

New York State Department of Taxation and Finance
Office of Counsel
Advisory Opinion Unit

TSB-A-10(34)S
Sales Tax
August 3, 2010

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S100219A

The Department of Taxation and Finance received a Petition for Advisory Opinion from [REDACTED]. Petitioner asks whether its proposed method of determining its receipts on the sale of tangible personal property subject to sales tax is acceptable when it leases both tangible personal property and real property to an affiliate.

We conclude that Petitioner's use of data from a reputable industrial publication and reasonable assumptions to determine the amount of receipts attributable to the lease of tangible personal property may be accepted for purposes of sales tax provided: (1) Petitioner can substantiate that the assumptions made in calculating the rental fee for tangible personal property are reasonable; (2) the total rent amount for the tangible personal property and real property is the fair market rental value for the lease of the total properties; and (3) a written contractual document outlines the method of calculation or the invoice billed to the affiliate lessee contains an itemized charge for the lease of tangible personal property that is based on the method.

Facts

Petitioner is the owner and landlord of a hotel property known as the [REDACTED] which is located at [REDACTED]. Petitioner is a subsidiary of a qualifying real estate investment trust (REIT), [REDACTED].

Federal tax laws limit the amount of non-qualifying income that can be earned by REITs, including income derived directly from the operation of hotels. As a result, Petitioner owns the real estate (land, buildings, and building improvements) and furniture, fixtures and equipment (FF&E) and leases this property in its entirety to [REDACTED]. (Lessee), a subsidiary designated as a taxable REIT subsidiary. Lease payments are made in a lump sum, which includes rental for both real estate and tangible personal property. The total rental amount is a base amount plus a percentage of revenue from hotel operations.

Petitioner's current method of calculating receipts from the lease of tangible personal property is based on the net book value (NBV) of its FF&E as a percentage of its NBV for total assets. This percentage is applied to total lease payments to yield receipts from the lease of tangible personal property. Petitioner believes that this method overstates receipts from the lease of tangible personal property in part because no adjustment is made for disposition of the tangible personal property in computation of NBV for FF&E.

Petitioner proposes to change its method of calculating receipts from the lease of tangible personal property by using data from a publication entitled "Hotel Development Cost Survey" published by HVS International (HVS). These publications contain historic and current data on hotel costs. According to a senior vice president of HVS, these survey publications have tracked hotel construction costs throughout the United States since 1976. The surveys break data down by six types of lodging: economic/budget hotels, midscale hotels without food and beverages, extended stay hotels, midscale

hotels with food and beverages, full-service hotels and luxury hotels and resorts. Costs are presented in the surveys on a per room basis.

HVS researches on an annual basis the developmental cost of actual hotel construction budgets, industry reports, and uniform franchise offering circulars. These sources provide the basis for a range of costs per room. New project construction cost data collected annually increases the range and/or impacts the mean or median of construction cost components.

Petitioner believes that its hotel comes within the HVS survey category of "full-service hotel." The first step in Petitioner's proposed method of calculating receipts from the lease of tangible personal property would be to multiply the number of rooms in its hotel (460) by the median value listed for FF&E in the full service hotel category of the current HVS survey. This computation would be updated annually.

Because FF&E amounts listed in the HVS surveys include fixtures that qualify as capital improvements for purposes of sales tax (e.g., wallpaper, window and door frames, showers, toilets, sinks, vanities, and installed lighting fixtures), Petitioner proposes to reduce the FF&E amount per room listed in the applicable HVS survey by 60% based on its estimate that tangible personal property is 40% of the total FF&E amount.

Adjusted FF&E cost (estimated total tangible personal property cost) would be divided by total hotel cost to yield a percentage, which would be applied to total lease payments owed by the Lessee to determine receipts on the lease of tangible personal property. This calculation would be updated annually.

Analysis

Tax Law section 1105(a) imposes sales tax on the receipts for the sale of tangible personal property. Sales tax regulation section 527.1(b) provides that when tangible personal property composed of taxable and exempt items is sold as a single unit, the tax shall be collected on the total price. The same result applies when a vendor sells tangible personal property and real property for a single price. Petitioner, thus, must collect sales tax on its total lease receipts unless a written contractual document outlines the method of allocating receipts or the invoice billed to the Lessee contains an itemized charge for the lease of tangible personal property. *See Petition of Northway Properties*, State Tax Commission, July 31, 1984, TSB-H-84(107)S.

The lease amount charged by Petitioner for tangible personal property must be reasonable in that it must approximate the fair market rental value for the lease of the tangible personal property. *Id.* The Department does not dictate how a vendor sets the sales price for tangible personal property, as long as the price is reasonable. Thus, a vendor has some leeway in selecting a method for determining the price for the sale of tangible personal property that is sold in conjunction with real property, provided that the vendor does not also sell the tangible personal property separately. (If the vendor does sell tangible personal property separately, the vendor's regular price for tangible personal property sold alone should be used when the tangible personal property is sold with real property.)

While the use of data from a reputable industrial publication to determine the charge for the lease of tangible personal property is not per se impermissible, Petitioner has not established that its proposed method of setting the lease price for tangible personal property is reasonable. Petitioner has not offered any affirmative reasons for concluding that its hotel is average in regard to the value of its tangible

personal property. Nor has Petitioner offered any explanation why it believes 60% of the purchases in the HVS category for FF &E represent fixtures that are not tangible personal property for purposes of New York sales tax. Finally, Petitioner has failed to explain how it will be accounting for indirect costs of leasing tangible personal property, such as financing. Therefore, it is not possible to opine on whether Petitioner's proposed method of using the HVS study is reasonable.

Petitioner's proposed method of determining charges for the lease of tangible personal property is premised on the total price charged for the lease of both tangible personal property and real property equaling the fair market rental value of the combined rental property. If the total rental price is not at fair market rental value, Petitioner's proposed method of determining charges for the lease of tangible personal property would be inherently flawed, irrespective of the caveats noted above. Because Petitioner and its lessee are affiliates, Petitioner should be prepared on audit to substantiate that its total lease charges are at fair market rental value.

As indicated above, the goal of any method of setting the price for the lease of taxable tangible personal property should be to approximate the fair market rental value of the property leased. Any method of setting the lease price for the tangible personal property that yields a total receipt stream at present value that is less than the cost of the tangible personal property would not be reasonable. Therefore, Petitioner should maintain all necessary records, including purchase records for tangible personal property, so that the Department on audit can verify that Petitioner's lease charges are at fair market rental value and that Petitioner is leasing the tangible personal property at an amount that reasonably reflects the cost of the tangible personal property.

While the amount of the taxable receipts or the method of determining taxable receipts may be delineated on any contractual document, the sales tax due must be stated, charged, and shown separately on the first sales slip, receipt, or other statement of price given the customer. Tax Law, §1132(a)(1), 20 NYCRR §532.1(b)(1).

DATED: August 3, 2010

/S/

Jonathan Pessen
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NOTE: An Advisory Opinion is issued at the request of a person or entity. It is limited to the facts set forth therein and is binding on the Department only with respect to the person or entity to whom it is issued and only if the person or entity fully and accurately describes all relevant facts. An Advisory Opinion is based on the law, regulations, and Department policies in effect as of the date the Opinion is issued or for the specific time period at issue in the Opinion.