

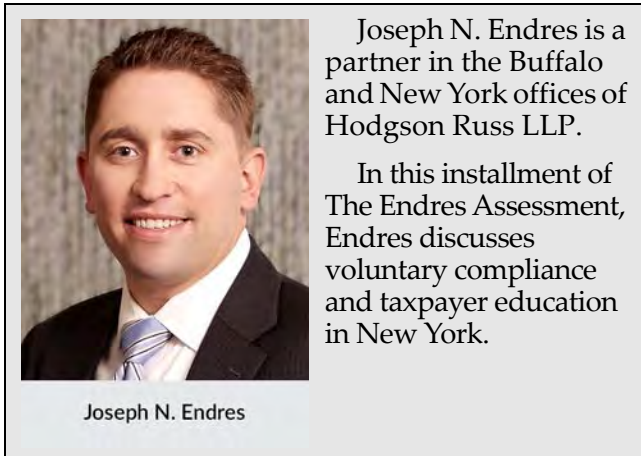
When the Student Is Ready, the Master Will Appear

by Joseph N. Endres

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I'm not exactly sure where the aphorism in the title of this article comes from, but its message is clear: When you're ready to know something, you'll seek out a way to learn it. Well, I've been ready to learn everything there is to know about New York sales tax for a long time. And in years past, the New York State Department of Taxation and Finance has been a wonderful master. It has provided me with numerous ways to learn the complex rules governing New York sales tax. This information includes sales tax publications, bulletins, memoranda, guidance, notices, form instructions, and advisory opinions.

According to the tax department's About Us webpage, "voluntary compliance" is "the cornerstone of the State's system of taxation."¹ According to the department, "[m]ore than 96 percent of the taxes collected are remitted voluntarily by taxpayers."² And the primary component of this high voluntary compliance rate seems to be education. It is difficult for taxpayers to comply with a legal obligation they do not understand.

Moreover, the tax department acknowledges that voluntary compliance is much more efficient and less expensive than *involuntary* compliance (that is, audits!). A copy of the tax department's "Compliance Continuum"³ establishes a dichotomy where, on one side of the continuum one finds "voluntary-less expensive-more efficient" actions, while, on the other end of the continuum, one finds "involuntary-more expensive-less efficient" actions. The "voluntary-less expensive-more efficient" actions include:

- Tax department: publish forms, instructions and guidance, and assist and educate taxpayers; and
- Taxpayer: learn about tax obligations, review information, file returns and make payments.

The "involuntary-more expensive-less efficient" actions include:

- Tax department: audit, collection, litigation and criminal enforcement; and
- Taxpayer: undergo audit, collection defense, litigation defense, and criminal enforcement defense.

We've heard tax department representatives tout their desire to increase voluntary compliance in numerous public presentations. But given this goal, and considering the fact that taxpayer education is a necessary component of this goal, it is a bit surprising that the department has virtually given up on issuing sales tax advisory opinions in recent years.

Advisory opinions are useful for taxpayers trying to comply with New York's sales tax law.

³The tax department's "Compliance Continuum" was previously available on its website at <https://tax.ny.gov/about>. The department has also used the "Compliance Continuum" in PowerPoint presentations during outreach events with taxpayers. A copy of the "Compliance Continuum" in a sample tax department PowerPoint presentation is on file with the author.

¹See New York State Department of Taxation and Finance, About Us.

²*Id.*

Taxpayers can petition the tax department to opine on how it believes the sales tax applies to a specific set of facts. These opinions are binding on the department regarding the taxpayer who requested them, so long as all material facts have been accurately provided by the taxpayer. And because the sales tax law is so fact-specific — the slightest change in the facts of a transaction can transform a nontaxable transaction into a taxable one — these opinions are particularly useful tools for applying the law to sales of new technologies and new structures.

For example, as software becomes more powerful and more integrated into service industries, clear distinctions between taxable software and nontaxable service offerings become blurred. Here's an example: Let's say I buy a software-as-a-service product to help me file and pay my personal income taxes. But as part of this service, I receive access to a CPA who will help me complete every box on the return. In other words, using the software-as-a-service functionality, I can open a chat box or place a telephone call and discuss every aspect of the return with a CPA. In this scenario, am I buying taxable software or a nontaxable accounting service?

To put it another way, is the software and the return creation the "primary function" of the transaction, or is the software merely a vehicle for delivering the nontaxable accounting service? Many businesses, especially those in technology industries, are faced with these types of difficult judgement calls. And in the past, advisory opinions have been a potential avenue of clarification, at least for the business requesting the advice (it can be difficult to discern a uniform principle from the entire body of advisory opinions applicable to a specific sector because some seemingly similar products have received divergent tax treatment from the tax department⁴).

While amending the tax law or regulations to keep up with new technologies and structures can be time consuming and slow, these opinions give the tax department the ability to be much more responsive and nimble. And the sales tax

demands this agility in a way that New York's other taxes do not. Historically, sales tax advisory opinions composed the majority of advisory opinions issued in a given year because of myriad factual distinctions that can affect the application of the tax. Though it does not appear that the department publishes the number of advisory opinion requests it receives each year, I would be shocked if the number of sales-tax-related requests didn't dwarf the number of requests regarding all the other taxes.

The problem here is that the number of sales tax advisory opinions issued by the tax department has been diminishing precipitously over the past several years. Take a look at the accompanying chart.

Year	No. of SUT AOs Issued
2015	53
2016	34
2017	23
2018	5
2019	1

I can appreciate that the tax department has limited resources, and we applaud the fact that among state tax authorities it certainly publishes more guidance than most (some states don't even have a formal means to petition for guidance). But this rate of decline in sales tax opinions is alarming. Moreover, the amount of time it takes to receive an advisory opinion these days makes them effectively useless.⁵ Based on our experience and anecdotal information from other taxpayers and practitioners, we've been telling taxpayers that are considering getting a sales tax advisory opinion that they'd better be willing to wait for two to three years. It is important to note that New York's tax law seems to require a quicker turnaround time. The New York tax law requires the tax commissioner "to render advisory opinions with respect to taxes administered by such commissioner within [90] days of the receipt

⁴Leah Robinson and Samuel R. Fowler, "How to Defend a Remote Access to Software Sales Tax Audit, Part III," *Tax Notes State*, Dec. 23, 2019, p. 1021.

⁵We previously wrote about this issue in a recent blog post: Christopher L. Doyle and Joseph N. Endres, "Wasn't the U.S. Constitution Written in Just 116 Days?" Noonan's Notes Blog (Apr. 26, 2018).

of a petition for such an opinion. Such [90] day period may be extended by such commissioner, for good cause shown, to no more than [30] additional days.”⁶ According to the applicable regulations, the tax department has some wiggle room on this deadline because the 90-day period starts to run “from the date of receipt of a *complete* petition for advisory opinion.”⁷ Even with the additional time that may accrue as a result of an “incomplete” petition, it is our experience that the issuance of the final opinion is still significantly late. This incubation period typically proves untenable for most taxpayers.

And this delay can impact another program administered by the tax department: the Voluntary Disclosure and Compliance (VDC) Program.⁸ New York’s VDC program provides potentially generous benefits that can be obtained in conjunction with the request for an advisory opinion. But there is some uncertainty surrounding the use of New York’s VDC program in conjunction with the tax department’s advisory opinion process. Box 6 on Form AD-1.8, “Petition for Advisory Opinion,” states:

The petitioner reserves the right to apply for the Voluntary Disclosure and Compliance Program pursuant to Tax Law § 1700 with respect to the subject of this advisory opinion request. The petitioner must apply within 30 days of the date the advisory opinion is issued or, if the petition is withdrawn before the advisory opinion is issued, within 30 days of the date that the petitioner notifies the Tax Department that the petition is withdrawn.

Further, the instructions for Form AD-1.8 state:

Note: The petitioner may elect, when submitting the petition, to reserve the right to apply for the Voluntary Disclosure and Compliance (VDC) Program pursuant to Tax Law § 1700 with respect to the

subject of the advisory opinion request. If an audit or investigation begins while a petition for advisory opinion is under consideration, the electing petitioner will not be prohibited from participating in the VDC Program with regard to the subject of the advisory opinion; however, the audit or investigation will proceed. If the electing petitioner chooses to participate in the VDC Program by then submitting an application, the department will extend to that petitioner the benefits of the VDC Program as long as the petitioner meets all other qualifications for the program. The petitioner must apply within 30 days of the date the advisory opinion is issued or, if the petition is withdrawn before the advisory opinion is issued, within 30 days of the date that the petitioner notifies the Tax Department that the petition is withdrawn. If the petitioner does not apply for the VDC Program within this 30 day period, the petitioner will not receive any of the benefits of the VDC Program and will be subject to any ongoing or impending audit or investigation.

One of the benefits of New York’s VDC program is a limited three-year lookback period for potential liability. If an advisory opinion can take two to three years from request to issuance, and the petitioner checks box 6 on form AD-1.8, it would appear that the benefits of the VDC program would apply during the pendency of the advisory opinion request. This could be very beneficial to the petitioner. Here’s how it would play out: Let’s say I run a business in which I’m unsure if my sales are taxable (similar to the tax return preparation hypothetical discussed above). My business has been operating in New York for the past 10 years, but it has never collected any sales tax or filed any sales tax returns. On January 1, 2020, my business files Form AD-1.8 and requests an advisory opinion, checking box 6. On June 1, before the tax department has issued my advisory opinion, it opens an audit of my business. But because my business has never filed any sales tax returns, the audit covers the previous six years (that is, June 1, 2014, through May 31, 2020). Based on the information in Form AD-1.8 and its instructions, the audit has to

⁶ N.Y. Tax Law section 171(24th).

⁷ 20 NYCRR 2376.3 (emphasis added).

⁸ See Department of Taxation and Finance, Voluntary Disclosure and Compliance Program.

proceed, but the benefits of the VDC program should apply. Thus, the tax department’s audit should be limited to the previous three years (rather than the full six years initially contemplated by the audit), and no noncompliance penalties (or the penalty rate of interest) should be assessed if my sales are indeed taxable. However, we have heard anecdotally from the department that this may not be the case. The full audit period may indeed be reviewable.

Unfortunately, the stakes for getting sales tax compliance wrong are grave either way: If a business doesn’t charge tax but should have, it is liable for the unpaid tax, interest, and possible penalties (this includes personal liability for those running the business); if it charges sales tax but shouldn’t have, it is vulnerable to class action overcollection lawsuits brought by its customers. This overcollection liability was a significant concern mentioned by employees of Apple Inc. in its recent litigation in the New York State Division of Tax Appeals.⁹

So consider this article to be a plea to the powers that be to increase the resources available to the tax department for sales tax advisory opinions. These opinions are particularly vital to sales tax voluntary compliance (much more than for other taxes). We wholeheartedly support the allocation of some additional revenue to hire a few more attorneys in the department’s Office of Counsel to help churn out more advisory opinions.

The students are here. We’re waiting for the master to (re)appear. ■

⁹ See *Matter of Apple Inc.*, DTA No. 827287 (N.Y. State Div. of Tax App. Dec. 24, 2019).





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