



Insights: Publications

5 Key Takeaways | New York Tax Developments

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Written by **Jeffrey S. Reed**

On December 8th, Kilpatrick tax partner **Jeff Reed** presented during a webinar hosted by HalfMoon. The webinar discussed recent New York tax developments.

Here are five key takeaways from the webinar:

1. The NY Tax Department Continues to Push the Envelope on What Constitutes Taxable Software

In New York, the tax department generally treats SaaS / online services as taxable sales of tangible personal property (canned software). For example, a Tax Appeals Tribunal decision currently on appeal to the Appellate Division concludes that an online platform used to provide tools for managing independent contractors is taxable as tangible personal property. Pushing the envelope even further, a recent administrative law judge determination concludes that facility maintenance agreements are subject to sales tax because the facility work orders are managed through a software portal. The determination could be criticized in that the true object of the transaction appears to be the purchase of a facilities maintenance service, rather than the purchase of software, with the software merely summarizing the status of facility maintenance requests.

2. Several Court Opinions Address the Constitutionality of Applying the Corporate Tax Regulations Retroactively

New York modernized its corporate income tax system, effective as of 2015. The regulations interpreting the statute were published online in draft form and ultimately were not finalized until December 2023. The department is applying the regulations retroactively to 2015, leading to administrative and judicial challenges. A New York court opinion held that the regulations addressing PL 86-272 with respect to internet activities were not invalid but that applying the regulations retroactively resulted in a violation of the due process clauses of the New York and Federal constitutions. A different decision involving a payroll service provider ruled that the regulations were not unconstitutionally retroactive because draft versions of the regulations gave the payroll provider sufficient prior notice of how the company's business receipts were to be apportioned. Taking the cases together, a company may be able to successfully challenge retroactive application of the corporate tax regulations depending on the company's facts and when the relevant sections of the regulations were first published in draft form.

3. The NY Court of Appeals Recently Narrowed the “Personal and Individual in Nature” Information Services Exclusion

New York imposes a sales tax on information services. The information services statute provides an exclusion that applies when the information services are “personal or individual in nature.” Accordingly, something can qualify as an information service and still not be taxable if it is personal or individual in nature. A recent New York Court of Appeals addressed the scope of the personal or individual in nature exclusion. The case addressed a company that provides advertising analysis services. The company's service measures advertising effectiveness using consumer surveys and compares the data against a broader database of aggregated, anonymized results from past studies. The company's clients receive reports that include data, analysis, and recommendations. The company argued that the service qualified for the “personal or individual in nature” exclusion since each client receives an individualized report based on its own advertising campaign. But because the information contained in the reports is built into the broad database used to analyze other campaigns the court concluded that the “personal and individual in nature” exclusion did not apply as the data is shared based on it being included in the broad database.

4. The NYC Division of Tax Appeals is Up and Running Again

Most New York taxes are imposed and collected at the state level. However, New York City also imposes taxes (e.g., a business corporation tax, a general corporation tax, and a commercial rent tax) and has its own tax agency. Challenges to New York City taxes go through the New York City Division of Tax Appeals. Until recently, there were no administrative law judges (“ALJs”) at the New York City Division of Tax Appeals, leading to cases being stuck and unable to move forward, with no ALJs to hear the appeals. Recently, three ALJs were hired, and cases are now moving again. One thing to watch is how the ALJs and the attorneys representing the department will handle the backlog of cases that have developed.

5. A Taxpayer Recovered Attorney Fees

It is difficult to recover attorney fees for tax controversies in New York. But a recent case was successful and perhaps provides a roadmap for taxpayers hoping to do so. The underlying dispute involved a night club that featured electronic dance music (EDM) shows. The tax department took the position that charges to attend the EDM shows were taxable admission charges and that the live dramatic or musical arts performance exception did not apply. The taxpayer prevailed in litigation by showing that the EDM performances were live performances that were not subject to sales tax. In petitioning for costs, the taxpayer was able to show that the tax department's position was not substantially justified (i.e., was not reasonable). Worth noting is that not all businesses can recover costs -- a partnership must have a net worth under \$7M and have 500 or fewer employees to be eligible to recover costs. Additionally, attorney fees are capped at \$150 an hour. All that said, given the result in the case smaller taxpayers may wish to consider petitioning for costs if they are forced to litigate, they prevail, and the department's position in the case seems unjustifiable.

For more information, please contact:

Jeff Reed, jsreed@ktslaw.com

Related People



Jeffrey S. Reed

t 212.775.8792

jsreed@ktslaw.com