



# New York State Sales Tax Considerations for the Commercial Real Estate Industry

Sales tax implications are often overlooked when considering tax issues impacting the New York commercial real estate industry. In fact, the New York State sales and use tax rules and regulations applicable to commercial real estate companies are quite complex and may hold pitfalls for the unwary.

Some of the main sales and use tax issues that affect property owners in the New York commercial real estate industry are: (1) the taxability of certain services provided to tenants and related purchases, (2) the taxability of purchases by property owners for repair and maintenance of their properties, and (3) the taxability of any leasehold improvements made to the building for or by the tenant.

Additionally, although not a sales tax, another tax that has widespread impact on landlords and lessees of commercial real estate is the New York City commercial rent tax, which is discussed further below.

## **Taxability of certain services provided to tenants and related purchases:**

Landlords often provide submetered electricity to their tenants along with other ancillary services such as trash removal, pest control services, window cleaning, etc. In general, the purchases of such services from vendors are taxable.<sup>1</sup> Specifically regarding the purchase of electricity,

landlords make such purchases on a lump-sum basis from utility companies on a master meter.<sup>2</sup> One portion of this electricity is consumed by the landlord in the common areas, and the other is resold by the landlord to tenants.<sup>3</sup>

The portion consumed by the landlord in the common areas is taxable, and the landlord should pay sales tax to the vendor at purchase.<sup>4</sup> The portion sold to tenants, including the cost of reading the meter, billing, and administrative costs of the submetering, is also subject to sales tax, which the landlord is responsible for collecting and remitting to the state.<sup>5</sup> However, the landlord can take a credit or apply for a refund of the sales tax it paid to the utility company for the portion of the electricity resold as submetered utility services to tenants.<sup>6</sup>

The credit can be claimed on the landlord's sales tax return and may be deducted from the amount of sales tax remitted by the landlord when filing its sales and use tax returns.<sup>7</sup>

Other ancillary services provided to tenants, such as trash removal, window cleaning, etc., are taxable if these services vary in relation to the square footage of property leased to tenants and are not incidental charges under the applicable lease agreement. The purchase of any enumerated ancillary services by the landlord is taxable.

### **Taxability for repair and maintenance services provided to real property owners:**

Real property and land refer to land inclusive of the trees on that land, building and structures erected on the land, mains, pipes and tanks for conducting steam, heat, water, oil, gas and electricity, boilers, heating, ventilating, lighting apparatus, plumbing, etc. Maintaining, servicing and repairing are terms used to cover activities that relate to keeping real property in a condition of efficiency, readiness or safety, or restoring it to such condition.<sup>8</sup> In general, such repair and maintenance of real property, whether inside or outside a building, are considered taxable.<sup>9</sup> However, if renovations or modifications to an existing structure result in a capital improvement, then it is exempt from New York sales and use tax.<sup>10</sup> A capital improvement is an addition or alteration to real property that meets the three-pronged test as follows: (i) it substantially adds to the value of the real property or prolongs the useful life of the real property; (ii) it becomes part of the real property or is permanently affixed to the real property so that removal would cause material damage to the property or article itself; and (iii) it is intended to become a permanent installation.<sup>11</sup>

In the case of a capital improvement, if the landlord purchases materials and supplies and performs its own labor, then tax should be paid to the supplier on the materials and supplies. If the landlord purchases materials and supplies and hires a contractor to perform the labor, then tax should be paid to the supplier on the materials and supplies, but there is no need to pay tax to the contractor for labor. Finally, if the landlord purchases materials and supplies and labor from the contractor, no tax is owed to the contractor.<sup>12</sup>

Often there is a fine line between what is considered a repair versus a capital improvement. For example, installation of a floor covering is a capital improvement only when it is installed as the initial finished floor covering in new construction, in a new addition to an existing construction, or in a total reconstruction of existing construction.<sup>13</sup> The term “floor covering” includes carpet, carpet tile, carpet padding, linoleum and similar floor coverings. In all other instances, the installation of a floor covering is a taxable repair.<sup>14</sup> Similarly, the painting of a new building, structure or addition is an exempt capital improvement, whereas the painting of existing building structures is a taxable repair. Therefore, the test of taxability would rest on whether the work being performed is a capital improvement or repair per the three-pronged test referenced above. Not surprisingly, the distinction between what is considered a repair versus a capital improvement historically has been the subject of significant litigation in New York.

### **Taxability of leasehold improvements:**

Additions or modifications to real property for or by a tenant with respect to leased premises are presumed to be temporary in nature. Therefore, they do not qualify as capital improvements unless there is a demonstrated intention to make them permanent.<sup>15</sup> For example, an intention of permanence would be demonstrated by a provision in the building lease indicating that, immediately upon installation, title to the installation vests with the lessor and the installed property is to remain with the landlord and remain with the premises after the termination of the lease:<sup>16</sup> “If a lease does not contain these provisions, other factors such as the nature of the installation, or written agreements other than a lease provision may be considered in determining the intention of the parties with respect to the permanence of the installation.”<sup>17</sup>

Finally, an important factor in considering tax consequences from a commercial real estate perspective in New York City is the commercial rent tax imposed at the city level.

## New York City commercial rent tax:

Although neither New York State nor New York City imposes a sales and use tax on receipts from rentals of real property, New York City does impose a commercial rent tax (CRT), which affects the landlords and lessees of commercial real estate in New York City. The CRT is charged to tenants who occupy or use a property for commercial activity in Manhattan south of 96th Street and pay an annualized gross rent of at least \$250,000.<sup>18</sup> Even billboards and advertising signs that meet the \$250,000 rent threshold are taxable premises under the CRT. The tax rate is 6% of the base rent. All taxpayers are granted a 35% base reduction, which reduces the effective tax rate to 3.9%.<sup>19</sup>

In addition, a credit is allowed if the rent is between \$250,000 and \$300,000. A small business credit further reduces the tax base on a sliding scale for tenants with total incomes that are between \$5,000,000 and \$10,000,000 and whose annual base rent before reductions is between \$500,000 and \$550,000.<sup>20</sup>

In summary, the New York State sales and use tax and the New York City commercial rent tax are key tax considerations for property owners and tenants of commercial real estate in New York. It is important to be aware of the rules and the particular facts of each situation in order to properly comply with the applicable payment and reporting obligations.

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## Endnotes

- <sup>1</sup> New York State Statute, “Imposition of Sales Tax, § 1105 (b)(1),” <https://www.nysenate.gov/legislation/laws/TAX/1105>.
- <sup>2</sup> Id.
- <sup>3</sup> Id.
- <sup>4</sup> Id.
- <sup>5</sup> Id.
- <sup>6</sup> Id.; State of New York Commissioner of Taxation and Finance, “Advisory Opinion, Petition No. S060321A” (March 19, 2007), [https://www.tax.ny.gov/pdf/advisory\\_opinions/sales/a07\\_8s.pdf](https://www.tax.ny.gov/pdf/advisory_opinions/sales/a07_8s.pdf).
- <sup>7</sup> Id.
- <sup>8</sup> Legal Information Institute, N.Y. Comp. Codes & Regs. Tit. 20 § 527.7, “Maintaining, servicing or repairing real property,” <https://www.law.cornell.edu/regulations/new-york/20-NYCRR-527.7>.
- <sup>9</sup> New York State Department of Taxation and Finance, “Publication 862, Sales and Use Tax Classifications of Capital Improvements and Repairs to Real Property,” <https://www.tax.ny.gov/pdf/publications/sales/pub862.pdf>.
- <sup>10</sup> Id.
- <sup>11</sup> Id.
- <sup>12</sup> Id.
- <sup>13</sup> Id.
- <sup>14</sup> Id.
- <sup>15</sup> Id.
- <sup>16</sup> Id.
- <sup>17</sup> Id.
- <sup>18</sup> New York City Administrative Code, “Title 11 – Taxation and Finance, Ch. 7 – Commercial Rent or Occupancy Tax § 11-701,” <https://nycadmincode.readthedocs.io/t11/c07/index.html>.
- <sup>19</sup> Id.
- <sup>20</sup> New York City Department of Finance: Commercial Rent Tax (CRT), <https://www.nyc.gov/site/finance/business/business-commercial-rent-tax-crt.page#:~:text=Beginning%20June%201%2C%202018%2C%20taxpayers,from%20the%20Commercial%20Rent%20Tax>.