NY Tax Minutes: Wayfair, Executive Budget, Goldman Offshore

By Timothy Noonan and K. Craig Reilly ·
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The New Year is in full swing here at "NY Tax Minutes," and we're sticking with our resolution to deliver all the month's New York City and state tax news in a way that's made for New Yorkers. Fast.

Timothy Noonan

This month, we cover New York's underwhelming response to the U.S. Supreme Court's Wayfair sales and use tax nexus ruling; we highlight the governor's new tax proposals from the 2020 executive budget; and we detail two recent cases from the city and state's Tax Appeals Tribunals.

Craig Reilly

The Headlines

New York State (Finally) Issues Guidance on Sales Tax Economic Nexus

In our first edition of NY Tax Minutes, we highlighted New York state's deafening silence on the U.S. Supreme Court's South Dakota v. Wayfair Inc.[1] decision, which sent shockwaves through the internet — and the state and local tax community — by overturning the Quill Corp. v. North Dakota[2] physical-presence nexus standard that had been the law of the land for sales tax purposes over the past several decades. In overturning Quill, the court allowed states to begin passing laws that said even if an out-of-state vendor didn't have physical presence in the state, the vendor would still have to collect and remit sales tax if it had enough of an economic presence in the state. Quickly, states around the country started proposing or enacting these

economic nexus provisions (41 different states at last count), but New York remained noticeably silent.

In highlighting New York's lack of a response, we also noted in our first article that the state already had a law on its books that could possibly give the Tax Department the right to impose tax collection and payment requirements on out-of-state vendors without a physical presence. We highlighted New York tax law Section 1101(b)(8)(i)(E), which already treats any person who "regularly or systematically solicits business in this state" as a vendor required to collect tax, so long as "such solicitation satisfies the nexus requirement of the United States constitution."[3] After Wayfair, we thought the state may try and rely on this law to impose its economic nexus rules, but we expected to hear a lot more from New York on this issue.

Well, we were half right. On Jan.15, 2019, the Tax Department issued a one page, three paragraph notice[4] explaining its position on economic nexus for sales tax purposes. And let's just say, we were not impressed.

According to the notice, an out-of-state vendor with no physical presence will be required to collect and remit New York sales tax if, during the immediately preceding four sales tax quarters:

1. The business made more than $300,000 in sales of tangible personal property delivered in the state; AND

2. The business conducted more than 100 sales of tangible personal property delivered in the state.

This economic nexus rule imposes quite different thresholds than those reviewed by the U.S. Supreme Court in Wayfair. The dollar amount is significantly higher ($300,000 versus $100,000), and the transaction count is significantly lower (100 transactions versus 200 transactions). And perhaps

most importantly, New York's rule imposes an "AND" test, rather than an "OR" test, which can have significant ramifications for high dollar, low volume retailers.

Many people (especially remote vendors) reading this news, may be pleased to see a higher dollar threshold combined with an "AND" test. We don't blame you. Why then are we so underwhelmed with this guidance? Here are a few of our issues:

Retroactive Effective Date?

According to the notice, the Tax Department is taking the position that Wayfair caused certain seemingly dormant provisions in New York's tax law to become "immediately effective."

The notice cites tax law Sections 1101(b)(8)(i)(E) (we called it!) and 1101(b)(8)(iv). As we mentioned, Section 1101(b)(8)(i)(E) says that if a seller systematically solicits business in the state by any means then it qualifies as a "vendor," required to collect and remit tax on taxable sales. But Section 1101(b)(8)(i)(E) also contains important limiting language. It only applies if, "such solicitation satisfies the nexus requirement of the United States constitution." Well, after the Wayfair decision, remote systematic solicitation can now theoretically satisfy constitutional nexus requirements.

But what type of systematic solicitation does New York think will satisfy constitutional nexus requirements? That brings us to the second section cited by the Tax Department in its notice. Tax law Section 1101(b)(8)(iv) establishes a presumption that a seller will be systematically soliciting in the state if during the immediately preceding four sales tax periods, the total amount of sales from property delivered into the state exceeds $300,000 and the seller made more than 100 sales of property into the state. Because of these provisions, the Tax Department believes that the state already has the legal foundation to force remote vendors to collect and remit sales tax. Thanks

for the heads up!

We’re not afraid to give the Tax Department credit when credit is due. Just last month, we praised the Tax Department for working to prepare and share draft regulations regarding the state’s sweeping corporate tax reforms. But that type of thoughtful transparency is nowhere to be found in the state’s economic nexus notice.

The notice states that Wayfair, “eliminated the prohibition on a state imposing sales tax collection responsibilities on businesses that have no physical presence in that state. Due to this ruling, certain existing provisions in the New York state tax law that define a sales tax vendor immediately became effective.” So if the provisions became effective as of the court’s ruling, is the state saying that economic nexus has been in force in New York since June 21, 2018!? In informal conversations with department representatives, this appears to be the official party line, with some representatives even claiming that New York has the right to impose its law going back before the court’s Wayfair decision!

This is unfortunate. But if New York does end up attempting to enforce its economic nexus rules beginning as of June 21, 2018 (or some earlier date), New York will likely face a significant legal challenge (maybe from us?). It is important to note that nearly all other states that have imposed economic nexus rules have done so on a prospective basis only. The vast majority of these new state laws/rules took force in the fourth quarter of 2018 or as of Jan. 1, 2019. And in all cases, these dates were after the enactment of the new law or publication of the new rule. This is not only good common sense, but it’s also consistent with the court’s ruling in Wayfair, which focused on South Dakota’s prospective only enforcement of its law.

A rule that is enforced retroactively to a date prior to a state’s announcement of its rule could, under a Wayfair analysis, jeopardize the rule’s constitutionality. It’s also just a slap in the face to taxpayers. Why wait nearly

seven months to issue a three-paragraph notice telling us that New York already had the legal authority to enforce economic nexus? If that was the case, a notice on, oh let's say, June 22, 2018 would have been a lot more helpful.

What about Service Providers?

Another question we have after reading the state's notice is how New York plans to apply its economic nexus rules to service providers. Both the Tax Department's notice and the tax law cited in the notice apply their economic presence provisions exclusively to sales of tangible personal property. Thus, out-of-state service providers with no physical presence in the state continue to have a reasonable legal position that they are under no legal obligation to collect and remit New York tax. If New York agrees with this reading, we'd like to hear that. If not, we'd also like to hear from the state, since keeping taxpayers in the dark does no one any favors.

Other Unanswered Questions

Finally, a hodgepodge of other issues remain unanswered in the notice, and we encourage the Tax Department to issue future guidance addressing these, and any other, questions that may be helpful for retailers trying to navigate the new sales and use tax landscape.

- Are wholesale transactions counted towards the applicable thresholds?

- If nexus is now based on thresholds calculated during a rolling period (e.g., "immediately preceding four sales tax quarters"), is the Tax Department really going to respect a vendor's position that it had nexus intermittently (i.e., quarter by quarter) if the vendor is close to the threshold limits?

- How does this law interact with the new proposed budget legislation (see below) that would require marketplace providers to collect sales tax on taxable sales of tangible personal property that they facilitate?

The Tax Department’s notice doesn’t answer these questions. And really, all that the notice does tell us is that New York believes the legislature, even before Wayfair, had laid the ground work for requiring remote retailers to collect and remit New York sales tax. So while we were right in our earlier article to point out New York’s existing tax laws, we’re still waiting for the helpful batch of guidance that we predicted in the immediate wake of Wayfair.

New Tax Proposals Announced in 2020 Executive Budget

On Jan. 15, Gov. Andrew Cuomo released the fiscal year 2020 executive budget,[5] which sets forth the governor's proposed tax law changes. The proposals include:

Make the E-File Mandate Permanent

Currently, Tax Law Section 29 requires tax preparers who meet certain criteria to e-file New York tax returns. The e-filing mandate was originally enacted in 2008 and is currently set to expire after the 2019 tax year. The governor’s bill would make the mandate permanent.

Provide a Sourcing Rule for GILTI Apportionment

Internal Revenue Code Section 951A(a) requires global intangible low-taxed income, GILTI, as defined by Section 951A(b)(1), to be included in federal gross income. To determine net GILTI, Section 250(a)(1)(B)(i) allows certain taxpayers a deduction for part of this income. Under current New York law, there is no rule for the net GILTI included in business income. The bill would establish a statutory sourcing rule for GILTI by requiring the net GILTI to be included in the denominator of the apportionment factor, with zero in the

numerator. Such treatment of GILTI would mirror the Tax Department's recent update to its filing instructions.

Buried in the state's recently released instructions for filing Forms CT-3[6] and CT-3-A[7] was a paragraph on how to treat GILTI. The text says that Section 951A income must be included on line 53 and instructs taxpayers to "include 100 [percent] of such income, less the Section 250(a)(1)(B)(i) amount (if applicable), on line 53 in the 'Everywhere' row. Such income is not included in the 'New York' row. You must attach to your return a statement that indicates the amount of GILTI included in the 'Everywhere' row."

Eliminate Internet Tax Advantage

The governor's bill would require marketplace providers to collect sales tax on taxable sales that they facilitate. Under the proposed law, a marketplace provider would be a person who, pursuant to an agreement with a marketplace seller, facilitates sales of tangible personal property by providing "a forum in which, or by means of which, the sale takes place or the offer of the sale is accepted, including a shop, store, booth, an internet website, catalog, or similar forum." The stated goal of the bill is to minimize the number of people with tax collecting responsibilities by relieving marketplace sellers of such responsibility. The bill would be effective immediately and apply to sales made on or after Sept. 1, 2019.

Although the governor included this provision in his 2019 budget plan, it was later stripped out by the Legislature. And, as we mentioned above, it's unclear how this law might interact with New York's new economic nexus guidance.

Extend Higher Personal Income Tax Rates for Five Years

The top New York state personal income tax bracket of 8.82 percent is currently scheduled to expire after 2019. The bill would immediately extend the higher bracket through 2024.

Close the Carried Interest Loophole

Currently, federal tax treatment allows hedge fund managers and private equity investors to treat carried interest income as capital gains, rather than ordinary income. New York is unable to tax such capital gain income when earned in New York by a nonresident. Mirroring a similar proposal from last year, this part of the bill would require all income from investment management services to be treated, for New York purposes, as income earned from a trade or business and would subject the gain to an additional 17 percent carried interest “fairness” fee. However, the portion of the bill dealing with carried interests would take effect only if Connecticut, New Jersey, Massachusetts and Pennsylvania enact legislation having a substantially similar effect.

Enact the Cannabis Regulation and Taxation Act

The governor’s bill includes a proposal for a new Cannabis Regulation and Taxation Act. High points of the act include provisions to legalize adult-use of marijuana along with the availability of hemp products, and to expand the state’s current medical marijuana program. The legislation would also add a new article to the Tax Law — Article 20-C, titled “Tax on Adult-Use Cannabis Products” — which would impose three new taxes: First, a tax on the producer on the cultivation of cannabis at the rate of $1 per “dry-weight gram of cannabis flower” and $0.25 per “dry-weight gram of cannabis trim;” second, a state-level tax on the sale by a wholesaler to a retail dispensary at the rate of 20 percent of the invoice price; and third, a county-level tax on the sale by a wholesaler to a retail dispensary at the rate of 2 percent of the invoice price. In addition, all wholesalers would be required to apply for and obtain a certificate of registration from the New York State Tax Department before starting business, and the registration would be renewable every two years. The initial application and renewal would be subject to a fee of $600.

Other Proposals

- Decouple from Internal Revenue Code federal basis for New York state qualified manufacturer test;
- Extend three-year estate tax gift addback rule and require binding New York state qualified terminable interest property election;
- Discontinue the energy transportation, transmission and distribution sales tax exemption;
- Create a New York state employer-provided child care credit;
- Include certain New York state gambling winnings in nonresident income;
- Permanently extend the tax shelter provisions and update tax preparer penalties;
- Extend personal income tax limitation on charitable contributions for five years; and
- Extend authorization to manage delinquent sales tax vendors permanently.

Keep an eye out for further updates in mid-February when the governor is set to release his “30-day amendments” to the executive budget.

The Cases

Each month, we highlight noteworthy cases from New York City and state’s Division of Tax Appeals and Tax Appeals Tribunal, along with any other cases involving New York taxes. This month, we highlight a New York City decision

addressing whether a foreign Goldman Sachs entity had a sufficient nexus with the city such that it was required to pay tax on its capital gain from the sale of an interest in a limited liability company with New York City business activities. We also review a recent decision from the New York State Tax Appeals Tribunal, which clarified the sales tax exemption rules for agents of tax exempt governmental entities.

New York City ALJ Upholds Corporation Tax on Capital Gains Earned by Non-New York City Business

In Matter of Goldman Sachs Petershill Fund Offshore Holdings Corp.,[8] a New York City administrative law judge, or ALJ, held that an investment management company with no direct activities in the city was properly assessed over $4 million in general corporation tax, or GCT, on capital gains received from its sale of an interest in a limited liability company with New York City operations. The taxpayer, Goldman Sachs Petershill Fund Offshore Holdings (Delaware) Corp., claimed that its passive interest in the limited liability company did not create sufficient nexus with the city for the tax to be imposed.

As explained by the ALJ, Goldman Sachs Offshore formed a limited partnership, Petershill U.S. IM Master Fund LP, to allow Goldman Sachs Offshore's owners to invest in alternative investment management companies. One of the alternative investment management companies in which Goldman Sach Offshore's owners invested was Claren Road Asset Management LLC, which engaged in business activities in New York City.

In 2010, the Master Fund sold its interest in Claren, which generated a capital gain of more than $54 million that flowed through to Goldman Sachs Offshore. In 2010, neither Goldman Sachs Offshore nor the Master Fund owned any real or tangible personal property in New York; had any employees in New York; conducted any business activities in New York (apart from activities related to the Master Fund's investment in Claren); and, in the proceedings

below, the parties stipulated that neither Claren and the Master Fund nor Claren and Goldman Sachs Offshore were part of a unitary business.

Despite these lack of contacts, the ALJ, citing to Allied-Signal Inc. v Commr. of Fin.,[9] held that the city's power to tax does need not be based on the taxpayer's own activities in the city, but instead can exist on the privileges and opportunities that the city has afforded to a taxpayer’s business entity operating in the city. According to the ALJ, “[a] jurisdiction's ability to tax turns on whether nexus exists between that jurisdiction and the taxpayer's business being sold. This inquiry does not call for the consideration of other factors, such as unitary business between the owner entity and the sold business, for taxation to be constitutional. Nexus is sufficient.”

The ALJ concluded that “[t]hrough its nexus with the City, Claren appreciated in value and enjoyed the protection, opportunities and benefits that the City conferred to it, [which] created the City's right to receive something in return.” And because the benefits that the city provided to Claren had a rational relationship to the gain that Goldman Sachs Offshore realized on its sale of Claren, the gain was mainly attributable to the benefits provided by the city. Thus, Goldman Sachs Offshore’s capital gain was subject to GCT through its inclusion in the company’s GCT business income to which Claren's BAP should be applied. According to the ALJ, the imposition of GCT on the gain did not violate the due process or commerce clauses.

Tax Appeals Tribunal Clarifies Sales Tax Exemptions for Agents of Tax Exempt Governmental Entities

In Matter of Garrison Protective Services Inc.,[10] the Division of Taxation filed an exception to an ALJ determination, which originally held that a private entity, Grenadier Realty Corp., qualified as an agent of the New York City Housing Authority, or NYCHA, and could therefore make tax exempt purchases of security services from the petitioner, Garrison Protective Services Inc.

As explained by the tribunal, NYCHA qualifies as a public authority under Public Housing Law Section 401 and is therefore exempt from sales tax, pursuant to Tax Law Section 1116(a)(1), which exempts sales to "[t]he state of New York, or any of its agencies, instrumentalities, public corporations ... or political subdivisions." And although it is not expressly provided by statute, the Tax Appeals Tribunal has long held that purchases made by an agent of an entity entitled to the exemption under Tax Law Section 1116(a)(1) are also exempt under that provision when the agent is acting within the scope of its agency. Thus, the issue in the case below was whether Grenadier's purchases of security services from Garrison were exempt from sales tax because Grenadier made its purchases as an agent of NYCHA.

Initially, the tribunal noted that had Garrison received properly completed Form ST-122, Exempt Purchase Certificate for an Agent of a New York Governmental Entity, and

DTF-122, Certification of Agency Appointment by a New York Governmental Entity, its sales would have been presumptively exempt from tax. This is a good reminder for taxpayers to properly collect and save exemption certificates. In this case, however, Garrison did not produce properly completed Forms ST-122 or DTF-122. Accordingly, its sales to Grenadier remained presumptively taxable, and the burden was on Garrison to show that its sales to Grenadier were exempt from tax.

The tribunal held that Garrison met its burden by showing that Grenadier satisfied the common law principles of agency in its relationship with NYCHA. The division argued that the contractual language between NYCHA and Grenadier stated Grenadier was an independent contractor, and thus Grenadier could not qualify as an agent of NYCHA. But both the ALJ and the tribunal found that this contractual provision did not preclude a finding of agency. According to the tribunal, "NYCHA had a sufficient degree of direction and control over Grenadier such that an agency relationship existed between

those entities." NYCHA controlled Grendaier's procurement procedures, work rules, and repair and safety standards. Additionally, Grenadier had the authority to alter the legal relationships between NYCHA and third parties — i.e., residents of the apartment buildings — which the tribunal noted was "a primary characteristic of a principal-agent relationship."

Based on "the totality of the facts and circumstances," the tribunal found that NYCHA had a sufficient degree of direction and control over Grenadier such that an agency relationship existed between the entities. Thus, Grenadier's purchases of security services from Garrison were exempt from tax, and the tribunal affirmed the ALJ's determination and directed the division to recompute Garrison's liability.

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[1] South Dakota v. Wayfair Inc., 138 S. Ct. 2080 (2018).

[2] Quill Corp. v. North Dakota, 504 U.S. 298 (1992).

[3] N.Y. Tax Law Section 1101(b)(8)(i)(E).

[4] https://www.tax.ny.gov/pdf/notices/n19-1.pdf.

[5] https://www.budget.ny.gov/pubs/archive/fy20/exec/artvii/revenue-artvii.pdf.

[6] https://www.tax.ny.gov/pdf/current_forms/ct/ct3i.pdf.

[7] https://www.tax.ny.gov/pdf/current_forms/ct/ct3ai.pdf.

[8] Matter of Goldman Sachs Petershill Fund Offshore Holdings Corp., TAT(H)16-9(GC) (Dec. 6, 2018). https://www1.nyc.gov/assets/taxappeals/downloads/pdf/169DET1218.pdf

[9] Allied-Signal Inc. v Commr. of Fin., 79 N.Y.2d 73 (1991).

[10] Matter of Garrison Protective Services Inc., DTA No. 826738 (Dec. 27, 2018). https://www.dta.ny.gov/pdf/decisions/826738.dec.pdf