2014 HOTEL TAX EXECUTIVE COMMITTEE MEETING

HOT TOPICS IN NEW YORK SALES TAX AND INCOME TAX

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I. CAPITAL IMPROVEMENTS

A. The Problem

- Under New York's rules, maintenance to real property is taxable. However, when maintenance involves improvement to real property that qualifies as a "capital improvement," it is not taxable. Hotels undergoing renovations often run into this issue.

- A "capital improvement" is defined as work to real property which adds value, results in an installation that, if removed, would cause damage to real property, and is intended to be a permanent installation.

- Auditors have a field day with these tests. According to personnel in New York's Field Audit Management, auditors have been told to be more reasonable on these issues. Yeah, right.

B. The Pilot Program

- Working group established in late 2012 to suggest legislative fix around the "percentage idea," which had general support in Department, except for the fact that it is a huge project.

- "Pilot program" idea hatched, with select hotels inviting auditors in to review projects at two hotels.

- Matrix developed from those visits. Work underway with audit teams to streamline review and come up with a taxable percentage for these projects.

- Albany auditors are interested in doing this for other hotels/projects.

II. TAXABILITY OF MANAGEMENT FEES

A. The Problem

- Hotel owner contracts with brand to manage all aspects of hotel. Employees are on payroll of brand. Management services provided include concierge, accounting, reservations, maintenance, cleaning, etc. Tax Department takes the position that a portion of the management services provided by brand are taxable (i.e., cleaning services, maintenance services, etc.).

- One of two results ensues. Some auditors argue that a portion of the management fee applicable to the taxable services are subject to New York sales tax as a taxable service. More aggressive auditors, however, assert that under New York's "Cheeseboard Rule," the entire charge is taxable since amounts for cleaning services are not separately stated.

B. Solutions

1. Taxability Questions and the Primary Function Argument

- TSB-A-91(43)S. Management fees charged by a company for managing apartments and houses for its clients; services included renting apartments and signing leases, collecting and depositing rents into client's checking accounts, writing checks for clients to pay their bills on such properties, answering telephone, doing bookkeeping, and maintenance/repair services. Costs for these services were separately billed to clients and sales tax was charged. Citing the "cheeseboard rule" (20 NYCRR 527.1), the AO concluded that if petitioner were to charge a single price for all of its services, the entire charge would be subject to tax. *See also 107 Delaware Associates v. New York State Tax Commn.*, 64 NY2d 935 (1984).

- *But see*: TSB-A-10(14)S. Petitioner sold integrated monitoring and management services in standard packages to its customers. The services involved IT asset monitoring, IT asset management, and offsite data backup management, all delivered to the customer via remote access. The Department concluded that the "primary function" of petitioner's service was to assist customers in the operation and management of its IT system and that the sales were not taxable. If, however, Petitioner sold portions of the services on a separate basis, charges could be taxable if the services were taxable.

- *Also see*: TSB-A-09(51)S. Petitioner's receipts for waste management consulting services were nontaxable, even though a component of that fee was the charge for the waste removal itself, which Petitioner passed through to its customer without marking up. The Department found that Petitioner's

management fee was a receipt for a service that was not taxable, even though components of the fee may have been individually taxable.

2. Who is Employer?

- There also is an argument that the hotel owner really is the "employer." The Tax Law provides no definition of when an employer-employee relationship exists. Thus the definition has developed through case law. The primary test that has developed for determining whether an employer-employee relationship exists is the right to *control and direct* the work of the employee. *See Building and Managers Association of Greater New York*, TSB-A-93(52)S (Oct. 4, 1992).

- Resolution of this issue turns on contract-specific terms. Management agreements can be structured to possibly get around this problem.

- January 2013 advisory opinion outlines this issue clearly. TSB-A-13(2)S. There, management firm hired to perform janitorial service for owners. Department rules that, since owner was true "employer" of janitorial workers despite being paid directly by management firm, management fees were not taxable. Positive contractual elements included:

  -- Management company is "agent" of owner
  -- Owner prescribes work rules and practices for workers
  -- Owner directs and controls workers
  -- Management company pays payroll as agent for owner only
  -- Owner retains liability for payment of compensation
  -- Management company indemnified and held harmless from tort claims made by workers

3. Going-Forward Fix: The "PEO" Structure?

- New York recently passed legislation creating "Professional Employer Organizations" (PEOs). The goal was to better define employment-related obligations with respect to payroll companies, staffing services and other companies that provide payroll and/or staffing services to clients. Management company can put employees on its payroll, withhold payroll taxes, pay workman's compensation and unemployment insurance, etc., but those employees can be considered legal "worksite employees" of the management company's client, rather than the PEO, for other purposes—including sales tax matters.

- The PEO statute specifically states that, under a valid arrangement between a PEO and its client: "*Worksite employees whose services are subject to sales tax shall be deemed the employees of the client for purposes of collecting and levying sales tax on the services performed by the worksite employee.*" (NY Labor Law § 922.8) (emphasis added).

- Set-up involves several steps, but is doable even under current management-agreement relationships, without having to create new companies or legal entities.

C. What's Been Happening?

- Are NY auditors really pushing this? It appears most cases are resolved at audit level.

- Look out for other states. Connecticut, for example, has a separate tax on business management services.

III. DECEMBER 2013 NYC TAX RATE ISSUE

A. The Problem

- The 5.875% NYC hotel tax rate expired effective December 1, 2013, meaning that the rate dropped back to 5%. But there was proposed legislation to extend the 5.875% rate, which contained a provision making it retroactive to December 1, 2013.

- So do hotels charge 5%? What happens if the law passes later in December and its retroactive? Only in NY!

- Some hotels were advised to charge the higher rate. We advised to keep at 5%.

B. The Solution

- On December 19, 2013, the New York City Council passed a measure to increase the City's Hotel Room Occupancy Tax rate from 5.00% to 5.875%. The new rate increase will be in effect from 12/20/2013 until 11/30/2015. The final version of the bill did not make the rate increase retroactive to 12/1/2013, as the initial version originally contemplated.

- Expect a repeat in December 2015?!

IV. OTHER ISSUES

A. Suites: When is a Room a Room?

- The Hotel Occupancy Tax ($2 per room over $40) is administered by NYC and is imposed on the rent "per day for every occupancy of a *room or rooms* in a hotel" in NYC.

- What's a room? When is a suite one room or two? A standard definition of "room" is "a portion of space within a building or other structure, separated by walls or partitions from other parts."

B. Rewards Programs

- Some of these issues still kicking around, in NY and other states.

- One primary issue concerns who the proper refund applicant is: the hotel or the program? In some states, like New York, it's the program. Other states, like Virginia, it's the hotel, but there could be ways of working around this. Other states, it must be only the hotel.

- Auditors are also working hard to make sure the hotels remitted the taxes.

C. Furnished Apartments

- New York advisory opinions upholds nontaxability of furnished rental apartments, generally for 30-days or more, lacking normal "hotel services" and demonstrating landlord-tenant relationship. *Korman Communities*, TSB-A-96(1)S and *ExecuStay Corporation*, TSB-A-03(15)S.

- *Matter of Old Forge Kampgrounds LLC* (Administrative Law Judge, 06/02/2011). Seven-day rule for "bungalow exemption" invalid. Under the Department's new policy, rent received for occupancy of a bungalow or similar living unit is not subject to the sales tax on hotel occupancy, regardless of the length of stay, as long as no housekeeping services, food services, or other common hotel services (including entertainment or planned activities) are provided by the lessor. See TSB-M-12(4)S.

- Audits still occurring in this area; be very careful about how these are marketed and pay attention to agreements.

- Look-out for NYC rules. They treat furnished apartments as hotels!

D. Airbnb Stuff

- Fighting with NYS Attorney General about subpoena for information on hosts. This is likely more of a local law/under30-day rental issue than a tax issue.

- Airbnb claims that it wants to collect state and local hotel taxes, but that New York law prohibit it.

V. RESIDENCY ISSUES: IN THE NEWS

A. The Problem

- New York State and City tax rates close to 13%. Lots of commuters and others who'd prefer to "live" in lower taxing jurisdictions. And 300 New York auditors who'd prefer otherwise. Over 5,000 audits per year on these issues!

- The tests are difficult. One test is "domicile," looking to where someone has their "permanent, primary home." Audits are very invasive, looking to personal history since birth, marital issues, extended family, business ties, possessions, etc.

- Other test is "statutory residency." Under this test, a taxpayer who really lives somewhere else can be a resident if they maintain a "permanent place of abode" in New York and spend more than 183 full or part days in New York (and a minute in NY counts as a day). These "day count" audits can be exasperating.

- Auditors are also on the look-out for nonresident income allocation issues. Look out Mitch Bryk!!

B. Recent Developments

- *Matter of Taylor* (TAT December 8, 2011): The taxpayer was a New York native who worked and resided primarily in London during the audit years, even though she maintained two NY residences. Subsequent to the audit period, she became a UK citizen. The Tribunal affirmed the ALJ's determination, which found that the taxpayer's pattern was to live abroad for temporary work assignments and that there was not yet a strong personal connection to London during the audit years. There was insufficient evidence that the taxpayer had abandoned her NY domicile and "landed" in the UK during the years at issue. However, the Tribunal did find that the taxpayer later developed a personal life in and ties to London and eventually adopted it as her domicile and home.

- *Gaied v. NYS*: February 14, 2014 decision from NY's highest court where court holds that an apartment the taxpayer maintained for his elderly parents was not his "permanent place of abode," so he could not be taxed as a NYC resident.