

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petitions	:	
of	:	
KROLL BOND RATING AGENCY, INC.	:	DECISION
	:	DTA NOS. 826900
	:	AND 827411
for a Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period December 1, 2010 through September 12, 2013.	:	

Petitioner, Kroll Bond Rating Agency, Inc., filed an exception to the Administrative Law Judge's determination issued on October 5, 2017. Petitioner appeared by McDermott Will & Emery LLP (Peter L. Faber, Esq., Alysse McLoughlin, Esq., and Kathleen Quinn, Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (M. Greg Jones, Esq., of counsel).

Petitioner filed a brief in support of its exception. The Division of Taxation filed a brief in opposition. Petitioner filed a reply brief. Oral argument was heard in New York, New York, on March 29, 2018, which date began the six-month period for issuance of this decision.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUE

Whether petitioner has demonstrated that it is entitled to a refund of sales tax paid on its securities rating services.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for findings of fact 4, 5, 7, 8, 9, 12, 13, 14, and 15, which have been modified to clarify and to more accurately

reflect the record. We have also made an additional finding of fact, numbered 16 herein. The Administrative Law Judge's findings of fact, the modified findings of fact and the additional finding of fact are set forth below.

1. Petitioner, Kroll Bond Rating Agency, Inc., is a securities rating agency that was founded in 2010 by Jules Kroll. Petitioner sought to create greater transparency for investors and to provide them with better information than did the other securities rating agencies.

2. On August 23, 2010, petitioner received its Nationally Recognized Statistical Rating Organization (NRSRO) license, which permitted it to provide securities rating services in the United States.

3. When petitioner was entering the business, it was competing against large competitors that, between them, controlled most of the securities rating industry. Petitioner's principal competitors were Moody's, S&P and Fitch. In 2011, Moody's and S&P each had approximately \$2.5 billion of revenue and Fitch had approximately \$900 million of revenue. Petitioner's revenue in 2011 was \$2.5 million.

4. Petitioner's primary objective upon entering the business was to make investors aware of its rating services so that issuers would hire it to produce a rating. Petitioner's fee for securities rating services was between an eighth and a quarter of the fee that other agencies charged. During the period at issue, petitioner negotiated its fees for securities rating services with each customer. Petitioner did not utilize a formula to set its fees. Each negotiated fee was memorialized in an engagement agreement before petitioner began its work for the customer. The engagement agreements include the details of each underlying transaction to be reviewed by Kroll, such as the number of properties and loans to be reviewed, the aggregate face amount of

the rated securities, the organizational structure of the issuing entity, and the type of offering. They include a particularized description of the services Kroll was to provide, including the issuance of a ratings letter that would be issued after it completed its analysis. The delivery of the ratings letter to the customer was subject to the satisfactory completion of all aspects of Kroll's rating process, which required the cooperation of the client. The rating process included phases, each comprised of underlying activities. The timing of the completion of each phase and the fee for each phase was included in the engagement agreement. The agreement included such other usual and customary contractual terms, and the provision for reimbursement of legal fees and surveillance fees, if necessary. The engagement agreements did not include any language regarding sales tax. Petitioner issued invoices for its services after its work was completed. The fee amount in the invoice nearly always matched the fee amount in the corresponding engagement agreement (the only exceptions being a few situations where the price for services was renegotiated or there was a mistake).

5. During the period at issue, petitioner was unsure whether the service that it provided was subject to New York sales tax. Although petitioner understood that the industry practice was not to collect sales tax, it was uncertain as to whether that practice was correct. In July, 2011, when petitioner's Chief Financial and Administrative Officer, Ajay Junnarkar, was preparing one of Kroll's first invoices for a fully published rating, he included 8.875% sales tax on the invoice and emailed it to the customer, Merrill Lynch. The fee on the invoice was \$100,000.00 and the sales tax amount was \$8,875.00. The engagement agreement for that invoice had provided that ratings fees will be \$100,000.00. In less than two hours after emailing the invoice, the Mr. Junnarkar received an email from Merrill Lynch in which the company's representative questioned the inclusion of sales tax on the rating bill. Petitioner's principals (Mr.

Nadler and Mr. Junnarkar) decided to remove the tax from that invoice and did not try to collect sales tax again from any clients.

6. In 2011, petitioner consulted with its principal outside tax advisor, Daniel Zeman at BDO, regarding whether petitioner's securities rating services were taxable. Mr. Zeman testified that he and his state and local tax colleagues determined that the New York tax law was unclear regarding the taxability of securities rating services; thus, he advised petitioner to request an advisory opinion from the Division. A petition for an advisory opinion was filed on or about March 8, 2012.

7. In October 2011, petitioner began including the statement "includes any applicable sales taxes" on its invoices for securities rating services, surveillance fees and certain legal fees while waiting to receive an answer to its request for an advisory opinion from the Division. Mr. Zeman acknowledged in his testimony that he did not know the technical law, but he would interpret the inclusion of this type of statement on an invoice to indicate that sales tax would be calculated on the entire invoice amount. This statement regarding sales tax was not included on an invoice issued to a municipality or an entity that was tax exempt.

8. Petitioner did not remit sales tax on reimbursement amounts, such as fees for legal services that petitioner believed were non-taxable. As to the fees that were considered taxable, petitioner backed into the amount of sales tax that was remitted for each invoice by adjusting its fee so that the total of the fee plus 8.875%, equaled the amount of the deemed taxable fee in the engagement agreement and invoice. In essence, petitioner reported taxable sales that were reduced by the amount of the sales tax remitted.

9. The advisory opinion, TSB-A-13(27)S, was issued on September 9, 2013, over 18 months after it was requested by petitioner. The conclusion reached by the Division was that petitioner's credit rating service was not taxable under Tax Law § 1105 (c) (1), but, rather, taxable under Tax Law § 1212-A (a) (3). As such, petitioner's credit rating services are subject to New York City sales tax, if the service is delivered in New York City. At the time the advisory opinion was issued, industry groups expressed concern because the Division had historically taken the position that bond rating services were not subject to State or City sales taxes. A working group of industry members hired an outside counsel to negotiate with the Division over what they perceived to be a change in the Division's position as to whether sales tax must be collected on securities rating fees. In discussions with the groups, the Division maintained that the services were subject to New York City sales tax but acknowledged that this was a change in its position and that the agencies would need time to put systems in place to begin collecting the tax. A Technical Service Bulletin issued by the Division provided a safe harbor period for vendors until September 1, 2015, if no sales tax had been collected previously.

10. On December 20, 2013, petitioner submitted a refund claim for the period December 1, 2010 through August 31, 2013, claiming a refund of the New York State portion of sales tax that it paid on sales of securities rating services during this period. The claimed refund was in the amount of \$1,355,525.00. By letter dated April 25, 2014, the Division denied this claim in full. The denial letter stated, in pertinent part, that:

“A review of our records, along with the books and records you have provided, indicate that the taxable sales reported on your returns have been reduced by the tax due. This indicates that sales tax was collected from your customer and remitted to the department. No documentation was received to indicate that this tax was repaid to the customer.”

11. Petitioner filed a request for a conciliation conference with the Bureau of Conciliation and Mediation Services (BCMS) to protest the refund denial letter. On January 23, 2015, a conciliation order, CMS No. 262580, was issued sustaining the denial of the refund.

12. Petitioner filed a timely petition (DTA No. 826900) on April 13, 2015, in protest of the conciliation order.

13. On March 30, 2015, petitioner filed a second claim for refund with the Division in the amount of \$944,432.00. This refund claim sought the local portion of sales tax paid by petitioner on sales of securities rating services during the period March 1, 2012 through September 12, 2013. By letter dated September 9, 2015, the Division denied the second claim for refund in full for the same reason as set forth in finding of fact 10.

14. On December 31, 2015, petitioner filed a petition (DTA No. 827411) in protest of the denial of its second refund claim.

15. On April 5, 2016, petitioner requested permission to amend its first filed petition (DTA No. 826900) to reflect the entire amount of sales tax that it had remitted for the period December 1, 2010 through August 31, 2013. The proposed amendment increased the refund amount from \$1,355,525.00 to \$2,317,727.00. The proposed amendment did not seek to add the short period of September 1, 2013 to September 12, 2013 that is included in the second refund claim.

16. On April 18, 2016, the Division filed a letter brief in opposition to petitioner's request to amend its petition. In its letter brief, the Division included a purported motion for summary determination of the second petition (DTA No. 827411) based upon the filing date of that petition. On April 27, 2016, petitioner filed a reply letter brief. Also, on April 27, 2016, the

Administrative Law Judge issued a letter ruling in which he granted the request to amend the petition and denied the motion for summary determination, finding that it did not constitute a proper motion in accordance with the Tax Appeals Tribunal's Rules of Practice and Procedure (Rules) section 20 NYCRR 3000.5 (c).

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge determined that the second filed petition (DTA No. 827411) would be deemed timely filed since the Division failed to prove proper mailing of the September 9, 2015 refund denial letter. She made no specific finding regarding the amendment to the original petition (DTA No. 826900). She noted that Tax Law § 1139 (a) requires that sales tax collected must be repaid to a customer before the Division may approve a refund. She determined that petitioner bears the burden of proof to show that it is entitled to the refund requested and that, based upon the invoices, engagement agreements and taxable sales reported on its sales tax returns, petitioner had not demonstrated that the sales tax was not collected from its customers.

The Administrative Law Judge considered petitioner's argument that it had paid the sales tax out of its own funds, but she concluded that if petitioner had, in fact, paid the sales tax on behalf of its customers, the sales tax rate would have been applied to the total amount set forth on each invoice. Instead, the Administrative Law Judge found that sales tax was not paid on the total amount of the invoice; rather petitioner subtracted the sales tax due from the invoice amount. The Administrative Law Judge determined that this method of breaking out the sales tax from the total amount received from its customers demonstrates that a portion of the amount collected from each customer represented sales tax.

The Administrative Law Judge also found that the statement “includes any applicable sales taxes” that was printed on petitioner’s invoices indicates that the entire invoice amount is subject to sales tax. Since petitioner did not remit sales tax on the entire amount charged on the invoice, she concluded that petitioner collected the sales tax from its customers and the claims for refund must be denied.

The Administrative Law Judge addressed petitioner’s claim of the untimely issuance of the advisory opinion and the claim of unjust enrichment. She noted that the Division of Tax Appeals has quasi-judicial authority to resolve tax controversies between the Division and taxpayers but determined that it does not have jurisdiction to consider petitioner’s claim of the untimely issuance of an advisory opinion. The Administrative Law Judge rejected petitioner’s claim of unjust enrichment, having already determined that petitioner’s customers paid the sales tax and petitioner failed to repay them.

ARGUMENTS ON EXCEPTION

On exception, petitioner argues that the Administrative Law Judge ignored the testimony and evidence that established that petitioner had paid the sales tax remitted to the Division out of its own funds and did not collect the sales tax from its clients. Petitioner argues that its clients, sophisticated banking and investment institutions, were not paying sales tax on securities rating services provided by other firms and that one of them objected to paying sales tax the first and only time petitioner tried to collect it.

Petitioner contends that its fees were individually negotiated with each client and that each fee was memorialized in an engagement agreement before petitioner began work for the client. Petitioner asserts that the fees in its invoices nearly always (with a small number of

exceptions for error or renegotiation) matched the fee in the engagement agreement relating to that invoice. There was no additional amount included for sales tax and the sales tax jurisdiction of the customer was not a consideration in petitioner's negotiation of the individual fee.

Petitioner argues that the Administrative Law Judge's conclusion that petitioner collected sales tax based upon the method used to compute the sales tax remitted makes no sense. It contends that only the fees for its services that were negotiated were included on invoices, not the sum of fees for services and sales tax, and it argues that whether petitioner paid the correct amount of tax is not an issue.

Further, petitioner asserts that the statement "includes any applicable sales taxes" on its invoices was only intended to assure its clients that no additional amounts would be charged later for sales tax. It contends that the Division's own regulations recognize that such a statement does not mean that the sales tax is included in the price and the Administrative Law Judge incorrectly concluded that such a statement indicated that sales tax was collected. Petitioner states that it tried in good faith to properly determine whether it was required to collect sales tax and that it should not be penalized for "doing the right thing." It argues that the Administrative Law Judge failed to properly consider petitioner's unjust enrichment argument when the Division itself has determined that no state sales tax was owed and when most of the sales tax was remitted after the date by which the Division was legally required to issue its advisory opinion.

Finally, petitioner asserts that only one refund claim is at issue; that is the claim associated with the amended petition, which is for the same period as the original petition but increases the amount of the refund to \$2,317,727.00. Petitioner contends that the amended

petition includes all the tax paid by petitioner during the period at issue and that it is irrelevant which portion of the combined tax is attributable to New York City tax.

The Division first argues that a presumption of correctness attaches to refund denials and that petitioner has not met its burden of proof to establish that the refund denials were erroneous or otherwise improper. The Division next argues that petitioner has not met its burden of proof to establish entitlement to the refund claims because it has failed to refund the sales tax collected and made errors in the calculation of tax remitted. The Division contends that petitioner's invoices and method of collection demonstrate that sales tax was, in fact, collected from its customers. It asserts that when sales tax is not separately stated on an invoice, the entire amount charged is subject to tax. It further asserts that petitioner calculated the amount of its receipts that represented sales tax, reduced its reported gross sales by that amount, and then remitted the difference as sales tax. Accordingly, the Division contends that the Administrative Law Judge correctly determined that petitioner's method of calculating its taxable sales and the amount of sales tax remitted indicates that petitioner collected sales tax from its customers.

The Division also asserts that petitioner is not entitled to its first refund claim because it made errors in the calculation of the refund amount for state sales tax. It contends that petitioner failed to prove the extent of its local sales and it failed to calculate tax on the entirety of its receipts. It, therefore, overstated the refund for state sales tax by understating the local sales tax due. The Division argues that petitioner is not entitled to its second refund claim because neither the Division's advisory opinion nor the technical memorandum issued by the Division after the issuance of the advisory opinion obviated petitioner's prior responsibility for collecting and remitting the local sales tax.

Additionally, the Division argues that the amended petition is substantively defective because the claimed amount of \$2,317,727.00 includes local sales tax and petitioner's services were properly subject to the New York City sales tax. The Division asserts that the amended petition is procedurally defective because the amount claimed exceeds the amount of the first refund claim denial and, thus, the Tribunal lacks subject matter jurisdiction over the amended petition. It also asserts that no subject matter jurisdiction exists where no refund claim was ever filed for the amount of \$17,770.00, which is the difference between the amount in the amended petition and the combined amount of the first and second refund claims.

Lastly, the Division asserts that the late issuance of the advisory opinion does not result in unjust enrichment.

OPINION

We begin with the procedural issue regarding whether the amendment of the petition in the matter of DTA No. 826900, filed in protest of the first refund denial notice is procedurally or substantively defective.¹ The amendment was accepted by the Administrative Law Judge in the letter ruling, dated April 27, 2016. The Judge advised that there would be an opportunity to argue the issue at, and after, the hearing, but the issue was not addressed in the determination.

Even though there is no exception addressing this issue, it is appropriate to review the facts and circumstances surrounding the amendment since they call into question the subject matter jurisdiction of the Tribunal. Subject matter jurisdiction may be raised at any point in a

¹ Although petitioner filed two refund claims and two petitions for different amounts and covering different time periods, it contends that the second refund claim is not relevant to the request to amend its first petition, which it argues is the only petition that is relevant to this proceeding. The Division asserts that the proposed amendment is an attempt to get around the fact that the second petition was untimely. Since the second petition is timely, the merits of both refund claims are at issue. Consequently, given the overlap in period for the two refund claims, by its amended petition, petitioner would have us also consider whether it is entitled to a refund of the local portion of sales tax on its services as remitted for the period December 1, 2010 through February 29, 2012.

proceeding (*see Matter of Scharff*, Tax Appeals Tribunal, October 4, 1990, *revd on other grounds sub nom Matter of New York State Dept. of Taxation & Fin. v Tax Appeals Trib.*, 151 Misc 2d 326 [1991]). In *Scharff*, the court held that the Tribunal had to give notice to the parties before dismissing the petition. In this case, petitioner was provided with notice and had an opportunity to respond to the Division's arguments regarding lack of subject matter jurisdiction.

The Rules prescribe the requirements for amended pleadings as follows:

“Either party may amend a pleading once without leave at any time before the period for responding to it expires, or within 20 days after service of a pleading responding to it. After such time, a pleading may be amended only by written consent of the adverse party or by the consent of the supervising administrative law judge or the administrative law judge or presiding officer assigned to the matter....No amendment shall be allowed under this subdivision after the expiration of the time for filing the petition, if such amendment would have the effect of conferring jurisdiction on the division of tax appeals over a matter which otherwise would not come within its jurisdiction under the petition as then on file” (20 NYCRR 3000.4 [d] [1]).

The intent of the Rules is to afford the public due process of law and the legal tools necessary to facilitate the rapid resolution of controversies, while at the same time avoiding undue formality and complexity (20 NYCRR 3000.0 [a]). Leave to amend pleadings shall be freely given upon such terms as may be just (20 NYCRR 3000.4 [d] [1]).

Proceedings in the Division of Tax Appeals are commenced by the filing of a petition protesting any written notice of the Division of Taxation that has advised the petitioner of a tax deficiency, a determination of tax due or a denial of a refund or credit application (Tax Law § 2008 [1]). To claim a refund or credit for any tax, a person must file an application for such refund or credit with the Division (Tax Law § 1139 [a]; 20 NYCRR 534.2 [a]). The Division, on behalf of the Department of Taxation and Finance, will review, and either grant, adjust or deny

the application for credit or refund and issue a determination to the taxpayer (20 NYCRR 534.2 [d] [1]). The determination is final and irrevocable unless the applicant, within 90 days after the date of mailing the notice of determination, applies to BCMS for a conciliation conference or to the Division of Tax Appeals for a hearing to review the determination (Tax Law § 1139 [b]; 20 NYCRR 534.2 [d] [3]). Such a claim for credit or refund of an overpayment of sales tax must be filed within three years from the time the return was filed or two years from the time the tax was paid, whichever is later (Tax Law § 1139 [c]).

As discussed above, after receiving the Division's advisory opinion, dated September 9, 2013, petitioner here filed an administrative claim for refund for only a portion of the total sales tax remitted during the period under review in DTA No. 826900. That original refund claim in the amount of \$1,355,525.00 was filed on December 20, 2013. After review, the Division denied the claim by the issuance of the refund claim denial notice, dated April 25, 2014. Petitioner filed a timely request for a conciliation conference in BCMS. BCMS issued a conciliation order, dated January 23, 2015, which sustained the denial of the refund. Thereafter, petitioner filed a timely petition on April 13, 2015. Petitioner sought to amend that petition to increase the amount of the refund claimed to \$2,317,727.00, without filing a refund claim with the Division for the increased tax amount.

The issue here is whether a petition in the Division of Tax Appeals filed in protest of a refund claim denial by the Division may be amended to increase the amount of the refund after the final determination had been made by the Division; after the deadline to file a petition had expired; and well after the expiration of the limitation period to file a refund claim.² Petitioner

². An amended sales tax return summary in the record shows that eleven ST-100 sales tax returns were filed between December 1, 2010 and August 31, 2013. All of those returns except for the last two were for periods more than three years before the date of the proposed amendment.

claims that the amendment was proper and did not confer jurisdiction on the Division of Tax Appeals over a matter that otherwise would not come within its jurisdiction under the petition as then on file. It bases that assertion on the fact that the additional sales tax refund claimed was remitted at the same time as the sales tax that is the subject of the original petition. Petitioner asserts that the sales tax is for the same transactions during the same tax period under review as in the original petition. It argues that the amendment properly reflects the entire amount of sales tax that petitioner remitted during the period at issue. Petitioner claims, therefore, that there is no prejudice to the Division and that it should have easily been able to discern the correct amount that should have been claimed. For the following reasons we cannot agree.

The Division of Tax Appeals is a forum of limited jurisdiction (Tax Law § 2008; *Matter of Scharff*). Its power to adjudicate disputes is exclusively statutory (*id.*). Tax Law § 1139 (a) and its implementing regulations require a person to file an application with the Division to receive a tax refund or credit (*see* 20 NYCRR 534.2 [a]). It is the written denial of a refund or credit application issued by the Division that is the critical document, which, if challenged within 90 days from issuance, provides the jurisdiction for review by the Division of Tax Appeals (*see Matter of Shnozz's, Inc.*, Tax Appeals Tribunal, February 22, 1991; Tax Law §§ 2008 [1]; 1139 [b]). Tax Appeals' subject matter jurisdiction extends only to the tax included in the Division's refund denial notice and there is no provision in the statute or regulations for increasing the tax amount of the refund denial notice. In effect, the amendment to the petition seeks to amend the refund claim. The fact that the transactions giving rise to the additional sales tax are the same as those in the original petition is not dispositive. The requested amendment would impermissibly expand the scope of the underlying petition to include a refund amount in

excess of the amount of the refund claim and refund denial letter well after the final action was taken on that refund application and well after the statute of limitations to file a refund claim had expired. Indeed, approval of the amendment would render the filing requirements and the statute of limitations for refund claims superfluous.

In support of the proposed amendment in the proceeding below, petitioner cited to two federal court cases for their persuasive rationale contending they would be instructive in deciding whether the amendment should be approved (*Mutual Assurance, Inc. v United States*, 56 F3d 1353 [11th Cir 1995] and *Red River Lumber Co. v United States*, 139 F Supp 148 [Ct Cl 1956]). These cases are distinguishable from the instant proceeding in that they pertain to administrative refund claims; here, we are addressing an amendment to a petition to review the denial of a refund claim. As such, those cases are not pertinent here.

The Division of Tax Appeals' general policy of applying procedural rules flexibly so as to reach a just result does not permit us to entertain matters outside of our jurisdiction. Based on the facts and legal issues presented, we find that the additional tax amount in petitioner's proposed amendment would have the effect of conferring jurisdiction on the Division of Tax Appeals over a matter that otherwise would not come within its jurisdiction under the petition as then on file. As such, the request to amend the petition should have been denied (20 NYCRR 3000.4 [d] [1]).

In light of the finding that the amendment was improper, we will review and consider the original amount claimed in the first filed petition in DTA No. 826900. In addition, given that the second petition in DTA No. 827411 has been deemed timely filed by the Administrative Law Judge and has not been challenged on exception, and given that the material facts and issues are

the same in both proceedings, we will consider the arguments made by both parties and render a decision with respect to the petitions in both DTA Nos. 826900 and 827411.

As to the merits of the proceedings, a presumption of correctness attaches to a properly issued statutory notice issued by the Division and petitioner bears the burden to prove by clear and convincing evidence that the denial of the sales tax refund claim was erroneous (20 NYCRR 3000.15 [d] [5]; *see Matter of Aum Sidhdhy Vinayak, LLC*, Tax Appeals Tribunal, December 8, 2011; *Matter of Land Trans. Corp.*, Tax Appeals Tribunal, June 29, 2000). In so doing, petitioner must demonstrate that it is entitled to the refund claimed (*see Matter of Gallagher*, Tax Appeals Tribunal, October 23, 2003).

Tax Law § 1139 (a) requires the Division to refund or credit any tax erroneously, illegally or unconstitutionally collected or paid upon a timely filed application. Such a refund is not automatic, however. Tax Law § 1139 (a) conditions such refunds as follows:

“No refund or credit shall be made to any person of tax which he collected from a customer until he shall first establish to the satisfaction of the tax commission, under such regulations as it may prescribe, that he has repaid such tax to the customer.”

The Division’s regulations at 20 NYCRR 534.8 (a) (2) further provide:

“(2) Any person who has erroneously, illegally or unconstitutionally collected a tax from a customer may, repay such tax to the customer and in turn claim a refund or credit of such tax from the Department of Taxation and Finance, provided the tax has been paid to the Department of Taxation and Finance.

(3) No refund or credit may be made to any person of tax which he collected from a customer until he shall first establish to the satisfaction of the Department of Taxation and Finance, as provided in section 534.2 of this Part [20 NYCRR 534.2], that he has in fact repaid such tax to the customer.”

The Division's regulations set forth the documentation and proof of payment required to establish that such a refund has been made (*see* 20 NYCRR 534.2). Neither the Tax Law nor its implementing regulations set forth specific requirements to demonstrate whether sales tax has been collected from a customer.

We have previously concluded that the requirements of Tax Law § 1139 (a) are clear and unequivocal: taxes collected must be repaid before a refund may be issued (*see Matter of New Cingular Wireless PCS LLC*, Tax Appeals Tribunal, February 16, 2016, *mod on other grounds Matter of New Cingular Wireless PCS LLC v Tax Appeals Trib. of the State of N.Y.*, 153 AD3d 976 [3rd Dept 2017] [Petitioner erroneously billed, collected and remitted New York sales tax on its sales of internet access services. The issue centered on the form and timing of the repayment of the sales taxes to New Cingular's customers]).

In this proceeding, there is no dispute that petitioner remitted the sales tax that is the basis of its two refund claims. Petitioner contends that it is not required to pay sales tax to its customers because it did not charge sales tax or collect sales tax from them. Rather, petitioner argues that it paid the sales tax out of its own funds while waiting for an advisory opinion to be issued by the Division on the issue of whether sales tax was due at all. Petitioner filed its petition for an advisory opinion on or about March 8, 2012, after consulting with its outside tax advisor, who concluded that clarification was needed to determine if its services were subject to sales tax.

In the advisory opinion issued on September 9, 2013, some 18 months after the petition was filed, the Division determined that petitioner's services constitute a credit rating service because they consist of evaluating a client's financial information and providing a rating on the client's financial products. The conclusion reached by the Division, therefore, was that

petitioner's services are not subject to state sales tax under Tax Law § 1105 (c) (1), because petitioner does not furnish information to its client and, therefore, is not providing an information service that would be taxable under that section of law. The Division also determined, however, that Tax Law § 1212-A (a) (3) authorizes New York City to impose a local sales tax on credit rating and credit reporting services (except to the extent otherwise taxable under Article 28 of the Tax Law). It further determined that Administrative Code of City of NY § 11-2040, in fact, imposes tax on those services. Thus, although petitioner's service is not an information service subject to tax pursuant to § 1105 (c) of the Tax Law, the Division concluded that its credit rating service is subject to tax under Tax Law § 1212-A (a) (3). The Division outlined the method to be used in determining the delivery location of credit rating services for purposes of the New York City sales tax in Technical Memorandum TSB-M-15(4)S, issued on July 24, 2015.

The Division asserts that sales tax was collected by petitioner from its customers and that its refund claim denials are proper because petitioner did not repay the collected sales tax as required by Tax Law § 1139 (a) and, therefore, petitioner did not demonstrate entitlement to the claimed refunds. The Division bases its position on the fact that petitioner's reported taxable sales were reduced by the tax due. The Division determined, and the Administrative Law Judge concluded, that such method of reporting sales tax indicated that petitioner's customers paid the sales tax. The Division also asserts, and the Administrative Law Judge agreed, that the statement printed on petitioner's invoices "includes any applicable sales taxes" supports the determination that sales tax was collected.

The Tribunal addressed the issue of what a taxpayer must prove to establish that it bore the cost of an excise tax in *Matter of Merit Oil Corp.*, Tax Appeals Tribunal, March 10, 1994. Like the sales tax, excise tax imposed under Tax Law § 284 (1) is borne by the purchaser, although there is no requirement that excise tax be separately stated (*see* Tax Law § 289-c [1]). In *Merit Oil*, the Tribunal concluded that a gasoline retailer was entitled to a refund of New York City gasoline tax paid in error because the taxpayer did not include the tax in the sales price. In making its determination, the Tribunal looked to federal law for guidance as to how a petitioner may prove that it bore the cost of an excise tax under Internal Revenue Code (IRC) (26 USC) § 6416, which provides, in relevant part, that:

“(a) Condition to Allowance.

(1) General Rule. No credit or refund of any overpayment of tax imposed by chapter 31 (relating to retail excise taxes), or chapter 32 (manufacturers taxes) shall be allowed or made unless the person who paid the tax establishes, under regulations prescribed by the Secretary, that he –

(A) has not included the tax in the price of the article with respect to which it was imposed and has not collected the amount of the tax from the person who purchased such article.”

The Tribunal relied upon a number of factors in reaching its decision in *Merit Oil*. First, among the factors relevant in this proceeding, the Tribunal noted that the taxpayer set its price on the basis of the prices of its competitors. Here, petitioner claims that it based its fees on the fees set by its competitors. While there is no evidence of competitors’ actual fees for credit rating services, petitioner has convincingly demonstrated that it was a new entrant into the securities rating business and that it was competing with some very large, established firms (*see* finding of fact 3). As such, petitioner contends that it was constrained to set its fees for services at a fraction of its competitors’ prices, charging between one eighth and one quarter of the fees

charged by its competitors so that issuers would hire it to produce a rating (*see* finding of fact 4).

Petitioner's president, James Nadler, testified as follows:

“Q. How do you know what the other agencies were charging? You said that you were charging fees much less than those of Fitch, and S&P, how do you know that your fees were lower?”

A. I used to work at Fitch; I ran a structured finance at Fitch [sic], and many of the people that used to work for me work at all of the firms now. And they were – so I had people that I could call who had direct knowledge that would describe to me what typical fee arrangements were for each of the rating agencies (hearing tr, p 54, lines 4 to 16).”

Where, as here, prices are set competitively, it is essential to demonstrate that the competitors' prices did not include sales tax (*see Matter of Merit Oil Corp.; Tenneco, Inc. v United States*, 17 Cl Ct 345 [1989], *affd* 899 F2d 1227 [1990]). Petitioner produced un rebutted testimony that its customers received ratings from multiple agencies on the same securities issuance and it may reasonably be inferred from the record that petitioner's competitors were not charging or collecting sales tax (*see* findings of fact 5 and 9).

While petitioner's executives believed that industry practice was not to collect sales tax, they testified that they were unsure if that practice was correct and took the conservative approach by remitting the sales tax to avoid a potentially damaging sales tax audit and claim by the Division. Petitioner did not want to damage its reputation as it was just breaking into the securities rating business and was still reliant on outside investors for funding its operations. Mr. Nadler further testified:

“Q. After this one client that told you that not only it would not pay sales tax but it understood that other agencies were not charging sales tax, did Kroll make any decision on sales taxes based on that?”

A. I think that we wanted – we sought to get clarification, but we were a new entity and my thought process, along with Ajay’s, what we discussed was that, “Look, let’s be conservative, I don’t want to – in addition to all the other obstacles that we face in starting a new business, I also don’t want to have a tax problem. So let’s be conservative, let’s pay it, and if we get guidance that we don’t need to pay it, certainly we will just get it back in a refund.”

Q. In other words, the decision was you would not charge –

A. We couldn’t charge issuers. It was clear we couldn’t charge issuers.

Q. And you would pay it out of your funds?

A. We would pay it out of our funds because we weren’t clear on the matter. We thought if we could get clarification as we grew, we would be able to adjust. But I didn’t see a downside. I saw a tremendous downside in not paying it . . . “
(hearing tr p 55 line 8 – p 56 line 12).

The executives believed they would be able to have the sales tax refunded to them in the event the Division determined that petitioner’s services are not subject to sales tax.

The existence of negotiated contracts that do not include sales tax is another factor to be considered in determining whether such tax was included in the sales price (*see Matter of Merit Oil Corp.; Tenneco, Inc. v United States*). Testimony and evidence produced in the proceeding below establish that petitioner’s fees were separately negotiated with each customer and memorialized in engagement agreements signed by petitioner and the customer before services were provided (*see* finding of fact 4). Petitioner produced 168 engagement agreements and corresponding invoices (all engagement agreements and invoices issued during the period at issue). Absent from the language of the engagement agreements is any mention of sales tax (*see* finding of fact 4).

Although petitioner’s invoices did not include a separately stated amount for sales tax, after its experience with Merrill Lynch the first time it tried to collect sales tax, petitioner began inserting the statement “includes any applicable sales taxes” to assure its clients that its price

was final and that it would not seek additional amounts for sales tax later. Petitioner asserts that it was not representing to customers that the price on the invoice included sales tax. This statement was included on invoices, regardless of whether the customer was in a taxing jurisdiction.

Tax Law § 1132 (a) (1) requires that sales tax shall be separately stated on any invoice or sales slip given to a customer. Division regulations provide that the words “tax included,” or words of similar import, on any invoice, sales slip or other document do not constitute a separate statement of tax and the entire amount charged on an invoice or sales slip is deemed the sales price of the property sold or services rendered (20 NYCRR 532.1 [b] [3]). We find that such statement on petitioner’s invoices had no bearing on the questions of who actually paid the tax remitted by petitioner and whether petitioner is entitled to the refunds of erroneously paid tax (*see Matter of Waxlife, U.S.A. v State Tax Commn.*, 67 AD2d 1040 [3rd Dept 1979]).

Courts have long recognized that “determining whether a particular business cost has in fact been passed on to customers or suppliers entails a highly sophisticated theoretical and factual inquiry . . .” (*see McKesson Corp. v Division of Alcoholic Beverages and Tobacco*, 496 US 18 [1990]). An examination of the federal cases on the subject shows that no single criterion is controlling. “All of the factors . . . must be weighed against the circumstances of the case to reach a proper determination” (*Anderson Co. v United States*, 24 AFTR2d 69-6145 [DC Ind 1969], *affd* 447 F2d 41 [7th Cir 1971]).

Petitioner’s method of reporting its gross sales and remitting sales tax merely created an inference that sales tax was included in the invoice amount and is not conclusive evidence of that fact. As noted, petitioner has established that it used competitive market pricing to set its fees

and that the fees of its competitors did not include sales tax. Petitioner has also established that, as a new entrant into the securities ratings business, it was constrained to keep its prices as low as possible to obtain business and its fees were not set at a level to make a profit. In fact, Mr. Nadler testified that as of the date of the hearing, petitioner had not sustained a profit in any year since it began operations in 2010. These facts establish that petitioner could not have included the cost of the tax in its ratings fees. Petitioner produced all of its engagement agreements for the period under review, none of which include any mention of sales tax. Although the associated invoices included the statement “includes any applicable sales taxes,” they did not include a separate statement of tax and we credit petitioner’s testimony that the meaning of that statement is that petitioner would absorb the cost of sales tax if later determined to be applicable. We also note that petitioner included that statement on invoices even if a customer was located in a non-taxing jurisdiction.

Based on the facts before the Tribunal, we find that petitioner has met its burden of producing clear and convincing evidence that it did not include sales tax in its fees for service and, thus, did not shift the burden of the tax to its customers. As such, it has overcome the presumption of correctness of the Division’s refund denials and is entitled to the refunds as claimed in its refund applications without having to first make payment to its customers.

Finally, in its advisory opinion, the Division determined that, although petitioner’s service is not subject to tax under Tax Law § 1105 (c), it is subject to tax under Tax Law § 1212-A (a) (3). In the follow-up Technical Service Bulletin, the Division concluded that:

“[C]redit rating agencies that have not previously been put on notice by the Department to begin collecting tax on these services will not be penalized for under collecting tax or using a different method of sourcing prior to September 1, 2015. However, any sales tax that has been collected and any monies collected purportedly as tax must be remitted to the Department.”

Since petitioner paid, but did not collect, sales tax, it is entitled to the refunds claimed for the sales tax paid and became responsible for collecting the New York City sales tax as of September 1, 2015.

Given the decision in favor of petitioner, we have chosen not to address the issue of unjust enrichment.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Kroll Bond Rating Agency, Inc. is granted;
2. The determination of the Administrative Law Judge is reversed;
3. The petitions of Kroll Bond Rating Agency, Inc. are granted; and
4. Petitioner's claims for refund of sales tax it paid on sales of securities rating services

during the period at issue (*see* findings of fact 10 and 13) are granted and the Division of Taxation is directed to refund such claimed amounts plus such interest as may be lawfully due.

DATED: Albany, New York
October 1, 2018

/s/ Roberta Moseley Nero
Roberta Moseley Nero
President

/s/ Dierdre K. Scozzafava
Dierdre K. Scozzafava
Commissioner

/s/ Anthony Giardina
Anthony Giardina
Commissioner