

The Nuts and Bolts of New York's Sales Tax on Interior Design

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In this edition of Noonan's Notes, the authors discuss New York's sales tax on interior design and contrast its application with related services such as architecture, construction contracting, and set design.

To determine whether a mauve paint scheme will complement your mid-century modern office concept, you may want to seek out a licensed interior designer. But to unravel the sales tax implications of that advice, you may need a tax attorney. New York's sales tax on interior decorating and design services would appear, at least on the surface, to be straightforward. From a practitioner's perspective, however, the interpretation and enforcement of the tax on interior design continues to present numerous challenges and often bizarre audit outcomes. This article explores the nuts and bolts (or perhaps more appropriately, the curtain hooks and upholstery tacks) of how this seemingly innocuous taxable service designation has created issues across numerous industries.

Background

We're aware of only one other state (West Virginia) that has specifically enumerated interior decorating or design as a taxable service.¹ New York City initially enacted a local sales tax on interior design services in 1989 as part of a revenue package aimed at closing a budget gap. New York state followed suit in 1990. While the city's tax on interior design was repealed in 1995, the state tax remains. New York Tax Law section 1105(b)(7) lists "interior decorating and design services (whether or not in conjunction with the sale of tangible personal property)" as one of the handful of services specifically subject to sales and use tax. This creates a conundrum in which the tax is imposed only at the lower state tax rate of 4.375 percent.²

The tax seems simple enough. Most would view an interior designer as a professional who consults on matters such as home or office decor, furnishings, window treatments, and similar issues, and who may select individual furniture items and fixtures. But the definition of interior design in the New York Education Law is actually a bit broader. Like architects and engineers, interior designers are required to be licensed by New York state. Under the education law definition, the practice of interior design involves:

rendering or offering to render services for a fee or other valuable consideration, in the preparation and administration of interior design documents (including drawings, schedules, and specifications) which pertain to the planning and design of interior spaces including furnishings,

¹ Some state statutes imposing tax on services to real property generally could include aspects of interior design.

² This represents the statewide tax of 4 percent, plus the tax imposed on transactions in the Metropolitan Commuter Transportation District.

layouts, fixtures, cabinetry, lighting, finishes, materials, and interior construction not materially related to or materially affecting the building systems.³

New York state's Department of Taxation and Finance has incorporated the definition into its policy guidance on interior design.⁴ More practically, the department's guidance lists a number of activities that would constitute taxable interior design under that definition, including the "preparation of layout drawings, schedules, and specifications pertaining to the planning and design of interior spaces; design and planning of furniture, fixtures, and cabinetry; staging; lighting and sound design; interior floral design"; and the "selection, purchase, and arrangement of surface coverings, draperies, furniture, and other decorations."⁵

The department also has made it clear that services taxable under section 1105(b)(7) are not confined to those provided by a licensed interior designer. Rather, interior design and decorating services subject to tax may be performed by interior consultants, bathroom and kitchen designers, and home decorators and designers, as well as by architects, engineers, lighting designers, event planners, and — for good measure — "any other person providing similar services."⁶

This broad application of the tax has raised some nuanced and difficult issues for tax practitioners in New York, particularly when interior design intersects with other, nontaxable services, such as architecture and engineering, or even construction contracting. We'll explore some of those conflicts here, as well as the peculiar rules for sourcing taxable interior design services.

Interior Design vs. Architecture

Perhaps the biggest conflict we've encountered in practice regarding interior decorating and design lies in where to draw the line between interior design (a taxable service)

and architecture (a nontaxable service). Like interior design, the practice of architecture is defined in the New York Education Law. Under section 7301, architecture encompasses:

rendering or offering to render services which require the application of the art, science, and aesthetics of design and construction of buildings, groups of buildings, including their components and appurtenances and the spaces around them wherein the safeguarding of life, health, property, and public welfare is concerned.

So what happens when an architect is hired to design the interior of a new or existing building? Common in any architectural contract is an architect's obligation to develop a layout of the interior spaces, which may include conceptual renderings depicting the layout of furniture to demonstrate the capacity of such spaces. And just as an architect's overall design may incorporate specific exterior siding and roofing materials, the architect may also incorporate details like interior flooring materials, wall finishes, and built-in cabinetry into the final architectural plans. Does this mean that the architect is providing a bundled service of both architecture and interior design in a basic architecture contract?

The answer, generally, is no. Consider the performance of these services in New York City, where the brunt of architectural and construction work concerns the renovation or reconstruction of interior spaces such as apartments and office buildings. Is an architect necessarily engaging in the practice of interior design, in whole or in part, merely because the building already exists? After all, the definition of interior design refers to the "preparation and administration" of documents "which pertain to the design and planning of interior spaces," including layouts and interior construction. The fuzzy line between architecture and interior design has arisen in numerous sales and use tax audits we've handled for architects, with auditors sometimes taking the position, for example, that some portion of an architectural design for a complete reconstruction of an apartment in an existing apartment building must constitute interior design.

³N.Y. Education Law section 8303.

⁴See New York state Department of Taxation and Finance, Sales Tax Bulletin No. TB-ST-400, "Interior Design and Decorating" (June 2, 2011).

⁵*Id.*

⁶*Id.*

Interestingly, precious little exists in the way of case law and published guidance attempting to demarcate between the practice of architecture and the practice of interior design. But several New York City cases — albeit not directly addressing sales and use tax — provide some indication of where the line might be drawn.

In *Marshall-Schule Associates Inc. v. Goldman*,⁷ a designer who was not licensed as an architect sued to collect unpaid fees from a customer who contracted for services, including floor plans, elevations, architectural drawings, as well as “furniture layouts, color schemes, fabric selections, wall coverings.” Part of the design work involved rearranging interior walls, closets, and openings. A city civil court judge denied the designer’s claim, finding that the contract involved the practice of architecture, which the designer was not licensed to perform. The judge found that there is a “thin — but plain — line between ‘interior design’ and ‘architecture services.’”⁸ That line, the ruling suggested, was crossed as soon as the work involved changes to the structure of the premises, particularly the rearrangement of doors and closets. According to the decision, “such is the type of activity the Legislature had in mind in enacting Section 7301 of the Education Law.” The judge focused on that distinction, writing:

As soon as it became apparent that structural work was to be done, the burden immediately was upon the plaintiff and its principals since they are not licensed architects — to refuse to prepare architectural designs and drawings for such structural work.⁹

Thus, if there is a bright line between taxable interior design and architecture, it arguably is crossed as soon as any planning involving structural elements or building systems is involved. The statutory definition of interior design assists further here, providing that designing interior construction would be included to the extent it is “not related to or materially

affecting building systems,” including “structural, electrical, plumbing, heating, ventilating, air conditioning, or mechanical systems.”¹⁰ Additionally, the definition notes that the plans of an interior designer are not to be confused with plans required to be stamped by an architect.¹¹

Still, if there is a bright line, it may only apply to architects. The tax department has made it clear that while services meeting the education law’s definition of architecture or engineering would not be subject to tax as interior design, this is true only if such services are performed by a licensed architect or engineer.¹² From a practical perspective, this makes sense: It’s unlawful to practice architecture or engineering without being licensed. But it also means that anyone not licensed as an architect who is designing interior construction in any form can be deemed to be engaged in interior decorating and design, even if the work crosses the line into building systems and structural elements.

By the same token, licensed architects cannot simply invoke their license to avoid tax on services that do not meet the definition of architecture. For example, some architects offer a distinct post-construction service of selecting or arranging the purchase of furniture and accessories that complement the project’s design. Such services are subject to tax — license or not. Architects who offer such services should ensure the services are optional and separately stated from the basic, nontaxable architecture services (if any). Additionally, interior design planning that does not rise to the level of architecture will be taxable notwithstanding that the work may ultimately be incorporated into nontaxable architectural drawings.¹³ An architect who purchases interior design services is deemed to be consuming them in performing his own, nontaxable services; thus, the resale exemption does not apply.¹⁴

¹⁰ N.Y. Education Law section 8303.

¹¹ *See id.*

¹² *See* New York State Department of Taxation and Finance, TSB-A-98(43)S (July 1, 1998); and New York Special Tax Department Notice, No. 06/01/90.

¹³ *See* New York State Department of Taxation and Finance, TSB-M-10(5)S (Apr. 26, 2010).

¹⁴ *See id.*

⁷ 137 Misc. 2d 1024 (N.Y. Civ. Ct. 1987).

⁸ *Marshall-Schule Associates*, 137 Misc. 2d 1024, 1026 (N.Y. Civ. Ct. 1987); *see also American Store Equipment and Construction Corp. v. Jack Dempsey’s Punch Bowl Inc.*, 174 Misc. 436 (Sup. Ct. N.Y. 1939).

⁹ *Marshall-Schule*, 137 Misc. 2d at 1028.

Interior Design vs. Construction Contracting

Another slightly less problematic issue arises when interior design intersects with construction contracting. For example, the department's guidance on interior design and decorating lists kitchen and bathroom designers as among those providing taxable services.¹⁵ But what happens if the designer is also a construction contractor that installs the bathrooms and kitchens it designs? Thankfully, the department's guidance addresses this situation, advising that:

When the services provided consist of a combination of renderings or plans followed by later physical implementation of the plans, the person providing the services is considered to be a construction contractor. As a result, the sale will not be treated as the sale of interior decorating and design services, but will instead be treated as a service to tangible personal property, real property, or both.¹⁶

In other words, if a contract for a new kitchen includes both the design plans and the installation of the kitchen, the contract will be taxable as a service to real property, even if a separate charge for the design portion of the work is stated. And assuming the new kitchen results in a capital improvement to the underlying real property, the entire contract would be considered to be for a nontaxable capital improvement.¹⁷

Again, this seems simple enough, but there are numerous considerations depending on the billing and the nature of the project as a whole. For example, if an interior designer who doesn't perform installation work contracts to design a new kitchen and also offers to enlist a contractor for the installation, is the interior designer's portion of the contract subject to tax? The answer may depend on how the job is contracted and

billed. If the interior designer and the installation contractor bill the customer separately, the design work would likely be subject to tax; however, if the designer bills the customer for both the design and installation work, using the installation contractor as a subcontractor, it would seem to us to qualify as a single, nontaxable capital improvement contract.

Interior Design vs. Set Design

One of the stranger issues we have recently encountered in this area arises in the fashion and entertainment industry. Several rulings have confirmed that some event planners who temporarily transform interiors into event spaces are providing interior design and decorating services.¹⁸ But we were caught off guard in a recent audit when the auditors insisted that a set designer who crafts a temporary backdrop for a photography shoot is performing interior design and decorating services. Granted, the photo shoot occurs inside a photography studio, but is the set designer really hired to design or decorate a photography studio? Or is the designer hired to create a temporary backdrop for a photo? Taken to its logical conclusion, the auditors' position would mean Broadway set designers are essentially just interior designers, decorating theaters.¹⁹ In our opinion, the set design position goes beyond what the interior design tax was intended to cover.

Interior Design vs. Sale of Tangible Personal Property

The set designer and event planner examples shed light on another conundrum when it comes to interior design and decorating — one that is especially important for projects in New York City. As noted above, because the city repealed its tax on interior design, such services are subject only to the state's 4.375 percent sales and use tax if performed in the city. Conversely, sales of tangible personal property in the city are still taxable at the

¹⁵ TB-ST-400, *supra* note 4.

¹⁶ *Id.* (emphasis added).

¹⁷ The service of installing tangible personal property is subject to tax under N.Y. Tax Law section 1105(b)(3) except where the installation results in a capital improvement to real property. N.Y. Tax Law section 1105(b)(3)(ii). A capital improvement is defined as an addition or alteration that (1) "substantially adds to the value of the real property, or appreciably prolongs the useful life of the real property; (2) becomes part of the real property or is permanently affixed to the real property so that removal would cause material damage to the real property or article itself; and (3) is intended to become a permanent installation."

¹⁸ See, e.g., New York Department of Taxation and Finance, TSB-A-03(35)S (Sept. 3, 2003); and New York Department of Taxation and Finance, TSB-A-07(17)S (June 26, 2007).

¹⁹ Of course, such services would be exempt under the general exemption for purchases of property and services for use in a dramatic or musical arts production.

combined state and city rate of 8.875 percent — more than double the rate applicable to interior design. Thus, how interior design services are billed can be critical, particularly in New York City. The department's position is that when interior design services are provided in conjunction with the sale of tangible personal property, the charge for the interior design service must be separately stated. Otherwise, the entire charge will be deemed a charge for the sale of the property, and therefore in New York City be taxed at the 8.875 percent rate rather than at 4.375 percent.²⁰

Interior designers, in addition to consulting and planning, often select and purchase furniture and accessories for their customers. In many cases, the designers express their fee as a markup to the cost of the furniture and fixtures passed on to the customer. As numerous rulings have confirmed, this type of billing generally fails to adequately state a separate charge for a service; therefore, the fee will generally be treated as a markup or commission on the sale of property.²¹ This can have big consequences for work in New York City, because the interior design service portion of the fee can be taxed at the lower 4.375 percent rate if properly billed. Rulings suggest that expressing the fee as a flat fee or hourly fee unconnected to the purchase price of any furniture and fixtures would accomplish this.²²

Sourcing Interior Design Services

Another confusing aspect of the tax on interior design services is how they are sourced. The department addressed this issue in published guidance in 2010 and 2011 — adopting a policy that depends on whether the contract involves design plans only, on-site consulting only, or both.²³ The following is a summary of the policy:

- If only plans are involved, tax is due if the plans are delivered to the customer in New York.

- If only on-site consultation is involved, the tax is due if the physical project is located in New York.
- If the contract for services includes both of these services for a single fee, the service is sourced to where the physical project is located. Thus, if the project is located out of state, the work would be nontaxable, regardless of where the plans are delivered.
- Finally, if the contract involves both on-site advice and plans, and the fees for each are separately stated, the delivery of each component is determined separately. For example, if the project is located outside New York but the plans are delivered in New York, only the charge for the plans would be subject to tax.

Sounds complicated, but it does offer designers some control over the taxability of their services, particularly when the project is located out of state but the customer might be based in New York.

Conclusion

As this discussion reconfirms, not much is straightforward when it comes to sales and use tax in New York. The tax on interior decorating and design is certainly no exception. ■

²⁰ See, e.g., TSB-A-03(35)S, *supra* note 18.

²¹ See *Matter of Mary Rinaldi Swet*, N.Y. Tax App. Trib. (Feb. 22, 1991); and *Matter of T.K. Design Inc.*, N.Y. Tax Commn. (Dec. 4, 1985).

²² See, e.g., *Matter of Mary Rinaldi Swet*, *supra* note 21.

²³ TB-ST-400, *supra* note 4.