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MoFo New York Tax Insights

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Peter Madoff Petition Dismissed as Untimely

By Hollis L. Hyans

In a reminder of the strict jurisdictional rules governing challenges to assessments, a New York State Administrative Law Judge has dismissed a petition filed by Peter Madoff seeking to challenge a responsible person assessment for nearly $1 million in allegedly unpaid sales and use tax. *Matter of Peter Madoff*, DTA No. 823411 (N.Y.S. Div. of Tax App., August 25, 2011).

A Notice of Determination dated May 4, 2009, arising from a sales tax audit of Bernard L. Madoff Investment Securities, LLC, was issued to Peter Madoff and, according to the Department, mailed to his home address. Mr. Madoff claimed he never received the Notice, and that the first knowledge he had of the assessment was a Notice and Demand dated August 27, 2009. On September 3, within a week of receipt of the Notice and Demand, Mr. Madoff's representative filed a request for a conciliation conference, which was dismissed as untimely, since it had not been filed within 90 days of the May 4 Notice date. Mr. Madoff then filed a petition for a hearing with the Division of Tax Appeals,

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Madoff Petition Dismissed

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alleging that the May 4 Notice was not received or properly served, and also challenging the computation of tax and interest. The Department moved to dismiss, and the only issue considered was the timeliness of the request for a conciliation conference.

To establish that the May 4 Notice had been properly mailed via certified mail, the Department presented copies of the records of mailing, two affidavits from its employees, and an affidavit from a U.S. Postal Service employee. The documents set forth the usual practice and procedure for processing statutory notices, identified the items that were mailed on September 4, including the one at issue, and explained the processes used. Although the records originally listed 192 pieces of mail, only 191 were received at the post office, and the affidavits explained that one piece of mail was pulled and a line drawn through the entry. Postmarks of both May 4 and May 5, 2009 appear on each page; the May 5 date was crossed off, and the affidavit of the Postal Service employee explained that indicated an error had been caught and corrected.

The ALJ held that the evidence established proper mailing on May 4, and that Mr. Madoff's attempts to challenge the mailing based on discrepancy between 191 and 192 pieces of mail and the two different postmark dates did not prevent the records from being regarded as reliable, since there were clear and reasonable explanations provided.

The ALJ found it "readily apparent" that standard mailing procedures were followed, and that the alleged defects had no bearing on the notice in question. He also rejected the arguments that, because the Department was seeking to hold Mr. Madoff liable for the sales tax of a defunct business, its "less than conclusive evidence of mailing" should not be considered sufficient to warrant dismissal, or that the lateness was a "mere technicality," noting that the 90-day period is jurisdictional. Finally, the ALJ also noted that Mr. Madoff was not without a remedy, since he could pay the assessment and file a claim for refund.

ONCE THE DEPARTMENT DEMONSTRATES ITS USUAL PRACTICE, AND THE RECORDS SHOW MAILING OF THE PARTICULAR NOTICE IN QUESTION... IT IS EXTREMELY, IT IS EXTREMELY DIFFICULT TO PROVE THE NOTICE WAS NOT MAILED.

Additional Insights. Attempts to challenge the Department's proof of proper mailing are rarely successful, and tend to involve unusual circumstances, such as the case described in the August issue of *New York Tax Insights*, in which the taxpayer's apartment had been destroyed by a fire that prevented delivery of mail. *Matter of Lassana Jabateh*, DTA No. 824176 (N.Y.S. Div. of Tax App., July 7, 2011). Once the Department demonstrates its usual practice, and the records show mailing of the particular notice in question, a presumption of receipt arises and it is extremely difficult to prove the notice was not mailed. There is no requirement that notices be sent with "return receipt requested" or that actual receipt by a taxpayer be demonstrated by the Department. While the prospect of having to pay a large assessment in order to challenge it is certainly daunting, there may be no other choice if the original notice has gone astray and the taxpayer does not learn of the purported liability until the jurisdictional period for challenge has elapsed.

Update on Partial Relief from Responsible Person Liability for Limited Partners and LLC Members

By Irwin M. Slomka

In the May 2011 issue of *New York Tax Insights*, we discussed a new policy memorandum of the Department of Taxation and Finance that provided partial relief from personal liability from sales tax for qualifying limited partners and members of limited liability companies. TSB-M-11(6)S (N.Y.S. Dep't of Taxation & Fin., Apr. 14, 2011). The policy was an attempt to mitigate the harsh effects of the strict liability imposed by the Tax Law on every partner of a partnership and member of an LLC for the business's sales

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Responsible Person Liability

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tax liability, regardless of whether the partner or member was under a duty to act for the business. Under that *Technical Memorandum*, the Department limited the liability of qualifying "eligible" persons based on their pro rata share of the partnership's or LLC's liability for sales and use tax and interest.

The Department has now issued a revised *Technical Memorandum* ("New Policy Relating to Responsible Person Liability under the Sales Tax Law," TSB-M-11(17)S (N.Y.S. Dep't of Taxation & Fin., Sept. 19, 2011)), which continues the partial relief policy in all material respects, but includes a few additional requirements:

- Under the prior *Technical Memorandum,* eligible limited partners and LLC members were required to "cooperate with the [D]epartment …in identifying persons who were involved in the day-to day affairs of the business." Moreover, in the case of a tiered ownership structure, the Department "expect[ed] the [eligible] member's assistance in detailing the overall ownership structure . . ." Under the revised *Technical Memorandum*, the eligible partner or member must enter into a written agreement with the Department, which will include the above-described "cooperation" requirement, as well as the partner/member's agreement to compute the pro rata share of the tax liability in the manner described in the new memorandum.
- The revised *Technical Memorandum* now contains step-by-step instructions on how to compute the eligible person's reduced responsible person liability. The earlier memorandum stated that each person's pro rata percentage should be multiplied by the total sales tax liability, including interest, of the business. Under the revised policy, the interest component is computed using the minimum statutory interest rate, rather than the full statutory rate.

  The revised policy makes clear that the tax and interest amount against which the pro rata ownership percentage is applied for each eligible person is reduced by payments made by the business, by responsible persons not eligible for relief (*e.g.*, general partners in a partnership), and by qualifying responsible persons who did not request relief when they made their tax payments.
- The Department continues the policy that payments made by eligible persons are not credited against the liability of other responsible persons who are also eligible for relief. However, under the revised policy, tax payments made by eligible responsible persons are credited against the business's own sales tax liability, but penalties and interest at the full statutory rate continue to accrue against the business.

The revised *Technical Memorandum* states that TSB-M-11(6)S is now obsolete.

ALJ Finds Audit Unreasonable and Cancels Assessment

By Hollis L. Hyans

A New York State Administrative Law Judge canceled a sales tax assessment against a taxpayer's restaurant business, finding that the Department's use of external indices was unreasonable. *Matter of A & J Grand Enterprises, Inc.*, DTA Nos. 822935, 822936 & 822937 (N.Y.S. Div. of Tax App., August 25, 2011).

The audit. The taxpayer, A&J, had during the period in issue operated a restaurant franchise – L & L Hawaiian Barbecue – located in downtown Manhattan. In 2007, A&J agreed to sell the restaurant; in January 2008, a bill of sale was executed. A bulk sale notification was submitted by the purchaser to the Department dated January 3, 2008, and was received by the Department on January 8. The bulk sale notice prompted a sales tax audit, which did not commence until nearly two months later. The auditor immediately prepared a request for all books and records to be made available for a field audit scheduled to begin on March 17, two weeks later.

Although the auditor was aware that A&J no longer conducted business at the restaurant's location, the auditor took the letter to the restaurant, where the manager of the new business promised to forward it to A&J's owner. The auditor also called the new business the next day, but did not mail a copy of the letter to A&J until March 7, four days later, when he sent copies of the letter to the

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ALJ Finds Audit Unreasonable

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owners of A&J at their home addresses, which were addresses used in a 2004 vendor registration application.

Meanwhile, on March 6, the auditor reviewed the case, decided to use a Robert Morris Statement Study Worksheet as a basis to compute tax, and prepared a schedule of tax due based upon his calculations. On March 12, the auditor spoke with the new owner, who claimed to have handed the letter to the seller. On March 13, the auditor met with his supervisor to review the case, decided to estimate the amount of tax due based on external indices, and issued a Statement of Proposed Audit Change, addressed to A&J at the address of the business now operated by the new owner. He relied on computations contained in a study of the restaurant industry to estimate gross sales, the selling prices of business assets, and the value of tangible personal property. On March 27, a Notice of Determination was issued to A&J, and a second Notice of Determination was issued on April 14. Another notice was issued to the owner of A&J as an allegedly responsible person. The ALJ noted that the record was silent on whether the new owner had been timely assessed as a bulk sale purchaser.

The ALJ decision. The ALJ held that the auditor's resort to external indices was improper. While New York law clearly allows an audit to rely on external indices when necessary, such reliance is permitted only when the taxpayer's records are determined to be inadequate, after the auditor has requested and examined those records. Here, the ALJ found that the auditor's requests for A&J's books and records were "weak and casual." Although the auditor knew that A&J no longer conducted business at the restaurant's location, he took the appointment letter there and relied on the new owner to forward it. He waited four more days to mail the letter, by which time he had already decided to use external indices, and then immediately concluded that a detailed audit was not possible because he had received no response. The ALJ found that A&J was not granted a reasonable opportunity to produce its books and records before a determination was made that the records were inadequate, and therefore it was improper for the Department to have resorted to external indices. Accordingly, the ALJ held that the notices of determination should be cancelled.

THE ALJ FOUND THAT A&J WAS NOT GRANTED A REASONABLE OPPORTUNITY TO PRODUCE ITS BOOKS AND RECORDS BEFORE A DETERMINATION WAS MADE THAT THE RECORDS WERE INADEQUATE, AND THEREFORE IT WAS IMPROPER FOR THE DEPARTMENT TO HAVE RESORTED TO EXTERNAL INDICES.

Additional Insights. Auditors are generally granted great leeway in the basis they use to reach a determination of tax due, and many cases support the proposition that, where the Department demands the taxpayer's book and records and no records are produced, the auditor may resort to external indices to estimate tax, as long as the estimate methodology is reasonably calculated to reflect the tax due. *See,* for example, *Matter of Your Own Choice, Inc.*, DTA No. 817104 (N.Y.S. Tax App. Trib., Feb. 20, 2003). Here, however, the ALJ's concern was the unreasonably short period of time allowed by the auditor for the taxpayer to respond to the request for books and records. The auditor did not take actions reasonably intended to get his request to the attention of the former owners, and then almost immediately decided no records would be produced and jumped right to external indices. The ALJ concluded that this process was not a proper basis for the resort to external indices, and that A&J "was not afforded a reasonable opportunity to produce its books and records" before a determination was made that the records were inadequate to allow the conduct of a complete audit.

Revised Guidance on N.Y.C. Tax Rates for "Bulk" Transfers of Cooperatives and Residential Condominiums

By Irwin M. Slomka

The New York City Department of Finance has released a memorandum revising its position on the real property transfer tax rate that applies to "bulk transfers" of cooperative apartments and residential condominium units in New York City. *Finance Memorandum*, "Real Property Transfer Tax on Bulk Sales of

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Transfer Tax Rates

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Cooperative Apartments and Residential Condominium Units," 00-6REV (N.Y.C. Dep't of Finance, Sept. 8, 2011).

The issue stems from a two-tiered rate structure under the real property transfer tax ("RPTT") which applies, in part, to sales of cooperative apartments and condominium units located in New York City. Transfers of an individual cooperative apartment or an individual residential condominium unit are taxed at either 1% of the consideration (where the consideration is $500,000 or less) or 1.425% (if it is over $500,000). For most other types of transfers of real property, the tax rate is 1.425% (where consideration is $500,000 or less) or 2.625% (if it is over $500,000).

The Department applies the higher tax rate to what it refers to as "bulk sales," that is, transfers of more than one co-op apartment or condominium unit by a single grantor to a single grantee. In 2000, the Department issued *Finance Memorandum*, 00-6 (N.Y.C. Dep't of Fin., June 19, 2000), in which it took the position that the transfer of adjacent co-op apartments or condominium units that were physically combined into a single unit *prior* to the transfer would not be treated as a "bulk sale," and would be taxed at the lower rates of 1% or 1.425%. However, if the units were not combined until *after* the transfer, the higher rates of 1.45% and 2.625% would apply.

Subsequent decisions of the New York City Tax Appeals Tribunal have called into question the continued viability of the Department's policy, and the revised *Finance Memorandum* cites three City Tribunal decisions holding that certain transfers of multiple condominium units to a single grantee were not "bulk sales" and thus qualified for the lower tax rate. In two of the decisions (the *Matter of Cambridge Leasing*, TAT(E) 2003-11 (RP), Sept. 12, 2006, Sept. 12, 2006, and *Matter of Rosenblum,* TAT(E) 2001-31(RP), Sept. 12, 2006), a grantee's purchases of more than one condominium unit from the grantor, where the additional unit purchased (respectively, a noncontiguous "maid's room" and a "suite unit") could only be purchased by a condominium unit owner, was held to qualify for the lower rate. In the third decision (*Matter of Gruber*, TAT(E) 2003-7 (RP), *et al.,* Sept. 12, 2006), the City Tribunal held that the purchase of three contiguous condominium units on one unfinished floor, which were temporarily made into separate apartments in order to obtain a Certificate of Occupancy, but which the grantee intended to and later did combine into a single unit, also qualified for the lower rate. The *Gruber* decision, issued in 2006, appears to have rendered the earlier *Finance Memorandum* invalid to the extent it required that the units be combined prior to the transfer in order to qualify for the lower rate.

THE REVISED *FINANCE MEMORANDUM* STATES THAT "THE FACTS AND CIRCUMSTANCES DIFFER IN EACH CASE," AND THAT IF IT IS UNCLEAR WHETHER TRANSFERS QUALIFY FOR THE LOWER [TRANSFER TAX] RATE UNDER [THE TRIBUNAL] DECISIONS . . . [THE TAXPAYER SHOULD] REQUEST A LETTER RULING.

However, rather than set out a revised policy in light of those decisions, the revised *Finance Memorandum* merely states that "the facts and circumstances differ in each case," and that if it is unclear whether transfers qualify for the lower rate under these decisions, "the Department recommends that you request a letter ruling to get the Department's opinion."

Additional Insights. While tax guidance is always welcome, the *Finance Memorandum*, unfortunately, does not provide much in the way of actual guidance. The only discernable policy is to take recognition of three not very recent City Tribunal decisions, and to advise taxpayers that if their particular facts are not clearly covered by those decisions, they should write in for a letter ruling (which requires payment of a $250 processing fee, and can involve up to a 90-day waiting period to obtain). The revised *Finance Memorandum* would have been more useful if it clearly set out the Department's position on what constitutes a "bulk sale" of co-op apartments or condominium units in light of these decisions, and made clear exactly what was being changed from its 11-year-old *Finance Memorandum* (which, having now been revised, has been removed from the Department's website). Despite the new *Finance Memorandum*, the Department's policy remains unclear as to which tax rate will apply, for example, when a grantee buys two adjoining co-op apartments with the intent of seeking co-op board approval to combine them, or when a grantee buys two condominium units from a seller as an investment.

Insights in Brief

Governor Cuomo Vetoes Taxpayer Advocate Bill

Governor Andrew Cuomo has vetoed the "Taxpayer Advocate" bill (S. 1072-2011) that would have made the existing Office of the New York State Taxpayer Advocate independent of the Tax Commissioner (discussed in the February and July 2011 issues of *New York Tax Insights*), comparable to the independent federal Taxpayer Advocate. *Veto Message No. 70*, Sept. 23, 2011. Governor Cuomo stated in his veto message to the Senate: "Given that [the existing Taxpayer Advocate office] has proven to be effective and successful, it seems unnecessary to create a new version of the same program." The Governor cited the need for fiscal austerity, control over costs and government efficiency as reasons for his veto.

Sales Tax Treatment of Prepaid Discount Vouchers

The Department of Taxation and Finance has issued guidance on the application of sales tax to purchases made using vouchers sold by Internet-based companies (referred to as "deal sites") that are later redeemed at a business that sells the property or service. *Technical Memorandum,* "Sales Tax Treatment Relating to the Sale and Redemption of Certain Prepaid Discount Vouchers," TSB-M-11(16)S (N.Y.S. Dep't of Taxation & Fin., Sept. 19, 2011). No tax is due on the sale of a voucher by a deal site, but tax must be collected from a customer when a voucher is redeemed for taxable products or taxable services. If a voucher is for a specific product or service, the amount subject to sales tax is the total price paid by the customer to the deal site; if a voucher is good more than once, the amount for each redemption is determined by dividing the total price paid by the number of times the voucher may be redeemed. If a voucher has a stated face value, it is treated like a gift card and sales tax is computed on the selling price of the items before the value of the voucher is applied. If it used to purchase products at less than the full value of the voucher, the business can either collect the sales tax from the customer in cash, or can allow the customer to use the remaining value of the voucher to pay the sales tax.

Advisory Opinion Clarifies "Destination" Rule for Local Sales Tax

In an Advisory Opinion, the Department of Taxation and Finance ruled that local sales taxes should be based on the rates in effect in the sales tax jurisdiction where the property is actually delivered to the purchaser. *Advisory Opinion*, TSB-A-11(23)S (N.Y.S. Dep't of Taxation & Fin., Aug. 19, 2011). Both the vendor and the purchaser agreed that the items in question, parts used by a marina operator to repair its forklift, were subject to sales tax, but the vendor contended that, because possession of the property was deemed transferred to the purchaser when the goods were turned over to a common carrier for shipping, the tax rate should be governed by the rate applicable in the vendor's local tax jurisdiction where the goods were delivered to the carrier. The Department found that, regardless of the contract terms (for example, whether the terms were FOB or FAS), the vendor must collect and remit tax based on the rates in the jurisdiction where the purchaser takes actual delivery of the goods from the common carrier.

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