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MoFo
New York Tax Insights

Membership in a Residential Club Does Not Constitute a Permanent Place of Abode in New York

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By Open Weaver Banks

In an *Advisory Opinion*, TSB-A-12(4)I (N.Y.S. Dep't of Tax. & Fin,. Aug. 28, 2012), the New York State Department of Taxation and Finance ruled that for New York income tax purposes, an individual's acquisition of an ownership interest in a private, member-owned residential club in New York City did not constitute maintaining a permanent place of abode in New York.

The Petitioner is a domiciliary and resident of New Jersey. However, he regularly commutes to his workplace in New York City and is presumed to be present in New York for more than 183 days in each taxable year. Since New York law treats an individual as a resident of New York if he or she spends more than 183 days in New York and maintains a permanent place of abode in New York, the Petitioner inquired whether he would be considered to maintain a permanent place of abode in New York as a result of his ownership of a membership interest in the residential club ("The Club").

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Residential Club is Not a Permanent Place of Abode

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The Club offers studio and one- and two-bedroom luxury apartments. Each member in The Club owns a one-eighth tenancy-in-common deeded fee interest in one of The Club's residences. Members also own the furnishings and accessories in the residences. Membership in The Club entitles each member to a priority right to use a residence for 45 days per year. If some members do not use a residence for their 45 days, then other members may be able to use a residence for more than their 45 allotted priority days. Reservations for up to 7 days are given on a first-come, first-served basis, subject to the other members' priority rights to use a residence for 45 days. An owner can reserve an available residence in a different Club residence category if no residences are available in the owner's residence type.

Noting that the Petitioner's right to use a residence in The Club was "circumscribed" by The Club's policies and procedures, the Department concluded that the Petitioner did not have "free and continuous access" to a residence and thus would not be considered to maintain a permanent place of abode in New York for income tax purposes solely by reason of his ownership interest in The Club.

Additional Insights. The *Advisory Opinion* does not turn on how many days the individual might actually stay at The Club. Rather, the most important criterion was whether he would have "free and continuous access" to the place of abode. According to the New York State Tax Appeals Tribunal in *Matter of John Gaied*, DTA No. 821727 (N.Y.S. Tax App. Trib., June 16, 2011), which was appealed to the Appellate Division, Third Department, there is no requirement that an individual actually dwell in the abode, as long as he or she simply maintains it. Thus, in *Gaied*, the Tribunal found a permanent place of abode in New York where the individual had "unfettered access" to the premises, even though he only stayed overnight at the premises "on occasion." Consistent with *Gaied*, the ruling in the *Advisory Opinion* turns on the Department's finding that the individual did not have such access to a residence. If the individual in the *Advisory Opinion* had free and continuous access to a residence in The Club for 365 days a year, the ruling would have certainly come out the other way, even if he only used the residence for 45 days.

Furniture Included in Hotel Sale Subject to Sales Tax as a Bulk Sale

By Kara M. Kraman

A recent decision by a New York State Administrative Law Judge illustrates some of the important sales tax issues that should be considered by a business entering into a contract to sell New York real property under which tangible personal property is also conveyed. *Matter of Empire Holdings LLC*, DTA No. 823762 (N.Y.S. Div. of Tax App., Sept. 6, 2012).

In 2004, Empire Holdings LLC ("Empire Holdings") sold the Empire Hotel, located in Manhattan, to an unrelated purchaser. The sales contract provided that all furniture and supplies, the value of which was specifically described in the Closing Agreement as "de minimis," were to be transferred as part of the sale. The sales contract did not allocate any part of the approximately $78 million purchase price to the tangible personal property. At the closing, a Bill of Sale was executed stating that the personal property was being transferred for ten dollars. No sales tax was paid on the transfer of the furniture, and a notice of bulk sale was not filed with the Department. However, New York State real estate transfer tax, at the rate of 0.4%, was paid on the full $78 million.

The purchaser planned to convert the hotel into condominium apartments. Having no interest in the hotel furniture and supplies, the purchaser donated them to a charitable organization and paid an additional $200,000 to the charity for removing the furniture from the hotel. Shortly before the sale, and in conjunction with the donation, the purchaser had the furniture and supplies independently appraised for $1,058,000, and it claimed a charitable deduction for that amount (plus the $200,000 payment) on its federal tax return.

The Department later commenced a sales tax audit of Empire Holdings. The audit eventually focused on the "bulk sale" of the furniture and supplies, and specifically on how to value those items. The auditor rejected as lacking sufficient detail the asset depreciation schedules furnished by Empire Holdings, which showed that the property was fully depreciated. Instead, the auditor valued the assets at their original cost of $5,184,000, and assessed sales tax on that amount against Empire Holdings as a vendor.

The transfer of business assets, other than in the ordinary course of business, is considered a bulk sale and is subject to sales tax,

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Furniture Included in Hotel Sale Subject to Sales Tax

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whether or not the transfer is a retail sale. 20 NYCRR 537.1(a). Empire Holdings took the position that there was no bulk sale of assets, maintaining that the only tangible personal property "sold" — the furniture and supplies — was of *de minimis* value. The ALJ found that the sales contract clearly provided for the sale of furniture and supplies, that the assets were in fact transferred, and therefore that a bulk sale had occurred.

On the question of what value should be attributed to the furniture and supplies, the ALJ agreed with the Department that Empire Holdings had failed to prove that the value was zero, referring to the "scant depreciation" documents in evidence as unconvincing. The ALJ also noted that he was not bound by the sales price allocation for the furniture in the sales contract. However, he concluded that the Department's valuation, based on the original cost with no allowance for depreciation, was unreasonable. Instead, the ALJ found the most reliable evidence of valuation to be the independent appraiser's contemporaneous valuation of $1,058,000. Thus, the ALJ held that $1,058,000 was the correct value of the furniture subject to sales tax.

The ALJ also rejected the taxpayer's claims that any sales tax owed should be offset by the New York State and City realty transfer taxes paid on the consideration attributed to the furniture under the doctrines of estoppel and equitable recoupment. He held that since the taxpayer did not pay the transfer taxes in reliance on an act or representation of the Department, the estoppel doctrine was inapplicable, and because equitable recoupment does not permit an offset for a different type of tax against the taxpayer's sales tax liability, that doctrine was inapplicable as well.

Additional Insights. Where a business conveys personal property in a contract of sale for real estate, real estate transfer tax *and* sales tax may both be due on the consideration attributable to each. This is true even when the personal property has a negligible value to the parties, or even a negative value because the purchaser must pay to have it removed. In order to avoid paying sales tax on personal property conveyed in a sale of real estate, it is critical that the seller ensure that the lack of value of the personal property is thoroughly documented because the Department is not required to accept the allocation of purchase price set forth in a contract of sale. Presumably Empire Holdings would be entitled to a refund of State transfer taxes paid on the $1,058,000 found subject to sales tax in the unlikely event the statute of limitations for transfer tax refunds remains open.

Department Proposes Amendments to Combined Return Regulations

By Irwin M. Slomka

The Department of Taxation and Finance has proposed amendments to its regulations regarding combined returns under Article 9-A. *N.Y.S. Register*, Vol. XXXIV, Issue 37, pp. 14-17 (Sept. 12, 2012). The main purpose for the amendments is to reflect changes to combined reporting enacted by 2007 legislation, which imposed mandatory combined reporting between "related corporations" having "substantial intercorporate transactions." That legislation went into effect beginning in 2007, and the Department thereafter issued a Taxpayer Guidance Division memorandum interpreting the new law. TSB-M-08(2)C (N.Y.S. Dep't of Taxation & Fin., Mar. 3, 2008), superseding TSB-M-07(6)C (June 25, 2007). However, the Department never amended its regulations to make them consistent with the legislative changes. The proposed amendments signal the Department's intent to adopt amendments in the near future.

What the Proposed Amendments Do. The proposed amendments principally clarify two important terms contained in the 2007 law: the term "related corporation" — which is substantially similar to the former "substantial ownership" requirement for combination — and the term "substantial intercorporate transactions." For the most part, the proposed regulations codify the interpretations contained in the Department's earlier TSB-M. Thus, as under the TSB-M, the proposed amendments set forth two alternative tests for finding the existence of substantial intercorporate transactions in a tax year: (1) where *50% or more of a corporation's receipts or expenditures* are from a related corporation or group of related corporations ("receipts or expenditures test"); or (2) in the event that assets have been transferred to a related corporation, where *20% or more of the transferee corporation's gross income* is derived from those transferred assets ("asset transfer test"). Meeting either test establishes that substantial intercorporate transactions exist for the year, and result in mandatory combination under Article 9-A. Also as under the TSB-M, the proposed amendments include a "10-step analysis" for determining which corporations must be included in a combined return.

Changes from the earlier TSB-M. While the proposed amendments generally follow the earlier TSB-M, the Department has made certain changes. One of the more significant changes relates to the inclusion in the substantial intercorporate transactions calculation of interest paid and received on loans between related

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Proposed Amendments to Combined Reporting Regulations

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corporations, even where the intercompany loan constitutes subsidiary capital. Under the TSB-M, interest on intercompany loans constituting subsidiary capital was not considered in the substantial intercorporate transactions calculation. Also, "intercorporate cost allocations" are excluded from the calculation.

Other Additions in the Proposed Amendments. In 2008, the Department circulated for comment to various professional organizations an earlier draft of the amendments. In that draft, the Department contemplated eliminating from the existing regulations long-standing language that imposes a unitary business requirement for combination. In response to comments, the proposed amendments now expressly provide that in order to be required or permitted to file a New York State combined return, the corporations must be engaged in a unitary business. Also in response to comments, the proposed amendments make clear that under the alternative "asset transfer test" for computing substantial intercorporate transactions, the test applies only to assets transferred on or after January 1, 2007, when the 2007 legislation went into effect.

THE PROPOSED AMENDMENTS PRINCIPALLY CLARIFY TWO IMPORTANT TERMS CONTAINED IN THE 2007 LAW: THE TERM "RELATED CORPORATION" — WHICH IS SUBSTANTIALLY SIMILAR TO THE FORMER "SUBSTANTIAL OWNERSHIP" REQUIREMENT FOR COMBINATION — AND THE TERM "SUBSTANTIAL INTERCORPORATE TRANSACTIONS."

Another addition in the proposed amendments relates to the "multi-year test" for computing substantial intercorporate transactions. Under that test, in any tax year where intercorporate receipts or expenditures are between 45% and 55%, the test will be considered satisfied if during the tax year and prior two years, the intercorporate transactions are, in the aggregate, 50% or more of total receipts or expenditures for that period. The proposed amendments now make explicit that the multi-year test will be used not only to *satisfy* the substantial intercorporate transactions test, but also to prove that the test is *not satisfied*.

Additional Insights. The Department's amendments in this area are long overdue, coming more than five years after the 2007 legislation. The delay may have been due to the Department's prior focus on its far more sweeping "corporate tax reform" proposal, the eventual outcome of which remains uncertain. The proposed amendments are not yet final. State law requires a minimum 45-day public comment period from the date of publication in the State Register. Inasmuch as the Department already received substantial comments on its earlier draft, we would expect the final amendments to be adopted later this year in a form substantially identical to these proposed amendments.

Tribunal Denies Costs to Petitioner

By Hollis L. Hyans

Affirming the decision of an Administrative Law Judge, the New York State Tax Appeals Tribunal has denied an application for costs and fees filed by a petitioner who had succeeded in substantially reducing the asserted sales tax liability through settlement. *Matter of Frank M. Grillo*, DTA No. 823237 (N.Y.S. Tax App. Trib., Aug. 23, 2012). The sole issue on appeal was whether the Department of Taxation and Finance was "substantially justified" in sending a Notice of Determination to Mr. Grillo at his former business address, two years after he left the business.

Background Facts. Mr. Grillo joined Trinsic Communications, Inc. in April 2003 as its senior vice-president – business group, and was solely responsible for Trinsic's business sales and marketing until August 2004. Trinsic's primary business address was in Tampa, Florida. Mr. Grillo had lived in Jackson, Mississippi, since January 1995, and worked primarily out of an office maintained by Trinsic in Alabama. In August 2004, Mr. Grillo was appointed Trinsic's acting chief operating officer, following the resignations of the company's previous chairman, president and chief executive officer, senior vice president and chief technology officer. He continued to work for Trinsic primarily from Alabama through August 2005, when he began work for another company in Atlanta, Georgia. Mr. Grillo resigned from Trinsic effective September 30, 2005. He remained a resident of Mississippi until he moved to Georgia in 2007.

In February 2007, Trinsic filed for protection under Chapter 11 of the United States Bankruptcy Code, and entered into an asset purchase agreement for the sale of substantially all of its operating assets. Trinsic later filed a motion to convert its Chapter 11 proceeding into a Chapter 7 liquidation proceeding. Mr. Grillo also filed for personal bankruptcy protection.

Audit and Assessment. The audit of Trinsic had commenced in May 2005, just a few months before Mr. Grillo left his position at Trinsic. Despite requests by the Department, no responsible party

Tribunal Denies Costs to Petitioner

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questionnaire, which would have included a home address, was submitted for him. He did not file New York State personal income tax returns, and did not appear in the Department's data system. Using the LexisNexis database, the auditor had found 16 different addresses for Mr. Grillo's name and social security number, and was unable to further identify a current address. Trinsic's 2004 federal income tax return listed the company's Tampa address as Mr. Grillo's address.

On March 2, 2007, the Department issued a Notice of Determination to Mr. Grillo as a responsible officer for $646,823, plus penalty and interest, in sales and use tax allegedly due from Trinsic for the period from December 1, 2003 through May 31, 2005, and mailed the notice to him at Trinsic's Tampa address.

Protest Filed. In June 2009, Mr. Grillo responded to a collection call from the Department and provided his current Georgia home address. A copy of the notice was then sent to him at the Georgia address, and he stated that he had been unaware of the existence of the notice prior to his receipt of this copy in 2009. He filed a petition challenging the notice. Since a timely petition had been filed in response to an associated assessment filed against Trinsic, Mr. Grillo's individual protest was therefore also considered timely under Tax Law § 1138[a][3][B], which provides that timely protests filed by a business will also be deemed to include protests by individuals charged with responsible person liability.

In 2010, Mr. Grillo entered into a negotiated closing agreement with the Department, resolving all issues raised by the 2007 Notice upon his total payment of $17,283. The closing agreement did not address whether either of the parties was the "prevailing party," which left Mr. Grillo with the ability to seek costs and fees. He filed an application for $44,525 in attorneys' fees and nearly $100 in expenses. He also provided information concerning his net worth, which was a negative number.

Application for Costs. In order to be entitled to costs, a party must be the "prevailing party," and have a net worth that does not exceed $2 million. Even if both criteria are met, the Department is not required to pay fees and costs if it can establish that its position was "substantially justified." Tax Law § 3030. In his application for costs, Mr. Grillo alleged that he was the prevailing party, due to the substantially reduced dollar amount for which the assessment was resolved, and that the Department should not have mailed the notice to him at the company address two years after he had left his employment. Therefore, he argued that the Department was not substantially justified in its actions.

The ALJ decision. The ALJ had concluded, first, that in light of the reduction of assessed tax from nearly $650,000, plus penalty and interest, to the settlement amount of a little over $17,000, Mr. Grillo qualified as the "prevailing party," and, since his net worth did not exceed $2 million, he was entitled to receive fees and costs under the statute, unless the Department established that its position was substantially justified.

The ALJ reviewed the Department's efforts to find the correct address for Mr. Grillo. The statute requires mailing to the person's last known address, and refers to use of an address given in the last return or application filed; if no such filing was made, notice must be sent "to such address as may be obtainable." Tax Law § 1147(a)(1).

Here, no filings had been made by Mr. Grillo in New York, and the ALJ acknowledged that there was no evidence he was ever obliged to make such a filing. The ALJ found that, under the circumstances, where the auditor had tried to locate a personal address but had been unable to do so, reliance on the company's address was reasonable, and "constituted the use of 'such address as may be obtainable'" as required by the statute. Therefore, he held that the Department was substantially justified, and no fees or costs were awarded.

IN HIS APPLICATION FOR COSTS, MR. GRILLO ALLEGED THAT HE WAS THE PREVAILING PARTY, DUE TO THE SUBSTANTIALLY REDUCED DOLLAR AMOUNT FOR WHICH THE ASSESSMENT WAS RESOLVED, AND THAT THE DEPARTMENT SHOULD NOT HAVE MAILED THE NOTICE TO HIM AT THE COMPANY ADDRESS TWO YEARS AFTER HE HAD LEFT HIS EMPLOYMENT.

The Tribunal Decision. The Tribunal agreed with the ALJ. It noted that Trinsic's 2004 federal income tax return listed the company's office in Tampa as Mr. Grillo's address. In light of the fact that the LexisNexis search revealed 16 different addresses, use of the company's address was found to be "reasonable and consistent with the requirement that the Notice be sent to 'such address as may be obtainable'" as required by Tax Law § 1147[a][1].

Additional Insights. The Tax Appeals Tribunal concluded that it was "unreasonable" to expect the Department to send Notices to all 16 possible addresses found in the Lexis/Nexis database. However, neither the Tribunal decision, nor the ALJ's decision that it sustained, addressed the fact that the company's address relied upon by the Department in 2007 had been provided in a *2004* return, and that Mr. Grillo had left the company in 2005, by which time the company had not only already filed for bankruptcy

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protection but had entered into a contract to sell all of its assets. Under these circumstances, it appears that further inquiry should have been made by the Department as to whether the three-year-old address of a company in bankruptcy was really a "reasonable" means of contacting Mr. Grillo.

The Department does not appear to have appealed to the Tribunal the decision by the ALJ that a party need not have received a favorable decision from the Division of Tax Appeals or the Tax Appeals Tribunal to be considered a "prevailing party" for purposes of obtaining costs. Here, where the settlement amount was less than 3% of the amount originally assessed, the ALJ found the petitioner to have been the prevailing party for purposes of an award of costs.

Insights in Brief

Delivery Charges on Rented Equipment Are Subject to Sales Tax

The Department of Taxation and Finance has ruled that a company that rents construction equipment and vehicles to customers must collect sales tax on its charges to tow or transport the equipment to the customer or between the customer's job sites, regardless of whether the delivery charge is separately stated on the customer receipt. The sales tax rate to be collected is the state and local tax rate where the customer takes possession of the equipment. *Advisory Opinion*, TSB-A-12(21)S (N.Y.S. Dep't of Taxation & Fin., Aug. 28, 2012).

Tribunal Upholds "Responsible Person" Sales Tax Liability Against Restaurant President

The Tax Appeals Tribunal has affirmed an Administrative Law Judge determination holding that an individual listed as a restaurant corporation's president on a Responsible Person Questionnaire was liable for the corporation's sales tax obligations as a responsible person. *Matter of Frederick P. Ippolito*, DTA No. 823187 (N.Y.S. Tax App. Trib., Aug. 23, 2012). The Tribunal held that it was irrelevant that the individual was temporarily filling in as president during his wife's illness, and that he never signed the company's tax returns, finding that he failed to prove either that he lacked the authority to act or that his authority to carry out his corporate duties was thwarted by others.

Advice Issued on Sale of Advertising and Installation of Advertising Displays

The Department of Taxation and Finance has issued an Advisory Opinion concluding that a company engaged in the business of selling advertising space on fixtures installed at hospitals, such as digital displays, backlit static and scrolling displays, and wraps and banners, need not collect tax on those sales, because the sale of advertising is not an enumerated service under Tax Law § 1105(c). However, sales tax is due on the payments made by the company to an independent contractor for installing and maintaining the displays, as charges for installing or maintaining tangible property, since the advertising displays were not intended to become permanent installations and therefore were not capital improvements. Tax is also due on the amounts the company pays to vendors for components and materials used in the displays. *Advisory Opinion*, TSB-A-12(20)S (N.Y.S. Dep't of Taxation & Fin., Aug. 28, 2012).