

NY Tribunal Ruling Instructive On Sales Taxation Of Artwork

By **Joseph Endres and Joshua Lawrence** (April 6, 2022)

In a Feb. 28 decision with significant implications for the sales taxation of artwork, the New York Tax Appeals Tribunal ruled in *Matter of the Petition of Objet LLC* that a one-half share in a painting was validly acquired for resale, resulting in a six-figure sales tax refund for the painting's co-owner.

Tribunal decisions on sales tax are significant in their own right, since they are somewhat rare and — unlike administrative law judge rulings — they become binding precedent. But the *Objet* ruling should have particular relevance to the art industry.

The decision tackles two issues that factor prominently in the high-stakes sales and related tax structuring that occur in the industry: the form-over-substance nature of sales tax and the proper analysis for determining when property is purchased exclusively for resale.

The artwork at issue in *Objet* was a painting by Pablo Picasso worth \$7.2 million. The painting was acquired by two parties who purchased the painting as tenants in common, each paying \$3.6 million for its one-half share.

One share was purchased by an individual — New York real estate mogul Richard LeFrak. The other share was purchased by a limited liability company held by trusts that benefit each of the individuals two sons, Harrison T. LeFrak and Jamie T. LeFrak, and their families.

The gallery invoiced both parties for \$3.6 million and collected sales tax of \$319,500 from each party. On the same day as the purchase, the trusts' limited liability company became registered as a vendor for sales tax purposes. Also on that day, the company entered into an agreement to lease its one-half share to the father — thus giving the father full possession of the painting in his home in New York City.

Under the lease, the father paid an annual lease payment to the company, which was calculated as a percentage — 1.09% — of the fair market value of the company's share of the painting. The lease term was one-year, but the lease allowed for renewals and was in fact extended for two additional terms.

The company never issued a resale certificate to the gallery at the time of the sale, but less than a year after the purchase, it filed a refund claim with the New York State Department of Taxation and Finance claiming that the company purchased its one-half share exclusively for resale and thus should not have paid tax.

On its refund claim, the company noted: "The taxpayer is a collector of artwork. On occasion, the taxpayer leases pieces of artwork."

The department denied the refund, stating in its denial notice that the lease transaction had "been determined not to be a sale for sales tax purposes." Therefore, the department argued during the litigation, the painting could not have been purchased exclusively for



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resale.

Significantly, the administrative law judge at the Division of Tax Appeals who heard the case prior to the tribunal rejected the department's attempt to look through and disregard the validity of the lease as a bona fide sale. The judge upheld the refund denial nonetheless, concluding that the company failed to show it made the purchase exclusively for resale purposes.

Rather, the judge concluded that the company — a self-proclaimed collector of artwork — effectively had two purposes for acquiring the artwork: leasing temporarily and eventually collecting, and therefore could not meet its burden of proving the intent at the time of sale was solely to lease the painting.

Among the facts the judge found relevant other than the "collector" designation were the fact the company had never before engaged in leasing artwork, and that the lease only conferred temporary possession to the father, which could be reclaimed at any time.

The tribunal reversed the administrative law judge's determination. The tribunal concurred with the judge that the lease was in fact valid and represented bona fide sale between the parties.

But the tribunal rejected the judge's characterization of the facts regarding the company's resale intent: "The fact that petitioner might, at some point, divert a leased piece of art into its own collection is not evidence that petitioner had such intent at the time it purchased the painting."

The tribunal further noted that if that happened, the department's remedy would be to impose use tax on the company.

Nor did the tribunal agree that a vendor is required to be principally engaged in leasing to obtain a resale exclusion.

And finally, the tribunal noted that the temporary nature of a lease is not evidence of a lack of an intent to resell, emphasizing: "Temporary possession is the essence of a lease transaction and a purchase for the purpose of leasing is a purchase for resale under the Tax Law." In doing so, the tribunal distinguished the facts at issue from those in *Matter of P-H Fine Arts Ltd.*[1]

In that case, a business owner set up a limited liability company to acquire art. The company issued resale certificates to dealers claiming purchased art was to be offered for sale; yet the facts demonstrated the works were "used" by virtue of being hung on the business's office walls with little attempt to market them. But the tribunal in *Objet* found that as long as there is "evidence of intent to resell and no evidence of a taxable use" at or after the time of the sale, the resale exclusion is properly allowed.

A significant aspect of the *Objet* decision is the clarity it brings to interpreting the resale exemption. Section 1101(b)(4) of New York's Tax Law defines a taxable retail sale to include a sale to a person for "any purpose other than ... for resale as such" — or for use in performing certain taxable services.[2]

The *P-H Fine Arts* decision clarified in 1994 that the relevant focus in determining the purpose of a sale is the purchaser's intent at the time of the sale, and that, for the resale exemption to apply, a purchaser has the burden to show the item "was purchased for one

and only one purpose: resale." This, according to the tribunal, requires proving not only that the item was purchased with the intent to resell it, but "proving that this was the only purpose" of the purchase.

The taxpayer failed to prove those elements in P-H Fine Arts largely because the evidence showed the artwork was used by the taxpayer — i.e., hung on its office walls, without ample evidence this was solely to market the works for sale.

The department argued in *Objet* — and the judge agreed — that the company had a dual purpose at the time of the sale: to lease the artwork temporarily, and to, at some point, add it to its collection.

The tribunal rejected that interpretation of the one-and-only-purpose rule, noting that the resale exclusion is properly met "where there is evidence of intent to resell and no evidence of a taxable use." Since there was a lease in place and no evidence of any immediate use other than leasing, the tribunal declined to attribute the possibility of a later use to the intent at the time of the sale.

New York's Legislature actually curtailed the use of the resale exclusion in 2017 by amending Tax Law Section 1101(b)(4)(v) to make certain purchases ineligible for resale treatment — namely, purchases by a single-member limited liability company for resale to the sole member; purchases by a partnership for resale to a partner; and purchases by a trust for resale to a beneficiary.[3]

The stated legislative purpose was to curtail the use of structures similar to that in *Objet*, which allow the sales tax on large purchases such as artwork to be deferred over many years, rather than paid upfront.

Notably the resale in *Objet* didn't fall within the transactions specified in the 2017 legislation. For this reason, the *Objet* decision is also relevant for its reaffirmation — albeit not explicit — of the form-over-substance nature of sales tax.

Even after the 2017 legislation, the department made it clear that even though the amendment foreclosed the resale exclusion from being claimed on the three referenced transactions, the amendment did not affect the taxability of the leases themselves. Thus, the department clearly anticipated that artwork leases themselves — even between a single-member limited liability company disregarded for income tax purposes and its sole member — to be bona fide sales for sales tax purposes.

And indeed, as *Objet* demonstrates, art-leasing structures are still used and can have beneficial sales tax implications. The fact that both the administrative law judge and the tribunal refused to ignore the validity of the lease structure here — despite the familial connection between the parties and despite the department's argument that the lease was substantively meaningless given the joint right to possess the painting — reaffirms the high hurdle the department must clear to look through otherwise legal entities or agreements for sales tax purposes.

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[1] Matter of P-H Fine Arts, Ltd. (Tax Appeals Trib., Oct. 13, 1994).

[2] Tax Law § 1101(b)(4) .

[3] See Tax Law § 1101(b)(4)(v) .