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NEW YORK TAX INSIGHTS

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SINGLE CHARGE FOR INVESTMENT MANAGEMENT SERVICES FOUND NOT SUBJECT TO NEW YORK SALES TAX

By Irwin M. Slomka

A financial services firm providing integrated investment portfolio management services to institutional clients in exchange for a single charge is not required to collect New York sales tax on its charge for those services. *Advisory Opinion*, TSB-A-13(12)S (N.Y.S. Dep't of Taxation & Fin., Apr. 23, 2013). The Department of Taxation & Finance reached this conclusion even though it acknowledged that certain components of the services, if viewed separately, would be taxable. The Advisory Opinion is a potentially important limitation of the so-called "bundled transaction" rule under the sales tax.

Facts. The Petitioner ("Service Provider") furnishes investment management and risk management services regarding investment portfolios, principally for financial institutions and other investment managers. One of its services (called "Product A") is a proprietary investment management platform through which it provides its clients with a variety of sophisticated risk analytics, together with portfolio management, trading and operations tools, as a single package.

The Advisory Opinion contains a highly detailed description of Product A, which will only be summarized here. Under Product A, the Service Provider creates a customized platform, maintained on its own databases and servers, which is delivered to clients via a private network using a web interface. The platform allows the exchange of information with clients, who can use the platform to, among other things, initiate trades, review portfolio balances and use financial analysis tools. The Service Provider procures and maintains the telecommunications services needed to connect its data centers with clients' data centers.

An important component of Product A is the furnishing of portfolio and risk analysis. This daily risk analysis involves the analysis of clients' portfolio and position information, and results in customized risk reports. Although this risk analysis is part of the Product A package, the Service Provider sometimes sells the service separately, but the service sold separately is somewhat more limited. When sold separately, New York sales tax is collected on those sales made to New York customers, presumably as a taxable information service. Product A also involves maintenance of a dedicated database for each client's portfolio information, facilitating client trade executions, and a desktop analytical calculator that clients can use to analyze securities and derivative products.

The Service Provider charges a single fee for all of the services furnished as part of Product A. The fee increases based on the client's overall use of the service and the overall complexity of the client's needs. There is also a separate "implementation fee" in the first year for putting the customized platform in place. The Service Provider requested an Advisory Opinion on whether its single charge for Product A is subject to sales and use tax.

Advisory Opinion. The key issue addressed in the Advisory Opinion was whether the services provided for a single charge should be treated as a "bundled transaction," which is the furnishing of both taxable and nontaxable services for a single charge. If viewed as a "bundled transaction," then the entire charge would be subject to sales tax. 20 N.Y.C.R.R. 527.1 (containing an example, commonly known as the "cheese board" rule, in which sales tax is found to be due on a vendor's single charge for a package containing assorted cheeses, a cheese board and a knife).

The Department noted that "[m]any of the components of Product A seem to qualify as taxable when viewed separately." For instance, the telecommunication connection between data centers might be a taxable telecommunications service; the web interface involved the furnishing of pre-written software; and the financial calculator and daily risk analysis appeared to constitute a taxable information service. In fact, as noted above, the Service Provider was already collecting sales tax on its risk analysis services when sold separately.

The Department concluded that the service should be viewed as a single, integrated transaction, citing *Matter of SSOV '81, Ltd.*, DTA Nos. 810966 & 810967 (N.Y.S. Tax App. Trib., Jan. 19, 1995) (which held that charges for a dating service were not subject to sales tax as an information service under the "primary function" rule). The Department reasoned that Product A was generally sold as an all-inclusive service, and its various components were "highly synergistic"—for example, the timeliness of the risk analysis was of critical importance, and was fostered by the Service Provider's maintenance of client databases.

The Department went on to rule that when viewed as a single, integrated transaction, Product A should be treated as a nontaxable information technology operations and management service. However, where the daily risk analysis and analytical calculator are furnished separately, they will each be considered a taxable information service.

Additional Insights

The Advisory Opinion is a potentially important development in the Department's approach to the "bundled transaction" rule under the sales tax. The Department concluded that the product furnished was not a "bundled transaction," despite the fact that certain components of the services, when viewed separately, were taxable. This is particularly noteworthy because the Department did not affirmatively conclude that the taxable components were trivial elements of the overall service.

In *Matter of Nerac,* Inc., DTA Nos. 822568 & 822651 (N.Y.S. Div. of Tax App., July 15, 2010), which involved whether consulting services that included the furnishing of technical written research reports constituted taxable information services, the Department invoked the bundled transaction rule. It claimed that since Nerac did not separate its single charge between the allegedly taxable components (the reports) and the nontaxable components (the consulting), the entire bundled charge was taxable. The ALJ in *Nerac* concluded that there were no taxable components, making the bundled transaction argument moot. Here, by not invoking the bundled transaction rule, the Department adopted a prudent approach that avoided forcing the Service Provider to separately price the individual components of its bundled services, or else risk subjecting its entire single charge to sales tax.

REMOTE VENDOR NOT "DOING BUSINESS" IN NEW YORK

By Hollis L. Hyans

The New York State Department of Taxation and Finance has determined that an out-of-state vendor, soliciting sales via catalogs, email and national advertisements, and fulfilling all orders from outside New York, is not "doing business" in New York and therefore is not subject to corporation franchise tax. *Advisory Opinion*, TSB-A-13(6)C (N.Y.S. Dep't of Taxation & Fin., Apr. 11, 2013).

Facts. The corporation requesting the advice (the "Vendor") sells women's apparel, accessories and footwear to customers nationwide through its catalog and website. It owns no retail stores in New York or in any other state. It accepts all of its orders outside of New York, and fulfills all the orders via common carrier or the U.S. postal service, shipping from

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outside New York. Its website is maintained outside New York. The Vendor did have an online web affiliate program, under which third parties would place a link to the Vendor's website on their own websites and receive a commission for any resulting "click-through" sales. However, by May 31, 2008, the Vendor terminated all such contracts with New York-based affiliates, and since then has not paid any commissions or fees to any New York residents for website referrals.

> Although it found that the visits to New York presented a "close question," the Department concluded that, given their "limited purposes and duration," the trips did not rise to the level of doing business.

The Vendor conducts all of its sales activities from outside New York, and provides all customer service from outside the state. Although it has no employees based in New York, employees did visit New York on a temporary basis for three purposes: to meet with potential merchandise vendors; to engage in "inspirational shopping" trips intended to gather information on fashion trends; and to attend trade shows. These visits involved six to eight of the Vendor's employees, lasted approximately two to three days, and occurred approximately nine to ten times annually in 2010 and 2011. None of the New York visits involved sales promotion or any selling activities.

Advisory Opinion. The Department concluded that the Vendor was not "doing business" in New York under Tax Law § 209.1 and 20 N.Y.C.R.R. Sec. 1-3.2(b)-(e), so as to be subject to corporation franchise tax. Given that the Vendor did not employ capital, own or lease property, or maintain an office in New York, the regulations direct attention to such factors as the nature, frequency and regularity of the company's activities in New York, and whether it employed agents, officers and employees in New York. Here, although it found that the visits to New York presented a "close question," the Department concluded that, given their "limited purposes and duration" the trips did not rise to the level of doing business.

The Department expressly noted that it was assuming from the facts presented that the Vendor had no employees in the state soliciting sales on its behalf. If it had, while the solicitation activity itself would be protected by Public Law 86-272, which precludes a state from imposing an income tax on an entity whose activities are limited to "mere solicitation" of sales, the non-sales related visits to New York would cause the Vendor to fall outside the protection of Public Law 86-272.

Additional Insights

What appeared critical to the Department in issuing this Advisory Opinion is that no solicitation activities were taking place in New York, and that the New York visits were limited to attending but not participating in trade shows, meeting with vendors (but not potential customers) and learning about fashion trends.

The opinion notes that the Vendor terminated all its agreements with New York affiliates in 2008, presumably as a result of the "Amazon" affiliate nexus statute enacted in New York in 2008, which imposes a presumption for purposes of the sales and use tax that an out-of-state vendor has nexus in New York based on such affiliate agreements. This Advisory Opinion deals only with whether the Vendor is itself subject to corporation franchise tax. It therefore does not address the issue of whether the Vendor would have sufficient nexus to New York, based on the employee visits that were found not to be solicitation of sales, so that it is obligated to collect New York sales tax on sales made to New York customers, despite terminating those affiliate agreements.

This Advisory Opinion appears to be a departure for the Department, which in recent years has generally not issued rulings opining on specific nexus questions, finding that the situations presented were too fact-based to permit resolution by Advisory Opinions.

NONRESIDENT PARTNER'S LOSS FROM 2005 DISPOSITION OF PARTNERSHIP INTEREST NOT INCLUDED IN NEW YORK SOURCE INCOME

By Kara M. Kraman

Applying New York law as it existed in 2005, a New York State Administrative Law Judge held that a nonresident partner properly included his share of the gain from the partnership's sale of a New York office building in his New York source income, but improperly included the loss from his disposition of that same interest. *Matter of Craig A. Olsheim*, DTA No. 824218 (N.Y.S. Div. of Tax App., May 9, 2013).

The nonresident partner, Craig A. Olsheim, was a limited partner in a partnership whose sole asset was an office building located in New York City. Because he had recently inherited his partnership interest, Mr. Olsheim's "outside basis" in the partnership interest (the fair market value of the partnership interest at the time he inherited it) and his "inside basis" in the interest (his pro rata share of the partnership's adjusted basis in

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the office building) did not match. In 2005, the partnership sold the office building and completely dissolved.

Mr. Olsheim reported his pro rata share of the gain from the sale of the office building on his New York nonresident personal income tax return. As he did at the federal level, Mr. Olsheim also claimed a capital loss resulting from the difference between his outside basis and his inside basis. For federal purposes, the loss was considered to be from the sale or exchange of his partnership interest. After an audit, the Department issued a Notice of Deficiency disallowing the loss.

In 2005, New York law provided, as it does today, that the New York source income of a nonresident partner included the partner's distributive share of all items of partnerships income, gain, loss and deduction entering into the partner's federal adjusted gross income to the extent such items are derived from or connected with New York sources. Tax Law § 632(a)(1). While Tax Law § 631(b)(1)(A)(1) currently provides that nonresidents must include gain or loss from the sale of an interest in a partnership that holds real property located in New York State as New York source income, this provision was not added until 2009, and was not made retroactive. In 2005, the Division's position on gain or loss from the sale or disposition of an interest in a partnership that holds real property in New York State was based on case law, and reflected in *Technical Service Bureau Memorandum*, TSB-M-92(2)I (N.Y.S. Dep't of Taxation & Fin., Aug. 21, 1992), which explicitly provided that such gain or loss was not includible in New York source income.

The ALJ held that Mr. Olsheim improperly included the loss from the disposition of his partnership interest in 2005 in his New York source income. While noting it was unfortunate for Mr. Olsheim that the current statute did not go into effect until 2009, the ALJ rejected Mr. Olsheim's argument that TSB-M-92(2)I was contrary to the established law at that time, noting that the enactment of Tax Law §631(b)(1)(A) was an acknowledgment that the established law at that time did not provide for the inclusion of such a loss.

Additional Insights

Although the law today is clear that the gain or loss from the sale of an interest in a partnership that only holds New York real property is includible in New York source income, that law only applies to sales made on or after May 7, 2009. It should be noted that the statute does not apply to all sales of interests in partnerships that hold New York real property. Specifically, it treats as New York source income only gain or loss from the sale of interests in partnerships that own New York real property having a fair market value greater or equal to 50% of the fair market value of all of the assets of the partnership on the date of the sale.

INSIGHTS IN BRIEF

ALJ Agrees with Taxpayer's Investment Income" Treatment of Dividends

A New York State Administrative Law Judge has found that dividends earned by the parent of companies engaged in the insurance agency business, arising from stock in American International Group ("AIG"), were properly treated as income from investment capital for Article 9-A purposes. *Matter of C.V. Starr & Co., Inc.*, DTA No. 824121 (N.Y.S. Div. of Tax App., Apr. 18, 2013). The ALJ rejected the Department's argument that Starr did not hold the AIG stock as an "investment" for its own account, finding that the AIG stock met all three criteria set forth in the definition of "investment capital" in Tax Law § 208(5), since it clearly qualified as "stocks, bonds and other securities, corporate and governmental"; it was not either held for sale to customers in the regular course of business," subsidiary capital, or stock issued by taxpayer; and it was held as an "investment." "By any reasonable view" of the term "investment," the ALJ found that Starr's ownership of the stock was an investment, carrying the expectation of a return as well as the risk of loss.

Lump Sum Charge for Providing Scaffolding, Including Temporary Pedestrian Walkways, Is Subject to Sales Tax Unless Walkway Is a "Temporary Facility"

A lump sum charge by a scaffolding company for the rental and service of installing scaffolding, safety netting, hoisting equipment, and temporary pedestrian walkways is subject to sales tax unless the installation is a "temporary facility" at a construction site necessary to the construction of a capital improvement to real property. *Advisory Opinion*, TSB-A-13(11)S (N.Y.S. Dep't of Taxation & Fin., Apr. 11, 2013). If the walkway is a qualifying "temporary facility," the lump sum charge will not be taxable. If the company separately states the charge for installing and dismantling the temporary pedestrian walkway, it will not be subject to sales tax if the separately stated charge is reasonable in relation to the total price. However, the separate charge for the rental of the walkway would be taxable.

Lump Sum Payment in Settlement of SERP and Deferred Compensation Plan Treated as Nontaxable Retirement Income of Nonresident Individual

The Department of Taxation and Finance has ruled that a lump sum settlement received by a nonresident individual from a nonqualified Supplemental Employee Retirement Plan ("SERP") and Deferred Compensation Plan pursuant to an order of bankruptcy is exempt from New York State income tax. *Advisory Opinion*, TSB-A-13(5)I (N.Y.S. Dep't of Taxation & Fin., Apr. 8, 2013). Beginning in 1996, Federal law prohibited states from imposing personal income tax on the retirement income of a nonresident or nondomiciliary individual. Here, the

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Department found that the payments in question would have constituted nontaxable retirement income had the nonresident's former employer not commenced bankruptcy proceedings. The fact that the bankruptcy caused the nonresident to accept a lump sum payment in settlement of retirement income payments does not change that result.

New York Announces Its First Business Ombudswoman

On April 23, 2013, the Department of Taxation and Finance and the Empire State Development announced the appointment of Mwisa Chisunka as New York State's first Business Ombudswoman and Director of Business Tax Services and Education. According to the announcement, Ms. Chisunka will work closely with the business community, launch pro-business programs, and work with chambers of commerce, small business development centers, trade associations and nonprofit organizations. It appears that the function of this new position is particularly addressed to tax issues of interest to New York's business community, while the Taxpayer Rights Advocate will continue her role of providing more general assistance to all New York State taxpayers and balancing the needs of taxpayer assistance against enforcement efforts.

No Sales Tax Collection Responsibility for Financing Purchases

The New York State Department of Taxation and Finance has determined that a Petitioner is not required to collect tax when he engages in a new business of facilitating purchases of equipment or supplies by a purchasing business. *Advisory Opinion*, TSB-A-13(10)S (N.Y.S. Dep't of Taxation & Fin., Apr. 11, 2013). The purchasing business will buy the equipment it needs in its name, and take title and possession, but Petitioner's credit card would be used for the purchase, and the purchasing business would execute a promissory note to Petitioner and pay back the amounts owed over time. Because the Petitioner would never acquire title or possession, and the vendor will collect any applicable sales tax on the purchase, there is no "sale" between Petitioner and the purchasing business, and Petitioner is not required to collect sales tax.

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