

REGULATORY IMPACT STATEMENT

DEPARTMENT OF TAXATION AND FINANCE

1. Statutory authority: Tax Law, sections 171, First; 1142(1) and (8); and 1250 (not subdivided). This statutory authority provides for the Commissioner of Taxation and Finance to make reasonable rules and regulations, which are consistent with law, that may be necessary for the exercise of the Commissioner's powers and the performance of the Commissioner's duties under the Tax Law. This authority also provides for the adoption of rules and regulations that are appropriate to carry out and jointly administer the New York State and local sales and compensating use taxes imposed by and pursuant to the authority of Articles 28 and 29 of the Tax Law.

2. Legislative objectives: The rule is being proposed pursuant to such authority and in accordance with the legislative objectives that the Commissioner equitably administer the provisions of the Tax Law and take judicious regulatory actions when such actions are warranted. Section 1105(c)(3)(ii) of the Tax Law provides that receipts from the sale of "laundering, dry-cleaning, tailoring, weaving, pressing, shoe repairing, and shoe shining services" are excluded from sales tax. These terms are not defined in the Tax Law. As discussed in the following section, a question was recently raised concerning the taxability of alterations to clothing. In order to effect the legislative intent of the subject exclusion, the rule clarifies that separately stated, reasonable charges for alterations to all items of clothing fall within the scope of this exclusion as tailoring. This rule is an exercise of the Commissioner's authority to reexamine the existing policies of the Department of Taxation and Finance and to prescribe a rule that, consistent with the Tax Law, will give guidance to vendors and taxpayers alike (*e.g.*, tailors, seamstresses, clothing retailers, and their customers).

3. Needs and benefits: As indicated, the purpose of this rule is to amend the Department's regulations to provide that alterations to clothing are to be treated as tailoring, a service that is specifically excluded from tax. The impetus of this rule was a recent inquiry from an individual who requested clarification of the application of sales tax to a clothing-alterations

business, in light of the recent exemption from sales and use tax for sales of clothing and footwear (Tax Law, section 1115[a][30]). Although this exemption is not directly applicable to tailoring services, it was apparent that it was necessary for the Department to reevaluate its policy concerning clothing alterations. Section 527.4(c) of the existing regulations provides by example that the service of altering a new suit by a tailor constitutes fabricating, a taxable service under section 1105(c)(2) of the Tax Law. Conversely, section 527.5 provides that altering clothing that is not new falls within the exclusion from tax for tailoring that is found in section 1105(c)(3)(ii). Indirectly, section 527.4(a)(4) of the regulations provides that when an alteration service is combined with the sale of clothing, the entire transaction is subject to tax (or exempt from tax) as a retail sale of tangible personal property. This rule is beneficial because it will remove these distinctions from the regulations and classify alterations to all items of clothing as nontaxable tailoring services. This exclusion does not depend on who performs the service or whether the individual items of clothing are new, old, taxable, or exempt. The consistent treatment of alterations to clothing as activities that are not subject to tax will have a positive impact on taxpayers, as well as the vendors that provide this service. In the case of alterations performed in conjunction with the sale of clothing, the clothing vendor will be required to distinguish between nontaxable alteration services and the potentially taxable sales of clothing. Accordingly, any charge for such alterations must be reasonable and must be separately stated from the charge for the clothing on the statement of the clothing's price given to the customer. The application of this rule does not pertain to the production of clothing, the monogramming of clothing, or the application of decals and like items.

Although the matter of alterations to clothing is the primary objective of this rule, technical and editorial amendments have also been made to each of the regulatory sections at issue. In this regard, the rule amends the existing examples to better reflect the incidences of tax and substitutes an example of fabricating sheet metal for

the repealed example of altering a new suit. The new example is similar to the example currently found in section 531.2(d)

of the regulations.

4. Costs: It is estimated that there are little or no costs to regulated parties associated with the implementation of, and continued compliance with, this rule. Any one-time costs for vendors would be attributable to reclassifying alteration services from taxable to nontaxable activities and are considered to be routine, nonmeasurable adjustments that will be handled in the normal course of business. For example, this may include informing employees of the new policy, reprogramming software for cash registers or point-of-sale terminals, and making other minor changes in accounting systems. Vendor costs will be reduced as a result of the simplified sales tax accounting for these services and a future stream of small accounting cost savings should then accrue to the vendors due to the simplification.

It is, however, estimated that there will be costs to the Department of Taxation and Finance, New York State, and its local governments for the implementation and continued administration of this rule. This Department will incur nonmeasurable implementation costs attributable to revising pertinent forms, instructions, and other publications to reflect the change in policy. These revisions will be handled in the normal course of the Department's business. In addition, because the rule provides that once-taxable activities will no longer be subject to State and local sales and use taxes, New York State and its local governments throughout this State (*e.g.*, counties, cities) that impose sales and use taxes will incur decreases in these revenues that are estimated to be \$1 million annually at the State level and \$1.6 million annually at the local level, which equates to a combined savings of approximately \$2.6 million annually for taxpayers. This revenue impact was developed by estimating the State and local sales taxes:

1. remitted by businesses providing clothing alteration services;
2. related to that portion of the sales tax revenue from clothing retailers which represents separately stated alteration charges for clothing priced at \$110 and higher and, for certain local sales taxes, clothing

priced at less than \$110; and

3. related to clothing priced at or above \$110 solely on account of the combined clothing and alteration charge.

An estimate of the sales taxes remitted by businesses providing clothing alteration services was made using the reported taxable sales for the reporting period from March 1, 1998 - February 28, 1999. The adjusted reported taxable sales were grown by three percent per year to approximate State fiscal year 2001-2002 for an estimated State cost of \$360,000. Localities would experience a similar revenue reduction.

The second part of this estimate determined the amount of sales tax remitted on alterations performed by a clothing retailer in conjunction with a taxable clothing sale. The State and certain localities exempt clothing costing less than \$110 per item, including any alteration services combined with the clothing sale. Therefore, the methodology separated clothing sold for less than \$110 from other clothing sales. It also estimated the additional local fiscal impact this change has in those localities which do not provide the local clothing exemption.

The amount of sales tax remitted on alterations performed by a clothing retailer in conjunction with a taxable clothing sale was estimated starting from the official legislative estimate for April 1, 2000 through March 31, 2001 of the exemption for clothing and footwear costing less than \$110 per item of clothing or pair of footwear. The official estimate put statewide sales of clothing and footwear costing less than \$110 at \$14.9 billion. That estimate was grown by three percent to \$15.3 billion to account for growth to State fiscal year 2001-2002. Using Division of the Budget estimates, total clothing sales were estimated at \$20.5 billion. Items of clothing sold at retail at or above a price of \$110 were estimated at \$5.2 billion.

To estimate sales of clothing priced below \$110 per item in localities that tax all clothing (and the associated alteration services), this Department computed clothing sales within each taxing locality - multiplying the \$15.3 billion

estimated sales subject to the exemption by an estimate of each county's share of statewide apparel and footwear sales. The county share of apparel sales used in this estimate was based upon data published in *Demographics USA 1999 - County Edition*, as published by Market Statistics, 355 Park Avenue, New York, New York 10010. Sales in those localities that do not provide the local clothing exemption totaled just over \$7 billion.

To estimate the value of alteration services sold combined with the sale of clothing, the Department used the U. S. Census Bureau report, *Merchandise Line Sales 1997: 1997 Economic Census, Retail Trade Subject Series*, published January 2001. Using Table 2 in this report, *Merchandise Lines by Kinds of Business for the United States: 1997*, the Department compared the total sales by clothing stores (NAICS 4481) and conventional department stores (NAICS 4521 101) with sales of "labor charges for work performed by this establishment." A shortcoming of the Merchandise Lines data is that for department store sales these data exclude "leased departments." A leased department would include, for example, a tailor who operates from within a men's shop at a department store. To take into account leased departments, the Department used the U. S. Census Bureau report, *Subject Series - New York, 1997 Economic Census, Retail Trade Subject Series*, published January 2001. The resulting estimate assumed that 0.25 percent (0.0025) of retail clothing sales in clothing stores and department stores relate to nonmerchandise service receipts from labor charges for alteration services. The 0.25 percent factor was multiplied by the different clothing sales estimates for State fiscal year 2001-2002. This is summarized in the following table:

In-Store Clothing Alterations	
<u>State Revenue Impact</u>	

	In-store alterations to items of clothing costing \$110 or more	\$12,899,000
	State Sales Tax at 4%	\$516,000
<u>Local Revenue Impact</u>		
	In-store alterations to items of clothing costing \$110 or more	\$12,899,000
	Estimated Local Sales Tax at 3.8%	\$490,000
	In-store alterations to items of clothing costing less than \$110 in counties which tax clothing at the local level	\$17,618,000
	Estimated Local Sales Tax at 3.5%	\$617,000
	Total Local Sales Tax Cost	\$1,107,000

The third component of this estimate measured of the amount of clothing priced at or above \$110 solely on account of the combined clothing and alteration charge (*e.g.*, a \$100 pair of men’s pants with a \$12 alteration charge: the sales price totals \$112). The Division of the Budget estimates that approximately two percent of clothing sales are items sold for between \$110 and \$120. This represents about \$406 million in clothing sales. For purposes of this estimate, the Department assumed that one percent of that amount could relate to items of clothing which became taxable solely because of the alteration charge, or approximately \$4 million in currently taxable clothing sales. Under this proposal, these sales would become exempt from the State sales tax at a revenue cost of \$160,000. These sales would also become exempt from local sales taxes in those localities that exempt clothing. The Department estimated that 54 percent of clothing sales are currently exempt from local sales taxes. Therefore, if 54 percent of the \$4 million in currently taxable clothing sales were impacted, and assuming a local tax rate of 3.8 percent, this aspect of the proposal would have a local revenue impact of an additional \$83,000.

All three aspects of this estimate are summarized in the following table:

Summary	
State Revenue Impact	\$1,036,000

	Alterations by Tailors, Other Service Providers	360,000
	In-store alterations to clothing costing \$110 or more	516,000
	Clothing Costing Above \$110 on Account of the Alteration Charges	160,000
Local Revenue Impact		\$ 1,550,000
	Alterations by Tailors, Other Service Providers	360,000
	In-store alterations to clothing costing \$110 or more	490,000
	In-store alterations to clothing costing less than \$110 in counties which tax clothing at the local level	617,000
	Clothing Costing Above \$110 on Account of the Alteration Charges in Localities which Provide a Local Clothing Exemption	83,000
Total State and Local Sales Tax Cost		\$ 2,586,000

This analysis is based upon discussions among personnel from the Department's Office of Counsel, Office of Tax Policy Analysis, Program and Technical Services Bureau, Fiscal Services, Operations Support Bureau, and Technical Services Division.

5. Local government mandates: This rule imposes no mandates upon any county, city, town, village, school district, fire district, or other special district. The local sales and compensating use taxes at issue are administered by the Commissioner of Taxation and Finance pursuant to the authority of Articles 28 and 29 of the Tax Law.

6. Paperwork: The rule imposes no reporting requirements, forms, or other paperwork upon regulated parties. For the most part, the opposite is true. Reporting requirements, forms, and paperwork attributable to clothing alterations that were previously subject to tax will no longer be necessary. In the case of alterations in combination with sales of clothing, however, it will be necessary under established sales and use tax principles to distinguish between nontaxable alteration services and potentially taxable sales of tangible personal property.

Accordingly, any charge for such alterations must be reasonable and must be separately stated from the charge for the clothing on any statement of price given to the customer.

7. Duplication: There are no relevant rules or other legal requirements of the Federal or State governments that duplicate, overlap, or conflict with this rule.

8. Alternatives: No significant alternatives to the rule were considered by this Department. In lieu of this rule, the Department's alternative would be to refrain from this proposal and to continue with its current policy of taxing certain sales and uses of alterations to clothing, while excluding or exempting others. Although such policy is a sound (albeit hyper-technical) interpretation of sections 1105(a), 1105(c), and 1110 of the Tax Law, the recent amendment to the Law to exempt sales of clothing and footwear compounded the complexity of this policy.

9. Federal standards: The rule does not exceed any minimum standards of the Federal government for the same or similar subject area.

10. Compliance schedule: No measurable time is needed in order for regulated parties to comply with this rule, other than a minimal amount for the initial reclassification of clothing alteration services from taxable to nontaxable activities.