

### The Joinder Problem: When Sales Tax Claims Are Not Arbitrable

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Consider the following scenario. A vendor sells goods to a New York customer but fails to charge sales tax at the point of sale—whether because of a system failure, an internal lapse, or employee misconduct. Months later, the vendor receives an audit notice from the New York Department of Taxation and Finance (DTF) assessing unpaid sales tax, penalties, and interest.

Seeking to stop the bleeding, the vendor pays the assessment and demands reimbursement from the customer, who refuses.

The vendor now has a problem. Suing a customer would be expensive and public—hardly an attractive option. Fortunately, the vendor’s standard form sales agreement offers an apparent solution. It requires customers to pay all applicable sales taxes and provides that if tax is not collected at the time of sale, the customer must reimburse the vendor. The agreement also contains a broad arbitration clause.

Problem solved—or so it seems.

The vendor’s assumed solution raises a surprisingly unsettled and consequential issue for litigators: whether a vendor may compel arbitra-



tion to recover unpaid New York sales tax—or to obtain reimbursement of sales tax the vendor has already paid to the state.

#### I. The New York Sales Tax Framework

New York’s sales tax regime assigns liability to both vendors and customers. Vendors are required to collect sales tax as trustees for the state, and customers are independently liable for the tax. N.Y. Tax Law §§1132(a), 1133(a). If sales tax is not collected at the time of sale, the vendor remains liable—not only as a collecting trustee, but also as a taxpayer. Tax Law

§1133(a) gives vendors the right to collect sales tax from a customer who fails to pay it, but conditions the vendor's right to bring an action against the customer on joining the Department of Taxation and Finance (DTF) "as a party to the action or proceeding."

The New York courts that have addressed the joinder provision have held that it is not a mere procedural technicality, but a matter of substantive law and a condition precedent to the vendor's right to pursue recovery from the customer. In *Stuyvesant Fuel Service Corp. v. Scola*, 117 Misc. 2d 944, 945 (N.Y. Civ. Ct. 1982), a New York court required joinder of the DTF even after the vendor had already remitted the sales tax to the state. And in *Matter of McKinley Parkway*, 1989 WL 127195 (Tax App. Trib. Mar. 2, 1989), the Tax Appeals Tribunal declined to treat prior favorable court findings as binding where the DTF had not been joined as a party.

The rationale for treating the joinder rule as substantive is to maintain the state's gatekeeping role in sales tax adjudication. Disputes over sales tax liability implicate the interpretation, application, and uniform administration of the state's tax laws. The legislature has vested that authority in the DTF, with judicial review available only after administrative exhaustion.

The DTF's interest in sales tax disputes is not merely fiscal. It is also regulatory and interpretive—ensuring consistent application of the Tax Law across transactions and tribunals. In effect, because it is the real party in interest, the DTF is a necessary party to the resolution of any sales tax dispute—even after the tax has been paid.

## **II. Why Vendors Cannot Arbitrate Sales Tax Disputes**

The joinder requirement makes vendor-initiated sales tax claims structurally incompatible with

private arbitration. In court, a joinder defect under Section 1133(a) is readily curable. The DTF can be added as a party, and the action may proceed. Arbitration is different. The DTF is not a signatory to private arbitration agreements and cannot be compelled to participate in arbitration.

As a result, when a vendor seeks to recover sales tax from a customer, the statutory condition precedent to the claim—DTF participation—cannot be satisfied in a private arbitral forum. This creates a threshold problem: the inability to join the DTF in arbitration may deprive the arbitral tribunal of authority to adjudicate the claim at all. Importantly, even strategic drafting of the sales agreement will not circumvent the joinder requirement. A vendor's effort to recast a sales tax collection dispute as a private "breach of contract" or "indemnification" claim under the reimbursement clause will likely fail. New York courts look to the gravamen of the claim, not the label attached to it.

Absent statutory authorization, a vendor has no cause of action under the common law to recover sales tax it failed to collect at the point of sale. That right is derived solely from the Tax Law. Where the relief sought is the recovery of sales tax under New York law, Section 1133(a) supplies both the source of the right and the conditions under which it may be exercised. A vendor cannot invoke the statutory right while evading the statutory condition.

Nor does the Federal Arbitration Act confer authority where state law creates none. The FAA enforces arbitration agreements; it does not manufacture substantive rights or nullify statutory prerequisites. Section 1133(a) defines both the vendor's right and its limitations. Arbitration clauses cannot expand that right or eliminate

those conditions. Private parties cannot reallocate the statutory rights and obligations of vendors and customers through boilerplate contractual provisions enforced in a forum that excludes the state entirely.

### III. Why This Matters for Litigators

For vendor-side counsel, this issue should prompt careful reconsideration of enforcement strategies. A vendor's ability to recover uncollected New York sales tax from a customer derives from Section 1133(a) and is subject to the statutory conditions imposed by that provision, including mandatory DTF participation.

Before commencing arbitration, counsel should anticipate the threshold defense that the DTF joinder requirement cannot be satisfied and should also recognize that the DTF would not consider itself bound by any arbitral determination reached in its absence. Where a vendor seeks to recover sales tax from a customer, proceeding in court or pursuing a refund administratively before the DTF under Tax Law §1139 are the only viable paths to a binding resolution.

For customer-side counsel, the joinder requirement presents a powerful threshold defense. Where a vendor seeks to arbitrate a claim that

is substantively grounded in sales tax law, the inability to join the DTF may render the claim non-arbitrable regardless of how broadly the arbitration clause is drafted. This issue underscores the importance of identifying when ostensibly "contractual" disputes are in fact governed by statutory regimes that impose non-waivable conditions on adjudication. Sales tax is one such area—but not the only one.

### IV. An Open Question

The New York Court of Appeals has not yet squarely addressed whether sales tax recoupment claims subject to Section 1133(a) may be resolved in private arbitration absent DTF participation. But the statutory text, the case law treating joinder as substantive, and the fundamental incompatibility between mandatory state participation and consensual private arbitration all point in one direction: these claims are not arbitrable. Counsel on both sides should be prepared to address arbitrability as a threshold issue—and to recognize that the contractual language governing a sale does not override the statutory framework governing sales tax collection and enforcement.

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