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2018–19 NEW YORK STATE EXECUTIVE BUDGET RELEASED

By Irwin M. Slomka

New York State Governor Andrew M. Cuomo has released the New York State 2018-2019 Executive Budget, containing several potentially significant tax proposals. They include the following:

1. **Require marketplace providers to collect sales tax.** For the second straight year, the Governor is seeking to require "marketplace providers," defined as persons who collect the purchase price and provide the physical or virtual "forum" where the sales transaction occurs, to collect sales tax from customers on sales of tangible personal property that they "facilitate," where they facilitate at least $100 million in sales each calendar year. New to this year's proposal, now captioned in the Governor's supporting memorandum as the "Internet fairness conformity tax," are several sales tax information return and notice to purchaser requirements imposed on marketplace sellers and marketplaces that do not collect sales tax, whenever the non-collecting seller's receipts from New York purchasers are at least $5 million in the prior calendar year. If enacted, the new law would go into effect on September 1, 2018. (Part AA.)

2. **Tax nonresidents on "carried interests" and impose a 17% "fairness fee" but only if nearby states conform.** The Governor has revisited previous failed attempts by New York State to treat carried interests earned by hedge fund promoters as income earned from a trade or business, which would allow the State to tax nonresident promoters with New York hedge fund operations on their carried interests. However, this proposal goes further than prior efforts, introducing a new 17% "carried interest fairness fee," which would remain in effect until federal law is amended to treat carried interests as service income (which the newly enacted federal tax reform legislation does not do). If enacted into law, these provisions would only go into effect if similar legislation is also enacted in four nearby states (Connecticut, New Jersey, Massachusetts and Pennsylvania), reflecting the concern that enactment by New York alone would prompt hedge funds to simply move their operations from New York into those surrounding states. (Part M.)

3. **Allow the Tax Department to appeal adverse Tax Appeals Tribunal decisions.** The Governor has revived past efforts to give the Department the ability to appeal adverse decisions of the New York State Tax Appeals Tribunal, which currently is afforded only to taxpayers. This would be a significant change to the existing Tax Appeals Tribunal system,

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which since its inception more than 30 years ago has precluded the Department from appealing Tribunal decisions. (Part N.)

4. **Defer use of large business tax credits for three years.** Taxpayers with business tax credits exceeding $2 million in the aggregate for tax years beginning between 2018 and 2020 would be required to defer the use of those credits for three years, with different deferral treatment depending on whether or not the credit is refundable. (Part S.)

5. **Codify responsible person administrative relief from sales tax liability for members of LLCs holding minority interests.** Under this proposal — which would codify existing administrative practice by the Department — a member of a limited liability company, or a limited partner in a partnership, could obtain relief from *per se* liability for sales tax owed by the LLC or partnership, but only if the member or partner was not under a "duty to act" with respect to the sales tax requirements, and only if the member or partner held less than a 50% share of the profits and losses in the business. Those members and limited partners would then only have sales tax liability based on their pro rata share of the LLC or partnership. (Part X.)

6. **"Clarify" statutory residency day-count requirements.** Under this proposal, made to counter a contrary but nonprecedential 2015 decision of an Administrative Law Judge, in determining whether an individual is present in New York State or City for more than 183 days during the year for purposes of the statutory residency test, days spent in the State or City for a part of the year in which the taxpayer was a domiciliary would still count toward the 183-day test. The memorandum in support refers to this as a "clarification" to reflect its long-standing policy and, if enacted, this would be effective for all open tax years. (Part O.)

7. **Impose a healthcare insurance windfall profit fee.** In the only proposal in the Executive Budget directly responding to the federal tax reform legislation, the Governor seeks to impose a new tax on corporate healthcare insurers. It would be imposed at the rate of 14% of the net underwriting gain from providing health insurance in New York State. The memorandum in support states that the tax rate is the equivalent of the 14% federal corporate tax rate reduction, noting that health insurance rates for 2018 were set before the federal rate reduction was enacted, perhaps suggesting that this is why the legislation targets this industry. (Part DD.)

The deadline for enactment of the New York State budget is April 1, 2018. It is widely expected that the Governor will make extensive modifications during the next two months to respond to the myriad of tax changes affecting individuals and corporations under federal tax reform, possibly including those discussed immediately below.

REPORT ISSUED ON NYS LEGISLATIVE OPTIONS IN RESPONSE TO FEDERAL TAX REFORM LEGISLATION

By Irwin M. Slomka

On December 22, 2017, President Donald J. Trump signed into law the federal Tax Cuts and Jobs Act of 2017, which enacted sweeping changes to how businesses and individuals are taxed beginning in 2018. At the request of Governor Andrew M. Cuomo, the New York State Department of Taxation and Finance prepared a 33-page report containing various New York State legislative proposals in possible response to that legislation. *Preliminary Report on the Federal Tax Cuts and Jobs Act* (N.Y.S. Dep't. of Taxation & Fin., Jan. 2018). This comprehensive report, prepared by the Department under considerable time constraints, is intended to serve as a roadmap of issues that may need to be addressed, possibly as part of the New York State budget.

The report first presents a series of possible proposals, many of which seek to minimize the effects on New York individual filers of the new $10,000 cap on the federal deductibility of state and local taxes.

- *Charitable deductions to State-operated charitable funds.* One approach would be for New York State to create State-operated charitable funds, to which taxpayers could contribute in support of certain State programs and services, and which (the Department believes) would be deductible for federal income tax purposes.

- *Employer payroll tax.* A far more significant undertaking would involve the creation of a new employer payroll tax on employee W-2 wages, presented under various alternative permutations. Such a system would be based on the assumption that, although state taxes are no longer deductible

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by individuals, they continue to be deductible for businesses. It also assumes that employers that would bear the State payroll tax cost would have the ability to reduce employee wages commensurate with their payroll tax liability. The report presents alternatives for implementing a new payroll tax and retaining the existing personal income tax for non-wage income. The Department acknowledges the complexity of such a system, including the difficulties in making the restructured tax system progressive.

- *Unincorporated business tax*. Another possible option for shifting nondeductible State income taxes to businesses would be through the creation of a State unincorporated business tax on pass-through entities, with a tax credit available to the owners against their State personal income taxes.

The report also discusses issues relating to federal conformity for individuals, such as the federal expansion of the standard deduction and the limitation of various itemized and nonitemized deductions.

Finally, the report identifies various issues resulting from changes to the federal corporate tax regime. These include changes relating to how corporations with foreign operations will be taxed, limitations on interest expense deductions, and 100% expensing for certain business assets.

The Department is seeking comments on its report, and has set up a comments page on its website. While the Department has expressed no official view regarding the intended timing of the possible legislative proposals, the contemplated restructuring of the State personal income tax to preserve the full federal state tax deduction for individuals seems particularly ambitious and subject to a multitude of assumptions that would seem to weigh against its enactment by the April 1, 2018 budget deadline.

ALJ CANCELS SALES TAX ASSESSMENT FOR LACK OF A RATIONAL BASIS

By Hollis L. Hyans

A New York State Administrative Law Judge has canceled an assessment to one of two related restaurants, finding that the method used by the auditor to estimate taxable sales lacked a rational basis. *Matter of 3152 Restaurant, Inc., Matter of On the Boardwalk Café, Inc., Matter of Tatiana Varzar, & Matter of Lev Blinder*, DTA Nos. 827174-827177 (N.Y.S. Div. of Tax App., Dec. 28, 2017).

Facts and Audit Issues. Petitioner 3152 Restaurant, Inc. (the "Restaurant") operated a restaurant and nightclub on the boardwalk in Brighton Beach, New York. Petitioner On the Boardwalk Café (the "Café") operated a casual restaurant next door. On May 25, 2011, prior to beginning the audit of the Restaurant, an auditor with the Department of Taxation and Finance surveyed the premises and had lunch at the Restaurant. She took a photograph of her guest check, which included itemization for the food purchased, gratuity, and sales tax, and bore an order number of 742. The Department then commenced an audit of the Restaurant for the period December 1, 2008, through August 31, 2011, and requested all of its books and records related to sales and use tax. After reviewing bank records, the auditor determined that taxable sales had been under-reported by over $750,000. The auditor also obtained the Restaurant's electronic sales records from its point of sale ("POS") system and was unable to find an entry corresponding to her May 25 lunch. The Restaurant was able to produce a receipt matching the date and amounts listed, but it bore an order number of 715, different from the 742 the auditor had originally photographed. The auditor did not provide a copy of her guest check to the Restaurant's representative, ask for an explanation, or do any further investigation.

Based on the discrepancy in the order numbers, the auditor deemed the Restaurant's records to be unreliable and resorted to an estimated methodology. She utilized the amount of gross sales to which the Restaurant had consented in an earlier proceeding before the Bureau of Conciliation and Mediation Services ("BCMS") for a prior audit period, and obtained the rent amounts from that prior period to estimate a rent factor of 4%. She then applied that 4% factor to the Restaurant's rent expense from its federal income tax returns for the current audit period, and determined that the Restaurant had under- reported taxable sales by over $6.3 million rather than the $750,000 originally determined. Based on this calculation, a notice of determination was issued to the Restaurant asserting tax due of over $552,000 plus interest and penalty.

During the same period, the auditor also audited the Café. Similarly, before beginning the audit, she purchased a meal and photographed her guest check, and then she requested the Café's books and records. This time, she was able to locate a copy of her guest check in the Café's POS system, so she deemed the Café's records to be reliable. However, after reconciling the POS sales records with sales tax returns, the auditor found additional unreported sales of nearly $255,000, and the Department issued a separate assessment against the Café of approximately $22,000 plus interest and penalties.

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The Restaurant and the Café challenged the assessments. Both the president and the manager of the Restaurant testified that they had never agreed to use the estimated method applied by the auditor. The Restaurant also presented the testimony of the owner of Super PC Systems, a dealer of the POS system used by the Restaurant. The owner, while noting differences between the guest check given to the auditor and the receipt in the POS system, testified that the orders were identical since they showed the same items, amounts, number of guests, station number, table number, and server name. He explained that if orders preceding the auditor's order were canceled by a server, for example if a customer had changed his or her order, the order number of all subsequent records would have been changed when the database was compacted, which the system provider recommended be done periodically, since it allows for faster data processing. He also conceded that it is possible electronic sales records could be deleted by using a database tool.

The ALJ also found that, whether or not the records were sufficiently unreliable that resorting to an estimated methodology was justified, the method used by the auditor "lack[ed] a rational basis."

Another witness, an employee of the Restaurant's and the Café's representative, testified that while he believed the electronic sales record was tamperproof, he was relying on the Restaurant's computer operator for his instructions. He also testified that, based upon his review, the Restaurant had under-reported sales by over $932,000.

Finally, the Restaurant presented the testimony of Gary Rosen, a CPA, certified valuation analyst, and certified fraud examiner. Mr. Rosen had been engaged to examine the Department's rent factor. After searching a database containing data on 4.5 million establishments, Mr. Rosen testified that rent as a percentage of sales for restaurants with sales similar to the Restaurant's averaged 7.1%; that, based on the Restaurant's location in New York, the factor should be higher than that average; and that the 4% factor used by the Department overestimated the Restaurant's sales.

The Decision. First, the ALJ reviewed the standard for the application of an estimated method, which requires the Department to request and thoroughly examine the taxpayer's books and records and, if it finds the records incomplete or inadequate, select a method reasonably calculated to reflect the tax due, after which the burden rests on the taxpayer to demonstrate the method or amount of the assessment was erroneous. *Matter of Your Own Choice, Inc.*, DTA No. 817104 (N.Y.S. Tax App. Trib., Feb. 20, 2003). Here the ALJ found that, while there was testimony explaining the change in order numbers, there is "some credence" to the Department's concern that the ability to delete orders and renumber guest checks impacts the overall reliability of the records. However, the ALJ noted that the Restaurant had not been given a copy of the auditor's guest check at the time of audit so that it could provide an explanation, and the auditor made no further investigation before deeming the records unreliable. The ALJ concluded that, under these circumstances, the Department should have made further inquiry.

The ALJ also found that, whether or not the records were sufficiently unreliable that resorting to an estimated methodology was justified, the method used by the auditor "lack[ed] a rational basis." He held that use of a gross sales amount from a matter settled before the BCMS cannot be used in another audit period in the absence of an agreement by the taxpayer, and that any discussions or proposed adjustments made at conciliation conferences are in the nature of settlement negotiations and may not be considered as precedent or relied upon in subsequent administrative proceedings, citing Tax Law § 170(3-a)(f). In addition, the auditor was unable to detail how the settlement figures were derived. Therefore, while the ALJ found there was "no serious dispute" that the Restaurant's sales had been under-reported based upon the auditor's analysis of credit card deposits and the Restaurant's own concession, there was no way to tell if the audit determination had a rational basis. Therefore, the notices of determination issued to the Restaurant and to its manager as a responsible person were canceled.

Since no evidence or testimony had been presented regarding the Café, that notice of determination was sustained against both the Café and Tatiana Varzar, who had been assessed as a responsible party.

ADDITIONAL INSIGHTS

As the ALJ recognized, it is well established that, when the Department concludes upon audit that a vendor's records are inadequate, it may resort to an estimation to determine the correct amount of tax due, but that estimation needs to be reasonable and supported by evidence. Generally, estimated assessments are based upon external indices and can be traced to publicly available records and databases, or to bank records or other third-party documents. Here, where the auditor appeared to rely solely on the results of a settlement at BCMS for earlier years and also seemed unable to explain exactly how the

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numbers were derived from those settlement figures, the necessary evidentiary support was missing.

This case also highlights the important point that settlements for one audit cycle, whether on audit or at BCMS, should never be regarded as binding for later audit cycles, and that evidence of prior settlements is not admissible in a contested case for different periods.

TRIBUNAL HOLDS TEMPORARY APARTMENT CONSTITUTED A PERMANENT PLACE OF ABODE

By Michael J. Hilkin

The New York State Tax Appeals Tribunal has affirmed the decision of an Administrative Law Judge that a furnished apartment provided to an employee by her new employer for her exclusive temporary use constituted a permanent place of abode for New York statutory residency purposes. *Matter of Leslie Mays*, DTA No. 826546 (N.Y.S. Tax App. Trib., Dec. 21, 2017).

Facts. Petitioner Leslie Mays was hired in October 2010 to take the position of Vice President, Diversity and Inclusion at a company with offices in New York, and was scheduled to start in her new position on January 4, 2011. Her offer of employment was for an indefinite duration.

As part of her employment transition, Ms. Mays participated in her employer's relocation program, through which her employer procured an apartment for her exclusive use in late January 2011 (the "temporary apartment"). The temporary apartment was located in New York City, was fully furnished, and had one bedroom, a bathroom, a living/dining room, and a kitchen. Ms. Mays was not aware of any lease for the temporary apartment, and she planned to stay at the temporary apartment until she could find suitable permanent housing either within or outside of New York.

Under the original arrangement reached by Ms. Mays and her employer, Ms. Mays was to stay at the temporary apartment for 90 days or approximately until the end of April 2011. However, the employer's relocation manager subsequently extended Ms. Mays' stay until the end of May, allowing Ms. Mays to remain in the temporary apartment until she could move into her fiancé's apartment on June 1, 2011. In total, Ms. Mays resided at the temporary apartment and her fiancé's apartment for 11 months and three days during 2011.

Following an audit, the Department concluded that Ms. Mays was subject to New York State and City personal income tax and negligence penalties as a New York resident in 2011 on the basis that she was domiciled in New York City or, alternatively, was a statutory resident of New York City. However, during proceedings before an ALJ at the New York State Division of Tax Appeals, the Department conceded that Ms. Mays was not domiciled in New York City in 2011.

The Tax Law. For New York State and City purposes, an individual not domiciled in New York will be subject to personal income tax as a statutory resident if she "maintains a permanent place of abode for substantially all of the taxable year" in New York and "spends in the aggregate more than one hundred eighty-three days of the taxable year" in New York. Tax Law § 605(b)(1)(B); Admin. Code § 11-1705(b)(1)(B); 20 NYCRR § 105.20(a)(2). The Department's regulations define a permanent place of abode as "a dwelling place of a permanent nature maintained by the taxpayer, *whether or not owned by such taxpayer*." 20 NYCRR § 105.20(e)(1) (emphasis added).

[T]he Tribunal examined the facts surrounding Ms. Mays' relationship with the temporary apartment to conclude that the apartment constituted a permanent place of abode even though she had no legal right to the apartment . . . .

The ALJ Decision. The ALJ had upheld the Department's tax and negligence penalties assessment against Ms. Mays. As there was no dispute that Ms. Mays was present in New York City for more than 183 days in 2011, the sole issue was whether Ms. Mays had maintained a permanent place of abode in New York City. The ALJ concluded that the temporary apartment constituted a permanent place of abode and, between the time spent at the temporary apartment and her fiancé's apartment, Ms. Mays had a permanent place of abode in New York City for substantially all of 2011.

The Tribunal Decision. The Tribunal affirmed the ALJ's determination in full. Much of the analysis focused on whether the temporary apartment constituted a permanent place of abode, even though Ms. Mays did not have a lease to the apartment and thus did not have any legal right to it.

The Tribunal found Ms. Mays's facts similar to those in a prior Tribunal decision, *Matter of John M. Evans*, DTA No. 806515 (N.Y.S. Tax App. Trib., June 18, 1992), *confirmed*, 199 A.D.2d 840 (3d Dep't, 1993). In the *Evans* case, the taxpayer was invited to reside with a friend at a

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church rectory in Manhattan. While the taxpayer did not have any legal right to reside at the rectory, the taxpayer and his friend shared common living expenses such as food and housekeeping, and the taxpayer had a key and unfettered access to the dwelling — facts that supported the Tribunal's conclusion that the rectory constituted a permanent place of abode of the taxpayer for statutory residency purposes.

Using the framework outlined in the *Evans* case, the Tribunal examined the facts surrounding Ms. Mays' relationship with the temporary apartment to conclude that the apartment constituted a permanent place of abode even though she had no legal right to the apartment, which "was provided on a temporary basis as a benefit" of Ms. Mays' employment. The Tribunal focused on the fact that the temporary apartment "had all the characteristics of a [permanent] dwelling," she "resided at and had unfettered access to the [temporary] apartment," and she was allowed to extend her stay at the temporary apartment until she was able to move in to her fiancé's apartment. On a related point, the Tribunal also concluded that, even without a lease in her name, Ms. Mays nevertheless "maintained" the temporary apartment, on the basis that she did what she needed to do "in order to continue her living arrangements there" — specifically, she stayed employed at the same employer.

Next, the Tribunal concluded that, between the time Ms. Mays spent at the temporary apartment and her fiancé's apartment, she maintained a permanent place of abode in New York for "substantially all of the taxable year." Although the phrase "substantially all of the taxable year" is not defined by New York statutes or regulations, the Department's audit guidelines have interpreted the phrase to mean a period of time in excess of 11 months. In this case, Ms. Mays stayed at the temporary apartment and her fiancé's apartment for a total of 11 months and three days in 2011, and the Tribunal agreed that such time period constituted "substantially all" of 2011.

Finally, the Tribunal rejected Ms. Mays' argument that negligence penalties should be abated on the basis that she relied on her accountant to prepare her 2011 tax returns. The Tribunal agreed with the ALJ that Ms. Mays had a nondelegable duty to properly prepare and file her returns, and reliance on her accountant was insufficient to represent ordinary business care and prudence in carrying out such duty.

ADDITIONAL INSIGHTS

The Tribunal's decision highlights regulatory changes that have increased the risk that individuals staying in New York dwellings for a temporary duration may nevertheless be classified as statutory residents. In 2008, language stating that "a place of abode . . . is not deemed permanent if it is maintained only during a temporary stay for the accomplishment of a particular purpose" was removed from the regulations. *See Amendments to the Definition of Permanent Place of Abode in the Personal Income Tax Regulations*, TSB-M-09(2)I (N.Y.S. Dep't of Taxation & Fin., Jan. 16, 2009). A footnote to the Tribunal decision agreed with the Department's argument that the removal of such language from the regulations rendered the intentionally "limited duration" of Ms. Mays' stay in the temporary apartment irrelevant.

NYC TRIBUNAL REJECTS TAXPAYER'S MERE CHANGE IN FORM CLAIM

By Irwin M. Slomka

The difficulties in establishing that a transferee increased his or her beneficial interest in real property before a taxable transfer occurs for purpose of claiming the "mere change in form" exemption under the New York City real property transfer tax are illustrated in a recent New York City Tax Appeals Tribunal decision. *Matter of Vestry Acquisition LLC*, TAT (E) 15-14(RP) (N.Y.C. Tax App. Trib., Dec. 1, 2017) (released Jan.10, 2018). The decision upheld the denial to a member of a limited liability company ("LLC") who purchased a condominium unit from the LLC of a 25% increased "mere change in form" exemption beyond his initial 25% membership interest upon formation of the LLC several years earlier.

In 2002, three individuals formed the Petitioner, Vestry Acquisition LLC ("Vestry"), to sponsor a seven-unit condominium development on Vestry Street in downtown Manhattan. Under the LLC Agreement, the three members made initial cash contributions and acquired corresponding capital interests of 50% (Harlan Waksal), 25% (Charles Dunne), and 25% (Andreas Kaubisch). The LLC Agreement provided that, notwithstanding any other provision in the Agreement, each member was entitled to a distribution of condominium unit based on the member's *pro rata* percentage. It also imposed various conditions in order for a member to transfer a membership interest in the LLC.

By 2012, five of the seven units had been sold, leaving two units remaining. In March 2012, Vestry distributed one of those two units to Mr. Dunne for $10 million. A real property transfer tax ("RPTT") return was filed claiming a 50% mere change in form exemption and remitting tax on

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half of the $10 million consideration. Following an audit, the Department assessed additional tax of approximately $35,000 on the grounds that the transaction only qualified for a 25% mere change in form exemption.

Despite the fact that the grantee (Mr. Dunne) had initially held only a 25% interest in the LLC, Vestry claimed that in 2006, he acquired Mr. Kaubisch's 25% membership interest. Vestry made this claim on the basis of a letter dated September 5, 2006, indicating that by agreement Mr. Kaubisch relinquished to Mr. Dunne his right in the unit, reducing Mr. Kaubisch's future capital contribution requirements and establishing that Mr. Dunne's contribution requirements correspondingly increased. Thus, Vestry claimed that Mr. Dunne's interest in the unit had increased from 25% to 50% several years prior to the 2012 transfer.

An ALJ had held that Vestry did not meet its burden of proof that Mr. Dunn's beneficial interest was greater than 25% at the time the unit was transferred in 2012, and the City Tribunal has now affirmed that determination.

Under the "mere change in form" exemption, no transfer tax is due to the extent the beneficial ownership of the realty or economic interest in an entity owning the real property remains the same after the transfer.

Under the "mere change in form" exemption, no transfer tax is due to the extent the beneficial ownership of the realty or economic interest in an entity owning the real property remains the same after the transfer. The City Tribunal remained unconvinced that Mr. Dunne's beneficial interest had in fact increased to 50% before the 2012 transfer. One reason was that the 2006 letter purporting to increase his ownership percentage did not satisfy the explicit requirements of Vestry's LLC Agreement for transfers of units. Another reason was that the City Tribunal found there to be inconsistencies between Mr. Dunne's capital accounts as reported in his federal K-1s from Vestry for 2011 and 2012, and his claimed 50% interest at the time of transfer. The City Tribunal noted that "Petitioner opted to proceed . . . without a hearing and, therefore, without any testimony from the individuals involved."

ADDITIONAL INSIGHTS

The decision illustrates the potential hurdles of proceeding in New York City tax disputes without a hearing and, in particular, without testimony to explain potential factual discrepancies. Here, likely given the amount of tax in issue, the case proceeded on submission without an evidentiary hearing and also without oral argument or briefing before the City Tribunal. Moreover, the outcome could conceivably have been different had the parties amended the LLC Agreement to reflect the changes in the members' ownership interests, rather than doing it by a separate letter agreement in which the third member did not participate.

ATTORNEY FEES AWARDED TO TAXPAYER IN CIGARETTE TAX LITIGATION

By Irwin M. Slomka

In the August 2017 issue of *New York Tax Insights*, we reported on a decision by an Administrative Law Judge canceling penalties imposed by the Department of Taxation and Finance under the cigarette and tobacco products tax against an employee of a Native American–owned cigarette wholesaler for possessing or transporting unstamped cigarettes. The same ALJ has now issued an Order awarding attorney fees to the taxpayer as the prevailing party. *Matter of Shawn E. Snyder*, DTA No. 825785 (N.Y.S. Div. of Tax App., Jan. 11, 2018).

Earlier Decision. In June 2017, the ALJ held that Shawn Snyder, an employee of a tobacco wholesaler located on a Seneca Nation reservation in upstate New York, who was found to be in possession of unstamped cigarettes, resulting in penalties totaling nearly $1.3 million, qualified for an exemption from penalties. The ALJ held that, since the employer was a contract carrier engaged in lawfully transporting unstamped cigarettes, even though not licensed by New York State, and inasmuch as Mr. Snyder was acting within the scope of his employment for the carrier, he qualified for the exemption, and the penalties against him were canceled.

Issue. The Department did not appeal the decision, and thereafter the taxpayer filed an application for administrative and litigation costs, including attorney fees, under Tax Law § 3030. That provision allows for the recovery by the "prevailing party" of "reasonable administrative" and "reasonable litigation" costs incurred after the issuance of a statutory notice or other document that provides a right to an administrative hearing. In order to be considered a "prevailing party," the taxpayer must "substantially prevail[]" with respect to the amount in controversy or the most significant issue(s) in the case and, in the case of an individual, have a net worth not exceeding $2 million. No fees are awarded if the Department proves that its position was "substantially justified." The Department opposed the awarding of

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attorney fees on various grounds, including that its position was "substantially justified" and that the costs sought were not shown to be "reasonable."

ALJ Order. The ALJ concluded that the taxpayer substantially prevailed and that the Department did not meet its burden of proving that its position was substantially justified. The ALJ pointed out that the evidence clearly showed that the employer was a contract carrier lawfully transporting unstamped cigarettes, and that the taxpayer was an employee acting within the scope of his employment at the time the cigarettes were seized by the Department. The amount of the penalty (approximately $1.3 million) was also found to be "grossly disproportionate" to the value of the unstamped cigarettes (approximately $164,000). Therefore, the ALJ concluded that Mr. Snyder was entitled to reasonable costs, with the ALJ accepting the number of hours worked by the taxpayer's attorneys, but limiting the hourly rate to the rate set by statute, in the absence of special circumstances warranting an increase here.

ADDITIONAL INSIGHTS

It is unusual to see the awarding of attorney fees in cases before the Division of Tax Appeals, and with good reason, since the Department should not be faced with paying attorney fees where it takes good-faith positions in cases where it does not ultimately prevail, in the same way that penalties should not be imposed where taxpayers take good-faith reporting positions on their returns. Here, however, the ALJ concluded that the facts and law were so straightforward that it was appropriate to award attorney fees to the taxpayer.

INSIGHTS IN BRIEF

TRIBUNAL UPHOLDS DENIAL OF DEDUCTION FOR GAMBLING LOSSES

Affirming the decision of an Administrative Law Judge, the New York State Tax Appeals Tribunal has held that a New York individual taxpayer was not engaged in the "trade or business" of gambling and therefore could not deduct his gambling losses against winnings on Schedule C as profit or loss from business, but instead could only include the losses as itemized deductions, which, for New York purposes, are limited by a "reduction factor" under Tax Law § 615(f). *Matter of Alfred and Debra Kayata*, DTA No. 825935 (N.Y.S. Tax App. Trib., Dec. 21, 2017). The Tribunal, relying on a list of nine factors applied by the IRS, and particularly on the fact that the taxpayer earned substantial income from his full-time practice as a chiropractor, concluded that Mr. Kayata was not a professional gambler, engaging in gambling for profit as his livelihood, but instead should be treated as a casual or recreational gambler. The Tribunal also noted that nothing in the record indicated Mr. Kayata had ever profited from gambling and that, to the contrary, he had lost over $600,000 during the three-year audit period.

ALJ DENIES SALES TAX REFUND

A New York State Administrative Law Judge has upheld a determination denying a refund of sales and use tax claimed by a company operating two restaurant businesses in Brooklyn, New York. *Matter of Front Street Restaurant Corp.*, DTA No. 827293 (N.Y.S. Div. of Tax App., Jan. 11, 2018). Pursuant to written agreements, the owners of two restaurants, Front Street Restaurant (the "Restaurant") and Grimaldi's Pizzeria, agreed to combine their businesses, forming Front Street Restaurant Corp. (the "Corporation"), with Grimaldi's moving its pizza operations into the Restaurant's neighboring location, and each continuing to maintain separate balance sheets and accounting records, and separate responsibility for sales tax collected and remitted to New York, but filing one single sales tax return under one vendor identification number. The ALJ rejected the Corporation's claim for refund based on an argument that the Restaurant paid more than its share of the tax liability, finding that, since the businesses had decided to file as one vendor, and there was no dispute that the Corporation collected and remitted the tax due, there was no basis for a refund, and noting that the underlying financial dispute between the principals of the two restaurants is beyond the jurisdiction of the Division of Tax Appeals.

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