STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
FREEPORT CASINO CRUISES, LLC	:	
for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period December 1, 2003 through August 31, 2005.	:	
	:	DETERMINATION DTA NOS. 822383 AND 822384
In the Matter of the Petition	:	
of	:	
D.L.T., INC.	:	
for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period March 1, 2004 through August 31, 2005.	:	
	:	

Petitioner Freeport Casino Cruises, Inc., filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 2003 through August 31, 2005.

Petitioner D.L.T., Inc., filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 2004 through August 31, 2005.

On December 18, 2008 and December 31, 2008, respectively, petitioners, appearing by David L. Hixson, CPA, and the Division of Taxation, appearing by Daniel Smirlock, Esq. (Lori

P. Antolick, Esq., of counsel), waived a hearing and agreed to submit the matter for determination based on documents and briefs to be submitted by May 18, 2009, which date commenced the six-month period for the issuance of this determination. After review of the evidence and arguments presented, Timothy Alston, Administrative Law Judge, renders the following determination.

ISSUES

I. Whether the Division of Taxation properly assessed tax on the lease of a vessel where lease payments were due but not paid.

II. Whether petitioner has shown error in a bulk sale assessment.

FINDINGS OF FACT

1. On May 14, 2007, following an audit, the Division of Taxation (Division) issued to petitioner Freeport Casino Cruises, LLC (FCC or petitioner), a Notice of Determination which asserted $140,868.49 in additional sales and use tax due, plus penalty and interest, for the period December 1, 2003 through August 31, 2005.

2. On June 4, 2007, the Division issued to petitioner D.L.T., Inc., a Notice of Determination which asserted $123,124.61 in additional sales and use tax due, plus penalty and interest, for the period March 1, 2004 through August 31, 2005.[1] The notice advises that D.L.T., Inc., was assessed as a responsible person of FCC pursuant to Tax Law § 1131(1) and §1133(a). D.L.T., Inc., did not contest the Division's assertion that it was a responsible person of FCC and thus liable for sales tax due from FCC.

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[1] The Division did not assess tax against D.L.T., Inc., for the quarter December 1, 2003 through February 29, 2004. This accounts for the difference between the two statutory notices at issue herein.

3. FCC operated out of Freeport, New York, and was in the business of providing cruise ship excursions featuring gambling, food and drink. FCC was a registered vendor for sales tax purposes and filed quarterly sales tax returns during the period at issue. FCC reported admission charges for its cruises as taxable receipts on its returns.

4. Pursuant to a Memorandum of Agreement dated July 15, 1998, FCC leased a vessel named Midnight Gambler II from Monte Carlo Cruise Concessions, Inc. (MCCI). The agreement provided for a five-year term, set to terminate on July 31, 2003, and further provided for one-year extensions, at FCC's option, at the same terms and conditions upon written notice to MCCI.

5. FCC and MCCI were related by common ownership.

6. FCC leased Midnight Gambler II pursuant to the Memorandum of Agreement and one-year extensions thereof throughout the period at issue and until it ceased business operations on May 30, 2005. FCC took delivery of Midnight Gambler II from MCCI in Freeport, New York.

7. The Memorandum of Agreement provided for monthly lease payments of $100,000.00. Effective January 2000, however, an Addendum to the Memorandum of Agreement dated January 5, 2000 reduced the monthly lease payment to $40,000.00.

8. Pursuant to the one-year extensions of the Memorandum of Agreement commencing August 1, 2003 and August 1, 2004, FCC owed MCCI monthly lease payments of $40,000.00. FCC incurred substantial operating losses and was insolvent during that time. It made no lease payments to MCCI in respect of either of the one-year lease extensions.[2]

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[2] In its brief the Division suggests that FCC did in fact make some lease payments to MCCI during the audit period, citing FCC's partnership returns for the years 2003 through 2005, which report deductions for rent and MCCI's 2005 return which reports rental income. Considering, however, that FCC rented equipment from a third party throughout the audit period, that MCCI rented the vessel in question to a third party in 2005 and, most significantly, the statement in the audit report that no such payments were made ("Lease payments were not made to

9. MCCI released FCC from its obligations to make lease payments as of December 15, 2004. At that point, according to the minutes of an extraordinary meeting of MCCI, FCC was far behind on its lease payments and "due to its economic viability, would most likely never be able to pay any further [lease payments]." The minutes further note that MCCI was fiscally unable to support the costs of repossession at that time. MCCI therefore determined to release FCC from lease payment obligations, but allowed FCC to continue to maintain, insure and operate Midnight Gambler II until MCCI found another lessee. MCCI did not release FCC from its past due lease payments.

10. FCC ceased operations due to its insolvency on May 30, 2005, and MCCI repossessed the boat at that time. Additionally, in consideration of its release from its debt to MCCI, which was in excess of $1.9 million, petitioner transferred equipment on the boat to MCCI. Such equipment included casino equipment leased from Central Leasing Co. of New Jersey. FCC had capitalized the Central Leasing leases for federal tax reporting purposes. The transfer also included casino equipment, vessel equipment, bar equipment and office equipment and furniture owned by FCC, and further included assets described in FCC's depreciation schedule as land improvements.

11. MCCI continued to make payments in respect of the Central Leasing leases. Central Leasing charged sales tax to MCCI on such lease payments.

12. MCCI subsequently leased Midnight Gambler II to an unrelated third party in July 2005.

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the lessor for the use of a gambling ship although the ship operated for several months of the audit period."), the Division's suggestion is rejected.

13. On audit the Division assessed sales tax of $63,000.00 on lease payments that were due from FCC to MCCI during the audit period. Specifically, the Division assessed tax on $40,000.00 per month (or $120,000.00 per quarter) for the period December 1, 2003 through May 31, 2005.

14. The Division also determined on audit that the transfer of equipment from FCC to MCCI in May 2005 was a bulk sale subject to tax. The Division calculated tax due based on the following federal income tax net book values of the assets transferred: Central Leasing leases of casino equipment $411,830.88; casino equipment owned by FCC $264,082.67; land improvements $52,672.59; vessel equipment $23,938.56; bar equipment $15,681.07; computer and office equipment $1,742.79; and office furniture $2,721.60.

15. The various items of casino equipment owned by FCC which were transferred to MCCI had been acquired and placed in service at various times from 1998 through 2003.

16. FCC did not take issue with the assessment of tax in respect of vessel equipment, bar equipment, computer and office equipment, or office furniture.

17. Also on audit, the Division assessed $6,198.06 in sales tax on $70,835.00 in untaxed admissions for FCC's cruises during the quarter December 1, 2003 through February 29, 2004. FCC did not protest this portion of the assessment.

SUMMARY OF PETITIONER'S POSITION

18. Petitioner takes issue with the assessment of tax on the amounts due under the vessel lease. Petitioner asserts that, as it was insolvent and no payments were made, no tax should be due. Petitioner notes that it is related to MCCI by common ownership and asserts that the lease transaction was not arms-length. Pointing to MCCI's allowance of petitioner to continue to lease the vessel despite its insolvency, petitioner contends that this arrangement was not a true lease,

but was more in the nature of a joint venture. Petitioner asserts that in order for there to be an obligation for the lease payment there has to be a reasonable expectation that the amount can and will be paid. Petitioner also contends that the assessment of tax on a quarterly basis with respect to the lease obligations is inconsistent with the Division's assertion that the entire amount of tax due under the lease is payable as of the date of the first payment.

19. Petitioner also takes issue with the claimed bulk sale of assets to MCCI. Specifically, petitioner objects to any tax on the transfer of the leases of casino equipment. Petitioner contends that assessment of tax on such leased property was improper because petitioner lacked title to the property. Petitioner also asserts that since the lessee continued to make payments and pay sales tax on the leased equipment to Central Leasing, the imposition of tax on the transfer from petitioner to MCCI resulted in double taxation on the same equipment at the same time. Petitioner also asserts that the casino equipment owned by FCC which was transferred to MCCI had little or no value. According to petitioner, the valuation as indicated by petitioner's federal income tax net book value, which was used by the Division in its assessment, "may or may not reflect current values." Petitioner further contends that the book value utilized a long (12-year) depreciation period, and thus further overstated the value of the equipment. Finally, as to the item described in petitioner's books as "land improvements," petitioner contends that such improvements were "parking lot, paving, etc." and further contends that such improvements reverted to the real property owner.

CONCLUSIONS OF LAW

A. There is no dispute in the present matter that receipts from MCCI's lease of the Midnight Gambler II to FCC were subject to sales tax (***see*** Tax Law § 1101[b][5]; § 1105[a]). What is in dispute is whether FCC is liable for sales tax on lease payments that were not made.

Tax Law § 1111(i) imposes special rules for computing receipts with respect to leases for a term of one year or more of certain motor vehicles, noncommercial aircraft and vessels as defined in section 2250 of the Vehicle and Traffic Law. Specifically, all payments under such leases are "deemed to have been paid or given and shall be subject to tax, and any such tax shall be collected, as of the date of first payment under such lease" (Tax Law § 1111[i][A]). With respect to the present matter, Midnight Gambler II was a "vessel" as defined in section 2250 of the Vehicle and Traffic Law[3] and, during the period at issue, FCC leased such vessel under one-year extensions to the July 15, 1998 Memorandum of Agreement. Accordingly, the special rules for computing receipts under Tax Law § 1111(i) are applicable herein.

B. As noted, pursuant to Tax Law § 1111(i)(A), all lease payments are deemed to have been paid and all tax due on such payments is to be collected as of the date of the first payment under such a lease. As the statute deems all payments to have been made as of the date the first payment is due, sales tax is also necessarily due on such deemed payments whether or not the lease payments are actually made. The Tax Appeals Tribunal has, on several occasions, affirmed this interpretation of section 1111(i)(A) in the context of refund claims for sales tax paid on automobile leases (***see Matter of Moerdler***, Tax Appeals Tribunal, April 26, 2001, ***confirmed*** 298 AD2d 778, 750 NYS2d 329 [3rd Dept 2002] [where no refund or credit was allowed the taxpayer whose automobile was stolen only four months into the lease period]; ***Matter of Torquato***, Tax Appeals Tribunal, October 12, 2000 [where no refund or credit was allowed the taxpayer who moved to California and registered her automobile in that state ten months into the lease period, facts and circumstances mirroring the ones herein]; ***Matter of Miehle***, Tax Appeals

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[3] Vehicle and Traffic Law § 2250 expansively defines "vessel" as "every description of a watercraft . . . used or capable of being used as a means of transportation on water."

Tribunal, August 24, 2000 [where no refund or credit was allowed the taxpayer whose automobile was badly damaged in a car accident resulting in the termination of the lease only one month into the lease period]; ***see also*** 20 NYCRR 527.15[c][1][i]). While the instant matter involves the question of tax liability in the first instance and not a refund of tax paid, the same result necessarily obtains, for the Tribunal's affirmation of the refund denials in each of the above-cited cases is premised on the existence of a liability resulting from the application of the special rules for computing receipts with respect to leases under Tax Law § 1111(i). Moreover, the Division's regulations specifically provide that "no refund or credit shall be allowed based upon the fact that receipts are not actually paid as in the case of early termination of a lease . . . or bad debt . . . since, under section 1111(i), such receipts are deemed to have been paid" (20 NYCRR 527.15[e]). Accordingly, FCC's insolvency and its resulting failure to actually make lease payments is, under the instant circumstances, no basis upon which to cancel the assessment of sales tax on the total amount of such lease payments under the one-year extensions to the July 15, 1998 Memorandum of Agreement. Furthermore, MCCI's decision to relieve FCC of the obligation to make further payments under the lease while allowing FCC to continue to lease the vessel is also not a basis for any adjustment herein.

C. Inasmuch as all lease payments were statutorily deemed to have been paid and, consequently, all sales tax on such payments was due at the inception of each one-year lease extension (20 NYCRR 527.15[a]), the transaction upon which tax was assessed necessarily occurred at the inception of each one-year lease extension, i.e., August 1, 2003 and August 1, 2004. In the Notice of Determination, however, the Division assessed FCC on its monthly lease obligations commencing December 1, 2003. By operation of Tax Law § 1111(i), however, FCC's monthly lease obligations were not taxable transactions. Accordingly, as petitioner

correctly notes, the Notice of Determination is in error to the extent that it lists the wrong taxable periods with respect to tax due on FCC's lease obligations. Similar errors have been deemed harmless absent a showing of prejudice to the petitioner (***see Matter of Pepsico v. Bouchard*** 102 AD2d 1000, 1001, 477 NYS2d 892, 893 [3rd Dept 1984]; ***Matter of Kadish***, Tax Appeals Tribunal, January 12, 1989). Petitioner has shown no such prejudice in the instant matter. That is, petitioner was aware that the Division was assessing tax on its lease obligations to MCCI and thus had the opportunity to raise whatever defenses to that assessment it deemed appropriate in this proceeding.

D. Petitioner's contention that, as a result of common ownership, the relationship between FCC and MCCI was in substance a joint venture and not a lease is rejected. "For the purpose of sales tax liability, petitioner is bound by the form it has chosen" (***Matter of Tops, Inc.***, November 22, 1989 citing ***107 Delaware Associates v. State Tax Commn.*** 99 AD2d 29, 472 NYS2d 467 [3rd Dept 1984] , ***revd on dissenting opn below*** 64 NY2d 935, 488 NYS2d 634 [1985]; ***Matter of Greco Bros. Amusement Co. v. Chu***, 113 AD2d 622, 497 NYS2d 206, 208 [3rd Dept 1986]). FCC and MCCI elected to conduct business in a certain manner and, in so doing, elected to enter into a lease agreement. Petitioner may not disregard this arrangement to avoid sales tax disadvantages resulting therefrom.

E. Turning to the Division's assessment of sales tax on the transfer of assets from FCC to MCCI, the record is clear that such transfer was a bulk sale as defined in the Division's regulations (***see*** 20 NYCRR 537.1[a]). That is, FCC, a sales tax vendor, ie., a person required to collect tax, transferred all of its business assets to MCCI in consideration of its release from its debt to MCCI, and clearly such transfer was not in the ordinary course of business. Accordingly, all tangible personal property so transferred is properly subject to sales tax.

F. Petitioner has failed to show error in the Division's determination of tax due on the bulk sale. Contrary to petitioner's contention, the transfer of leased property constitutes a "transfer of possession" and thus falls within the broad definition of sale under Tax Law § 1101(b)(5). As to petitioner's complaint of double taxation with respect to the leased casino equipment, petitioner has not pointed to any provision by which the transfer of the leased equipment to MCCI would be excluded or exempt from tax. Additionally, while petitioner contends that the transferred casino equipment had little or no value, petitioner offered no evidence of the fair market value of such equipment. The Division's use of petitioner's book value in its assessment was therefore proper. As to the assets classified as "land improvements," petitioner appears to contend that such assets were capital improvements to the property and therefore not tangible personal property subject to sales tax. Petitioner, however, failed to introduce any evidence in support of this contention.

G. The petitions of Freeport Casino Cruises, LLC, and D.L.T., Inc., are denied and the notices of determination dated May 14, 2007 and June 4, 2007 are sustained.

DATED: Troy, New York
August 27, 2009

/s/ Timothy Alston
ADMINISTRATIVE LAW JUDGE