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Advisory Opinion Guides Property Owners on Sales Tax

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A new advisory opinion issued last month by the New York Department of Taxation and Finance provides guidance on an important issue affecting all real estate owners—the imposition of sales tax on cleaning and maintenance services at real properties. The opinion focuses on an exemption to the sales tax applicable where such services are performed by building staff, and reaffirms helpful guidance previously issued by the Department.

Background

Generally, sales tax¹ is imposed on receipts from the sale of cleaning, maintenance, and repair services provided to real property. However, there is an exception to this general rule which provides that where cleaning, maintenance and repair services are rendered by an employee for his or her employer, compensation paid to the employee by the employer for such services is exempt from sales tax (the “employee wage exemption”). Thus, if a real estate owner’s employees provide cleaning or maintenance services at the building, any salaries paid to the employees for such services will not be subject to sales tax.

Additionally, sales tax is not imposed on receipts from management, supervisory, or consulting services pro-

vided in connection with real estate, even if the underlying services being managed or supervised are subject to sales tax.

Real estate owners operate and manage their buildings in a variety of ways, depending on factors such as the building’s size and the owner’s business model. For example, a small building owner might manage its property directly, while a larger building owner might hire an outside property manager. Some building owners hire a staff of building workers (e.g., janitors, engineers) to perform cleaning or maintenance services, while other owners do not employ any building employees and instead hire third-party service providers for such services. In the case where a building owner uses only outside providers for such services, sales tax is imposed on these services. On the other hand, if the building owner employs a staff of janitors and engineers to perform these services at the building, no sales tax is imposed on the compensation paid by the building owner to the employees for such services, under the employee wage exemption described above.

If an outside property manager is used, the manager coordinates all operations at the building, including the collection of rents, the coordination of tenant requests, and the supervision of all building employees at the building. The manager generally charges the building owner a management fee that is typically either a flat fee or a percentage of gross

rents, and is reimbursed by the building owner for costs incurred to operate the building. No sales tax is imposed on management services.

In some cases, a building owner might also ask its manager to provide accounting and payroll services for the property, including putting the building’s employees on the books of the manager and having the manager provide W-2 forms to the employees and pay the employees out of building revenue. The manager might also be asked to coordinate benefits and insurance for the employees, and enter into union contracts on behalf of the building owner. This is often done for the administrative convenience of the owner and in some cases to shield the owner from insurance requirements or other local law requirements. Economically, however, the manager is acting on behalf of the building owner and is not bearing any of these costs or liabilities itself. The manager is reimbursed by the building owner for the payroll, benefits, and any other costs borne by the manager, as well as for any liabilities arising from contracts entered into by the manager in connection with building employees.

Nevertheless, in order to qualify for the employee wage exemption from sales tax, the cleaning and maintenance employees must be the employees of the building owner, and not the employees of the manager. Over the past two decades, the Department of Taxation and Finance has issued a handful of advisory

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opinions providing guidance on how to determine if the building employees are in fact employees of the building owner for purposes of the employee wage exemption. Although an advisory opinion technically only applies to the particular taxpayer to whom it is issued, advisory opinions often shed light on general principles applicable to the facts presented by an opinion.

1993 Advisory Opinion

In 1993, the Department issued an advisory opinion to the Building Owners and Managers Association of Greater New York and The Real Estate Board of New York (TSB-A-93(52)S), which provided guidance on how to evaluate whether maintenance workers who performed services at the building owner's properties were the employees of the building owner for purposes of the employee wage exemption. The Department found that the determinative factors to be evaluated were: (i) the employer's right to direct and control the work of the employee, (ii) the "payment of wages," and (iii) the "right to hire and discharge" the employee. The Department stated the determining element was the employer's right to direct and control the work of the employee, with the other two factors being of lesser importance.

Under the facts presented in the opinion:

- the building owner approved the prescribed work rules and practices for the workers, in cooperation with the collective bargaining agreements and labor laws.
- the building owner determined the number of employees, the work hours and shifts, the compensation levels for nonunion employees and the amount of premium rates above the union scale

for union workers to be paid to such workers.

- the building owner was liable for covering the employees under the New York State Disability Benefit Law, the New York State Unemployment Law and for tort liability purposes.
- the employees were typically hired by the manager and were sometimes placed on the payroll of the manager.
- in some cases, the manager paid the workers and issued W-2 forms in the manager's own name; however, in all cases, the building owner reimbursed the manager for all payroll expenses incurred, and in most cases, the payroll checks were drawn on a special payroll account in the name of the manager in trust for the owner.

In the advisory opinion, the Department concluded that under the factors delineated above, the workers were employees of the building owners, and therefore that wages paid to such employees for the performance of their services were exempt from sales tax.

A handful of advisory opinions issued over the following two decades applied the same identical analysis to similar facts, and concluded in each case that the cleaning or maintenance services were exempt from sales tax under the employee wage exemption.

2013 Advisory Opinion

Last month, the Department issued an advisory opinion (TSB-A-13(2)S) which reaffirmed the Department's position in the 1993 opinion with respect to the employee wage exemption. The facts presented in this opinion were very similar to the facts in the 1993 opinion. In this opinion, managers were hired by

building owners to manage the performance of cleaning and janitorial services and maintenance and engineering services at the building owners' properties. The workers were subject to the owners' ultimate direction and control, and performed the services in accordance with work rules and practices prescribed by the owners. However, the managers hired and supervised the workers to perform the services, maintained payroll records, and issued W-2 forms to the workers. All payroll costs were operating expenses paid by the manager from funds provided by the owner.

In the advisory opinion, the Department used the same factors it had applied in the 1993 opinion to determine whether an employer/employee relationship existed. After evaluating the facts presented by the taxpayer, the Department concluded that the building workers were under the control of the building owner and therefore were employees of the building owner, despite payroll arrangements and other arrangements that nominally appeared to the contrary. Thus, the employee wage exemption to sales tax was applicable, and no sales tax was due on the provision of the services by the building workers.

The common sense position in last month's advisory opinion is consistent with the idea that the building employees in all of these cases are economically the responsibility of the building owner. Ultimately, even if the manager is terminated, at the end of the day the building employees, who are frequently union employees, will remain at the building employed by the building owner. The opinion is a helpful reaffirmation of the Department's position on how to determine whether an employer/employee relationship exists for purposes of the employee wage exemption to sales tax.

¹ The sales tax rate in New York City is currently 8.875%.