC. Thus, since the master tapes in the Advisory Opinion had a situs in NY, were used in New York to produce the duplicates, and met the other requirements of the ITC (e.g., the master tapes were deemed to be tangible personal property and acquired by purchase) they were eligible for the ITC. With respect to duplication of the master tapes qualifying as a manufacturing activity, the Advisory Opinion stated the following:

> In the *Matter of Epic Chemicals, Inc.*, Dec St Tax Commn, October 30, 1981, TSB-H81(59)C, it was held that the printing of personalization upon promotional literature affects such a change in the literature as to constitute "processing." (See also *Matter of Multimode, Inc.*, Dec St Tax Commn, May 20, 1983, TSB-H-83(23)C.) The conversion of raw film or tape into a form suitable for playback or transmission is in effect a form of imprinting, and the production of duplicate tapes using a master tape constitutes "processing" within the meaning of section 210.12(b) of the Tax Law. (See Technical

[8] Tax Law § 210-B.1(b)(i)(A).
[9] *See* TSB-A-06(5)C..

> Services Bureau Memorandum TSB-M-85(11)C, dated June 27, 1985 entitled *Opinion of Counsel, Investment Tax Credit*.). Therefore, the production of duplicate copies using a Program Master constitutes "processing" within the meaning of section 210.12 of the Tax Law.

B. Summary of Proposed Change and Stated Justification

The Budget Bill would amend Tax Law Sections 210-B and 606 to exclude from the definition of potentially credit-qualifying "tangible personal property and other tangible property" any property principally used by the taxpayer "in the creation, production or reproduction, in any medium, of any audio or visual recording, . . . or in the duplication, for purposes of broadcast in any medium, of a master of any audio or visual recording . . . ." This could be read to eliminate the availability of the ITC for acquisitions of capital assets used to produce master recordings, as well as the acquisition of master recordings acquired to produce subsidiary recordings. It would also render void the ruling in TSB-A-06(5)C that master tapes themselves are qualifying ITC assets when used to produce duplicate recordings in New York.

The Memorandum in Support of the Budget Bill includes the following passage in support of the proposal:

> The accounting treatment of program masters assigns a cost basis, which is the basis of the ITC, equal to all the costs incurred to produce the content on the master. Thus, it includes all the costs of filming and producing the content, which can be millions of dollars. Moreover, none of that activity has to occur in New York to generate the credit; it is sufficient that the completed master merely be located in New York.

C. Comments

The Memorandum in Support of the Budget Bill implies that the primary concern addressed by the proposed law change is the allowance under current law (as set forth in TSB-A-06(5)C) of an ITC for the acquisition of master recordings and the use of those masters within New York to produce duplicate recordings. From a technical perspective, the proposal, if enacted, would nullify the Advisory Opinion by disqualifying master tapes from eligibility as ITC qualifying assets. The proposal could also be read, however, as eliminating from the universe of assets the acquisition of which could qualify for the ITC *all* tangible property principally used to make audio or visual recordings even in cases where all such expenditures were incurred in New York to purchase equipment used in New York. Such a view could also negatively impact qualification for the 0% income tax rate afforded to Qualified New York Manufacturers, specifically, the requirement that otherwise qualified entities must have eligible ITC assets located in New York with a New York adjusted tax basis of at least $1 million at the end of a given tax year. We are unsure if this is what was intended by the proposal given the apparent focus in the Memorandum in Support on the qualifying use of master tapes in New York as qualifying ITC assets.

We note that under Tax Law § 210.1(b)(1)(G), the ITC would remain available tangible personal property and other property "principally used as a qualified film production facility . . . where the taxpayer is providing three or more services to any qualified film production company using the facility . . . .[10] This would appear to preserve the ITC for qualified film production facilities providing services to film production companies. As noted above, however, it would not appear to preserve the ITC for equipment purchased by film production companies themselves, regardless of whether they undertake their film production activities in New York. If this was not the intention of the proposal, we recommend clarifying its language.

IV. Part V: Modernize Tax Law to Include the Vacation Rental Industry

A. Current Law

In general, Article 28 of the Tax Law imposes sales tax on "[t]he rent for every occupancy of a room or rooms in a hotel."[11] If the rent is for occupancy of a room in a hotel located in New York City, a charge of $1.50 per day (the "Hotel Unit Fee") is also imposed.[12] Both sales tax and the Hotel Unit Fee are administered by the New York State Department of

[10] Tax Law § 210-B.1(b)(i)(G).
[11] Tax Law § 1105(e)(1).
[12] *Id*. § 1104(a).

Taxation and Finance (the "Department"),[13] and the same definitions and exemptions applicable to sales tax also apply to the Hotel Unit Fee.[14]

Sales tax and the Hotel Unit Fee are only imposed on the rental of hotel occupancy, and not on the rental of real property.[15] Under current law, it is unclear whether the definition of "hotel" encompasses a "vacation rental." A "hotel" is defined as "a building or portion of it which is regularly used and kept open as such for the lodging of guests," and includes "an apartment hotel, a motel, boarding house or club, whether or not meals are served."[16] According to the Regulations, a building, or portion thereof, falls within the definition of "hotel" if, among other factors:

> **(i)** sleeping accommodations are provided for the lodging of paying occupants on a regular basis; **(ii)** typical occupants are transients or travelers; **(iii)** housekeeping, linen, or other customary hotel services are provided for occupants; and **(iv)** the relationship between the operator of the establishment and the occupant is that of an innkeeper and guest, not that of a landlord and tenant ("e.g.," the occupant does not have an exclusive right or privilege with respect to any particular room or rooms, but instead merely has an agreement for the use or possession of the room or rooms).[17]

The Regulations exclude "bungalows" and "similar furnished living unit[s] limited to a single-family occupancy" from the definition of "hotel,"[18] provided that "no housekeeping, food, or other common hotel services, such as entertainment or planned activities, are provided by the lessor."[19]

Sales tax is imposed on the "rent," or consideration received, for hotel occupancy, including any charge required to be paid as a condition for occupancy.[20] The Hotel Unit Fee,

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[13] *Id*. §§ 1105, 1210, 1109, 1104(b); N.Y. Comp. Codes R. & Regs. tit. 20, § 527.9(a)(2)(ii).
[14] *Id*. § 1104(b).
[15] TSB-M-12(4)S, *Elimination of One-Week Stay Test to Determine if the Rental of a Bungalow or Similar Living Unit is Subject to Sales Tax* (N.Y.S. Department of Taxation & Finance Mar. 16, 2012).
[16] Tax Law § 1101(c)(1).
[17] NYCRR 527.9(b)(1).

[18] N.Y. Comp. Codes R. & Regs. tit. 20, § 527.9(e)(5).
[19] *Id.*
[20] Tax Law § 1101(c)(6).

however, is not subject to sales tax and must be separately stated on a customer invoice.[21] Sales tax and the Hotel Unit Fee are collected and remitted by the person operating the hotel,[22] which includes a "room remarketer;" that is, a person who furnishes occupancy, directly or indirectly, for rent.[23]

For purposes of imposing sales tax on the receipts from retail sales of *tangible personal property*, the Tax Law contains rules for "marketplace providers." Under the rules, a "marketplace provider" and "marketplace seller" are both deemed vendors for purposes of sales tax collection. A "marketplace provider" is a "person who, pursuant to an agreement with a marketplace seller, facilitates sales of tangible personal property by such marketplace seller."[24] "Facilitating" includes providing the forum in which the sale takes place, and collecting the receipts paid by a customer to the marketplace seller.[25] The Tax Law's "marketplace provider" provisions only apply to sales of tangible personal property.

A marketplace provider has all of the obligations and rights of a typical vendor, including the duty to collect and remit the tax, to obtain a certificate of authority, to file returns, and the right to accept a certificate of exemption or exclusion from tax.[26] A marketplace seller is relieved of the duty to collect and remit sales tax, and of the requirement to include the receipts from the sales of tangible personal property on its return, so long as the marketplace provider is facilitating the sale and the marketplace seller receives a properly completed certificate of collection from the marketplace provider. Additionally, any failure of the marketplace provider to collect and remit sales tax must not be caused by the provision of incorrect information by the marketplace seller.[27]

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[21] TB-ST-331, *Hotel and Motel Occupancy* (N.Y.S. Department of Taxation & Finance, May 9, 2012).
[22] Tax Law § 1131(1).
[23] *Id*. § 1101(c)(4),(8).
[24] *Id*. § 1101(e)(1).
[25] *Id*. § 1101(e)(1).
[26] *Id*. §§ 1101(b)(8); 1132(l)(1); 1133(a).
[27] *Id*. § 1132(l)(2).

B. Proposed Changes

Part V of the Budget Bill[28] reintroduces the legislature's fiscal year 2022 proposal,[29] which would require "vacation rental marketplace providers" to collect sales tax and the Hotel Unit Fee on "vacation rentals" that they facilitate.[30] The Budget Bill's proposed amendments to Article 28 are substantially similar to last year's;[31] in general, the amendments would: (1) update the Tax Law to impose sales tax and the Hotel Unit Fee on "vacation rentals;" (2) require "vacation rental marketplace providers" to collect sales tax on the vacation rentals they facilitate; and, as made explicit by the current Support Memorandum,(3) reverse the "bungalow" rule.[32] Unlike last year's proposal, the Budget Bill would also amend Tax Law § 1131(1) to relieve certain "vacation rental" operators of their sales tax and Hotel Unit Fee collection responsibility.

1. *Definitions*

Like last year's proposal, the Budget Bill would amend Tax Law § 1101(c) by including definitions for "vacation rental" and "vacation rental marketplace provider." Additionally, the definition of "room remarketer" would remain limited to rent for occupancy in a hotel (i.e., it would not apply to "vacation rentals"), and the definitions of "occupancy," "occupant," "operator," "permanent resident," and "room" would be expanded to include "vacation rentals" (and those who operate and occupy them). As proposed, the Budget Bill defines the term "vacation rental" as:

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[28] Unless otherwise noted, the term "Budget Bill" refers to the current FY 2023 NYS Executive Budget.
[29] FY 2022 NYS Executive Budget.

[30] FY 2023 NYS Executive Budget, Support Memorandum, pp. 20; FY 2023 NYS Executive Budget, Part V. *See* FY 2022 NYS Executive Budget, Part I.

[31] FY 2022 NYS Executive Budget, Part I.

[32] FY 2023 NYS Executive Budget, Support Memorandum, pp. 20-21.

> A building or portion of it that is used for the lodging of guests. The term ‘vacation rental’ include a house, an apartment, a condominium, a cooperative unit, a cabin, a cottage, or a bungalow, or one or more rooms therein, where sleeping accommodations are provided for the lodging of paying occupants, the typical occupants are transients or travelers, and the relationship between the operator and occupant is not that of a landlord and tenant.

The term “vacation rental” would include a “bungalow” regardless of whether meals, daily housekeeping, concierge service, linen service, and other similar amenities are provided.

A “vacation rental marketplace provider” is defined by the Budget Bill, in relevant part, as:

> A person who, pursuant to an agreement with an operator, facilitates the occupancy of a vacation rental by such operator or operators. A person ‘facilitates the occupancy of a vacation rental’ . . . when the person meets both of the following conditions: (A) such person provides the forum in which, or by mean of which, the sale of the occupancy takes place or the offer of such sale is accepted, including a shop, store or booth, an internet website, catalog, or similar forum; and (B) such person or an affiliate of such person collects the rent paid by a customer to an operator for the occupancy of a vacation rental, or contracts with a third party to collect such rent.

As noted above, the term “vacation rental marketplace provider” would not include a “room remarketer,” which is generally defined as a person who “reserves, arranges for, conveys, or furnishes occupancy, whether directly or indirectly, to an occupant in a hotel for an amount determined by the room remarketer.”

2. *Imposition of the Hotel Unit Fee and Sales Tax*

Like last year’s proposal, the Budget Bill would amend Tax Law § 1105(e) to impose sales tax on the rent for “occupancy” in a “vacation rental” located in New York. Similarly, the Budget Bill would amend Tax Law § 1104(a) to impose the Hotel Unit Fee on the rent for “occupancy” in a “vacation rental” located in New York City.

3. *Administrative Provisions*

Like last year's proposal, the Budget Bill would amend Tax Law § 1131(1), "persons required to collect tax," to impose a tax collection obligation on an operator of a "vacation rental" and on a "vacation rental marketplace provider," with respect to the rent for occupancy in a "vacation rental" that it facilitates. However, unlike last year's proposal, the Budget Bill would exclude "vacation rental" operators: (1) who rent out their own property; (2) for no more than three days during the calendar year; and (3) who do not use a "vacation rental marketplace provider" to facilitate the rental. The Budget Bill would also amend Tax Law § 1131(2), "customer," to encompass occupants of rooms in a "vacation rental."

Like last year's proposal, the Budget Bill would amend Tax Law §§ 1132, 1133, 1134(a), and 1136(a) to delineate the rights and obligations of "vacation rental marketplace providers" and operators of "vacation rentals." Per the Budget Bill, "vacation rental marketplace providers" would have the same obligations and rights as a vendor, including the duty to collect and remit tax, to obtain a certificate of authority, to file returns, and the right to accept a certificate of exemption or exclusion from tax. Operators of "vacation rentals" would be relieved of: (1) registering with the State to collect sales tax and the Hotel Unit Fee; (2) collecting sales tax and the Hotel Unit Fee; and (3) including rent from occupancy in a "vacation rental" on its return, so long as "vacation rental marketplace providers" are facilitating the rentals and provide operators of "vacation rentals" with a properly completed certificate of collection. Additionally, any failure on behalf of the "vacation rental marketplace provider" to collect and remit tax must not be caused by incorrect or insufficient information provided by the operator of "vacation rentals." If the operator of "vacation rentals" provides incorrect or insufficient information, the "vacation rental marketplace provider" is relieved of liability.

Like last year's proposal, the Budget Bill would amend Tax Law §§ 1132 and 1142 to expand the authority of the Department to have the discretion to allow a "vacation rental marketplace provider" to obligate itself to collect and remit tax, on behalf of the operator of "vacation rentals" for which it facilitates rentals in the State, without having to furnish a certificate of collection to the operator of "vacation rentals." The Department would also have the authority to publicize, on the Department's website, the "vacation rental marketplace providers" whose certificates of authority have been revoked. Additionally, the tax commission would have the authority to impose the duties otherwise assigned to the "vacation rental marketplace provider" on the operators of "vacation rentals," where the "vacation rental marketplace provider" facilitating the operator's rentals has had its certificate of authority revoked.

Unlike last year's proposal, the Budget Bill would amend Tax Law § 1138 to clarify the authority of the commissioner to determine, or redetermine, the amount of tax claimed to be due from a "vacation rental" operator. The Budget Bill would amend Tax Law §§ 1145 and 1817 to extend civil and criminal penalties to persons operating "vacation rentals" who are required to obtain certificates of authority but fail to do so. The Budget Bill would also amend Tax Law § 1210 to clarify that, for purposes of city sales tax administered by New York State, imposed on the rent for occupancy of a "vacation rental," "permanent resident" would be expanded to include occupants of a room in a "vacation rental."

C. Comments[33]

1. *Ambiguity in definitions*

Like last year's proposal, the current Support Memorandum states that the Budget Bill will improve taxpayer compliance and level the playing field for New York hotel operators. We continue to question whether the Budget Bill will improve taxpayer compliance in all respects. The proposed definitions of "operator" and "vacation rental" reintroduced by the Budget Bill are in some ways vague and internally inconsistent.[34]

Per the Budget Bill, an "operator" is defined as "any person operating a . . . vacation rental."[35] "Vacation rental" is in turn defined as:

> A building or portion of it that is used for the lodging of guests . . . . includ[ing] a house, an apartment, a condominium, a cooperative, a cabin, a cottage, or a bungalow . . . where sleeping accommodations are provided for the lodging of paying occupants, the typical occupants are transients or travelers, and the relationship between the operator and occupant is not that of a landlord and tenant. It is not necessary that meals are served. A building or portion of a building may qualify as a vacation rental whether or not amenities, including but not limited to daily housekeeping services, concierge services, or linen services, are provided.[36]

The foregoing language appears to make the provision of amenities irrelevant to the determination of whether the transaction is a vacation rental (as defined). However, it is clear that if the transaction creates a landlord-tenant relationship, it is not a vacation rental.

Despite the Budget Bill's use of the term "vacation", this term, and its definition would arguably encompass all occupancies and not only those sought for vacation purposes; for example, the tax would likely reach a homeowner that rents his or her Manhattan apartment to

[33] The comments in this section are substantially similar to those contained in our report of March 6, 2021, but have been modified to address changes from last year's to this year's proposal. *See* Report No. 1449 – Report on Governor Cuomo's New York State FYE 2022 Executive Budget, New York State Bar Association Tax Section (March 6, 2021) at 30-40.
[34] N.Y. Comp. Codes R. & Regs. tit. 20, § 527.9(e)(5).
[35] FY 2022 New York State Executive Budget, pg. 304-05.
[36] *Id.*

an occupant visiting the city on business. Last year's definition of "operator" did not include a threshold (either in dollars or in length of stay), and we commented that a homeowner could be considered an operator even where he or she only rented the apartment for one week out of the tax year, which would raise compliance concerns as homeowners renting their properties for business purposes may be unaware of their potential tax liability for providing "vacation rentals." Additionally, homeowners that engaged in only a handful of rentals per year could be unaware of their status as an "operator" and their resulting obligation to collect and remit tax. This year, the Budget Bill helps to address these compliance concerns by including a length of stay threshold; as proposed, the Budget Bill would exclude from a collection responsibility, a homeowner that rents out his or her own property for three days or less during the calendar year, and who does not use a "vacation rental marketplace provider" to facilitate the rental.[37] While we acknowledge that a threshold would help bring greater certainty, a three-day maximum may not be long enough to make much of a difference in terms of taxpayers accidently falling out of compliance, especially since such accommodations are typically rented by the night and therefore a three night rental would extend over four days, presumably triggering collection responsibility. If this was not intended, it should be clarified.

The definition of "vacation rental" excludes rentals of real property from the tax (i.e., where there is a landlord-tenant relationship). As pointed out above, the current regulations state that such a relationship is absent when: "The occupant does not have an exclusive right or privilege with respect to any particular room or rooms, but instead merely has an agreement for the use or possession of the room or rooms." This definition appears consistent with the normal common law definition of such a relationship.[38] It is possible than many vacation rentals would

[37] *See* FY 2023 NYS Executive Budget, Part V § 4(1).

[38] *See* Daniel Finkelstein & Lucas A. Ferrara, *New York Practice Series: Landlord and Tenant Practice in New York* § 2:28 (Dec. 2021); *see also Feder v. Caliguira*, 208 N.Y.S.2d 970, 973 (N.Y. 1960) ("It is the transfer of absolute control and possession of property at an agreed rental which differentiates a lease from other arrangements dealing with property rights.").

pass this test. On the other hand, the Bill removes from consideration several indicators that have historically been looked to by the Department and the courts to determine whether an innkeeper-guest relationship exists (which is subject to tax under current law). Under the current law, "bungalows" limited to a single-family occupancy are excluded from the definition of "hotel," and thus exempt from the tax on hotel occupancy, where common hotel amenities are not provided.[39] The proposed definition of "vacation rental" purports to tax "bungalows" regardless of whether meals, daily housekeeping, concierge service, linen service, and other similar amenities are provided, but not if the rental constitutes a landlord-tenant relationship as defined above. If this result was not intended, it should be clarified by the Budget Bill.

Like last year, as drafted, the Budget Bill also creates potential ambiguity on the tax base that is subject to tax in the context of a "vacation rental". Specifically, the Budget Bill does not modify the current definition of "rent", which is defined as the consideration received for occupancy in the hotel or vacation rental:

> The consideration received for occupancy, including any service or other charge or amount required to be paid as a condition for occupancy, valued in money, whether received in money or otherwise and whether received by the operator or a room remarketer or another person on behalf of either of them.

In the context of a "vacation rental" that is facilitated by a "vacation rental marketplace facilitator," the definition of rent, which is focused on the amount received for occupancy, raises the question of whether the fees received by the vacation rental marketplace facilitator for the use of its platform is subject to tax. By way of example, assume an individual books a rental of a taxable accommodation through an online home-sharing platform for one night at $100 per night. In consideration for using the vacation rental marketplace facilitator's platform, assume the operator of the accommodation (e.g., the homeowner) is obligated to pay the platform a $7 fee and the individual booking the accommodation is obligated to pay the

[39] N.Y. Comp. Codes R. & Regs. tit. 20 § 527.9(e)(5).

platform a $3 fee. In this scenario, the vacation rental marketplace facilitator will receive and process a payment from the individual booking the accommodation in the amount of $103. The vacation marketplace facilitator will keep $10 for the use of its platform and remit $93 to the homeowner. Does the definition of "rent" subject to tax include the $10 paid to the vacation rental marketplace facilitator for the use of its platform? Or is the "rent" subject to tax limited to the amount remitted to the homeowner (i.e., $93)? Alternatively, perhaps amount subject to tax is $100 on the basis that this is the amount paid to the homeowner for the rental, out of which the homeowner pays as an expense $7 to the vacation marketplace facilitator. The Budget Bill should clarify how rent is defined in the context of a "vacation rental" facilitated by a "vacation rental marketplace facilitator".

2. *Tax collection burdens*

Similar to last year, the current Support Memorandum states that the Budget Bill will help ease tax collection burdens for operators of "vacation rentals."[40] Although the Budget Bill seeks to relieve operators of their tax collection obligation, some questions arise as to how and when such relief would apply. For one, operators of "vacation rentals" are required to provide correct and sufficient information to "vacation rental marketplace providers," so that such providers can collect and remit the sales tax and Hotel Unit Fee due. Failure to provide correct and sufficient information will relieve the "vacation rental marketplace provider" of liability.

It is unclear, however, whether an operator will be liable for the entire tax liability, or a reduced amount based on the incorrect/insufficient information provided. For example, if an operator provides an incorrect address for a taxable rental, such that the sales tax rate imposed is 8.25 percent instead of 8.5 percent, is the operator liability for the entire 8.5 percent in tax or just the incremental 0.25 percent associated the operator's error? More broadly, the Budget Bill does not specify what information needs to be provided. Specifically, it is unclear whether the

[40] Support Memorandum, p. 15.

operator is only required to provide accurate factual information or whether the operator must communicate correct taxability determinations to the vacation rental marketplace facilitator. For example, it is one thing to require the operator to provide a correct address for the rental, but should the operator be responsible for determining and communicating whether the accommodation is exempt because the rental constitutes a landlord-tenant relationship? Or should the operator only be required to provide information regarding the characteristics of the rental, leaving the taxability determination to the vacation rental marketplace facilitator?

Like last year's proposal, the Budget Bill suggests that "vacation rental marketplace providers" would be allowed to collect on all "vacation rentals," without determining whether each rental is subject to sales tax and the Hotel Unit Fee. In this case, although the obligation to collect tax is removed from the operator, the operator is required to include tax in every rent for occupancy of "vacation rentals," even where the rental is an exempt under the Tax Law (e.g., a rental to an employee of an exempt government agency). This raises concerns for individuals booking the rental, such as who should be entitled to a refund of the tax collected and remitted? The Tax Section is concerned that many individuals will be unaware of their right to a refund and suggests the Budget Bill adopt a requirement that the individual booking the accommodation be notified of the potential right to a refund in such circumstances.

Unlike last year's proposal, the Budget Bill would amend Tax Law §§ 1138, 1145, 1817 and 1210. We agree with the legislature's changes and have no comments.

Finally, the proposal excludes licensed real estate brokers from the provision's collection obligations. We understand a corporation can qualify as a licensed real estate broker, in which case it would presumably be exempt.[41] If this was not intended, it should be addressed in the legislation.

[41] *See* Real Property Law §§ 440-a, 441-a.2.