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NY Tax Talk: New ALJs, New Rules, Apportionment, Bundling

By **Elizabeth Cha and Periklis Fokaidis** (December 4, 2025, 5:40 PM EST)


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This article is part of a quarterly column that examines recent developments in New York tax law. In this installment, we focus on appointments to the New York City Tax Appeals Tribunal, rules implementing corporate business tax changes, apportionment, and the sales tax consequences of bundling software.

The third quarter of 2025 saw numerous notable developments across New York state and New York City, offering new insights and challenges to navigate.

Administrative law judge vacancies at the New York City Tax Appeals Tribunal have been filled, and New York City issued the first set of rules to implement corporate business tax regulations.

Paychex Inc. requested a New York appellate court to invalidate state apportionment regulations requiring professional employer organizations to exclude expense reimbursements from apportionment calculations.

And, the New York State Tax Appeals Tribunal concluded that a facilities management services provider was required to remit New York state sales tax on prewritten software bundled with nontaxable services.

NYC Tax Appeals Tribunal Vacancies Filled

Two vacancies at the New York City Tax Appeals Tribunal's Administrative Law Judge Division were filled by ALJ Sung Hwang and ALJ Eva Niedbala, both starting during the third quarter of 2025. This is welcome news to taxpayers, as the absence of ALJs in the tribunal was a substantial impediment to taxpayers' ability to adjudicate their tax disputes.[1]

NYC Business Corporate Tax Regulations

On Oct. 16, the New York City Department of Finance issued the first part in a series of proposed regulations for the Business Corporation Tax. The proposed rules provide definitions of relevant terms and set forth the activities required to satisfy nexus standards.

The proposed rules regarding nexus generally track New York state's regulations and the Multistate Tax Commission's 2021 guidance on internet activities.

Further, New York City's proposed rules provide that a foreign corporation's activities in New York state, but outside of New York City, may be considered for purposes of determining whether such entity exceeds mere solicitation with regard to the application of P.L. 86-272 for New York City tax purposes.

P.L. 86-272 is a federal law that limits a state's ability to impose income tax on an out-of-state business. Specifically, out-of-state businesses' employees or representatives must engage only in solicitation activities and certain ancillary activities in New York state in order to receive protection under statute P.L. 86-272. An out-of-state corporation that goes beyond solicitation activities would go outside the scope of protection offered by P.L. 86-272. Importantly, here, the proposed rules specifically state that "the applicability of Public Law 86-272 to taxes imposed by New York City is determined by the nature of a foreign corporation's activities in the entire State."[2]

NYC has previously indicated it will diverge from New York state regulations with regard to certain areas, such as sourcing rules, and weigh the City's interests to provide a different approach in areas where there was historically no consistency between city- and state-level corporate income tax statutes or where there was divergence between city and state corporate income tax statutes to begin with.[3]

The city's first issuance of proposed regulations does not address such topics. In the coming months, we will see how and to what extent New York City diverges from New York state regulations. Given the recent attention to New York CIty tax reform, the outcome of these regulations, and whether or not they detract from state-level provisions, will be of great importance to taxpayers and likely the subject of further commentary.

Paychex

Taxpayers are routinely faced with departmental interpretations of statutes, via regulation, that could have a significant impact on their tax profiles. The case that follows is once such instance, and implicates certain administrative processes and constitutional arguments that we believe taxpayers should be aware of.

As we discussed in our first installment of 2025, in Paychex v. New York Department of Tax and Finance, the taxpayer challenged New York's 2023 corporate franchise tax regulations at the New York Supreme Court. The taxpayer requested a declaratory judgment that the retroactive application of two subsections of the regulations violated state and federal law, as well as the taxpayer's due process rights.[4]

The regulations at issue disallowed the inclusion of the reimbursement of expenses received from a customer by a professional employer organization in such organization's apportionment factor**.**

The taxpayer, which engaged in professional employer organization and nonprofessional employer organization activities during the years at issue, argued that the New York regulation created a new definition of the term "receipt" for apportionment purposes that was inconsistent with the plain meaning of the term.

The taxpayer also argued that the retroactive application of the regulations violated its due process rights.

On Dec. 18, 2024, the court ultimately ruled in favor of the department, granting its motion to dismiss

on the grounds that (1) the taxpayer had not sustained an injury, but instead, argued it would sustain some future harm, thus, requiring the taxpayer to exhaust administrative remedies prior to seeking resolution in the state courts; and (2) the taxpayer's due process rights were not violated because the taxpayer was aware of the department's position, vis a vis its regulations, as articulated in the draft form of the regulations.[5]

The taxpayer filed a notice of appeal on Jan. 17 of this year.

Appeal

The taxpayer appealed the trial court's ruling to the New York State Supreme Court Appellate Division on Sept. 17. In its brief, the taxpayer argued that it had, in fact, suffered a justiciable injury and was at risk of continued harm due to the department's position.[6]

The taxpayer further asserted that the "only way to limit further damage is to have the courts rule on the validity of the Challenged Subsections."[7]

The taxpayer argued that the trial court incorrectly ignored the plain conflict between the regulation and the statutory law. Further, with respect to its pursuit of administrative remedies, the taxpayer stated that it had exhausted the administrative remedies available to it at the time.[8]

The taxpayer sent three letters to the department challenging the subsections at issue, all of which addressed its concerns and legal issues with the regulations.[9] However, the department had made no changes to the subsections at issue.

The taxpayer further argued that additional attempts would have been futile, and that New York law does not require the futile pursuit of administrative remedies.[10]

The taxpayer also rearticulated its position that the subsections at issue violated its due process rights by imposing an excessive retractive period of nine years.[11] The taxpayer cited the N.Y. State Supreme Court's April **decision** in American Catalog Mailers Association v. Department of Taxation and Finance, in which tax reform regulations adopted by the department, at the same time as the above challenged subsections, were invalidated on due process grounds due to their excessive retroactive application.[12]

Implications

If the court finds in favor of the taxpayer, determining that its early engagements with the department constituted an exhaustion of remedies, taxpayers could have a clearer path toward adjudicating their claims in court. Such a judgment may permit taxpayers to challenge the retroactive application of regulations without being required to argue their position on audit, at the Department of Tax Appeals and at the Tax Appeals Tribunal before reaching a final judgment on the merits.

FacilitySource LLC

In today's business climate, companies often offer software in conjunction with certain personal services, all in the same transaction. The combination of these offerings begs the question — what is really being sold?

This question has been the subject of numerous New York cases looking at the primary purpose of a

transaction — is software being sold, or a service? New York has ruled on these questions quite consistently throughout the years.

Continuing New York's lineage of cases holding that services sold in conjunction with taxable prewritten software constitute taxable transactions, on Sept. 18 the New York Tax Appeals Tribunal upheld an ALJ determination requiring a taxpayer to remit sales tax on the full charge for services bundled with taxable prewritten software.

In Matter of FacilitySource LLC, the taxpayer provided facilities management services for a number of retail chains and also granted its customers a license for software used in facilities management services.[13]

The department determined that the taxpayer was licensing software to customers, which under the New York statute, constituted a taxable sale.[14]

The taxpayer made two arguments on appeal. First, the taxpayer asserted that, under the primary function test, its licensing of software should not be taxable when bundled with nontaxable services.[15]

New York's primary function test is a fact-based inquiry looking to whether the primary function, or true object, of a bundled transaction is subject to New York sales tax. If the primary function of the bundled transaction is not subject to sales tax, the bundled transaction as a whole should not be subject to tax.

Historically, however, New York has not applied the primary function test to bundled transactions consisting of tangible property and services.

Here, the Tax Appeals Tribunal ultimately declined to extend this treatment to the provision of tangible personal property and services.[16] Accordingly, the taxpayer's provision of software was deemed a taxable sale for New York sales tax purposes.

Implications

This case should be on taxpayers' radar, as New York can be quite predictable in its application of these rules. A consistent theme in New York sales tax decisions is that when a transaction includes a software license and the provision of a service, the state generally treats the entire charge as taxable unless the charges are separately stated.

Here, the Tax Appeals Tribunal also declined to extend the primary function test to bundled transactions consisting of prewritten software — i.e. tangible property — and nontaxable services.

While the primary function test might not be extended to bundled transactions consisting of tangible property and services, it has been consistently used in the sales tax context, and will likely continue to serve as an analytical tool employed by the department and taxpayers alike throughout New York state tax controversies.

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general information purposes and is not intended to be and should not be taken as legal advice.

[1] New York City Tax Appeals Tribunal, Administrative Law Judge Division, https://www.nyc.gov/site/taxappeals/about/administrative-law-judge-division.page.

[2] New York City Department of Finance, Notice of Public Hearing and Opportunity to Comment on Proposed Rules, https://rules.cityofnewyork.us/wp-content/uploads/2025/10/Business-Corporation-Tax-Implementation-Rules-Certified.pdf.

[3] Id.

[4] Paychex Inc. v. New York Dep't of Taxation & Fin., No. 904047-24 (N.Y. Sup. Ct. Dec. 18, 2024).

[5] Id. at 14–15.

[6] Paychex Inc. v. Dep't of Tax'n & Fin., No. CV-25-0098 (N.Y. App. Div., 3d Dep't Sept. 17, 2025).

[7] Id. at 30.

[8] Id. at 27.

[9] Id. at 31.

[10] Id.

[11] Id. at 38.

[12] Id. at 38–39 (citing American Catalog Mailers Assn. v. Dep't of Taxation and Fin., 2025 Slip Op. 31588(U) (N.Y. Sup. Ct. Apr. 25, 2025)).

[13] In re FacilitySource, LLC, No. 829500 (N.Y. Tax App. Trib., Sept. 18, 2025).

[14] Id. at 25.

[15] Id. at 33.

[16] Id. at 41.