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MoFo New York Tax Insights

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Governor Nominates Thomas Mattox as New Tax Commissioner

Governor Andrew Cuomo has nominated Thomas H. Mattox to be the next Commissioner of Taxation and Finance. Mr. Mattox was previously a Managing Director at Goldman Sachs & Co., and a Senior Vice President at Chase Manhattan Bank. Most recently, he served as treasurer of the Harvard Club in New York City.

Pending his confirmation, Mr. Mattox is currently serving as Acting Tax Commissioner. We wish him well and look forward to his leadership at the Department.

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Shooting Birds Held to Constitute the Taxable Purchase of Property

By Hollis L. Hyans

In a decision involving the application of the sales tax laws to a game preserve, a New York State Administrative Law Judge has held that the charges hunters pay to shoot birds at a game preserve represent charges for the sale of tangible personal property and are subject to sales tax. *Matter of Frank M. Gugliotta D/B/A Parkview Lodge and Upland Game Preserve*, DTA No. 823157 (N.Y.S. Div. of Tax App., Dec. 30, 2010).

The taxpayer operates a lodge and game preserve, and offers hunting of pheasant, chukar and quail. Hunters direct the preserve to release birds before the hunt begins, and then have a set period of time to shoot the birds that were released at their request, as well as any other birds that remain from previous hunts, or that may have happened to fly by. Pricing is based solely on the number of birds the hunter wants to have released, with some set minimums, and varies depending upon the type of bird. There is no guarantee that the hunter who paid for a set number of birds will kill all, or even any, of them, since the birds may escape or the hunter may simply not be skillful enough. While the decision says that hunters may take more or fewer birds than are released without a change in the fee, there is no indication of how often the actual number of birds shot varies from the amount charged, or whether it is commonly larger or smaller. The preserve is not permitted to sell live birds to the public, but only to a licensed breeder or a preserve operator. Following the hunt, most hunters clean their own birds in an area provided by the preserve, although some use a bird-cleaning service provided by the preserve for a separate charge, or a taxidermy service also available at an extra charge. The decision says hunters "often" eat their birds, but doesn't say how often.

In 1965, the Division had provided advice to other hunting preserves, stating that the provision of game birds at a charge by bird on a private shooting preserve is not subject to sales tax, and this advice was confirmed in letters issued in 1971 and 1991. Despite this earlier advice, the Division was now taking the position that the charges were taxable.

THE ALJ HELD THAT THE CHARGES PER BIRD WERE FOR THE SALE OF TANGIBLE PERSONAL PROPERTY FOR USE IN CONJUNCTION WITH A PARTICIPATORY SPORTING ACTIVITY.

The ALJ held that the charges per bird were for the sale of tangible personal property for use in conjunction with a participatory sporting activity, and analogized the sales to the rental of bowling shoes. Although hunters received both game birds and the right to hunt for the charge, since the game preserve chose to charge only for the birds, the per-bird charges were considered to be sales of tangible personal property in their entirety. Even if the charges were deemed to include an amount allocable to the nontaxable activity of hunting, they would still be fully taxable as a single charge with both taxable and nontaxable components that are not separately broken out, leaving the entire charge subject to tax. The ALJ rejected the taxpayer's argument that the charges were hunting fees, since the preserve charged only for the birds. He also rejected the argument that the birds were nontaxable "food sold for human consumption," finding that they were sold as prey under conditions where the success of the hunt was not guaranteed.

However, the ALJ did set aside the penalty, finding that the petitioner reasonably relied on the prior written advice from the Division to others operating similar businesses.

Additional Insights

This case raises interesting questions that are not answered by the decision. While the ALJ notes that success of the hunt is not guaranteed, and uses that as a rationale for finding that the birds were not being sold as food, there is no discussion of what correlation there might be between the number of birds generally paid for and the number of birds taken home. If hunters commonly pay, for example, for 12 birds, and most only end up shooting 6, it seems odd to hold that the charge for the 6 that got away is a charge for tangible personal property, since no tangible personal property ended up being transferred to the hunter. On the other hand, the sales tax law does include, within the definition of "sale," "[a]ny transfer of title or possession or both, … lease or license to use or consume … conditional or otherwise…", Tax Law § 1101(b)(5), so perhaps it could be argued that the hunters paid for a "conditional" "license" to the birds that got away. However, the analogy to the rental of bowling shoes seems misplaced: bowlers who rent shoes clearly pay for one pair and receive the use of one pair. Here, while a hunter is required to pay for at least some birds, a hunter could conceivably leave with no birds at all. Moreover, under the rationale of this decision, it appears that a game preserve could use a different billing system, for example, charging solely by the hour, and fit comfortably within the sales tax exclusion provided by Tax Law § 1105(f)(1), which provides that sales tax does not apply to charges to a patron for admission to or use of facilities for sporting activities in which the patron is to be a participant.

Tribunal Rules that Vacation Home is a "Permanent Place of Abode"

By Irwin M. Slomka

In a decision that reminds nonresidents of the perils of owning vacation homes (or other secondary residences) in New York State and City, the Tax Appeals Tribunal has held that a Connecticut couple's vacation home in the Hamptons constitutes a "permanent place of abode" for income tax purposes. Since the taxpayer was present in the State for more than 183 days during each of the years in issue, the taxpayer was thus held to be taxable as a New York resident. *Matter of John J. and Laura Barker*, DTA No. 822324 (N.Y.S. Tax App. Trib., Jan. 13, 2011).

John and Laura Barker lived in New Canaan, Connecticut, together with their three school-age children. It was undisputed that they were domiciled in Connecticut. Mr. Barker commuted daily to his job in Manhattan as an investment manager for Neuberger Berman. He conceded that he was present in the State more than 183 days during the years 2002, 2003 and 2004.

In 1997, the Barkers purchased a modest vacation home in the Hamptons, Long Island, which they sporadically used for less than three weeks each year. The house was 138 miles from their Connecticut home, and beyond regular commuting distance to Mr. Barker's Manhattan office. Mrs. Barker's parents, who live on Long Island, frequently used the vacation house several days a week in the summer months, and on many weekends year round. The house was concededly usable throughout the year, having the necessary amenities for year-round habitation such as heat, electricity, hot water, and telephone and cable TV service.

On audit of their nonresident tax returns, the Department's auditor concluded that their vacation home was a "permanent place of abode" within the meaning of the income tax law. Therefore, since the taxpayer was present in the State more than 183 days each year, the Department assessed resident income tax on all their income, as well as negligence and substantial understatement of tax penalties.

"[T]HERE IS NO REQUIREMENT THAT THE PETITIONER ACTUALLY DWELL IN THE ABODE, BUT SIMPLY THAT HE MAINTAIN IT."

At the hearing before the Administrative Law Judge, the taxpayers had argued that their vacation home should not be considered a permanent place of abode. They maintained that under their circumstances—the intended purpose for the vacation home, the lack of full access because of the regular use by Mrs. Barker's parents, and the size of their immediate family which made it difficult to use the home for anything more than sporadic vacation use—it should qualify as a "camp or cottage, which is suitable and used only for vacations," which under the regulations is excluded from the definition of a permanent place of abode. The ALJ rejected these arguments, and held that the vacation home was a permanent place of abode, and therefore the taxpayers were New York residents. The ALJ also upheld the imposition of penalties.

On appeal to the Tax Appeals Tribunal, the taxpayers raised substantially similar arguments to those raised before the ALJ. The Tribunal upheld the ALJ's determination that the vacation home was their permanent place of abode. First, it rejected the taxpayers' assertion that under its decision in *Matter of Evans* DTA No. 806515 (N.Y.S. Tax App. Trib., June 18, 1992), *confirmed Matter of Evans v. Tax Appeals Tribunal,* 199 A.D.2d 840 (3d Dept. 1993), the Tribunal had adopted a subjective standard for determining whether a dwelling constituted a permanent place of abode, which required consideration of "the individual's relationship to the place." The Tribunal disagreed, saying *Evans* merely stands for the proposition that a dwelling could be a permanent place of abode even where the taxpayer did not own or otherwise have a legal right to the dwelling. According to the Tribunal, since the Barkers *owned* the Hamptons home, *Evans* was inapplicable. The Tribunal also rejected the claim that the vacation home was, under the circumstances, in the nature of a "camp or cottage." The Tribunal found that the home was "objectively suitable for year-round habitation" and, quoting from its decision in *Matter of Roth*, DTA No. 802212 (N.Y.S. Tax App. Trib., Mar. 2, 1989), noted that "[t]here is no requirement that the petitioner actually dwell in the abode, but simply that he maintain it."

After ruling that the taxpayers were statutory residents, the Tribunal remanded the case to the ALJ on the issue of penalties. Specifically, it directed the ALJ to address "whether the record demonstrates a reasonable basis for petitioners' claim that they did not maintain a permanent place of abode … or whether petitioners' conduct was intentionally obfuscatory or willfully negligent" by reason of having answered "NO" to the question on the tax return, "Did you or your spouse maintain living quarters in New York State?"

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Permanent Place of Abode

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Additional Insights

The Tribunal's decision, which the taxpayer can appeal to the New York courts, is a stark reminder of the ramifications of a nonresident owning or leasing a secondary home or *pied-a-terre* in New York, including a vacation home, unless the taxpayer is not present in the State for more than 183 days (and can reasonably document that on audit). It certainly seems to be an unduly harsh consequence to arise from ownership of a sporadically used vacation home, located hours away from the taxpayer's domicile in Connecticut and his place of employment in New York.

Regardless of the eventual outcome of the case, the question remains whether the Department's policy—which will undoubtedly give many pause before they acquire secondary homes in the State—is reasonable under the law and fair as a matter of policy. Since the Department has long interpreted the tax law, by regulation, to exclude "camps and cottages" from the definition of a "permanent place of abode," it should consider amending the regulations or, if necessary, the tax law itself, to avoid results such as this. The decision is an example of an interpretation of the tax law that results in a finding of residency far beyond the intended purpose for the statutory residency definition.

The Tribunal's remand of the penalty issue back to the ALJ for a supplemental determination is curious. The ALJ did address the penalty issue, concluding that the taxpayers' denial on their tax returns that they maintained living quarters in New York supported the imposition of the negligence penalties. Yet, the Tribunal directed that the case be remanded, seemingly not to develop additional facts, but for the ALJ to address the penalty issue again, rather than the Tribunal ruling on the question *de novo* as it could have done.

QEZE Tax Credits Disallowed for Lack of a Business Purpose

By Hollis L. Hyans

An Administrative Law Judge has held that the Division of Taxation properly denied claims for qualified empire zone enterprise ("QEZE") credits because the petitioner did not have a valid business purpose for restructuring. *Matter of Dunk & Bright Furniture Co.,* DTA Nos. 823026 and 822710 (N.Y.S. Div. of Tax App., Dec. 30, 2010). The business purpose requirement had been added to the statute in 2002 to prevent existing businesses from setting up in a new form solely to obtain QEZE credits.

Petitioner Dunk & Bright Furniture Co., Inc. ("D&B Furniture") operated a retail home furnishings business. In the late 1990s and early 2000s, the business owner, James Bright, made changes in the company's operations, including the creation of a special-purpose company to lease warehouse space and sublet the space to D&B Furniture; purchasing property for warehouse space; assuming responsibility for delivering the furniture, a service that had previously been performed by a third party; and engaging in other ventures related to the furniture business. Mr. Bright had considered the business advantages of forming separate special-purpose entities to conduct various parts of the business. In 2002, a plan of reorganization was proposed by counsel, described as a "tax planning idea," which included setting up a holding company that would allow flexibility to restructure the existing operations, segregate the liabilities, and allow for the realization of additional incentives under the Empire Zone Program. Pursuant to this plan, Dunk & Bright Holdings, Inc. ("D&B Holdings") was formed, and later changed its name to Dunk & Bright Furniture Co., Inc. Mr. Bright was the sole shareholder of D&B Holdings, and the ALJ found that all decision-making and day-to-day operational authority remained with him or an employee that he oversaw. The Board minutes stated that the reorganization was undertaken "'to maximize tax benefits,'" and the corporate tax returns contained a statement that the purpose for the reorganization "'was to provide the corporate structure the flexibility to take advantage of certain New York State incentives.'" A Statement of Business Purpose prepared in connection with the audit also referred to, in addition to the tax benefits, segregation of liabilities, isolation of profits of the various business operations, and financing considerations as additional reasons for the restructuring. However, no other separate entities were created, and none of the claimed business purposes ever materialized.

The Division conducted an audit and concluded that the petitioner did not meet the "valid business purpose" test set forth in the law, and that the reorganization was undertaken solely for the tax benefits.

The ALJ agreed. First, he reviewed the requirements of the statute. Qualified businesses received certain tax credits and exemptions directly linked to job creation, and the level of benefits was, in very general terms, determined by a comparison of the number of jobs in a base period to the number of jobs in a particular subsequent period. In order to obtain greater benefits, a business like D&B Furniture would have had to either increase its employment level to twice its base year employment level, or become a "new business" so that, with a base period employment level of zero, the addition of even one job would result in its entitlement to 100% of the available benefits. The

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Lack of a Business Purpose

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possibility of an existing business simply forming a new entity to qualify for such benefits had been identified as a potential "loophole" in the law, and the statute was amended to provide that a corporation will not be treated as a new business if it was similar in operation and ownership to an existing entity and was not formed for a valid business purpose as defined in the statute. Tax Law former § 14(j)(4)(B). A valid business purpose must "alone or in combination constitute the primary motivation for some business activity… which… changes in a meaningful way, apart from tax effects, the economic position of the taxpayer." Tax Law § 208(9)(o)(1)(D).

The business purpose requirement was enacted on May 22, 2002, and was made applicable to entities created on or after August 1, 2002. The change resulted in a significant increase in the number of businesses being set up between May 22 and August 1, and therefore the legislature added an additional requirement that businesses first certified as eligible to receive QEZE benefits prior to August 1, 2002 had to meet the business purpose test to retain those benefits for tax periods beginning on or after January 1, 2005. This case involved assessments of additional personal income tax issued to Mr. Bright and his wife for 2005 through 2007, based upon the disallowance of QEZE-based real property tax credits claimed for those years, and assessments of sales and use tax issued to D&B Holdings for 2005 through February 2008, based upon disallowance of the company's QEZE-based sales tax exemption.

The ALJ interpreted the statutory language as requiring petitioners to meet both parts of a two-part standard: they had to establish that the reorganization was undertaken for one or more business purposes which, apart from tax avoidance or reduction, constitute the *primary* motivation for the reorganization; and second, that the reorganization was not undertaken solely in order to gain QEZE benefits. He rejected the petitioners' argument that the statute required the Division to establish that the reorganization was undertaken solely in order to gain QEZE benefits and to establish that there was no business purpose, holding that such a standard would reverse the appropriate burden of proof and incorrectly place the burden of proof on the Division, when taxpayers should bear the burden of proving entitlement to tax credits and exemptions.

THE ALJ INTERPRETED THE STATUTORY LANGUAGE AS REQUIRING PETITIONERS TO... ESTABLISH THAT THE REORGANIZATION WAS UNDERTAKEN FOR ONE OR MORE BUSINESS PURPOSES ... AND NOT SOLELY TO GAIN QEZE BENEFITS.

Relying on the statements in the Board minutes and tax filings, and the timing of the reorganization (just after the law was changed and shortly prior to the closing of a perceived window of opportunity), obtaining QEZE benefits appeared to the ALJ to be the motive for the reorganization, and not the other considerations raised by the petitioners regarding business expansion, limitation of liability, etc. The ALJ found that "[w]hile the noted reasons for reorganizing are all legitimate and valid … petitioner has provided no evidence of having engaged in any subsequent activities consistent therewith. … It is obviously difficult to accept the premise that any meaningful economic or other changes in business resulted from the reorganization, given that none of the envisioned steps or activities available under the business structure as reorganized were ever undertaken or carried out." The ALJ found that obtaining the QEZE benefits "was not only the *primary* motivation for the reorganization but in fact was petitioners' *sole* reason for reorganizing."

Additional Insights

While the "business purpose" for various transactions is often an issue in state tax disputes, many cases involve a dispute about whether a business motive is even necessary if all other statutory requirements are met. This case presents an example of a situation where the statute itself explicitly requires a valid business purpose, since the legislature had already identified what it perceived as a problem in existing businesses simply reconstituting themselves as "new" in order to take advantage of credit opportunities. Here the petitioners admitted that maximizing the QEZE benefits was the purpose from the perspective of the attorney who had proposed and implemented the transaction, but claimed that there were several other legitimate reasons and purposes. However, because none of those reasons or purposes were ever documented, pursued, or implemented, the ALJ was unwilling to accept that any of them was the primary purpose for the reorganization, and instead found that tax savings solely motivated the change in form.

Department Applies Customer-Based Sourcing of Receipts under Article 9-A

By Irwin M. Slomka

The New York State Department of Taxation and Finance has issued an Advisory Opinion addressing how receipts from the sale and processing of prepaid debit cards should be sourced under Article 9-A. *Advisory Opinion*, TSB-A-11(1) C (N.Y.S. Dept. of Taxation & Fin., Dec. 28, 2010). The Advisory Opinion signals the Department's increased propensity to apply customer-based sourcing of receipts under Article 9-A, and its willingness to look to Article 32 (the bank tax) for guidance in sourcing certain types of income in the absence of direct authority under Article 9-A.

Prepaid Credit Card Program. The petitioner markets and processes prepaid debit cards throughout the U.S. It contracts with issuing banks to manage the prepaid debit cards connected with the banks' customer accounts, using its own proprietary software and account and customer service representatives. It facilitates the sale, activation, loading and re-loading of the cards. The petitioner distributes the cards through third-party "distributors," typically retail stores, and provides the stores with the card inventory, marketing materials and IT functionality at the point of sale. It also manages the entire prepaid debit card program. The prepaid debit cards (including gift cards) can be purchased by customers from retailers that accept payments through credits cards such as MasterCard, VISA and Discover, or can be purchased online through the petitioner's website.

The petitioner derives several types of revenues from these activities. First, it charges a flat *fulfillment fee* upon the issuance and subsequent use of the cards, which is paid by the cardholder and split between the petitioner and the retailer. Once the money is loaded onto a card, the petitioner charges various *transactional fees*, which include "interchange fees" (fees usually charged by a card-issuing bank to the merchant bank for processing the cardholder's purchases, but charged by petitioner because it handles the processing), and various *service fees* (such as fees charged each time the card is used by the customer). The petitioner's account managers are located in various states, and solicit business and maintain relationships with existing retailers, including assisting in marketing the cards.

The petitioner, from its out-of-state offices, processes the transactions and manages the cardholder's account data, including activating the card, processing, clearing and settlement and a host of other services. For example, the petitioner receives electronic notification from the retailer when the cardholder makes a purchase over a designated amount. It then verifies that the cardholder has sufficient funds on account with the issuing bank, and notifies the cardholder's bank to release the funds to the merchant.

Advisory Opinion. At issue was how the petitioner should source the various types of fees it receives for purposes of the receipts factor under Article 9-A. The petitioner is able to track its fulfillment fees on a state-by-state basis based on where the underlying card sale takes place, but cannot track the location of transactional fees.

The Department first ruled that *fulfillment fees* generated from the sale of prepaid debit cards to customers should be treated as "other business receipts" under Tax Law section 210.3(a)(2)(D), and sourced based on where they are "earned." For cards sold at a retailer's establishment, the fee is considered "earned" based on where the card is purchased—*i.e.,* at the retail store. Where the customer purchases the card through the petitioner's website, the fees should be allocated to New York if the location where the customer accesses the website is in New York. If that information is unavailable, then the Department will allow it to be sourced based on the customer's billing address. The Department noted that this was consistent with an earlier Advisory Opinion (*Deloitte & Touche*, TSB-A-02(3)C (N.Y.S. Dept. of Taxation & Fin., Apr. 18, 2002)), which concluded that merchant certificates and gift checks sold to customers over a website should be sourced based on where the customer accessed the website and, if that wasn't known, it was presumed that access was from the customer's mailing address.

The Department then addressed the sourcing of the *interchange fees* charged for petitioner's various processing activities, such as card activation and maintenance, transaction authorization, processing and clearing. The Department first concluded that the interchange fees should also be classified as "other business receipts." It acknowledged that neither the tax law nor the Article 9-A regulations provided specific guidance for where those fees were "earned." In the absence of guidance under Article 9-A, however, the Department looked to how income from bank and credit card receivables are sourced under Article 32. There, interest and similar fees on credit cards are sourced in the receipts factor based on the cardholder's mailing address. Also, merchant discounts by the issuing bank for processing the credit card sales are sourced under Article 32 based on the location of the merchant. Here, analogizing to merchant discounts, the Department ruled that it was appropriate for the petitioner to source its interchange fees for processing transactions using a method similar to the sourcing method used under Article 32—based on the location

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Sourcing Receipts from Debit Cards

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of the retailer or, if that location cannot be determined, based on the cardholder's mailing address.

In reaching this conclusion for sourcing interchange fees, the Department stated that an earlier Advisory Opinion (*Peach Tree Bancard Corp.* (*Advisory Opinion*), TSB-A-95(13)C (N.Y.S. Dept. of Taxation & Fin., Aug. 4, 1995)), which held that credit card processing fees should be sourced based on where the processing services are performed, was no longer valid. ("Neither the conclusion in *Peach Tree* nor the rationale remains valid.")

The Department went on to rule that the petitioner's *maintenance and use fees* charged when a customer initiated a transaction, like the interchange processing fees, should be sourced either where the cardholder initiated the transaction (*e.g.*, where the customer re-loads the prepaid credit card) or, if the location cannot be determined, then based on the cardholder's mailing address.

Additional Insights

While Article 9-A does contain special customer-based sourcing rules for certain industries and types of income, questions regarding sourcing continue to persist. The Advisory Opinion appears to reflect recognition by the Department that various types of income should properly be treated as "other business receipts," and thus sourced based on where they are "earned," and that certain types of income are "earned" based on where the underlying customer transaction which generated the income took place. It is noteworthy that the Department expressly overruled an earlier Advisory Opinion treating certain credit card processing fees as services income based on where the services are performed. In that regard, the Advisory Opinion is a reasonable attempt by the Department to avoid vastly different sourcing rules for essentially similar transactions based on whether the taxpayer is subject to Article 9-A or Article 32.

Trio of Decisions on Procedural Issues

By Hollis L. Hyans

Three recent decisions highlight procedural rules in the Division of Tax Appeals that should be kept in mind by anyone who is intending to contest a tax determination.

First, in *Matter of Royal Fried Chicken of New York, Inc*, DTA Nos. 822557 and 822601 (N.Y.S. Tax App. Trib., Dec. 30, 2010), the Tribunal held that an exception to the decision of an Administrative Law Judge, although filed within the period to appeal, was not in proper form. It did not contain a statement of findings of fact and conclusion of law with which the petitioners disagreed, or a statement of requested alternative findings, and the petitioners failed to respond to a Notice of Intent to Dismiss Exception. Therefore, the Tribunal concluded that a timely and proper petition had not been filed, and it dismissed the exception with prejudice.

In *Matter of Marc S. Sznajderman and Jeannette Sznajderman*, DTA No. 823177 (N.Y.S. Div. of Tax App., Jan. 6, 2010), an ALJ held that the Division of Tax Appeals had no jurisdiction to entertain the case because the petitioners had agreed to participate in a Tax Shelter Voluntary Compliance Initiative ("VCI"). The Department had issued a Notice of Deficiency to the petitioners asserting tax, interest and penalties for 2001, including a penalty for failing to participate in an earlier VCI that had been offered to taxpayers who participated in certain transactions regarded by the Department as "tax avoidance transactions." *See New York Dept. of Taxation & Fin. Publication No. 672* (Aug. 8, 2008). After receiving the Notice, petitioners initially requested a conference in the Bureau of Conciliation and Mediation Services. They then elected to participate in the VCI, under the option that allowed them to retain their right to file a claim for credit or refund for amounts paid. When they were notified by the Department that their VCI application could not be accepted if they had any open administrative proceedings, they withdrew their request for a conciliation conference contingent upon their acceptance into the VCI program. They were accepted into the VCI. Several months later, they filed a petition for hearing in the Division of Tax Appeals, but they had never filed a request for refund of the amounts paid with their election to participate in the VCI.

The ALJ held that the Division of Tax Appeals lacked jurisdiction over the matter. The petitioners had chosen to participate in the VCI program, and had elected the option that preserved certain appeal rights. Under that option, taxpayers could file a petition with the Division of Tax Appeals only after the Department took action on a claim for refund of the amounts paid, or certain time periods had elapsed – the earlier of either 180 days after the date of a final determination by the IRS with respect to the transactions involved, or three years after a claim for refund is filed or two years after full payment was made.

Here, the petition was found to be premature. Since the petitioners had never filed a claim for refund of the tax paid, much less waited for the expiration of the various periods specified in the statute for when a petition could be filed, the ALJ held there was no jurisdiction to consider their request. Despite the fact that the Department had agreed to withdraw its argument that jurisdiction was lacking, the ALJ held that such a concession was not binding, and that the parties cannot stipulate to confer jurisdiction in the absence of statutory authority.

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Procedural Issues

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Finally, in *Matter of Cateria Corporation*, DTA No. 823700 (N.Y.S. Div. of Tax App., Jan. 6, 2011), an ALJ held that the petitioner was not entitled to a hearing to contest amounts claimed due in several "Notices and Demands" issued during 2009. The notices had been issued based upon the Department's review of the petitioner's sales and use tax returns for mathematical accuracy, reported computation of tax by locality, timely filing and full payment of the amounts due, and the review conducted by the Department concluded that the petitioner had not made full payment of the tax shown to be due on the returns.

The ALJ dismissed the petition, based upon Tax Law § 173-a. This provision was added in 2004, and provides that a taxpayer does not have the right to a pre-payment hearing to contest a notice and demand claiming tax is due because of errors on a return, federal changes, or failure to pay the tax shown as due on the return. *See* "Summary of 2004 Budget Legislation and Other Recently Enacted Legislation Relating to Sales and Compensating Use Tax," TSB-M-04(8) S (N.Y.S. Dept. of Taxation & Fin., Dec. 3, 2004).

Additional Insights

These cases highlight the importance of paying close attention to the procedural rules set out in the statutes and regulations that established the Division of Tax Appeals and give it its authority. While it operates in a less formal manner than a judicial body, the Division of Tax Appeals only has the authority granted to it by statute, and cannot hear matters outside that authority. Petitions need to be in the specified form, and include a copy of the notice being contested and all the grounds for the protest. Exceptions filed with the Tax Appeals Tribunal to contest ALJ decisions need to specifically describe the findings that are contested and submit alternative findings. When seeking relief from payment under a specific program such as the Voluntary Compliance Initiative, taxpayers need to be sure they have followed all the correct steps in the right order: requesting a refund, if that is what is desired, waiting the appropriate amount of time, and then seeking review in the Department. As the decision in *Sznajderman* demonstrates, even if the Department explicitly withdraws any objection, an ALJ will not hear a case that is not properly before the Division of Tax Appeals. And the decision in *Cateria* stresses the importance of careful review of the kind of notice received by a taxpayer to decide on the appropriate remedy. The issuance of a notice and demand will not give a taxpayer an automatic right to a pre-payment hearing. While in certain circumstances the Department will agree to hold a "courtesy conference," that remedy cannot be counted upon. However, a taxpayer who receives such a notice does have the right to pay, file a claim for refund, and then exercise full appeal rights if the refund is denied.

Bill Introduced to Formally Establish Taxpayer Advocate Office

By Irwin M. Slomka

Legislation has been introduced to formally establish an "Office of the Taxpayer Advocate." S. 1072. In October 2009, the New York State Department of Taxation and Finance created a new Office of the Taxpayer Rights Advocate, headed by Jack Trachtenberg, and modeled after the National Taxpayer Rights Advocate. The Taxpayer Rights Advocate reports directly to the Commissioner, and is authorized to assist taxpayers who are experiencing problems with the Department. In the little more than a year since its formation, the Taxpayer Rights Advocate has been well received by the public, and many have felt that it would be important to formalize the position through legislation, similar to the establishment of the National Taxpayer Advocate.

If enacted, the bill would establish an Office of the Taxpayer Advocate, under the direction and supervision of the Taxpayer Advocate, who would be appointed by the Governor for a four-year term. The Taxpayer Advocate would report directly to the Commissioner, but the Commissioner would have no authority over the staffing, operations and management of the office, including any power or authority over its budget.

The bill would authorize the Taxpayer Advocate to assist taxpayers in resolving problems with the Department. It would also call upon the Taxpayer Advocate to identify problem areas, and to propose solutions and recommend legislative action to resolve problems. As part of those duties, the Taxpayer Advocate would be required to prepare an annual report to the Governor, legislative leaders and the Commissioner discussing its activities during the year, but also making recommendations for administrative and legislative action.

Additional Insights

Given the vital role already played by the Taxpayer Rights Advocate in advocating for taxpayers and working on systemic problems within the Department, many practitioners and taxpayers will undoubtedly welcome this legislation to insure the continuation of the office going forward. The likelihood of the legislation being enacted will probably depend on whether the newly-elected Governor, and the Department itself, supports the bill.

The current Taxpayer Rights Advocate was to prepare an annual report to the Commissioner which, among other things, would identify systemic problems within the Department and recommend reforms. Perhaps the release of that report when finalized would further demonstrate the need for this legislation.

Insights in Brief

U.S. Supreme Court Remands Case on Sovereign Immunity

In our November issue, we reported that the U.S. Supreme Court had granted review of a Second Circuit Court of Appeals decision which had held that two New York counties were barred by the principle of tribal sovereign immunity from proceeding with a foreclosure action against the Oneida Indian Nation for unpaid county taxes, even though the taxes were properly assessed, leaving the counties with a right but no remedy. *Madison County v. Oneida Indian Nation*, Dkt. Nos. 05-6408, 06-5168 & 06-5515 (2d Cir. Apr. 27, 2010), *cert granted*, 562 U.S. __ (No. 10-72) (Oct. 12, 2011). After review was granted, the Oneida Indian Nation submitted a letter advising that the Nation had passed a declaration waiving its sovereign immunity, and the counties submitted a responsive letter, questioning the validity, scope and permanence of the waiver, to which the Nation responded. Now, the Supreme Court has vacated its judgment granting review and remanded the case to the Court of Appeals, for it to consider the effect of the letters and the original ruling on sovereign immunity, and if necessary to address other issues in the case. *Madison County v. Oneida Indian Nation,* 562 U.S. ____ (2011).

Amended Commercial Aircraft Exemption Does Not Apply to Aircraft Purchased Before the Amendment

In 2009, the definition of "commercial aircraft" owned by nonresidents and exempt from sales and use tax was amended, and it now excludes aircraft used primarily to transport employees, officers, members and others associated with affiliated persons. *See* "Amendments Affecting the Application of Sales and Use Tax to Aircraft, Vessels and Motor Vehicles," TSB-M-09(4)S (N.Y.S. Dept. of Taxation & Fin., May 12, 2009). In an Advisory Opinion, TSB-A-11(1)S (N.Y.S. Dept. of Taxation & Fin., Dec. 20, 2010), the Department has advised that the tax status of an aircraft purchased in 2003 would not be affected by the 2009 amendment, even if the aircraft were now to be relocated to New York. Since the petitioner was a nonresident at the time it purchased the aircraft, and at the time of purchase the aircraft qualified as a commercial aircraft for purposes of the commercial aircraft exemption, subsequent use of the aircraft in New York would not subject it to use tax.

Partners of Partnership Located Within Metropolitan Commuter Transportation District Taxable on Earnings within the District

The Department of Taxation and Finance has ruled that two partners who operated an antiques partnership out of their home located within the Metropolitan Commuter Transportation District (MCTD), but who traveled to trade shows in and outside of the MCTD where they made sales, were each subject to the Metropolitan Commuter Transportation Mobility Tax (MCTMT) only on their net earnings arising from business activity actually conducted within the MCTD. *Advisory Opinion*, TSB-A-10(2)MCTMT (N.Y.S. Dept. of Taxation & Fin., Oct. 28, 2010). The Department ruled that each partner's net earnings should be allocated, based either upon the books and records of the partnership or by applying a formulary business allocation percentage, in order to determine whether (i) the $10,000 annual threshold for taxability has been met, and (ii) if met, to compute the amount of MCTMT due.

ABB v. Missouri
Albany International Corp. v. Wisconsin
Allied-Signal, Inc. v. New Jersey
American Power Conversion Corp. v. Rhode Island
Citicorp v. California
Citicorp v. Maryland
Clorox v. New Jersey
Colgate Palmolive Co. v. California
Consolidated Freightways v. California
Container Corp. v. California
Current, Inc. v. California
Deluxe Corp. v. California
DIRECTV, Inc. v. Indiana
DIRECTV, Inc. v. New Jersey
Dow Chemical Company v. Illinois
Express, Inc. v. New York
Farmer Bros. v. California
General Mills v. California
General Motors v. Denver
GTE v. Kentucky
Hair Club of America v. New York
Hallmark v. New York
Hercules Inc. v. Illinois
Hercules Inc. v. Kansas
Hercules Inc. v. Maryland
Hercules Inc. v. Minnesota
Hoechst Celanese v. California
Home Depot v. California
Hunt-Wesson Inc. v. California
Intel Corp. v. New Mexico
Kohl's v. Indiana
Kroger v. Colorado
Lanco, Inc. v. New Jersey
McGraw-Hill, Inc. v. New York
MCI Airsignal, Inc. v. California
McLane v. Colorado
Mead v. Illinois
Nabisco v. Oregon
National Med, Inc. v. Modesto
Nerac, Inc. v. NYS Division of Taxation
NewChannels Corp. v. New York
OfficeMax v. New York
Osram v. Pennsylvania
Panhandle Eastern Pipeline Co. v. Kansas
Pier 39 v. San Francisco
Reynolds Metals Company v. Michigan Department of Treasury
Reynolds Metals Company v. New York
R.J. Reynolds Tobacco Co. v. New York
San Francisco Giants v. San Francisco
Science Applications International Corporation v. Maryland
Sears, Roebuck and Co. v. New York
Shell Oil Company v. California
Sherwin-Williams v. Massachusetts
Sparks Nuggett v. Nevada
Sprint/Boost v. Los Angeles
Tate & Lyle v. Alabama
Toys "R" Us-NYTEX, Inc. v. New York
Union Carbide Corp. v. North Carolina
United States Tobacco v. California
USV Pharmaceutical Corp. v. New York
USX Corp. v. Kentucky
Verizon Yellow Pages v. New York
W.R. Grace & Co.—Conn. v. Massachusetts
W.R. Grace & Co. v. Michigan
W.R. Grace & Co. v. New York
W.R. Grace & Co. v. Wisconsin

When these companies had difficult state tax cases, they sought out Morrison & Foerster lawyers.

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