



## Inside the New York Budget Bill: Proposed Sales Tax Amendments

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Governor Andrew Cuomo's 2015–2016 New York State Executive Budget Bill proposes several significant changes to New York's sales and use tax statutes. Several of these changes, while touted by Governor Cuomo as "closing certain sales and use tax avoidance strategies," are much broader and, if enacted, will have a significant impact on the sales and use tax liabilities resulting from routine corporate and partnership formations and reorganizations.

### The Nonresident Use Tax Exemption

Tax Law section 1118(2) currently provides an exemption from use tax for the use within New York of tangible personal property or services purchased by a nonresident (either an individual or a business entity), provided that at the time of purchase the nonresident was not engaged in the conduct of a trade or business in New York in which the property or service was used. The New York State Department of Taxation and Finance's regulations provide that a "resident" for this purpose includes "[a]ny corporation incorporated under the laws of New York, and any corporation, association, partnership or other entity doing business in [New York] or maintaining a place of business in [New York.]" There is no requirement under current law that a nonresident do business or maintain a place of business *outside* of New York at the time the nonresident purchases the property or service.

The Budget Bill would eliminate the nonresident exemption for business entities unless an entity has been doing business

outside of New York for at least six months prior to the date that the entity brought such property or service into the state. The nonresident exemption for individuals would remain unchanged. If this change is enacted, newly formed entities could benefit from the nonresident exemption only if they operate outside of New York for at least six months before using property or services in New York. There does not appear to be a requirement that the property or services be used in the trade or business conducted outside of New York in order to be eligible for the revised exemption. This amendment would be effective immediately (subject to the transitional provisions in the Tax Law).

### Treatment of Single-Member Limited Liability Companies

The Budget Bill would provide that, for sales and use tax purposes, "a single member limited liability company [SMLLC] and the member of that limited liability company shall be deemed to be one person." The Budget Bill further provides that, as a result, "a purchase or sale by one shall be deemed to be a purchase or sale by the other," and neither an SMLLC nor its member can make a purchase for resale to the other. The Memorandum in Support indicates that this provision is intended to eliminate a purported "abusive sales tax avoidance scheme" whereby an SMLLC makes an otherwise taxable purchase but relies on the sale for resale exclusion because it later sells the item to its single member. However, the impact of this amendment could be more sweeping than intended. For example, by treating an SMLLC and its member as one person, previously taxable transactions between an SMLLC and its member should no longer be taxable, presenting opportunities and potential tax savings for New York businesses. Additionally, under current law, the sale of all of

the interests of an SMLLC is considered a sale of intangible membership interests and is not subject to sales or use tax; however, if an SMLLC and its member are deemed to be “one person” for sales and use tax purposes, the sale of all of the interests of the SMLLC could be viewed as a sale by the member of all of the SMLLC’s assets, converting a previously nontaxable transaction into a potentially taxable transaction. Only a handful of states treat sales of SMLLCs in this manner, and such treatment would increase transaction costs for sales of SMLLCs. It is hoped that forthcoming amendments will clarify this issue. This amendment would be effective immediately (subject to the transitional provisions in the Tax Law).

## Related-Party Leases

Tax Law section 1111(i) currently provides that for leases of certain vessels, motor vehicles and noncommercial aircraft with a duration of one year or more, sales tax is due on all payments due under the lease as of the date of the first payment under the lease (or, if the property is outside of New York on that date, the date the property is brought into New York). The Budget Bill would expand this provision to *all* leases of tangible personal property between related entities, regardless of the length of the lease or the total payments due under the lease. The Budget Bill would also provide the Commissioner with discretion to estimate the true value of the lease payments if it is found that the sum of the payments due under the lease does not reflect the “true value or cost of the property.” The Budget Bill does not provide how such a finding is to be made or include limits on the exercise of such discretion.

This change, if enacted, would eliminate the time value of money savings that can ordinarily be accomplished through the use of a long-term lease whereby sales or use tax would be paid on each lease payment over time. The Budget Bill is intended to prevent abusive transactions in which tax is deferred by using unreasonably long lease terms, but it would apply as well to short-term leases that are not tax motivated. This amendment would be effective immediately (subject to the transitional provisions in the Tax Law).

## Transfers, Distributions and Contributions of Property

Tax Law section 1101(b)(4)(iv) currently provides that the term “retail sale” does not include the following: (1) transfers of tangible personal property to a corporation, solely in consideration for the issuance of its stock, pursuant to a merger or consolidation effected under the law of New York or any other jurisdiction; (2) distributions of property by a corporation to its stockholders as a liquidating dividend; (3) distributions of property by a partnership to its partners in whole or partial liquidation; (4) transfers of property to a corporation upon its organization in consideration for the issuance of its stock; or (5) contributions of property to a partnership in consideration for a partnership interest therein. A notable exception to these exclusions exists in Tax Law section 1111(q) for transfers, distributions or contributions of aircraft or vessels, except in the case where two corporations are to be merged or consolidated and such corporations are not affiliated with one another (using a 5 percent direct, indirect or common ownership test). Special rules apply to determine the computation of the sales or use tax that is due if an aircraft or vessel is transferred, contributed or distributed, and the purchaser of the aircraft or vessel is entitled to a refund or credit against its sales or use tax liability equal to the amount of sales or use tax that has already been paid by the seller.

The Budget Bill would expand the current exception for aircraft and vessels to all tangible personal property—thus vastly expanding the carve-out in section 1111(q) and significantly limiting the types of transfers, contributions and distributions that would be excluded from the definition of “retail sale” under section 1101(b)(4)(iv). If the Budget Bill is enacted, only transfers of tangible personal property pursuant to a merger or consolidation between unaffiliated parties (*i.e.*, corporations with less than 5 percent direct, indirect or common ownership) will be excluded from the definition of a retail sale. This change has the potential to significantly increase the sales and use tax exposure for individuals and entities involved in corporate and partnership formations and reorganizations that result in a transfer of tangible personal property.

Although the statute provides the purchaser (or transferee) with the ability to claim a refund or credit for any sales or use

taxes previously paid by the seller with respect to the property to avoid double taxation, there is still potential for double taxation in the context of successive transfers. It is not uncommon for corporate reorganizations to be structured in multiple steps—for example, the drop down of assets into a new entity (Transfer 1) followed by a merger of that entity into another entity (Transfer 2). As drafted, any credit or refund available to the transferee in Transfer 2 would appear to be limited to the tax paid by the seller in Transfer 2, which would presumably be no or very little tax (assuming the transferor claims the sale for resale exclusion upon purchase or gets a refund or credit for the tax paid by the seller in Transfer 1). It is hoped that this apparently unintended result will be corrected through the amendment process.

Additionally, while the statute provides the transferee with the ability to claim a refund or credit for taxes paid by the seller, it does not clarify the seller's collection obligation—is the seller required to collect and remit the full amount of tax due from the purchaser, or can the seller collect only the “net” amount due (the tax due after taking into account the transferee's credit or refund)? Future amendments hopefully will address this issue as well.

This amendment would be effective immediately (subject to the transitional provisions in the Tax Law).

## Prepaid Mobile Calling Services

The Budget Bill would amend the definition of taxable prepaid telephone calling services to include prepaid mobile calling services, defined as the right to use a commercial mobile radio service, whether or not sold with other property or services, that must be paid for in advance and is sold in predetermined units or dollars that decline with use in a known amount, whether or not that right is represented by or includes the transfer to the purchaser of an item of tangible personal property. The Budget Bill would also amend the sourcing rule for prepaid telephone calling services by providing that if the sale or recharge of a prepaid telephone calling service does not take place at the vendor's place of business, there is no item shipped, and the vendor does not have the address or the location associated with the customer's mobile telephone number, the sales should be sourced to such address, as approved by the Commissioner, that reasonably reflects the customer's location at the time of the sale or recharge. This

change would be effective immediately (subject to the transitional provisions in the Tax Law).

## Solar Power Purchase Agreements

Under current law, receipts from the sale of residential or commercial solar energy systems equipment are exempt from state sales and use tax. To encourage the deployment of solar installations in New York, the Budget Bill would also exempt from state sales and use tax receipts from the sale of electricity by a person primarily engaged in the sale of solar energy system equipment and electricity generated by solar energy system equipment pursuant to a written agreement under which such electricity is generated by residential or commercial solar energy system equipment that is (1) owned by a person other than the purchaser of the electricity; (2) installed on the residential or commercial property of the purchaser of such electricity; and (3) used to provide heating, cooling, hot water or electricity to such property. The Budget Bill would also provide localities with the option of electing to adopt this new exemption. This exemption would be effective immediately (subject to the transitional provisions in the Tax Law).

## Alcoholic Beverage Tastings

In recognition that breweries, distilleries, cideries and wineries are a growing part of New York's economy, and to encourage more tastings throughout the state, the Budget Bill would (1) expand the current sales and use tax exemption for wine furnished for consumption at a wine tasting to also apply to the bottles, corks, caps and labels used to package the wine, and (2) adopt a similar use tax exemption for other alcoholic beverages furnished to customers for consumption at no charge at a tasting held by a licensed brewery, farm brewery, cider producer, distillery or farm distillery in accordance with the Alcoholic Beverage Control Law. Under current law, items taken from inventory (including the product and the packaging materials) for use or consumption at a tasting are subject to use tax. These exemptions would be effective on June 1, 2015.

## Marketplace Providers

In a novel approach to the internet sales tax issue, the Budget Bill would impose a sales and use tax collection responsibility on marketplace providers, effective March 1, 2016. For more detail about this provision, see [McDermott's Inside SALT blog post](#).

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