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DEPARTMENT RELEASES NEW NONRESIDENT AUDIT GUIDELINES TO ADDRESS *GAIED*

By Michael J. Hilkin

Four months after the Court of Appeals held in *Matter of Gaied v. Tax Appeals Tribunal*, 22 N.Y.3d 592 (2014) (discussed in the March 2014 issue of *New York Tax Insights*), that there was no rational basis for the Department's position that an individual who maintains a dwelling in New York for others but does not reside in that dwelling nonetheless has a "permanent place of abode" in New York for statutory residency purposes, the Department has updated its personal income tax Nonresident Audit Guidelines ("Guidelines"). The revisions to the Guidelines primarily address the *Gaied* decision, but also provide other guidance to auditors and to taxpayers.

Revisions Addressing the Gaied Decision. Under New York's "statutory residency" test, individuals who maintain a permanent place of abode in New York and spend more than 183 days in the State during a year are treated as residents for income tax purposes. The Guidelines have customarily contained a lengthy discussion regarding the statutory residency test. The revised Guidelines now include a summary of *Gaied,* and state that the Court of Appeals concluded in the case that "for a taxpayer to be maintaining a permanent place of abode, he must have a 'residential interest' in the dwelling."

The Department's revised Guidelines state that the ruling in *Gaied* "is consistent with current Audit policy that the taxpayer must have a relationship to [a] dwelling for it to constitute a permanent place of abode." However, the list of factors for an auditor to consider when determining whether a taxpayer has a sufficient relationship with a dwelling for it to be classified as a permanent place of abode no longer contains a factor examining "[w]hether the taxpayer has ownership or property rights in the dwelling."

Borrowing language from the holding in *Gaied*, the revised Guidelines now state that a property may be classified as a permanent place of abode if the taxpayer has a "residential interest" in the property. The revised Guidelines also provide examples clarifying the circumstances in which the Department believes a taxpayer will have a residential interest in a property. Those examples indicate that the Department continues to focus primarily on a taxpayer's ability to use a property as a dwelling space, rather than the taxpayer's actual use of the property as a dwelling space. In one new example, an individual who listed her New York home for sale in connection with a change of domicile to Florida nonetheless is considered to maintain a permanent place of abode for

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statutory residency purposes when the listed home remains fully furnished and the taxpayer maintains "unfettered access" to the home, even if "she no longer resided there." The Department justifies its conclusion on the basis that the taxpayer has the unrestricted ability to use the home "which had been her primary residence in the past and *no one else is using [] as a residence currently*." (Emphasis in Guidelines.) However, if the taxpayer listing her home had "demonstrated that the contents of the home were moved to her Florida residence and the New York home was vacant," the Department would not treat the listed home as a permanent place of abode for statutory residency purposes because "it would not be reasonable to expect her to use a vacant home."

Borrowing language from the holding in *Gaied*, the revised Guidelines now state that a property may be classified as a permanent place of abode if the taxpayer has a "residential interest" in the property.

Other Revisions. The revised Guidelines also provide some new guidance unrelated to the *Gaied* decision. For example, with respect to the statutory residency requirement that a taxpayer spend more than 183 days in New York, the revised Guidelines now acknowledge that taxpayers do not always maintain a paper trail to substantiate their whereabouts on weekend days where they claim to have been in their state of domicile, and provide that auditors "should generally accept [a] taxpayer's allegations" that he or she was not in New York on weekends "absent evidence to the contrary."

Additional Insights

While the Guidelines state that "they have no legal force or effect" and are not precedential, they are nevertheless "generally binding on audit staff." The new examples in the revised Guidelines indicate that the Department intends to take a narrow reading of the conclusions reached by the court in *Gaied*. The Court of Appeals stated in *Gaied* that the legislative history of the statutory residency test indicates that the test is intended "to prevent tax evasion by New York *residents*" (emphasis in decision), and highlighted language from the legislative history discussing taxpayers "who actually maintain homes in New York and spend ten months of every year *in those homes* . . . but . . . claim to be nonresidents." (Emphasis added.) However, in two of the new examples in the revised Guidelines, the Department concludes that a property will be classified as a permanent place of abode even though the taxpayer does not actually reside in the property. The Department's attempts to limit the reach of *Gaied* should not be particularly surprising. Nonetheless, the reasoning of the Court of Appeals in the *Gaied* decision may give taxpayers reason to pause before accepting an auditor's statutory residency assertion supported by the examples in the revised Guidelines.

NUCLEAR POWER PLANT THAT PRODUCES STEAM AND WATER TO GENERATE ELECTRICITY IS NOT ELIGIBLE FOR INVESTMENT TAX CREDIT

By Kara M. Kraman

The Tax Appeals Tribunal has affirmed the determination of an ALJ that various assets used in the operation of a pair of nuclear power plants to produce steam used to generate electricity did not qualify for the investment tax credit ("ITC") for manufacturing under Article 9-A. *Matter of Constellation Nuclear Power Plants LLC*, DTA No. 823553 (N.Y.S. Tax App. Trib., June 18, 2014).

The taxpayer owned and operated two nuclear power plants in New York State. Both plants created steam from water, which was then used to generate electricity. As part of the same process, the steam was condensed back into water so the cycle could be repeated. Although different methods were used to create the steam, both plants used the steam to generate electricity that they sold. Both of the plants sold only electricity, and did not sell steam or water.

An ITC is allowed under Article 9-A for tangible personal property and other tangible property that is "principally used" by the taxpayer in the production of "goods" by manufacturing. Tax Law § 210(12)(b)(i)(A). Under the case law, "goods" constitute "tangible movable personal property having intrinsic value." *Matter of Leisure Vue v. Comm'r of Taxation & Fin.*, 172 A.D.2d 872, 873 (3d Dep't 1991). The term "goods" does not include electricity. Tax Law § 210.12(b)(i)(A).

While the taxpayer did not claim the ITC for equipment that was clearly used to produce electricity, the taxpayer did claim the ITC for the equipment it used to turn steam into water and water into steam on the grounds that the equipment was principally engaged in the production of steam from water and water from steam, not in the production of electricity, and both water and steam qualify as "goods."

The ALJ had rejected the taxpayer's argument, finding that the relevant equipment was part of "an integrated and continuous system that must operate in a synchronized and harmonious manner," and that the subject assets were used to produce electricity for 99% of their operating time. The ALJ did not reach

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the issue of whether the process of changing steam into water and water into steam constituted the manufacture of "goods."

The Tribunal affirmed the ALJ's determination, concluding that the assets were principally used in the production of electricity, and therefore did not qualify for the ITC. Relying on the Appellate Division decision in *Matter of Brooklyn Union Gas Company v. Tax Appeals Trib.*, 107 A.D.3d 1080 (3d Dep't 2013), the Tribunal held that when determining whether the ITC should apply, "the key inquiry is whether the claimed equipment is principally used to manufacture a usable product that substantially differs from the beginning inputs." The Tribunal found the taxpayer's argument that it produced "steam from water and water from steam" was unpersuasive, as the steam produced from the water is condensed back into water to repeat the cycle, and the beginning water therefore did not differ materially from the ending water.

[T]he Tribunal explained that "it is inappropriate to artificially divide a unitary process when the facts show that the parts and steps operate interdependently and indivisibly in accomplishing a singular task."

The Tribunal also rejected the taxpayer's argument that *Brooklyn Union Gas* stood for the proposition that the claimed manufacturing equipment should be viewed on an "asset-by-asset" basis, under which the assets, although part of the electricity production process, might qualify for the manufacturing ITC because when viewed in isolation, they produced steam and water. Citing to *Niagara Mohawk Power Corp. v. Wanamaker*, 286 A.D. 446 (4th Dep't 1955), *aff'd* 2 N.Y.2d 764 (1956), the Tribunal explained that "it is inappropriate to artificially divide a unitary process when the facts show that the parts and steps operate interdependently and indivisibly in accomplishing a singular task."

Unlike the ALJ, the Tribunal addressed the issue of whether the taxpayer was principally engaged in producing a "good" suitable for use, but concluded that the taxpayer failed to carry its burden of establishing the water or steam was a "good" suitable for use because they were incapable of either leaving the system or being used for any process other than producing electricity.

Additional Insights

The Tribunal noted that part of the reason it rejected an "asset-by-asset" approach was because it "did not comport with the facts of this case." This leaves open the possibility that there may be facts and circumstances under which an asset-by-asset approach would be appropriate in determining whether the ITC applies. However, to employ such an approach, a taxpayer would presumably need to manufacture "goods" that are themselves eligible for the ITC, even if those goods are not for sale.

ALJ HOLDS FIXED MONTHLY CHARGES FOR MOBILE VOICE SERVICES SUBJECT TO SALES TAX

By Hollis L. Hyans

A New York State Administrative Law Judge has held that sales tax was properly assessed on interstate wireless voice services bundled with intrastate services, but that Internet access services and interstate overage charges were not subject to sales tax. *Matter of Helio, LLC*, DTA No. 825010 (N.Y.S. Div. of Tax App., June 12, 2014).

Facts. Helio LLC was a mobile virtual network operator that sold wireless mobile telecommunication services to customers throughout the United States, including in New York during 2006 through 2009, the audit period. Helio offered customers two fixed monthly charge plans. "A La Carte" plans allowed interstate and intrastate voice calls and ancillary services, such as call waiting and call forwarding, for a specified number of minutes per month. "All-In" plans were similar, but also included data-based services such as Internet access, text messaging, and email, and had higher monthly rates. For either plan, customers were charged per-minute overage charges if they exceeded their allotted minutes each month, which were separately stated on customer invoices. All-In plan customers were charged per-kilobyte data usage overage charges for data usage exceeding the amount included in the plan, which were also separately stated on invoices. Helio also invoiced its customers for its costs of contributing to the Federal Universal Service Fund ("FUSF"), relying on safe harbor percentages established by the Federal Communications Commission to calculate the amount of FUSF contribution cost fee to charge to its customers.

Helio collected and remitted New York sales tax only on the portion of the fixed monthly charges for the two plans that it determined was attributable to voice services for intrastate calls and took the position that the portion it deemed attributable to interstate calls was not subject to sales tax. It also collected and remitted sales tax only on the overage charges that were attributable to intrastate voice service, and not on the portion attributable to interstate calls or Internet access. It did not collect sales tax on the FUSF contribution fees that it recovered from its customers.

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Issues. The Department of Taxation and Finance relied on estimates for a portion of the audit period, despite Helio's offer to produce complete records. It assessed sales tax on the full amount of the fixed monthly charges for the A La Carte and All-In plans, taking the position that bundled charges were taxable in their entirety; tax on all of the overage charges for interstate wireless voice service and Internet access, although conceding that charges for interstate voice service and Internet access service, if separately stated, are not subject to tax; and tax on the FUSF contribution recoveries. Only minimum interest was imposed, and the Department stated in the audit report that reasonable cause existed for Helio's filing position.

The ALJ … found that the full amount of fixed monthly charges for mobile voice services is subject to tax and not covered by the exemption … for interstate telephony.

Decision of the ALJ. First, the ALJ found that the Department's reliance on an estimate for the portion of the audit period was improper, since Helio's books and records were adequate and Helio had not agreed to a test period, so the assessment for that part of the audit period was canceled.

The ALJ then went on to analyze the taxes imposed by Tax Law § 1105(b). Helio was relying on the language in § 1105(b)(1), which imposes tax on telephony and telephone services "except interstate and international … telephone … service and except any telecommunications service the receipts from the sale of which are subject to tax under paragraph two of this subdivision …" to argue that the charges for interstate calls were specifically exempted. The ALJ focused on § 1105(b)(2), which imposes tax on "the receipts from every sale of mobile telecommunications service … *or* any other services that are taxable under subparagraph (B) of paragraph one … sold for a fixed periodic charge (not separately stated) …" (emphasis added), and found that the full amount of fixed monthly charges for mobile voice services is subject to tax and not covered by the exemption in § 1105(b)(1) for interstate telephony, and that "use of the disjunctive 'or' [in § 1105(b)(2)] indicates that subdivision (b)(2) applies to voice services and nonvoice services … sold for a fixed periodic charge." The ALJ also relied on the decision in *People v. Sprint Nextel Corp.*, 41 Misc. 3d 511 (N.Y. Sup. Ct., N.Y. Cnty. 2013), *aff'd.*, 114 A.D.3d 622, *leave to app. granted*, No. 103917/11 (N.Y. App. Div. 1st Dep't June 12, 2014), in which the courts did not accept, for purposes of a motion to dismiss, Sprint Nextel's arguments that interstate voice services were excluded from New York sales tax under § 1105(b)(1).

The ALJ also rejected the argument – again, as did the courts in *Sprint Nextel* – that the federal Mobile Telecommunications Sourcing Act ("MTSA") preempts the Tax Law, finding no conflict between the Tax Law and the MTSA, since the MTSA applies only to tax on mobile telecommunications charges aggregated with other charges if the taxing jurisdiction does not otherwise subject the mobile telecommunications charges to tax, and here the ALJ found that New York does otherwise subject the charges to tax. The ALJ also found that the FUSF fee was properly subject to tax because it was an integral part of the service that Helio chose to pass on to its customers and was not related to actual interstate usage.

However, with regard to the interstate overage charges, the ALJ agreed with Helio that these were not subject to tax, since they were not part of the bundled plans, and found that Helio had met its burden of demonstrating that the charges were related to interstate services and subject to the exclusion. After April 2007, Helio identified and separately stated the interstate charges, as recognized by the audit report, and could support the charges with its books and records. For charges until April 2007, although Helio's billing data did not distinguish between interstate and intrastate voice charges, Helio was able to identify from its books and records the interstate charges by call detail, and thus those charges were similarly found exempt. Helio's charges for Internet services were also found to be exempt, although included in the bundle, since Helio was able to identify charges attributable to the Internet access service. This was generally done by demonstrating the difference in price between plans sold with and without Internet service with the same number of calling minutes, since the price differential was based on the cost for Internet access services. Finally, Helio's separate data overage charges, also separately stated, were found to be exempt.

Additional Insights

Although the ALJ found that the Tax Law imposed tax on the interstate charges when bundled with intrastate charges, there is an exemption provided in Tax Law § 1105(b)(1) for interstate charges, and the ALJ's determination involved a technical interpretation of a complicated law and the use of the term "or" in a subsection following the exemption to preclude application of the exemption to bundled charges. To the extent the ALJ's opinion relied on the Appellate Division's affirmance of the trial court decision in the *Sprint Nextel* case, that reliance may turn out to be misplaced: on the same day the *Helio* decision was issued, the Appellate Division granted Sprint Nextel's request to have its appeal heard by the Court of Appeals. *State of New York v. Sprint Nextel Corp., et al.*, No. 103917/11 (N.Y. App. Div. 1st Dep't June 12, 2014). Further proceedings in that action have been stayed pending appeal.

It is also interesting to note that on audit in *Helio*, the Department imposed only minimum interest and sought no penalties, acknowledging that Helio had reasonable cause for its

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interpretation of the statute, while in *Sprint Nextel* the Attorney General has pursued the issue under the False Claims Act and sought substantial penalties for what appears to be the same interpretation of the statute relied upon by Helio.

MANAGEMENT FEE PAID TO CORPORATE PARTNER HELD NOT DEDUCTIBLE FOR UBT PURPOSES

By Irwin M. Slomka

The deductibility of payments to partners under the New York City unincorporated business tax ("UBT") has long been a source of controversy. Among the areas of dispute is the deductibility of payments made to a corporate partner. In a case involving the deductibility of payments made to a corporate partner as compensation to the partner's employees who also were partners of the taxpayer partnership, an Administrative Law Judge has held that those payments were subject to the UBT add-back for payments to partners for services. *Matter of Tocqueville Asset Mgmt. L.P.*, TAT(H)10-37(UB) (N.Y.C. Tax App. Trib., Admin. Law Judge Div., June 17, 2014).

Facts. Tocqueville Asset Management L.P. ("Tocqueville") is an investment advisor limited partnership that conducts business in New York City and is subject to the UBT. Tocqueville has no employees of its own. Its affairs are managed by, and it acts solely through, the employees of its sole general partner, Tocqueville Management Corp. ("TMC"), an S corporation that also manages a related securities broker-dealer.

Tocqueville paid TMC an annual management fee for these management services, computed based on TMC's expenses incurred to provide the services. The largest component of TMC's expenses was compensation paid to its employees, many of whom were also partners in Tocqueville. Tocqueville's partners, including TMC, then received their distributive share of Tocqueville's net income after payment of the management fee.

In its UBT returns for 2005, Tocqueville deducted the management fee paid to TMC that represented compensation paid to TMC's employees, including those employees who were also partners in Tocqueville. The Department of Finance disallowed the deduction for payments for salaries to partners, totaling nearly $11 million. (The decision does not state explicitly whether the Department also disallowed the portion of the management fees that represented salaries paid to TMC's employees who were *not* partners in Tocqueville.)

The UBT law provides that no deduction is allowed "for amounts paid or incurred to a proprietor or partner for services or for use of capital." Admin. Code § 11-507(3).

There are detailed UBT rules interpreting this section. For instance, the rules state explicitly that payments to a corporate partner for services provided by the corporate partner's *officers* are not deductible. 19 RCNY 28-06(d)(1)(ii)(B). Most relevant, the rules do permit the deduction of payments made to a corporate partner "which reasonably represent the value of services provided by the unincorporated business *by the employees of such partner*." 19 RCNY § 28-06(d)(1)(ii)(D) (emphasis added) ("D Exception"). The rule conditions deductibility on the payment being "included in that partner's gross income for Federal income tax purposes."

At the administrative hearing, Tocqueville argued that the UBT rules do not require the add-back of payments to a corporate partner for the services of an employee of that partner who is also a partner in the taxpayer partnership. To the extent the payment made to TMC was for services of Tocqueville's individual partners, those partners were rendering services as employees of TMC. Thus, Tocqueville maintained that it was not a payment to a partner for services performed for the partnership, and was properly deductible. The Department took the position that the payments were nondeductible payments for services rendered by partners.

The ALJ noted that if Tocqueville's position was upheld, taxpayers could avoid UBT "by simply establishing a corporate partner and making the taxpayer's partners employees of that corporate partner."

Decision. The ALJ held that because the management fees paid by Tocqueville to its corporate partner were compensation for services provided by partners in Tocqueville, they were not deductible. It did not matter whether the services were performed by those partners directly for Tocqueville. Although the ALJ found that the taxpayer's management fee arrangement was bona fide and had economic substance, and was not done to avoid UBT, he nonetheless concluded that those facts were not relevant, since the statute itself was clear.

Tocqueville also claimed that it qualified for the D Exception to the add-back in the UBT rules, which (as discussed above) allows a deduction to the extent the payment to the corporate partner is for services provided by employees of the corporate partner. The ALJ held that the D Exception did not apply, interpreting that rule as applying "only where the employees are not themselves partners in the partnership."

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The ALJ noted that if Tocqueville's position was upheld, taxpayers could avoid UBT "by simply establishing a corporate partner and making the taxpayer's partners employees of that corporate partner." The ALJ cited the City Tribunal decision in *Miller Tabak Hirsch & Co.*, TAT(E) 94-173(UB) (N.Y.C. Tax App. Trib., Mar. 30, 1991), which held that payments made to employees of a partnership in their capacity as employees, but who are also partners in that partnership, are not deductible. The ALJ concluded that *Miller Tabak* "made clear that once it is determined that payment is to a partner, the payment for services 'in whatever capacity' [quoting *Miller Tabak*] is not deductible."

The ALJ also rejected the applicability of the D Exception to the add-back because it also requires that the payments be included in the partner's gross income in order to be deductible. Here, TMC, the corporate partner, acknowledged that it did not report the management fee as income for tax purposes. While there were bona fide reasons for not reporting the income — including the fact that it had the same effect it would have had if TMC had deducted the employee salaries and reported the management fee income — the ALJ concluded that this was not relevant to qualifying for the add-back exception.

Additional Insights

The language of the UBT add-back for payments to partners for services is admittedly broad in scope. Taxpayer claims that a payment to a corporate partner qualifies as a deduction often involve analyzing whether that scope has been narrowed under the UBT rules. The ALJ is correct in stating that the law and rules should not be interpreted in a way that facilitates tax avoidance by simply allowing a partnership to create a corporate partner and make its partners employees of the corporate partner. On the other hand, nowhere in the D Exception to the add-back does the rule deny the exception to payments for services of the employees of the corporate partner if the employees are also partners in the taxpayer partnership. In contrast, it is quite clear under the UBT rules that payments made to a corporate partner for services performed by an individual who is both an officer and an employee of the corporate partner are not deductible. Given the continuing confusion regarding the scope of the D Exception, the time may be ripe for clarifying amendments.

PATENT LICENSE FEES FOR LASER SURGERY PROCEDURES HELD NOT SUBJECT TO SALES TAX

By Irwin M. Slomka

A New York State Administrative Law Judge has held that patent license fees charged for the use of a taxpayer's patents covering methods and apparatus used to perform laser corneal surgery are not subject to sales tax. *Matter of AMO USA, Inc.*, DTA No. 824550 (N.Y.S. Div. of Tax App., June 19, 2014). The decision rejects multiple arguments raised by the Department of Taxation and Finance to support taxability, most of which were based on the contention that the fees were in actuality part of the sales price for the laser equipment itself.

Facts. AMO USA, Inc. ("AMO") is engaged in the development, manufacture, and distribution of surgical procedures and technology for use in laser-assisted corneal surgery. Since 1985 and through the period in issue (March 1, 2004 through November 30, 2006), AMO applied for and received 56 United States patents related to performing laser corneal surgery. It granted a nonexclusive license to 65 U.S. patents to perform the surgery (although six of those patents had expired midway through the audit period).

The ALJ held that both the form and substance of the transactions evidenced that the patent license fee was a payment for a valuable and bona fide intangible right, and therefore was not subject to sales tax.

AMO sold excimer lasers used for laser surgery, and it collected New York sales tax on its nonexempt sales of those lasers in New York. When AMO sold an excimer laser directly to a physician or hospital, it also entered into a nonexclusive patent license agreement with that purchaser-operator. The license gave the purchaser-operator permission to perform the patented and FDA-approved corneal surgery. In exchange, the purchaser-operator agreed to pay AMO a per-procedure license fee of either $100 or $235, depending on the procedure. The fees were included as a separately identifiable line item on AMO's invoices. AMO did not collect sales tax on the procedure license fees.

AMO also sold plastic key cards that were required to be inserted in the laser in order to perform the surgical procedures. AMO did collect sales tax on the charges for the key cards. AMO also entered into license agreements with competitors, allowing those companies to manufacture and distribute lasers covered by its patents, and allowing those companies to license to surgeons the right to perform the patented procedures, in exchange for a license fee.

Sales tax is imposed on the sale of tangible personal property, but not on intangible personal property. The sales tax law and regulations do not specifically define "patents" as intangible property, although they are so defined under Article 9-A.

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Following an audit of AMO's sales tax returns, the Department assessed sales tax on the procedure license fees. At the administrative hearing, AMO took the position that patent license fees were for a separately identified and invoiced intangible right that was not subject to sales tax.

The Department made several arguments in support of taxability. First, it called into question the validity of the fee itself, since the charges did not account for the expiration of six patents. The Department claimed that the fee was merely an additional cost for the lasers that was "backloaded" in the transaction ("[a] ploy to increase business"). It also claimed that the arrangement was "an integrated or step transaction" in which both the patent license and the key card were merely part of the taxable sale of the excimer laser system.

Decision. The ALJ held that both the form and substance of the transactions evidenced that the patent license fee was a payment for a valuable and bona fide intangible right, and therefore was not subject to sales tax. The ALJ found that the laser sales agreement, key card agreement, and patent license agreement "clearly established both the form and substance of the transaction," and that AMO did not convey its patent rights when it sold the laser system.

The ALJ rejected as unsupported by the record the Department's claim that the sale of the laser and key card included an implied right to use it, and that the fee was merely an additional cost of the laser system separately stated to avoid sales tax. As for the Department's argument that the expiration of six of AMO's 65 patents, without any reduction of the license fee, showed that the fees had no rational basis, the ALJ noted that the expired patents were the oldest and least technologically advanced. He also rejected the Department's claim that the fee was a "pricing scheme" by which AMO "backloaded" part of the cost of the lasers.

As the patents were intellectual property of considerable value, the fees for the patents also were not an expense item of AMO passed through to purchasers of the lasers. The ALJ distinguished the case from *Penfold v. State Tax Commission*, 114 A.D.2d 696 (3d Dep't 1985), where the Third Department upheld the imposition of sales tax on "dumping fees" for the taxable service of trash removal, finding that the dumping of trash was merely an expense of the company performing the trash removal. In contrast, the patent license fees were made pursuant to a separate written agreement and were designed to protect a valuable intangible right. In *Advisory Opinion*, TSB-A-11(32)S (N.Y.S. Dep't of Taxation & Fin., Dec. 7, 2011), the Department had ruled that a seller of laser surgery equipment that also charged equipment purchasers a per-use fee was presumed to be making taxable sales with respect to those fees. The ALJ distinguished the Advisory Opinion on the grounds that it involved a fee by a taxpayer that did not own the patent, so that the fee was merely an expense that was being passed along to purchasers of the laser equipment.

The ALJ's discussion of two other legal arguments by the Department is noteworthy. The Department claimed that AMO was selling an "indivisible bundled transaction" under which the patent license fee could not be broken out. The ALJ pointed out that under the bundled transaction rule, where a single invoice charge includes both taxable and nontaxable components, the entire charge is subject to sales tax. Here, however, the taxable and nontaxable portions were separately purchased, with separately identified charges that were shown to be reasonable, and thus the rule was inapplicable.

The ALJ also addressed the Department's contention that the sale of lasers was an "integrated transaction" based on a "step transaction" analysis, and that the license fee could not be broken out. The ALJ referred to the Department's "novel application [of the step transaction doctrine] to the sales transaction herein [as] ill-fitting and tenuous." Even if the step transaction doctrine were applied, however, the ALJ concluded that the individual step of having customers purchase patent licenses "was an intended end result in and of itself."

Additional Insights

While the Department appears to have viewed the procedure license fee as nothing more than part of the sales price of AMO's taxable sale of the lasers themselves, the ALJ correctly concluded that the patents were bona fide and valuable intangible rights that were separately licensed between unrelated parties for a separate charge. Moreover, the license fee was sometimes charged even where AMO did not sell the lasers. Thus, there was both form and substance to the licensing arrangements, and the Department's resort to various creative arguments to tax those arrangements was unavailing.

REFUND ARISING FROM FRAUD FOUND BARRED BY STATUTE OF LIMITATIONS

By Hollis L. Hyans

An art gallery was denied a refund of sales tax that it had collected from one of its clients and remitted to the Department of Taxation and Finance, although the gallery had returned both the purchase price and the sales tax to the client when the painting was found to be a forgery, because the refund claim was held to have been untimely. *Matter of Richard L. Feigen & Company, Inc., LLC*, DTA No. 824996 (N.Y.S. Div. of Tax App., July 10, 2014).

Facts. Richard L. Feigen & Company, Inc. (the "Gallery"), is an art gallery located in New York City. In September 2003, the Gallery acquired from a Swiss seller what was represented to be a Max Ernst painting, "Forêt," for $2.325 million. The authenticity of the painting was supported by a Provenance showing the history of ownership and a Certificate of Authenticity from a respected art historian who was known to

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be a leading expert on Max Ernst. In January 2004 the Gallery sold the painting for $2.5 million to Anna-Marie Kellen, and collected and remitted to the Department $215,625 in sales tax.

At the time of the 2004 sale, neither the Gallery nor Ms. Kellen had any knowledge or suspicion that the painting was not authentic. However, in late 2010, news articles began to expose an art-fraud ring that included paintings purportedly painted by Max Ernst, and three persons were arrested in Germany for their involvement. They were later convicted and sentenced, and it was also discovered that the art historian who had provided the Certificate of Authenticity had been fooled by the forger as well. In February 2011, the Gallery received notice from the Berlin Police Department that the painting might be a forgery; it provided information, retrieved the painting from Ms. Kellen, and sent it for a scientific examination, which resulted in a conclusion by the Gallery that the painting was not authentic. In March 2011, the Gallery requested a refund from the Swiss seller of the $2.325 million it had paid for the painting, plus reimbursement for examination and shipping expenses, which was received in full. On June 20, 2011, the Gallery in turn refunded the full purchase price, and the sales tax, to Ms. Kellen. The next day it applied for a refund of the $215,625 in sales tax, relying on 20 NYCRR 534.8, which permits a refund when a taxpayer "erroneously collected sales tax on the sale of tangible personal property fraudulently misrepresented as an original work of art." The refund claim was denied by the Department as untimely.

The ALJ rejected the Gallery's claim that equity requires a refund, since the Division of Tax Appeals "does not have authority to determine matters equitably."

Decision. The Administrative Law Judge upheld the denial, in reliance on the statute of limitations contained in Tax Law § 1139(c), which requires applications for refund or credit of sales tax to be filed within three years from the time the return was filed, or two years from when the tax was paid. The Gallery argued that the statute of limitations should have been tolled until, at the earliest, March 2011, as a result of fraud, citing CPLR § 213, which allows a civil action based on fraud to be filed by the later of six years from the date it accrued or two years from the time the fraud was discovered or could reasonably have been discovered. The ALJ rejected this argument, finding that the Tax Law specifically disallows the granting of refunds after the specified period of time has passed, and that public policy does not favor granting a refund filed late. She relied on the decision in *Matter of Renaud*, DTA No. 823595 (N.Y.S. Tax App. Trib., Oct. 13, 2011), for the proposition that the statute of limitations allows a reasonable time for a taxpayer to realize an error has been made and seek a refund, and that the State knows there is only a specific statutory period during which it could be liable, after which the matter is ended, and "[a]nything less than this degree of certainty would make the financial operation of government difficult, if not impossible." The ALJ rejected the Gallery's claim that equity requires a refund, since the Division of Tax Appeals "does not have authority to determine matters equitably." The ALJ also found that the "special refund authority" provisions of Tax Law §§ 697(d) and 1096(d) apply only to personal income tax and corporation franchise tax, and that failing to apply those provisions to the sales tax does not amount to a violation of the Gallery's Constitutional rights to Equal Protection or Due Process.

Additional Insights

Given the statutory limits on refunds and the inability of the Division of Tax Appeals to award relief in equity, the ALJ had limited tools available to deal with the late-filed claim. However, the case relied upon by the ALJ for her conclusion regarding the inapplicability of the CPLR provisions providing for tolling of the statute of limitations in the case of fraud, *Matter of Renaud,* does not seem to fully support the conclusion that the fraud tolling provisions are totally inapplicable, since it did not involve any claims that the taxpayer had been defrauded, or that the statute of limitations should be tolled for any reason. In fact, the taxpayer in *Renaud* had pled guilty to charges of grand larceny and was seeking in 2009 a refund of the amount it had been required to pay in restitution in 2001, so it is unsurprising that its refund claim was denied as untimely. The Gallery in this case seems to have done everything it could under the circumstances, since it reasonably relied on the documents it had been provided by the seller, responded appropriately to a German police investigation, and returned the full purchase price and sales tax to its customer. Since the fraud was not discovered until long after the usual sales tax statute of limitations had expired, the Gallery – an innocent party – is left bearing the sales tax.

INSIGHTS IN BRIEF

ALJ Dismisses Petition Submitted by Out-of-State Attorney

In a decision highlighting the importance of following the rules regarding appearances by out-of-state attorneys, a New York State Administrative Law Judge held that a petition signed by an out-of-state attorney who had not obtained the requisite special permission to appear from the Tribunal was not in the correct form and must be dismissed. *Matter of Watson L. Showers*, DTA No. 825659 (N.Y.S. Div. of Tax App., June 19, 2014). Pursuant to Section 3000.3(d)(1) of the Rules of Practice and Procedure of the Tax Appeals Tribunal, the petitioner had been notified on February 21, 2014, of the nature of the problem and given 30 days to file a corrected petition. No response was received, and the petition was dismissed with prejudice.

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No Resident Credit Permitted for Taxes Paid to Massachusetts on Income from Sale of an Intangible

A New York resident who reported a substantial gain from the sale of Massachusetts property indirectly owned by a partnership in which she was a partner was not permitted to take a credit against her New York personal income tax liability for the tax she paid to Massachusetts. *Matter of Beatrice Goldman*, DTA No. 824682 (Div. of Tax App., June 26, 2014). Massachusetts had determined that the gain was subject to tax as gross income derived from or connected with a trade or business in the Commonwealth, but under New York law the gain was treated as the sale of a partnership interest, and thus a sale of an intangible, and the ALJ found the payment to Massachusetts did not qualify for the credit because Massachusetts had not treated the income as arising from the sale of an intangible. The ALJ also found, relying on *Matter of Mallinckrodt*, DTA. No. 807553 (N.Y.S. Tax App. Trib., Nov. 12, 1992), that the Due Process Clause does not prohibit such double taxation by the state of residence and the state with which the taxpayer or the property has contact.

ALJ Dismisses Petition for Estate Tax Refund on the Grounds the Surrogate's Court Has Exclusive Jurisdiction

A petition for hearing filed by the beneficiary of a decedent, seeking a refund of overpaid estate tax, was dismissed on the grounds that the Division of Tax Appeals did not have jurisdiction because the matter involved the decedent's estate, over which the Surrogate's Court has exclusive jurisdiction. *Matter of Carol Marie Kerler*, DTA No. 826115 (N.Y.S. Div. of Tax App., July 10, 2014). Under Tax Law § 2006(4), the Tribunal has the power to conduct a hearing, "unless a right to such a hearing is specifically provided for" in another provision of the law. Since the Surrogate's Court Procedure Act confers jurisdiction on the Surrogate's Court, the Division of Tax Appeals was "effectively disqualified" from hearing the case.

Department Explains When Professional Musician May Be Subject to Metropolitan Commuter Transportation Mobility Tax

The Department has ruled that a nonresident professional musician who performs several times a year in the Metropolitan Commuter Transportation District ("MCTD") will be subject to the Metropolitan Commuter Transportation Mobility Tax ("MCTMT") if he derives earnings exceeding $50,000 from performances in the MCTD during a taxable year. *Advisory Opinion*, TSB-A-14(1)MCTMT (N.Y.S. Dep't of Taxation & Fin., July 2, 2014). The Department also ruled, however, that services provided to the musician by his business manager and by his accountant on a nonexclusive basis within the MCTD do not subject the musician to the MCTMT because the business manager and accountant were not his agents.

ABB v. Missouri
Albany International Corp. v. Wisconsin
Allied-Signal, Inc. v. New Jersey
AE Outfitters Retail v. Indiana
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
Crestron v. New Jersey
Current, Inc. v. California
Deluxe Corp. v. California
DIRECTV, Inc. v. Indiana
DIRECTV, Inc. v. New Jersey
Dow Chemical Company v. Illinois
DuPont v. Michigan
EchoStar v. New York
Express, Inc. v. New York
Farmer Bros. v. California
General Motors v. Denver
GMRI, Inc. (Red Lobster, Olive Garden) v. California
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
IGT v. New Jersey
Intel Corp. v. New Mexico
Kohl's v. Indiana
Kroger v. Colorado
Lorillard Licensing Company v. New Jersey
McGraw-Hill, Inc. v. New York
MCI Airsignal, Inc. v. California
McLane v. Colorado
Mead v. Illinois
Meredith v. New York
Nabisco v. Oregon
National Med, Inc. v. Modesto
Nerac, Inc. v. New York
NewChannels Corp. v. New York
OfficeMax v. New York
Osram v. Pennsylvania
Panhandle Eastern Pipeline Co. v. Kansas
Pier 39 v. San Francisco
Powerex Corp. v. Oregon
Rent-A-Center v. Oregon
Reynolds Metals Company v. Michigan
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
Scioto Insurance Company v. Oklahoma
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
Thomson Reuters v. Michigan
Toys "R" Us-NYTEX, Inc. v. New York City
Union Carbide Corp. v. North Carolina
United States Tobacco v. California
UPS v. New Jersey
USV Pharmaceutical Corp. v. New York
USX Corp. v. Kentucky
Verizon Yellow Pages v. New York
Wendy's International, v. Illinois
Wendy's International v. Virginia
Whirlpool Properties v. New Jersey
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

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