JONES DAY

Volume 13 Number 2

January 2006

State Tax Return

New York Franchise Tax Nexus Not Created By Use Of Independent Third-Party Contractors

Robert D. Lochridge
Dallas
(214) 969-3760

Laura Kulwicki
Columbus
(330) 656-0416

The New York Department of Taxation and Finance (the "Department") recently considered whether the use of independent third party contractors to perform certain activities in New York created New York State franchise tax obligations for a New Jersey company that otherwise lacked physical ties with the state. In *SafetyCare, Inc.*, Adv. Op. Comm. T&F, October 24, 2005, TSB A 05(13)C, the Department concluded that the activities of the independent contractors would not be sufficient to create franchise tax obligations for the out-of-state company unless an agency relationship exists. Without such a showing, the third parties' activities are not attributable to the out-of-state company for franchise tax purposes.

Facts

The Petitioner, SafetyCare, Inc. ("SafetyCare"), was a New Jersey corporation that provided monitoring services for its personal emergency response and alarm systems. SafetyCare performed all monitoring services from its New Jersey facility over telephone lines and radio signals. The vast majority of SafetyCare's customers were located in New Jersey, but some sales had been made to customers located in New York State. The sales to the customers located in New York State occurred through word of mouth by friends and family of SafetyCare's officers and employees.

SafetyCare did not maintain any office, employees, representatives or inventory in New York State. SafetyCare did, however, contract with a third party to buy and install monitoring equipment in New York homes. SafetyCare paid the third party for the installation and the equipment and invoiced its New York customers for the sale of the equipment, installation, and monitoring services. All servicing of the equipment in New York homes was likewise provided by an independent third party.

The Department's Analysis

Under New York law, a corporation organized outside of New York will be subject to the New York franchise tax if it is doing business, employing capital, owning or leasing property or maintaining in office within the State. SafetyCare did not employ capital in New York, nor did it maintain an office within New York or own or lease any property within the State. Therefore, the issue as framed by the Department was whether

SafetyCare was "doing business" in new York through the activities of the independent third parties.

In analyzing the matter, the Department looked to Section 1-3.2 of the Business Corporation Franchise Tax Regulations for guidance. The regulation notes that the determination as to whether a corporation is doing business in New York is determined by the facts in each case with consideration being given to: (1) the nature, continuity, frequency and regularity of the activities of the corporation in New York; (2) the purpose for which the corporation was organized; (3) the location of the corporation's offices and other places of business; (4) the employment in New York of agents, officer and employees; and (5) the location of the actual seat of management or control of the corporation.

Based upon an analysis of the above factors, the Department concluded that SafetyCare was not doing business in New York and was not subject to the New York franchise tax. Specifically, the Department determined that "the activities of the third parties hired by SafetyCare as independent contractors in New York to install and service the monitoring equipment were not considered activities conducted by [SafetyCare]."

The Department did warn however that if it could be determined that there existed an agency relationship between SafetyCare and the third parties, the New York regulations would characterize SafetyCare as doing business in New York and subject to the franchise tax. After issuing this warning, the Department concluded that the determination of whether an agency relationship exists is a factual matter not subject to characterization in the context of an advisory opinion. Thus, the Department declined to affirmatively rule as to whether or not the relationship between SafetyCare and its independent contractors in fact established an agency relationship in this particular case.

Taxpayers that conduct some part of their business in New York should closely monitor the relationships that they maintain with any third party or independent contractors hired to perform services in New York. Care should be taken to insure that these relationships cannot be characterized as an agency relationship under New York law. Failure to take into account recent New York pronouncements regarding the establishment of an agency relationship may result in assertions that the taxpayer is now subject to the New York franchise tax.■

This article is reprinted from the *State Tax Return,* a Jones Day monthly newsletter reporting on recent developments in state and local tax. Requests for a subscription to the *State Tax Return* or permission to reproduce this publication, in whole or in part, or comments and suggestions should be sent to Susan Ervien (214/969-3694 or shervien@jonesday.com) in Jones Day's Dallas Office, 2727 N. Harwood Street, Dallas, TX 75201.