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MoFo New York Tax Insights

Tribunal Upholds *Barker* Penalties; Case Now Poised for Judicial Appeal

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By Irwin M. Slomka

The saga of the *Barker* case continues. Readers of *NY Tax Insights* will recall that in January 2011, the Tax Appeals Tribunal held that a Connecticut couple's vacation home in the Hamptons constituted a permanent place of abode, causing the husband, who worked in New York City, to be considered a New York State resident. While the Tribunal ruled on the substantive issue, it remanded the case to the Administrative Law Judge for a supplemental determination regarding whether there was reasonable cause to abate penalties. In April 2011, the ALJ issued a decision upholding the penalties and the Barkers appealed. The Tribunal has now upheld the imposition of penalties, making the case ripe for appeal to the New York courts on the more important substantive issue regarding the definition of a permanent place of abode. *Matter of John J. and Laura Barker*, DTA No. 822324 (N.Y.S. Tax App. Trib., Jan. 26, 2012).

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Tribunal Upholds *Barker* Penalties; Case Now Poised for Judicial Appeal

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The Tribunal had previously ruled that the Barkers' vacation home in the Hamptons constituted a permanent place of abode in the State, regardless of how infrequently it was used by the Barkers, and how distant it was from Mr. Barker's place of employment in New York City. In his original decision in 2009, the ALJ held that by having answered "no" to the question on the New York State nonresident tax return asking whether the Barkers "maintained living quarters in New York State," the taxpayers had avoided having to complete a schedule that would have disclosed the existence of the Hamptons home and the number of days spent in the State. The ALJ considered this "disingenuous at best and obfuscatory at worst," and found that it justified the imposition of penalties. On remand, in April 2011 the ALJ again upheld the penalties, this time emphasizing that only a few weeks after they filed their State nonresident tax return, the Barkers had responded to a nonresident audit questionnaire acknowledging having a Hamptons summer home.

"GOOD FAITH IN AN INCORRECT LEGAL INTERPRETATION DOES NOT CONSTITUTE REASONABLE CAUSE."

On appeal to the Tribunal solely on the penalty issue, the Barkers argued that given the limited use of the summer home – approximately 12-15 days during the summer months – their interpretation of the law that it was not a permanent place of abode was "reasonable."

The Tribunal disagreed. It began by stating the principle that "good faith in an incorrect legal interpretation does not constitute reasonable cause." According to the Tribunal, the Barkers' interpretation was not reasonable, since the summer home had many amenities and was available for year-round use; furthermore, the Barkers bore the costs of maintaining the property. Thus, the Tribunal held that the Barkers did not meet their burden of establishing reasonable cause for their filing position.

Additional Insights. As we pointed out in the February 2011 issue of *NY Tax Insights*, it seemed curious that the Tribunal remanded the case on the penalty issue in the first place – delaying the outcome of the case by a year – since the ALJ's earlier decision *did* address penalties. Nonetheless, with both the residency issue and the penalty issue now having been decided by the Tribunal, the case appears ready for appeal to the New York courts.

Interestingly, the Tribunal, in a footnote, pointed out that the Barkers took issue with the ALJ's earlier characterization of their "no" response to the question of whether they "maintained living quarters" in the State as being "intentionally obfuscatory." The Tribunal stated that it was upholding penalties on the grounds expressly stated in its decision, which did not include such a characterization, although the Tribunal did note that the ALJ's "analysis was thorough." By ruling on the penalty issue without taking into account the taxpayer's response to the question whether he "maintained living quarters" in the State, the Tribunal's decision focused on essentially the same factors that it relied upon in its substantive ruling last year. This seems correct for determining whether there was reasonable cause for the taxpayer's filing position, but leaves unresolved the significance of an erroneous answer to a seemingly important question asked of taxpayers on the State nonresident tax return.

Guidance Issued on New Sales Tax Exemption for Electronic News Services

By Hollis L. Hyans

Last year, legislation was enacted providing an exemption from the sales and use tax for certain electronic news services and electronic periodicals. Ch. 583, Laws of 2011. The new exemption takes effect on March 1, 2012, and the Department of Taxation and Finance has now issued a Technical Memorandum explaining the operation of the new statute. *Sales and Use Tax Exemption for Electronic News Services and Electronic Periodicals*, TSB-M-12(1)S (N.Y.S. Dep't of Taxation & Fin., Jan. 31, 2012).

The 2011 legislation provided a new exemption in addition to the exemption that already existed for newspapers and periodicals delivered electronically. That preexisting exemption, provided under Tax Law §§ 1101(b)(6) and 1115 (a)(5), applies to separately stated charges for newspapers and periodicals delivered electronically that have the exact same content, other than advertising, as the paper editions. The new exemption, which does not require an electronic publication to have exactly the same content as a paper version, applies to both "electronic periodicals," which are made totally exempt from sales and use tax, and to a newly created category, "electronic news services," which are exempt if the consideration does not exceed a specified "cap amount" as described below.

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Guidance Issued on New Sales Tax Exemption for Electronic News Services

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Electronic periodicals: These are publications delivered electronically or digitally, whose predominant purpose is presentation of news content, published at stated intervals, at least four times a year but no more than weekly, and not updated between issues, except for display of reader comments or letters to the editor, or "incidental" provision of additional news content. To determine whether the news content added between issues is incidental, the Department will consider its amount and frequency. Other requirements include: the publication's news content must be written by employees or independent contractors, or purchased from wire services; it must be described as a magazine or periodical; and the only search function it can offer without a separately stated reasonable charge is a search of its or an affiliate's present or past news content.

Electronic News Services: These are services provided electronically or digitally, with the predominant purpose of presentation of news content, and must meet a list of other criteria, including the provision of general news accessible without the use of a search function, be newly published or updated at least daily, unless another interval is specified, and the news must be produced by employees or independent contractors of the provider or by wire services. They cannot be a listing, catalog, database or compilation, and there are specific guidelines governing how search functions may be offered.

To be exempt, the electronic news service must also be sold at or below the "cap amount," which is 300% of the annualized average daily newsstand price of the three newspapers with the largest total paid national daily circulation. The Department will determine the cap amount annually by April 1 of each year and will publish it on its website; that amount will apply for the succeeding 12-month period beginning on June 1 and ending on May 31. For the sales tax quarter beginning on March 1, when the new law takes effect, the cap amount was determined based on the newsstand prices that were in effect from October 1 to October 7, 2011, and has been set at $2,034. If the subscription period of the electronic news service is other than a year, the annual cap amount must be pro-rated. For example, if the electronic news service is sold on a monthly basis, the cap amount is one-twelfth of the annual cap amount.

If an electronic news service is sold together with another component (for example, a stock quotation service) for a single or bundled price, and the provider does not separately sell the electronic news service, treatment depends on the other component: if it is subject to tax (as a stock quotation service would be, since it is a taxable information service), the entire bundled price is subject to tax, and if the other component is not subject to tax, and the bundled price is less than the cap amount, the entire sales price is exempt. If the provider of the electronic news service sells the service separately, and also sells each of the other components, and the separate price of the service does not exceed the cap amount, a portion of the bundled price is exempt and is determined by a formula.

IN LIGHT OF THE APPLICATION OF SALES TAX IN NEW YORK (AS IN MANY OTHER STATES) TO "INFORMATION SERVICES," FURTHER CLARIFICATION OF THE LAW WAS BECOMING INCREASINGLY NECESSARY, AS THE DIVIDING LINE BETWEEN A "NEWS SERVICE" AND AN "INFORMATION SERVICE" BECOMES HARDER AND HARDER TO DISTINGUISH.

Additional Insights. Newspapers and periodicals have long been exempt from sales and use tax in New York, and an exemption has similarly been provided for newspapers and periodicals delivered electronically, but only if they have the exact same content, other than advertising, as the paper editions. Given the increasing reliance on electronic delivery of news, the expansion of the sales tax exemption to explicitly cover electronic news services and electronic periodicals appears to further the original legislative intent to exempt news sources from sales tax to help keep the public better informed. However, in light of the application of sales tax in New York (as in many other states) to "information services," further clarification of the law was becoming increasingly necessary, as the dividing line between a "news service" and an "information service" becomes harder and harder to distinguish. The legislation enacted last year, and explained in this Technical Memorandum, was the product of discussions between industry and the Department, and supported by the New York State Business Council, which described the legislation as having been designed to ensure that the sales tax exemption applies to modern practices in news dissemination while reducing the possibility that the exemption would be applied to unintended categories of information services. The Legislative Memorandum in support of the bill in the New York Senate also stressed that, by subjecting the exempt electronic news services to a price cap and including other safeguards and limitations, the existing information service sales tax base would not be eroded.

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NYC Changes Procedure for Requesting Alternative Allocation Method

By Kara M. Kraman

The New York City Department of Finance announced that it has changed the procedure for requesting permission to use an alternative allocation method under both the general corporation tax and the unincorporated business tax. *Requests for Permission to Use an Alternative Allocation Method* (N.Y.C. Dep't of Finance, released February 2, 2012). The change brings the City's procedure in line with the State's procedure for requesting alternative allocation, which was amended by regulation in April of last year.

Prior to the change in procedure, a taxpayer requested an alternative allocation method by checking a box on its return, and submitting the required information on the alternative allocation method along with the return. Under the new policy, a taxpayer must submit a separate written request for permission to use an alternative allocation method, which can be made either before or after it files its return. The request must fully explain the proposed allocation method, describe the nature and scope of business activities carried on within and without the City, detail how the proposed allocation method would allocate income more equitably than the statutory method, and contain calculations of the tax due under both the statutory method and the proposed alternative allocation method. A taxpayer must request permission to use alternative allocation anew each year.

The Department's release does not indicate how much time it will take the Department to respond to an alternative allocation method request. However, unless the Department consents to the use of an alternative allocation method before the taxpayer files its return, the taxpayer must file its return using the statutory method. The release states that cases where the Department consents to use of an alternative allocation method after the taxpayer has already filed and paid its taxes using the statutory method, the taxpayer may be entitled to claim a refund.

Additional Insights. The Department's release is welcome for putting in place a prescribed procedure for taxpayers to obtain authorization for alternative allocation in *advance* of filing their returns. However, the fact that the Department has not identified any time frame within which it will respond to requests may lead to significant taxpayer uncertainty and inconvenience if the taxpayer does not make its request sufficiently in advance of the due date for the return. But how far in advance is sufficient?

Although the City conformed its procedure for requesting alternative allocation to the State's procedure, it should be noted that the City's statutory allocation formula is not identical to the State's. The City is in the midst of phasing in a single-sales factor allocation formula by 2018, while the State already uses a single-sales factor allocation formula.

New 1099-K Reporting Requirements Take Effect in 2012

By Open Weaver Banks

In a *Technical Memorandum*, TSB-M-12(2)C, (2)I, (2)S (N.Y.S. Dep't of Taxation & Fin., Feb. 8, 2012), the New York State Department of Taxation and Finance has issued guidance for those required to file duplicates of federal information returns relating to payments made in settlement of payment card and third-party network transactions pursuant to Internal Revenue Code § 6050W.

IRC § 6050W requires that payment settlement entities (such as payment processors and third-party settlement organizations) report merchant payment card (e.g., VISA, MasterCard, or American Express) and third-party network transactions (e.g., PayPal or Google Wallet) to the Internal Revenue Service. This reporting requirement began in early 2012 for payment card and third-party network transactions that occurred in 2011.

Under IRC § 6050W, reporting entities must file Form 1099-K in order to report the gross amount of each merchant's transactions for the year and must also provide a copy of the Form 1099-K to the merchant. Only those merchants that accept merchant payment cards or third party network transactions in payment for goods or services will be the subject of Form 1099-K reporting. For example, if a business sells items on eBay and accepts merchant payment cards for payment, the business will receive a Form 1099-K for the gross amount of proceeds for the goods purchased through use of a merchant payment card in a calendar year. With respect to third-party network transactions only, reporting is only required if the total number of transactions exceeds 200 and the aggregate value exceeds $20,000 in a calendar year.

In response to the new federal reporting requirements, New York enacted Tax Law § 1703, which requires reporting entities

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New 1099-K Reporting Requirements Take Effect in 2012

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that are subject to IRC § 6050W to file with the Department either a duplicate of all information returns or a duplicate of such information returns relating to New York State payees. The duplicates of Form 1099-K must be filed within 30 days of the filing of the information returns required by the IRS. Under the IRS rules, information returns are due by February 28 of the following year if the return is not filed electronically, or by March 31 of the following year if filed electronically. The Technical Memorandum advises that the first duplicate information returns must be filed with the Department by either March 29, 2012, or April 30, 2012, depending on whether the information returns are filed with the IRS in a paper format or electronically. This represents a change from guidance that had been provided in *Technical Memorandum*, TSB-M-10-(7) C and (13)I (N.Y.S. Dep't of Taxation & Fin., Dec. 10, 2010) and TSB-M-10-(18)S (Dec. 6, 2010), which indicated that the first information returns were due March 1, 2012.

THE NEW YORK STATE LEGISLATURE INTENDED THAT THE GROSS PAYMENT INFORMATION PROVIDED TO THE DEPARTMENT ON FORMS 1099-K WOULD BE USED TO ANALYZE SALES AND OTHER TAX RETURNS TO DETERMINE IF THERE MAY BE UNDERREPORTING OF SALES AND INCOME TAX LIABILITIES.

While reporting entities have the option of filing either duplicates of all information returns filed with the IRS or duplicates of any information returns for New York State payees, the Department "suggests" that, for ease of compliance for the reporting entity, all information returns required to be filed with the IRS be filed with the Department. For reporting entities that choose to file information returns relating only to New York State payees, the Department will make available a database of New York State taxpayers and persons registered for sales tax purposes. Tax Law § 1703(c) prohibits the Department from using any information received on an information return concerning a person who is not subject to tax in New York.

Tax Law § 1703 mirrors IRC § 6050W only as to the requirement to file an information return. New York has not adopted the federal requirement that reporting entities perform backup withholding with respect to merchants that fail to furnish a correct taxpayer identification number.

The Department may impose a $50 penalty for each failure to file a duplicate information return, with an annual maximum penalty of $250,000. The Department has the authority to waive all or a portion of the penalty if it is shown that the failure was due to reasonable cause and not due to willful neglect, or if rescinding the penalty would promote compliance with the requirements of the Tax Law and effective tax administration.

Additional Insights. According to the legislative history of Tax Law § 1703, the New York State Legislature intended that the gross payment information provided to the Department on Forms 1099-K would be used to analyze sales and other tax returns to determine if there may be underreporting of sales and income tax liabilities. While the Department had sources of information for reporting and withholding requirements on entities making payments to individuals, until the passage of IRC § 6050W and Tax Law § 1703, the Department did not have a similar source of information to validate sales reported by New York State businesses. The enactment of Tax Law § 1703 was estimated to increase revenue by $35 million in the State's fiscal year 2012–13 and $83 million per year thereafter.

As a practical matter, reporting entities may follow the Department's advice and file copies of all information returns required to be filed with the IRS, even if some of the merchants reported thereon have no New York sales or no New York tax obligations, rather than taking the time and trouble to segregate New York State payees. Faced with the risk of substantial penalties for failure to file the required information returns for New York State payees, reporting entities may err on the side of overreporting. Non-New York merchants may, therefore, have concerns about the Department's use of the information reported on Forms 1099-K to identify merchants that the Department believes should be collecting New York State tax. However, the legislative history is clear that the information reported on the Forms 1099-K was intended to be used to analyze sales and other tax returns to determine if there may be underreporting. Accordingly, the additional revenue projected to result from Tax Law § 1703 should arise solely from the detection of underreporting by New York vendors and not the identification of non-filers.

Insights in Brief

Empire Zone Tax Benefits Not Lost by Restructuring of Taxpayer Entity

The Department of Taxation and Finance has ruled that an LLC treated as a partnership for income tax purposes that was certified for New York State Empire Zone ("EZ") tax benefits did not lose its certification as a result of its inserting two new single-member LLCs as direct owners, where the two original members retained the same indirect ownership and control of the LLC after the restructuring. *Advisory Opinion*, TSB-A-12(1)I (N.Y.S. Dep't of Taxation & Fin., Jan. 31, 2012). The Department reasoned that the restructuring did not change the identity of the party who ultimately would receive the flow-through of EZ tax benefits. The Department also stated that should there be any future modifications or revocations of the Advisory Opinion based on possible subsequent structural changes, such modifications or revocations would operate prospectively only.

Department Issues Guidance on Recent Changes to Metropolitan Commuter Transportation Mobility Tax

The Department of Taxation and Finance has issued a Technical Memorandum discussing changes to the Metropolitan Commuter Transportation Mobility Tax that go into effect in 2012. *Legislative Amendments to the Metropolitan Commuter Transportation Mobility Tax*, TSB-M-12(1)MCTMT (N.Y.S. Dep't of Taxation & Fin., Jan. 26, 2012). Among the changes discussed is the increase in the threshold for self-employed individuals subject to the tax (raised from $10,000 to $50,000 in annual self-employment earnings within the district), and the increase (beginning April 1, 2012) in the employer's threshold for liability for the tax (increased from $2,500 in payroll expense in a calendar quarter to $312,500 in a calendar quarter). Also, employers meeting the definition of an "eligible educational institution" are no longer subject to the tax.

Revised List of Designated Private Delivery Services

Ever since the enactment of the 1997 Taxpayer Bill of Rights, documents and payments sent to the Department of Taxation and Finance are regarded to have been timely sent if they are timely delivered to certain private delivery services, as an alternative to having been timely postmarked by the U.S. Postal Service. The Department has now updated *Publication 55*, as of January 2012, providing a list of private delivery services that currently qualify, and explaining how each delivery service establishes the date the item was received, which can be relied upon as a filing date. However, it is important to note that these rules govern only mailings to the Department of Taxation and Finance, and the Division of Tax Appeals has not explicitly incorporated in its own separate rules the ability of taxpayers to rely on such private delivery services.