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2019-20 NYS BUDGET ENACTED, INCLUDING REAL ESTATE TRANSFER TAX INCREASES

By Irwin M. Slomka

On April 12, 2019, Governor Andrew M. Cuomo signed into law the New York State Budget Bill for the State's 2019-20 fiscal year, which began on April 1, 2019. (S. 1509-C. A. 2009-C.) The legislation contains several important tax provisions, including increases to the New York State real estate and "mansion" transfer taxes that were not in the Governor's proposed budget released this past January. The most significant of the new tax provisions are summarized below:

1. ***Increases tax rates on real estate transfers.*** The New York State real estate transfer tax, currently imposed at the rate of 0.4% of the consideration for the real property, is increased to 0.65% for conveyances of (i) residential real property located in New York City where the consideration is at least $3 million and (ii) non-residential real property located in the City where the consideration is at least $2 million. In addition, the New York State "mansion tax" – currently imposed on sales of residential real property for a consideration of $1 million or more at the rate of 1% – would be increased for conveyances within New York City at graduated tax rates of between 1.25% (where the consideration is at least $2 million but less than $3 million) up to 3.9% (where the consideration is at least $25 million).

   The funds raised from the new taxes are designated for the benefit of the Metropolitan Transportation Authority, which provides public transportation in New York City and nearby New York State counties. The new taxes will apply to conveyances made on or after July 1, 2019, except for conveyances made pursuant to written contracts entered into on or before April 1, 2019. (Part OOO.) These increased State real estate transfer taxes were not part of the Governor's proposed budget released last January, but were introduced as a way to provide additional funding for mass transit. The tax increases were enacted in the face of significant opposition to other proposed legislation that would have increased property taxes on high-value *pieds à terre*, that is, on residential real property (including cooperatives) that is not the owner's primary residence.

2. ***Sales tax: Requires marketplace providers to collect sales tax.*** After several failed attempts by the Governor in recent years, the Legislature finally passed legislation requiring "marketplace providers" to collect

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and remit sales tax on sales that they “facilitate.” “Marketplace providers” are defined as persons that, under an agreement with a seller, “facilitate” sales of tangible personal property, which involves both (i) providing the “forum” in which the sale takes place, whether a physical location (such as a brick and mortar store) or an Internet website or catalog, and (ii) the provider (or an affiliate) collecting the purchase price from customers on behalf of the seller. The new law applies to marketplace providers that either have a physical presence in New York State, or that have made or facilitated in-State sales resulting in total New York State receipts in the immediately preceding four quarterly sales tax periods of more than $300,000 or that have more than 100 in-State sales during those periods, which the Governor’s memorandum in support had characterized as “large marketplace providers.” The new law applies to sales made on or after June 1, 2019. (Part G.)

3. ***Sales tax: Vendors may now advertise that they will pay sales tax on behalf of customers.*** Scaling back on a long-standing prohibition, and effective immediately, vendors may now advertise or otherwise hold themselves out to customers as paying the sales tax on their behalf, provided certain conditions are met. Among the conditions is that bills and receipts given to purchasers must state that the vendor is paying the tax, and cannot state that the transaction is exempt or otherwise excludable from sales tax. (Part DDD.)

4. ***Corporate tax: Imposes a sourcing rule for GILTI apportionment.*** Legislation was enacted under the New York State and New York City corporate taxes whereby corporations with global intangible low-taxed income (“GILTI”) must include in the denominator of the apportionment fraction – but not in the New York numerator – their “net global intangible low-taxed income,” defined as GILTI less the amount deducted federally under IRC § 250(a)(1)(B)(i). Efforts by some business groups seeking legislation that would have excluded GILTI from the income tax base altogether proved unsuccessful. The new GILTI sourcing provision applies to taxable years beginning on or after January 1, 2018, *i.e.*, to all years in which the GILTI inclusion may apply for federal, and New York, tax purposes. (Part C.)

5. ***Corporate tax: Decouples from federal basis in determining whether a manufacturer is a qualified manufacturer.*** Under Article 9-A, a “qualified New York manufacturer” is entitled to reduced tax rates, including a zero percent tax rate on business income, if, among other requirements, the manufacturer has New York property with an adjusted basis for federal income tax purposes of at least $1 million. The Federal Tax Cuts and Jobs Act allows corporations to treat certain capital expenditures as expenses in lieu of capitalizing them, which could result in reductions to the federal adjusted basis of a manufacturing corporation’s New York property to bring it below the $1 million threshold. The legislation decouples from the federal adjusted basis and substitutes a New York State adjusted basis, which presumably means an adjusted basis that treats the items expensed for federal purposes as capitalized expenditures for State purposes. The legislation similarly decouples for a “qualified New York manufacturing corporation” under the New York City corporate tax. (Part D.)

6. ***Income tax: Extends top personal income tax rates for five years.*** The top New York State personal income tax bracket for individuals, currently at 8.82%, has been extended for another five years through 2024. That top rate, initially enacted as a temporary rate increase, would have expired after 2019. (Part P.)

7. ***Income tax: Extends for five years the limitations on itemized charitable deductions for high- income individuals.*** While the Governor and the Legislature continue to combat the $10,000 federal limitation on state and local tax deductions, regardless of the taxpayer’s income, individuals with New York adjusted gross income of more than $10 million who claim itemized deductions for charitable contributions will continue to have those charitable deductions limited to 25% for another five years for New York State and City income tax purposes. The limitations were to expire after 2019. (Part Q.)

The final legislation did not include the Governor’s proposal to legalize and tax adult-use cannabis. It also did not include the Governor’s proposal to tax “carried interest” income of hedge fund and private equity investors as ordinary earned income, and to impose a “17 percent carried interest fairness fee,” if neighboring states enacted substantially similar legislation.

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COURT OF APPEALS DENIES REVIEW OF DECISIONS UPHOLDING CONSTITUTIONALITY OF NEW YORK'S RESIDENCY SCHEME

By Hollis L. Hyans

The Court of Appeals, New York's highest court, has denied review of two Appellate Division decisions dismissing actions brought by out-of-state domiciliaries challenging the constitutionality of New York's taxation of statutory residents. *Chamberlain v. N.Y.S. Dep't of Taxation & Fin.*, No. 2018-1236, 2019 NY Slip Op. 66247 (N.Y., Mar. 26, 2019); *Edelman v. N.Y.S. Dep't of Taxation & Fin.*, No. 2018 1235, 2019 NY Slip Op. 66249 (N.Y., Mar. 26, 2019). In two identical brief orders, the Court of Appeals, on its own motion, dismissed the appeals on the ground "that no substantial constitutional question is directly involved." In both of the decisions below, the Appellate Divisions had rejected the taxpayers' challenges and found that the U.S. Supreme Court's decision in *Comptroller of the Treasury v. Wynne*, 135 S. Ct. 1787 (2015), does not affect the constitutionality of New York's statutory residency scheme.

Background. For New York personal income tax purposes, individuals who are domiciled outside New York may be taxed as "statutory residents" of New York if they maintain a permanent place of abode in New York and are present in New York for more than 183 days during a year. Tax Law § 605(b). While New York, like many states, provides a tax credit for income taxes paid by its residents to other states, the credit is only available where the taxes paid to the other state arise from income "derived" from (*i.e.*, earned within) another state. Tax Law § 620(a). The credit is generally not available for intangible or investment income, which is usually not treated as having been directly derived from any specific state. More than 20 years ago, in *Tamagni v. Tax Appeals Trib.*, 91 N.Y.2d 530 (1998), the Court of Appeals upheld the system against a constitutional challenge, finding that, under *Goldberg v. Sweet*, 488 U.S. 252, 266 (1989), the dormant Commerce Clause did not apply because it does not "protect state residents from their own state taxes."

However, in 2015, the U.S. Supreme Court in *Wynne* explicitly repudiated the statement in *Goldberg* that was relied on in *Tamagni*, and concluded that Maryland's residency credit scheme, which allowed credits against a state level tax for taxes paid to other states but not against a county level tax, violated the Commerce Clause's "internal consistency" test, which requires a tax to be structured so that if every state were to impose an identical tax, no multiple taxation would result.

The Chamberlain and Edelman cases. In both cases, the plaintiffs were domiciled in Connecticut, but had permanent places of abode in New York and were present in the state more than 183 days. They filed Connecticut resident income tax returns and paid tax on all of their income, which included income from investments and intangibles. They also filed New York nonresident income tax returns, reporting only wage income earned in New York. In both cases, after audit, the Department of Taxation and Finance determined that the taxpayers were statutory residents who should have filed New York resident income tax returns, and assessed additional tax on the intangible income. The tax was calculated without any credits for the taxes that had been paid to Connecticut.

Because intangible income "has no identifiable situs" and "cannot be traced to any jurisdiction". . . The two appellate courts concluded New York's method "does not affect interstate commerce . . . . "

In both cases, the trial court upheld the assessment, finding that *Tamagni* continues to control, despite the U.S. Supreme Court decision in *Wynne*. Appeals were taken to the First Department and the Third Department, and both appellate courts upheld the determinations of the trial courts, concluding that *Tamagni* remained the law in New York despite the decision in *Wynne*. The court in *Chamberlain*, which was decided in November 2018, cited and relied on the June 2018 decision in *Edelman*, which distinguished *Wynne* as involving taxpayers who were residents of only one state whose out-of-state business income was at issue, rather than involving intangible investment income as in *Tamagni*. Because intangible income "has no identifiable situs" and "cannot be traced to any jurisdiction" (citation omitted), the two appellate courts concluded New York's method "does not affect interstate commerce," despite the decision in *Wynne*. Both courts noted that New York provides a credit for income taxes paid by its residents to other states if the income is "derived therefrom"—meaning earned in the other state—and that therefore New York's residency tax system was not unconstitutional.

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Both taxpayers sought review by the Court of Appeals under CPLR 5601(b)(1), which provides that decisions of the Appellate Division may be appealed to the Court as of right "where there is directly involved the construction of the constitution . . . of the United States." However, the Court found no substantial constitutional question involved and denied review.

ADDITIONAL INSIGHTS

The decisions by the Third Department in *Chamberlain* and the First Department in *Edelman* assume that, because intangible income is not tied to any particular state, the holding in *Wynne* requiring the application of the internal consistency test did not apply. However, the Court in *Wynne* phrased the test in terms of whether taxpayers are subject to multiple taxation that would not apply if they were solely taxpayers in one state. Neither Appellate Division court applied that test, or discussed the fact that the dissent in *Tamagni* did apply that test and would have found New York's statutory residency scheme unconstitutional. Under the internal consistency test, it does appear that New York's system might be subject to further challenge before the U.S. Supreme Court, since if it were the law in every state, taxpayers who are domiciliaries of one state (where they are subject to tax on all of their income, including intangible income), and statutory residents of another, where they are similarly subject to tax on that same intangible income without a credit, are subject to multiple taxation.

It is not yet known whether the plaintiffs in *Chamberlain* and *Edelman* will seek review by the U.S. Supreme Court.

NYS TRIBUNAL HOLDS THAT TAXPAYER MADE TIMELY INFORMAL REFUND CLAIM

By Irwin M. Slomka

In a potentially significant decision regarding the timeliness of a refund claim under Article 9-A, the New York State Tax Appeals Tribunal has held that a taxpayer timely filed an "informal" refund claim for the 2007 tax year when it filed its return for 2008 claiming the balance of the refund amount. *Matter of Accidental Husband Intermediary, Inc.*, DTA No. 827186 (N.Y.S. Tax App. Trib., Apr. 11, 2019).

At issue was whether the statute of limitations for refunds under Article 9-A barred a corporation from obtaining a refund claim in an amount that was not in dispute and that, but for the timeliness question, would have been clearly due. A corporation must file a claim for credit or refund within three years of the filing of its return, or two years from payment of the tax, whichever is later. Tax Law § 1087(a), (e). The refund in the case related to the Empire State Film Production Credit ("film production credit"), which is available to qualified film production companies for production expenditures made in New York. Tax Law §§ 24 and former 210(36). Where the credit amount is between $1 million and $5 million, the credit must be taken over a two-year period beginning with the year in which the film production is completed (the "completion year"), with 50% of the credit claimed in the completion year and 50% claimed in the next succeeding year. Tax Law § 24(a)(2). The tax credit is refundable, but the refund does not bear interest.

Facts. The taxpayer, Accidental Husband Intermediary, Inc., produced a film in New York City entitled *The Accidental Husband* (a romantic comedy starring Uma Thurman), and production was completed in 2007. In November 2006, it had applied to the Governor's Office of Motion Picture & Television Development for a film production credit, and in October 2008 received from that office a certificate indicating an allowed credit amount of $1.2 million and a completion year of 2007. In light of the credit amount, it was required to be claimed 50% for 2007 and 50% for 2008.

In September 2008, before receiving the certificate of approval of the credit, the taxpayer filed its original Article 9-A return for 2007. It could not claim 50% of the credit since it did not yet know the approved credit amount. By the time it filed its 2008 Article 9-A return, however, the taxpayer had received the certificate with the approved credit. In September 2009, it filed its 2008 return claiming 50% of the $1.2 million credit amount, which it subsequently received.

The issue in dispute was whether the taxpayer timely claimed the other 50% of its credit for 2007. The deadline for claiming the credit for 2007 was September 15, 2011. The taxpayer asserted that it had filed an amended 2007 Article 9-A return in January 2009 claiming the other 50% of the credit, within the statute of limitations, but the evidentiary record of that filing was found to be unclear. In June 2012, the taxpayer submitted to the Department a copy of that 2007 amended return claiming a refund of the other 50%, which the Department denied as untimely. The taxpayer appealed that refund denial.

ALJ determination. The parties waived a hearing before the Administrative Law Judge, who first held that the taxpayer had not substantiated that the amended 2007

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return was filed in January 2009. She also rejected the taxpayer's alternative contention that its 2008 return, on which it claimed 50% of the credit, should be considered an informal refund claim for the 2007 year. In addition, the ALJ rejected application of the Department's "special refund authority" under Tax Law § 1096(d), which provides relief from the statute of limitations where there are no questions of fact or law and where the taxpayer made payment under a "mistake of facts." The ALJ upheld the refund denial, and the taxpayer appealed to the Tribunal.

The Tribunal framed the ultimate question under the informal refund claim doctrine as "whether the taxing authority knew or should have known that a refund claim was being made" under the "totality of the facts."

Tribunal decision. The Tribunal reversed the ALJ determination on the informal refund claim issue, holding that the taxpayer's 2008 Article 9-A return, together with the attached copy of the certificate of tax credit showing the $1.2 million credit, constituted an "informal" refund claim for 2007, which was timely filed in September 2009.

The Tribunal described the federal "informal refund claim" doctrine as consisting of three requirements: (i) the taxing authority must be provided with notice that the taxpayer is claiming a refund; (ii) the taxpayer must describe the legal and factual basis for the refund; and (iii) there must be a written component. The Tribunal noted that it has applied the informal refund claim doctrine in other contexts, such as in *Matter of Rand*, TSB-D-90(14)I (N.Y.S. Tax App. Trib., May 10, 1990) (finding that personal income tax returns with attached riders stating that the taxpayer was not subject to tax, but that did not formally request a refund, constituted timely informal refund claims) and *Matter of Greenburger*, DTA No. 810773 (N.Y.S. Tax App. Trib., Sept. 8, 1994) (where the payment of real estate transfer tax by four checks, each marked "Paid under Protest," was found to be a timely informal refund claim). The Tribunal framed the ultimate question under the informal refund claim doctrine as "whether the taxing authority knew or should have known that a refund claim was being made" under the "totality of the facts."

The Tribunal found that two of the factors – the "written component" and "legal and factual basis" for refund requirements – had been clearly met. The remaining question was whether the 2008 return had provided the Department with sufficient notice of a 2007 refund claim. The Tribunal concluded that the taxpayer's 2008 return – to which was attached the certificate of credit approval for $1.2 million – was sufficient to have put the Department on notice that the taxpayer was eligible for and had not formally claimed the film production credit for 2007 and to enable the Department to investigate further, if it chose to do so. The Tribunal did not view as dispositive the fact that the taxpayer's 2008 return did not actually request a refund for 2007. Thus, the Tribunal held that the taxpayer's 2008 return was a timely informal refund claim for 2007. Since there was no dispute as to the taxpayer's entitlement to that amount, the Tribunal directed that the refund (albeit long-delayed and without interest) be granted.

ADDITIONAL INSIGHTS

The Tribunal appears to have gone further than it did in prior decisions regarding the scope of the informal refund claim doctrine. Under the facts in this case, however, its decision appears justified. Certainly, the Department had reason to know that there were unclaimed credit amounts. While the Department may not have had an affirmative duty to investigate the 2007 tax return, the Tribunal was of the view that the Department could not reasonably claim that it was not sufficiently on notice of that potential refund claim here.

Ruling as it did on the informal refund claim, the Tribunal did not address the taxpayer's alternative argument that the refund should be granted under the special refund authority provision in Tax Law § 1096(d). That provision allows refunds to be granted "[w]here no questions of fact or law are involved" and where "moneys have been . . . paid by such taxpayer . . . under a mistake of facts." The ALJ had narrowly interpreted the special refund authority as inapplicable because the taxpayer was claiming a "refundable credit," and not "an overpayment of moneys that were paid in error." Since there were no questions of law or fact here, and the Department's own records confirmed the unclaimed credit amount for 2007, the case presented a strong set of facts for application of the special refund authority, but that issue was not reached by the Tribunal.

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THIRD DEPARTMENT CONFIRMS DECISION HOLDING A FLORIDA DOMICILIARY TO BE A NY STATUTORY RESIDENT

By Hollis L. Hyans

The Appellate Division, Third Department, has confirmed the decision of the Tax Appeals Tribunal that a publishing executive who was domiciled in Florida was a statutory resident of New York. *Ruderman v. Tax Appeals Trib.*, No. 525610, 2019 NY Slip Op. 02392 (3d Dep't, Mar. 28, 2019).

Facts and Issues. During the 2007 year in issue, Mr. Ruderman was an executive in the magazine publishing industry, and it was undisputed that he maintained a permanent place of abode in New York City. He filed a New York State and New York City nonresident and part year resident return for 2007. The Department of Taxation and Finance conducted an audit, which included the review of records such as credit card statements, telephone bills, and air travel records. The Department concluded that he was present in New York City on 190 days, relying in part on credit card charges and calls made from his New York City apartment on dates when he claimed to be outside New York. In addition, the Department could not determine Mr. Ruderman's whereabouts on 38 days and therefore treated those as New York State and City days, reaching a conclusion that Mr. Ruderman was present in New York State and City for a total of 228 days during 2007.

Under the law, a non-domiciliary of New York is treated as a "statutory resident" if he or she maintains a permanent place of abode in New York for substantially all of the year and is present in the State and/or City more than 183 days during the year. Tax Law § 605(b)(1)(B); Admin. Code § 11-1705(b)(1)(B). The Department issued a Notice of Deficiency asserting additional New York State and City personal income tax of nearly $1 million, plus interest and penalties.

At the hearing, Mr. Ruderman had asserted that he was outside New York for an additional 78 days, which when combined with the 137 conceded by the Department totaled 215 days outside New York. His testimony included statements that he allowed other people, including his grown children, to use his credit cards as needed and to make telephone calls from his New York City apartment. Mr. Ruderman provided a letter from his Florida dentist about dates of dental treatment in Florida, and affidavits from his hairdresser, personal assistant, three concierges and a handyman at his Florida residence, and his current wife.

Decisions below. An ALJ had concluded that Mr. Ruderman did not meet his burden of proof to show by clear and convincing evidence that he was not present in New York on the disputed days, finding that the testimony and affidavits presented very little specific information, and that Mr. Ruderman's testimony, while "forthright and honestly given," also lacked specificity and detail. The ALJ also sustained a late filing penalty, since the 2007 return was filed late. The Tribunal affirmed the ALJ's decision, agreeing that Mr. Ruderman did not meet his burden of proof. The Tribunal noted not only that the petitioner has the burden of demonstrating by clear and convincing evidence that he was not a statutory resident, but that the regulations also require any non-New York domiciliary who maintains a permanent place of abode in New York and files as a nonresident to keep adequate records to establish that he or she did not spend more than 183 days in New York. 20 NYCRR 105.20(c). The Tribunal agreed with the ALJ that the testimony and statements provided by Mr. Ruderman and the affiants were too general and lacked specificity, and were insufficient to establish Mr. Ruderman's whereabouts on each of the days in issue. The Tribunal also upheld the late filing penalty, finding that the only argument offered by Mr. Ruderman—that he believed he was not present in New York for more than 183 days in 2007—did not establish reasonable cause for the late filing of his personal income tax return.

Here, the court relied on the fact that there was no contemporaneous diary or other documentary evidence that Mr. Ruderman did not spend more than 183 days in New York.

Third Department decision. The Third Department upheld the Tribunal's decision. The court noted first that it is the taxpayer's burden to establish he or she is not a statutory resident and that as long as the Tribunal's decision has a rational basis and is supported by substantial evidence, that decision will not be disturbed on appeal.

Here, the court relied on the fact that there was no contemporaneous diary or other documentary evidence that Mr. Ruderman did not spend more than 183 days

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in New York. While he testified that purchases made in New York were made by others, and that he frequently visited his ailing mother outside New York, the evidence "lacked the requisite specificity" as to particular dates. The court also found that the supporting affidavits similarly "suffered from a general lack of detail," and were sometimes contradicted by Mr. Ruderman's own testimony. Also, the court found that it could not infer presence outside New York by relying on an established pattern of conduct, since Mr. Ruderman acknowledged that his trips between Florida and New York had no particular regular pattern. Therefore, the court sustained both the assessment and the late filing penalty, concluding that Mr. Ruderman's belief, even if in good faith, that he had not exceeded the 183-day threshold is not alone enough to constitute reasonable cause to abate the penalty.

ADDITIONAL INSIGHTS

Due to the fact-specific issues in a residency case, it is critical for a taxpayer to compile and retain the best possible evidence of his or her whereabouts. Audits involving carefully kept contemporaneous calendars, and those including a clearly established pattern of conduct from which a taxpayer's location could be determined on a day for which there was no documentary evidence, can result in success for taxpayers, and may be resolved without litigation. Here, even though Mr. Ruderman was acknowledged to be a credible witness, the general nature of the testimony and affidavits was insufficient to meet the burden of proof. It is always advisable for a nondomiciliary claiming to be a nonresident to keep as detailed a set of records as possible, including a contemporaneous diary, very specific travel receipts, and credit card records that demonstrate purchases made directly by the taxpayer—as opposed to by other family members—involving physical presence outside New York.

Recently, Governor Cuomo noted that many New Yorkers appear to be leaving New York, which he attributed, at least in part, to the change in federal tax law substantially lowering the available deductions for state and local taxes. Henry Goldman, *Cuomo Blames Trump Tax Plan for Reduced New York Tax Collections*, Bloomberg (Feb. 4, 2019), https://www.bloomberg.com/news/articles/2019-02-04/cuomo-blames-trump-tax-plan-for-reduced-new-york-tax-collections. If this turns out to be correct, and if those who are leaving retain at least some New York connections, such as an apartment, we can expect to see more audits and cases involving former residents, who will need to be sure to keep very careful records.

CITY TRIBUNAL AND STATE ALJ REACH SAME CONCLUSION – TAXPAYERS CANNOT RESTATE FEDERAL TAXABLE INCOME UNDER FEDERAL CONFORMITY

By Kara M. Kraman

In two cases, decided just one week apart, both the New York City Tax Appeals Tribunal and a New York State Division of Tax Appeals ALJ concluded that a corporate restaurant owner was not entitled to deduct for City and State purposes excess social security and Medicare taxes it paid, and for which it received a federal tax credit. *Matter of Ark Restaurants Corp.*, TAT (E) 16-18 (GC) (N.Y.C. Tax App. Trib., Mar. 21, 2019); *Matter of Ark Bryant Park*, LLC, DTA No. 827801 (N.Y.S. Div. of Tax App., Mar. 28, 2019). The decisions demonstrate the challenges faced when attempting to deviate from federal taxable income when computing entire net income. Both the City Tribunal and the State ALJ also rejected the corporations' claims of selective enforcement of this deduction disallowance.

[T]he thrust of both decisions is that federal conformity does not require that beneficial tax treatment (such as a deduction) for a taxpayer at the federal level must also necessarily benefit the taxpayer at the state or local level.

Facts. Although the two cases involved different (but related) taxpayers and different tax years (all prior to 2015), the relevant facts and laws at issue in both cases were essentially the same. Both Ark Bryant Park, LLC (the State petitioner) and Ark Restaurants Corp. (the City petitioner) (referred to interchangeably as "Ark") operated restaurants. Ark's employees received tips as part of their income, and Ark paid the employer and employee portions of the social security taxes and Medicare taxes on that income ("FICA taxes") to the Internal Revenue Service.

Ark's share of the FICA taxes it pays on behalf of its employees is a deductible expense under IRC § 162. However, the IRC permits food and beverage

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establishments such as Ark to elect to take a tax credit instead of a deduction for any "excess" FICA taxes they pay, which is defined as the employer's share of the social security or Medicare tax that exceeds tip income treated as wages for minimum wage law purposes ("excess FICA taxes"). IRC § 45B. When a taxpayer elects to take the excess FICA taxes credit under IRC § 45B, no deduction is allowed for that amount. Ark paid excess FICA taxes, and elected to take the federal tax credit instead of a deduction.

Issues. The issue in both the City and State cases was whether Ark properly took a subtraction modification on its City and State corporate returns for the amount of its excess FICA federal tax credit. Both the New York City general corporation tax ("GCT") and Article 9-A use federal taxable income ("FTI") as a starting point in computing a corporation's entire net income, subject to certain additions and subtractions. Since Ark had taken an excess FICA tax credit on its federal tax return, and not a deduction, Ark's FTI did not include any deduction for excess FICA taxes paid. Moreover, there is no subtraction modification to FTI under the GCT or Article 9-A for the amount of excess FICA taxes paid.

While it did not dispute that there was no specific subtraction modification allowing a deduction for excess FICA taxes paid, Ark nevertheless claimed a deduction on both its City and State corporate tax returns. Ark argued that the principles of federal conformity and the "comparable context" principle, which in New York provides that any terms used in Article 9-A or the GCT should have the same meaning as when used in a comparable context in the laws of the United States relating to federal income taxes, require allowance of the deduction. Ark reasoned that because there is no excess FICA tax credit allowed under City and State law, it was appropriate for it to restate its FTI as if a deduction, and not a credit, had been claimed for federal income tax purposes.

Decisions. Both the City Tribunal and the State ALJ rejected Ark's argument. The City Tribunal found that, by claiming that it should be allowed to modify its FTI for City tax purposes as if it had taken a deduction of the excess FICA taxes, Ark was effectively arguing *against* federal conformity. The City Tribunal further noted that the GCT (and Article 9-A) specifically provide a subtraction modification for the portion of wages and salaries paid for the taxable year for which a deduction is not allowed pursuant to IRC § 280C, which denies a deduction for the sum of specifically enumerated IRC employment credits. However, IRC § 45B credits are not among the enumerated credits in IRC § 280C for which a deduction is allowed. The City Tribunal concluded that this demonstrated that the Legislature had permitted deductions for credited amounts only in specific instances.

The State ALJ held that "the fact that application of the federal conformity principle leads to the taxpayers losing out on a tax benefit does not justify a deviation from that principle." The State ALJ also rejected application of the tax benefit rule, which among other things provides that if a credit was allowable with respect to any amount for any prior year and during the year there is a subsequent downward price adjustment or similar adjustment, the tax imposed should be increased by the amount of the credit attributable to the adjustment. Here, the taxpayer was arguing for a decrease in FTI and all the adjustments occurred in a single year, and not over multiple years, making the tax benefit rule inapplicable.

[M]erely alleging that one or more other taxpayers received different treatment is not enough to sustain a claim of selective enforcement, which also requires that the taxpayer establish an invidious motive for the selective enforcement.

Ark also argued that it should be allowed a deduction for excess FICA taxes paid, because the City and State only selectively enforced the disallowance of that deduction. Ark's selective enforcement claim was based on its allegation that the City and State taxing authorities permitted other taxpayers to take deductions for their excess FICA tax credit amounts. At the hearing before the State ALJ, Ark's tax return preparer testified that he knew of cases where the Department did allow such a deduction, and Ark also introduced an article from *Metropolitan Corporate Counsel* magazine which referred to the New York City Department of Finance not being consistent in disallowing this deduction. In the City case, Ark submitted unsworn statements alleging essentially the same facts.

Both the City Tribunal and State ALJ found that Ark had not met its burden of proof to demonstrate selective enforcement. According to the City Tribunal, even if Ark had met its burden of proof on this issue, state and federal courts have uniformly recognized that selective enforcement is unlawful only if coupled with "evil intent." The person alleging selective enforcement must show that the selectivity arose from an intentional and invidious plan of discrimination. Ark did not claim any invidious motive by the taxing authorities. Accordingly, the City Tribunal and State ALJ also rejected Ark's selective enforcement claim.

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ADDITIONAL INSIGHTS

Ark essentially argued that federal conformity and the "comparable context" principle mandated similar favorable treatment for the excess FICA taxes it paid at the City and State levels as Ark received at the federal level. However, the thrust of both decisions is that federal conformity does not require that beneficial tax treatment (such as a deduction) for a taxpayer at the federal level must also necessarily benefit the taxpayer at the state or local level. In this case, a *deduction* for excess FICA taxes paid at the federal level is only available if a deduction, not a credit, is taken at the federal level. While it may seem arbitrary to deprive a taxpayer of a deduction solely because it elected to claim a credit and not a deduction for federal purposes, the taxpayers' remedy may be with the Legislature, not the courts.

These cases also serve as a reminder of how difficult it is to prevail on a claim of selective enforcement of a tax provision by the City or State. Auditors do have discretion to negotiate and compromise on multiple issues presented by a single taxpayer. Not surprisingly, this can result in situations where allowances or deductions given to one taxpayer are not given to another. However, merely alleging that one or more other taxpayers received different treatment is not enough to sustain a claim of selective enforcement, which also requires that the taxpayer establish an invidious motive for the selective enforcement.

INSIGHTS IN BRIEF

ALJ HOLDS THAT TWO SEPARATE CONTRACTS CONSTITUTED A SINGLE TRANSACTION FOR REAL ESTATE TRANSFER TAX PURPOSES

An Administrative Law Judge held that the sale of vacant land and an agreement for construction of a new house on the same land, made pursuant to separate contracts between the same buyers and two related sellers (one of which was a construction company), constituted a single transaction for purposes of the New York State "mansion" tax on residential real property for consideration of $1 million or more. *Matter of Lisa & Mitchell Solomon*, DTA No. 828076 (N.Y.S. Div. of Tax App., Mar. 28, 2019). The parties had filed a transfer tax return for the vacant land sale, and claimed that the property was not subject to the tax because at the time of sale it was not residential real property. The ALJ concluded, in a motion for summary determination by the sellers, over the objection of the Department, that the Department properly treated the two contracts as constituting a single integrated transaction that was subject to tax, and found that it did not matter that there was a business purpose for carrying out the sales through separate contracts.

INVESTMENT TAX CREDIT DISALLOWANCE UPHELD FOR PROPERTY EXPENSED UNDER IRC § 179

In two separate decisions involving the same issue, the shareholders of an S corporation were denied New York investment tax credits for property having a useful life of less than four years because the S corporation had elected to deduct the cost of the property as an IRC § 179 expense, rather than capitalize and depreciate it. *Matter of Robert Stanton*, DTA No. 827970 (N.Y.S. Div. of Tax App., Apr. 4, 2019); *Matter of Mark & Evelyn Walsh*, DTA No. 827971 (N.Y.S. Div. of Tax App., Apr. 4, 2019). The Administrative Law Judge concluded that inasmuch as the ITC is only available for property that is depreciable under IRC § 167, by having elected to take an expense the property necessarily had a zero basis and was not depreciable under § 167, thus making the property ineligible for the ITC. The ALJ also upheld the denial of ITC for claimed property having a useful life of less than four years, since the Tax Law only allows ITC for property having a useful life of at least four years.

TRIBUNAL REMANDS DECISION STRIKING SUBPOENA FOR FURTHER REVIEW OF REQUESTED DOCUMENTS

The New York State Tax Appeals Tribunal granted a taxpayer's exception to a decision by an ALJ that had determined that the public-interest privilege, which protects confidential communications between public officers, outweighed the taxpayer's interest in having the documents disclosed through a subpoena served on the Tax Department. *Matter of Moody's Corp. & Subsidiaries*, DTA No. 827396 (N.Y.S. Tax App. Trib., Mar. 22, 2019). Although the documents had already been held protected from disclosure under the Freedom of Information Law ("FOIL"), the Tribunal found that the FOIL exemption is not dispositive with regard to documents requested by subpoena, which requires a balancing test of the parties' interests. Here, the Tribunal found that the ALJ erred in determining that the public interest privilege attached to the requested documents without conducting an *in camera* review of the documents, which would allow specific findings on whether the disclosure of the documents serves or harms the public interest, and remanded the case back to the ALJ to conduct such a review and determine whether the public interest privilege applies.

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