

# New York Sales Tax Litigation: 2019 Review

Defending a New York sales tax audit can be an eye opening and grueling experience. No matter the industry, from construction to hospitality, and no matter a business's size, from very large to "mom-and-pop," New York's sales tax rules are complicated and often counter-intuitive. This article highlights a few practical problems and issues that taxpayers frequently confront by surveying several recently litigated cases from 2019 involving New York's sales taxes.

Businesses and their owners become entangled in these rules quite often. For anyone sitting down to perform a client's or company's weekly bookkeeping or, worse, for those who are already facing an audit, a few useful lessons can be drawn by looking at the recent misfortune of others. The cases selected for discussion below demonstrate just how quirky and murky sales tax can be in practice. Further, they highlight the various permutations of several common issues, broadly speaking, that taxpayers encounter.

## Is It a Taxable Sale?

A threshold question for any business operating within New York is to determine whether the goods or services it *sells* are even subject to taxation. Several cases litigated during 2019 demonstrate that this inquiry can, in fact, be very complex. Determining whether you are, figuratively speaking, selling apples or, rather, selling oranges can make all the difference.

### Boat Slips

This summer, just in time for the launch of boating season, the New York Division of

Tax Appeals issued a Determination concluding that certain docking fees charged by Genesee Yacht Club to its members for use of its docks are, in fact, taxable "dues" subject to sales tax.<sup>1</sup> While the yacht club qualified as a social or athletic club for which dues would typically be taxable, it argued that the dock fees constituted nontaxable rentals of real property (*i.e.*, charges for the use of the piers and docks).

In making this argument, the Club looked just a few minutes downstream, where curiously another similar yacht club had obtained an earlier (unreported) court ruling treating its dock fees as, you guessed it, nontaxable rentals of real property. While the court acknowledged the earlier case, it concluded, in summary, that it was not manifestly unjust to reach a different conclusion and treat Genesee Yacht Club's fees as taxable "dues." In other words, what others in your industry or local community are doing may not mean your business will qualify for the same treatment, rightly or wrongly.

### Haunted Houses

Eerie Productions operated a seasonal haunted attraction called "Frightworld" in Buffalo during the Halloween season.<sup>2</sup> The dispute in this case centered on the rather



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weedy issue of whether the charges to enter the haunted attractions constituted taxable "admissions to a place of amusement" or, rather, constituted exempt charges for the use of amusement devices (such as a nontaxable carnival ticket to ride a Ferris wheel). Patrons could enter Frightworld, the venue, free of charge, but they had to pay to enter the various haunted houses located within Frightworld. Under the circumstances, the taxpayer argued that the type of fee he was charging was not subject to sales tax. The auditors, and ultimately the Tax Appeals Tribunal, disagreed.

This dispute involved a very technical issue and required lots of work by the taxpayer in producing a variety of evidence while proceeding through both a trial and then an appeal. Ultimately, the court concluded the haunted houses themselves constituted taxable places of amusement and not merely nontaxable devices. This case is a good reminder that sales tax can sometimes require what regular people would call hairsplitting, which in this instance surely resulted in a hair-raising experience for the taxpayer.

### Indoor Cycling Classes

New York City imposes a local sales tax on gyms, health salons, and similar establishments. Soul Cycle, Inc., a provider of instructor-led indoor cycling filed a petition seeking a determination that its cycling classes were excluded from the tax.<sup>3</sup> Essentially, Soul Cycle asserted a factual question as to whether it qualified under a specific exception for participatory sports facilities. In other words, the taxpayer argued that it was a sporting facility, not a gym or similar establishment.

The administrative law judge, though, analyzed the applicable statutes and certain historical amendments thereto and concluded this exception no longer exists under New York City's tax law, despite guidance suggesting otherwise. This was another tough break for taxpayers. The sales tax rules are riddled with various exemptions benefiting taxpayers, but sometimes the rules can be so dizzying that even a stationary bike can lose its balance.

### Is It a Taxable Purchase?

Another threshold question for taxpayers operating within New York is to determine whether the goods or services they *purchase* are subject to taxation. The central question here is whether a taxpayer should have paid sales tax on its purchases, and if not, does the taxpayer now owe use tax? Several cases litigated during 2019 demonstrate that this inquiry, too, can be equally confusing.

### Front Doors

Can a household door be exempt from tax? Michael Donnelly challenged the denial of a refund claim arguing that his purchase of a new front door for his residence qualified as an exempt capital improvement.<sup>4</sup> The taxpayer purchased a door from a retailer and then hired a contractor for the installation. The door installation by a contractor would likely qualify as an exempt capital improvement, but what about the purchase of the door itself?

In his refund claim, the taxpayer argued that had the contractor purchased the door, the contractor would not have been required

to pay tax. Unfortunately, that is not correct. Generally, the purchase of materials, even for capital improvement projects, whether by the contractor or the property owner, is subject to tax. Nevertheless, this rule is commonly overlooked. All too often, retailers, contractors, and property owners confuse these rules, leaving the door open for audit exposure.

### Lease Assignment

When does a purchase of business assets qualify as a "bulk sale," which could, in fact, transfer the seller's sales tax liabilities to the buyer? Singh Restaurant, Inc. acquired certain business assets from a failing restaurant that was closing and which owed sales tax liabilities to New York.<sup>5</sup> Under an asset purchase agreement, the purchaser took over the seller's lease and also acquired a few tables and chairs.

In defense of a subsequent bulk sale assessment against it, the purchaser argued it did not acquire the majority of the seller's assets; rather it only acquired a few, namely the lease assignment, and thus the transfer failed to qualify as a bulk sale. Further, the purchaser argued that a bulk sale cannot be found after a seller is no longer in business. Unfortunately, both of the purchaser's assertions are incorrect. The bulk sale rules can be a powerful tool used by auditors to transfer liability for unpaid taxes from seller to buyer to ensure sales tax debts are paid. Of course, the purchaser could have avoided the transfer of liability by properly following the bulk sale notification procedures. Here, though, this restaurateur, unfortunately, purchased spoiled goods.

### For Tax Advisors

These are quirky cases that demonstrate some very technical rules that taxpayers and their advisors need to be aware of. Sales tax can be far more complex than merely tacking on a small percentage to the purchase price. Due to space constraints, this article is intended merely to raise a few issues and demonstrate a few pitfalls hot off the press from cases litigated in 2019. Understanding how other taxpayers have lost their own cases can shed light on how to avoid a similar fate.

Advisors should familiarize themselves with their client's internal operations as well as any industry specific rules. Helping a business become properly oriented to its tax obligations early on is an important step for that business to achieve healthy and profitable operations. As highlighted above, these rules can be tricky and audits can sometimes feel surprisingly counter-intuitive.

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1. *In re Genesee Yacht Club*, DTA 827668 (ALJ Unit) (05/02/19).
2. *In re Ronald J. Doherty, Jr. d/b/a Eerie Productions*, DTA 826909 (Tax App. Trib.) (05/29/19).
3. *In re Soul Cycle, Inc.*, DTA 827698 (ALJ Unit) (05/23/19).
4. *In re Michael Donnelly*, DTA 828135 (ALJ Unit) (08/22/19).
5. *In re Singh Restaurants, Inc.*, DTA 827456 (Tax App. Trib.) (08/15/19).

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