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Double-Dipping for the State of New York?

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In two recent determinations, the New York State Tax Appeals Tribunal's Division of Tax Appeals permitted the State Tax Department to impose sales tax first when the taxpayers bought the item and second when they later sold or leased it. In a case involving catering and in another case involving the leasing of taxi cabs, the taxpayers, Between the Bread II, Ltd.[1] and Best Taxi Management, Inc.[2] effectively paid sales tax twice on the items they "rented" to third parties. As a practical matter, these decisions represent a pyramiding of state tax that results in unfair double taxation.

General Application of the Sales Tax

Sales tax in New York, as in other States, is a tax imposed on the ultimate consumer; the tax is collected by the seller and remitted to the State. As a tax on the consumer, and to avoid multiple taxation, generally, sales for resale are exempt from tax. Those who purchase goods for resale use a resale certificate which permits the wholesaler or other vendor to sell the goods without collecting sales tax since the retailer, registered with the tax department as an authorized vendor, will collect the tax from the ultimate consumer. Also, since the tax is imposed on the sale of goods, it is also imposed on equivalents of a sale such as the leasing or rental of taxable items (e.g., automobile leasing and other rentals).

Caterers

Generally, unprepared food purchased for off premises consumption is exempt from sales tax. Food sold for on premises consumption at a restaurant, tavern or other establishment is subject to sales tax. Also, food sold for off premises consumption where the vendor (or someone acting on behalf of the vendor) serves, cooks, or provides services with respect to the food or drink is subject to sales tax.[3]

As a corporate caterer, Between the Bread II, Ltd. ("BTB") prepared, sold, and delivered food and beverages to corporations and individuals. Sales of prepared food where the vendor delivers the items and arranges them so that the food is ready to serve to guests, is taxable.[4] Some edibles (e.g., candy) are subject to sales tax even when sold at retail stores. However, if candy is purchased by a registered sales tax vendor for resale, a resale certificate may be used to limit payment of the sales tax only to the retail sale to the ultimate consumer. So, if a caterer purchases candy for the event, it would use its resale certificate, not pay tax to its wholesaler, then collect and remit one sales tax on the sale to its customer.

Another Regulation[5] states that tangible personal property used or consumed by a caterer in performing catering services are *not* purchased for resale. Therefore, if a caterer owned its own tables and chairs, it would pay sales tax on the purchase of those items and collect sales tax on the amounts it charged its customers for the use of the items.

At times, BTB provides its customers with serving staff and bartenders. Upon request of its customers, BTB arranges for tables, chairs, and other equipment necessary for the event. BTB rented all of the equipment from independent third party vendors that delivered the items directly to BTB's customers and back-hauled the items when the event was finished. BTB charged its customers sales tax for the rental of the chairs, tables, and equipment. However, BTB did not pay any tax on its payments to the third party vendor who provided the tables and chairs. The State argued that when BTB arranged for the equipment, it should have paid sales tax to the third party vendor. BTB maintained that its rental of tables, chairs, and other equipment were sales for resale and therefore exempt pursuant to Tax Law Section 1101(b)(4)(i), since it would "re-rent" the equipment to its customers.

The Administrative Law Judge rejected BTB's argument concluding that these rentals were not the equivalent of sales for resale. The ALJ based this conclusion on the finding in a Tribunal decision, *D-M Restaurant Corp.* (Apr. 18 1991), this case involved the re-rental of tableware by a restaurant for private parties. In *D-M Restaurant*, the Tribunal discussed an Appellate Division case of *Matter of Levine v. State Tax Commission*.[6] *Levine* involved a caterer's purchase of flowers for weddings. The court held that the purchase by the caterer was exempt as a sale for resale because the customer (the host of the event) was granted every right of ownership and could dispose of the flowers after the event. In *D-M Restaurant*, the Tribunal distinguished *Levine*, stating that the Petitioner "has not proved that its customers had right of ownership and control over the disposition of the tableware."

This conclusion is irrational in the context of a rental agreement. The renter would never have the right to dispose of the property, merely the right to use it for a period of time. If this Determination is upheld, BTB will be required to pay tax on the front-end of the transaction and collect from its customers and remit to the State sales tax on the back-end of the transaction. In other words, the State collects sales tax twice on the rental of the chairs, tables, and other corporate catering equipment, once when the caterer rents them from the rental company and again when the cost of the rental is included in the total bill to the customer.

Rental of a Yellow Taxicab

The taxi industry in New York City is one of the most highly regulated industries in town. The nostalgic idea of the owner-operator of a taxi navigating knowledgeably through every neighborhood in the City has not been reality for many years. Now, the industry is dominated by fleets and "mini-fleets" through which those holding taxi medallions lease them to others who find drivers willing to cruise the streets of New York.

Once the classic owner-operator was no longer the norm, the question arose as to the tax implications of the lease of a medallion and cab to a driver. The taxi business most often involves the lease of a very valuable medallion (the price of a medallion is about $180,000) and an appropriate vehicle to a cab driver, who pays a fixed amount for a twelve-hour shift. He keeps the fares (and any tips) paid by the passenger.

In the face of uncertainty about the tax implications of such an arrangement, the industry asked the State Tax Department whether the sales tax applied and received the response that the sales tax was due on the transaction.[7]

In what has become a typical arrangement for the New York City taxi industry, Best Taxi Management, Inc. ("BTM") leased the right to use a taxi medallion (for an average of $18,000 per year) to drivers, along with the right to use a BTM yellow taxicab. The drivers have the right to retain any profits from the operation of the taxicab. The drivers paid approximately $80 for a twelve-hour shift. The tax department argued that $24 of the $80 was subject to sales tax, as a retail sale of tangible personal property—the car itself. Also, the tax department asserted that the special tax on passenger car rentals was owed on these transactions.

Under New York law, sales tax is imposed on the "receipts from every retail sale of tangible personal property, except as otherwise provided."[8] Section 1105(b)(5) of the Tax Law defines sale as "any transfer of title or *possession* or both, exchange or barter, *rental*, lease or *license to use* or consume . . . conditional or otherwise, in any manner or by any means whatsoever for a consideration . . ." (emphasis added). Citing this Section, the Administrative Law Judge conceded that the term "sale" is "defined expansively" and concluded that the taxicab driver's *possession* of the taxicab in exchange for some part of the eighty dollars rendered to BTM, constituted a taxable "sale" of tangible personal property. Significantly, the ALJ emphasized that it did not matter that the taxicab drivers had no dominion or control over the vehicles; instead, "the license to use . . . in any manner" was sufficient.

Since a medallion is considered intangible property, the portion of the $80 that represented the taxicab driver's use of the medallion was not subject to tax. Relying on a June 26, 1986-letter from the late John P. Dugan, then Deputy Commissioner and Counsel of the New York State Department of Taxation and Finance (and later President of the New York State Tax Appeals Tribunal), the ALJ adopted the auditor's allocation of $24 of the $80 as representative of the sales tax based on the value of the taxi[9].

BTM asserted that the State should have utilized the fair market value of the medallions ($180,000) against the average purchase price of the taxicabs ($10,000 for a mix of new and used vehicles), which would have yielded an allocation of about $4 (versus the State's $24.00) to the rental of the taxicab and the remainder to the rental of the medallion. The ALJ rejected BTM's allocation, since the transaction involved is not a sale of the medallion.[10] The ALJ also noted that the taxpayer had not presented evidence of the amounts charged for a medallion lease when the driver already owned a vehicle.

However, in upholding the tax department's position imposing sales tax on $24 as the portion of the lease attributable to the vehicle, either the taxpayer failed to raise or the ALJ failed to consider, the tax paid by BTM when it purchased the vehicles. To the extent that the transaction is considered a taxable lease to the driver, then the purchase of a vehicle for the purpose of leasing it to others should be not taxable.

This "sale for resale" exemption exists, in order to avoid taxing a transaction until it has reached the "back-end" or final retail part of the deal. New York has adopted this exemption in Section 1101(b)(4)(i) of the New York Tax Law. Since the sales tax is a consumption-based tax, the theory behind this exemption is that the end-user, the individual that consumes the product, should bear the ultimate tax liability. Here, BTM could end up bearing the sales tax burden on the initial purchase of the vehicle (sale for resale) and on the final consumption (retail sale), at least for the past periods when BTM cannot collect the sales tax from the lessee drivers. Thus, BTM from a theoretical standpoint, should be entitled to a credit for any sales or use tax it paid when it purchased the vehicles or brought the vehicles into New York, since it was deemed to have sold the right to use such vehicles to the taxicab drivers.

Ultimately, the industry will pass on the tax to the drivers who lease the medallions and vehicles (sales tax @8.25% and the special tax on passenger car rentals @5% would be $3.18 per shift). This will come directly out of the pockets of the drivers and possibly making it more difficult to find a cab in New York City when you need one.

Conclusion

Once again, it seems that in these two cases the technical arguments convinced the ALJs that the law permitted the 'double-dipping' or pyramiding of the sales tax. There may be ways of alternative structures for the transaction, at least in the catering context, by having the caterer arrange for the table and chairs to be rented as agent for the customer rather than in its own name, so that the tax is due only once. Nevertheless, it appears that the broader issue of whether, in fairness, the sales tax ought to be paid twice hasn't been considered by the tax department pursuing these cases or the Tribunal deciding them.

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1 *Matter of Between The Bread II, Ltd. and Matter of Ricky Eisen*, (ALJ Determination, November 9, 2000).
2 *Matter of Best Taxi Management, Inc.*, (ALJ Determination, December 14, 2000).
3 Sales Tax Regulations Section 527.8.
4 Sales Tax Regulations Section 527.8(f).
5 Sales Tax Regulations Section 527.8(f)(2).
6 144 AD2d 209 (3rd Dept., 1988).
7 In TSB-A-86(2)S the State Tax Department advised that sales tax applies to the amount paid for leasing a vehicle even though the right to use a medallion (a nontaxable intangible) was also part of the transaction.
8 N.Y. Tax Law Search7RH 1105(a).
9 The amount of the allocation apparently reflected an agreement reached between the tax department and representatives of the Metropolitan Taxicab Board of Trade in the summer of 1994.
10 The numbers in the Determination would show that leasing the medallions costs $24.65 per shift ($18,000 divided by 2 shifts per day or 730).