Transfers of Tangible Property, Look Out for Sales Tax
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I. Sales Tax on Any Transfer of Tangible Property for Consideration

New York tax law imposes sales tax on the receipts of every retail sale of tangible personal property.[1] A "sale" is defined 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 or any agreement therefor…."[2] The definition of a sale is extremely broad and appears to cover any imaginable scenario.

On January 29, 2014, the New York State Department of Taxation and Finance (the "NYS-DTF") issued an Advisory Opinion concluding that a substitution of property between a grantor and a grantor trust constituted a transfer for consideration, and therefore the New York sales and use taxes were applicable to the transfer.[3] The commissioner held that "[i]f there is consideration given in any form in connection with the transfer, a retail sale of tangible property occurs and sales tax is imposed."[4] Consideration is present if an individual receives something of value in the transfer (*i.e.* if it's not a gift, it's a sale).[5]

The commissioner also explained that all trusts are separate entities even if they are grantor trusts or revocable trusts. Though transfers to such entities may be disregarded for income tax purposes, such transfers will still be transfers for sales tax purposes.[6] Therefore, a transfer to one's revocable trust for consideration will also trigger sales tax.

II. Solutions

Sales tax is explicitly only imposed on *tangible personal property*. Intangible property is not covered by Section 1105(a) of the New York Tax Law and therefore excluded from the imposition of sales tax. The trick is turning the tangible property into intangible property through the use of a wrapper (*e.g.* an LLC, a limited partnership or a corporation).

This method has been used by non-residents to exclude real and tangible property having situs in New York State from the New York State estate tax regime.[7] If real or tangible property is held by a corporation or partnership and such entity has a legitimate business purpose, the interest held by a non-resident will be the interest in such entity (not the entity's underlying assets).[8] This interest is an intangible and not subject to New York estate tax.[9] However, a single member LLC is considered a disregarded entity, and its activities are treated that of the owner.[10] Therefore, a non-resident would still be considered owning the underlying assets of the LLC, and such assets would be subject to the estate tax.[11]

Though the Advisory Opinions dealt with the estate tax rather than sales tax, the similarities of the factual scenarios would infer that these requirements would also be applicable in the sales tax context when using a wrapper to turn tangible property into intangible property. Therefore, when using an LLC, the LLC must (1) not be classified as a disregarded entity and (2) have a business purpose in order to shield one from the sales tax on the transfer.

Related party transactions may be subject to more scrutiny. In two separate Advisory Opinions where a multi-member LLC owned real property to rent and was respected for tax purposes, the commissioner made note of the degree of separation from the owner and the property. In one scenario, the commissioner pointed out that the property was rented to only unrelated persons to the partners of the partnership.[12] In the other scenario, the commissioner noted that the decedent never resided in or personally owned the properties.[13] Since the commissioner ruled in favor of the taxpayer in both scenarios where no related party was present, it left open the possibility that a related party transaction may not receive a similar result. Though an arms-length transaction with a related party should be respected and not cause an entity to be disregarded, it is another arrow in the quiver for the NYS-DTF.

If one forms an LLC to hold tangible property and intangible property such as securities and then sells LLC interests to a grantor trust, such sale could trigger sales tax. Based on the Advisory Opinions, the NYS-DTF may consider the LLC a disregarded entity depending on its structure and use and re-characterize the sale as a sale of tangible property and securities rather than a sale of an interest in an LLC. In this circumstance, an alternative solution exists. Instead of initially funding the LLC with all of the intended assets, only intangible property should be used to fund the LLC prior to the sale. Since none of the underlying property of the LLC would be tangible property, the sales tax rules would not be applicable nor the need to meet the requirements of the wrapper work around stated above. After the sale of the LLC interest to the trust, the grantor could then make a contribution of capital to the LLC of the tangible property which is a sales tax free transfer.[14] The trust would then have a partial interest in such later contributed tangible property and avoid the imposition of sales tax on the transfers. However, one should be mindful of the proximity of timing of these transfers and space them over a period of time in order to avoid the application of the "step-transaction" doctrine.

III. Conclusion

Though this new ruling by the NYS-DTF may be burdensome and objectionable, the ruling is not uncommon in the NYS-DTF's aggressive approach to collect taxes. Outside of legislative help, this ruling is here to stay. Assets such as art and jewelry which a client may have been more willing to part with than cash or securities, may now have lost much of their shine when used in estate planning transfer techniques.

When possible, clients should avoid using tangible property in estate planning sales transfer techniques to avoid the sales tax issue all together. However, clients should find comfort in the Advisory Opinions that if the requirements are followed, they will fall outside of the sales tax regime similarly to how they fall outside the estate tax regime using similar techniques.

[1] New York Tax Law (TL) Section 1105(a).

[2] TL Section 1101(b)(5). *See also* 20 NYCRR Section 526.7(a) and (b).
[3] TSB-A-14(6)S, Jan. 29, 2014.
[4] TSB-A-14(6)S, Jan. 29, 2014.
[5] *Id*.
[6] *Id*.
[7] TSB-A-10(1)M, April 8, 2010; TSB-A-11(1)M, Oct. 12, 2011.
[8] TSB-A-08(1)M, Oct. 24, 2008. Though this ruling did not explicitly apply the business purpose requirement to partnerships, it is inferred that the requirements for a corporation versus a partnership to be respected for tax purposes would be no less stringent.
[9] *Id.*
[10] If the LLC elects to be treated as an association and hence a corporation, it will not be considered a disregarded entity. *Id*.
[11] *Id*.
[12] TSB-A-11(1)M, Oct. 12, 2011.
[13] TSB-A-10(1)M, April 8, 2010.
[14] TL Section 1101(b)(4)(iv)(A)(V).