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NEW YORK TAX INSIGHTS

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STATE COURT REFUSES TO DISMISS ACTION CHALLENGING CONSTITUTIONALITY OF NYC PROPERTY TAX SYSTEM

By Hollis L. Hyans

The Supreme Court, New York County, has denied motions to dismiss an action seeking relief for alleged inequalities in the New York City property tax system. *Tax Equity Now NY LLC v. City of New York*, Index No. 153759/2017, 2018 NY Slip Op. 32378(U) (Sup. Ct. N.Y. Cty., Sept. 24, 2018). The court, while dismissing some of the claims against New York State, including claims alleging violations of the Equal Protection Clause and the Federal Fair Housing Act ("FHA"), allowed the other claims to proceed, finding that the plaintiff organization, Tax Equity Now NY LLC ("TENNY"), sufficiently alleged the existence of injuries to its members and did not have disqualifying conflicts of interest.

The parties. The action was brought against the City of New York and the New York City Department of Finance (the "City Defendants") and the State of New York and the New York Office of Real Property Tax Services (the "State Defendants"), seeking major changes in the system used to assess property tax on New York City properties. In its complaint, TENNY describes itself as "an association committed to pursuing legal and political reform to address the inequity and illegality of New York City's property tax system," with members that include owners and renters of real property claiming to be harmed by New York City's property tax system, as well as organizations "dedicated to securing equal treatment and economic justice for minority residents of New York City." (Complaint ¶ 33.) TENNY's Policy Director, Martha Stark, served as the Commissioner of the New York City Department of Finance from 2002 to 2009.

The issues. The New York Real Property Tax Law ("RPTL") classifies New York City properties into four classes, and the dispute centers on Classes One and Two: Class One properties are one, two, and three-family residences, excluding most cooperatives or condominiums; Class Two properties are condominiums, cooperatives, and rental apartment complexes. The complaint alleges that the system, among its other faults, "imposes wildly unequal tax burdens" on similarly valued properties within the same property class (Complaint ¶ 5), resulting in similarly valued homes being taxed differently depending on where in the City they are located; and systematically undervalues Class Two cooperatives and condominiums, thereby benefitting owners of cooperatives and condominiums at the expense of rental property owners, who typically pass the higher tax burdens on to renters (Complaint ¶ 10). The complaint contends, among other allegations,

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that the system not only violates state and federal constitutional mandates that require members of the same property class to be treated equally (Complaint ¶ 5), but is also discriminatory, claiming that owners of properties in primarily white neighborhoods receive lower tax assessments than owners of similar properties in primarily minority neighborhoods (Complaint ¶ 25) and that co-op and condo owners, who are alleged in the complaint to be predominately white, are treated preferentially to renters (who are alleged to be predominantly black and Hispanic) (Complaint ¶ 16).

The court denied the motions to dismiss based on lack of standing, [finding that] TENNY had submitted affidavits alleging specific injuries in exact dollar amounts.

Motions to Dismiss. Both the State Defendants and the City Defendants moved to dismiss the entire case on the grounds that TENNY, as an organization, lacks standing to bring the action, because it has not suffered the specific "injury-in-fact" that would be required under New York law for an association to assert standing on its own behalf, and it failed to sufficiently identify its members and how it is financed and governed. The defendants also claimed that there were conflicts of interest among TENNY members and between certain members and TENNY itself, such as conflicts between landlords and renters, renters and condominium/cooperative unit owners, and homeowners in gentrified and poorer neighborhoods. The defendants also sought dismissal of specific causes of action brought under various state and federal laws.

Decision. The court denied the motions to dismiss based on lack of standing. The judge found, first, that unlike other cases where organizations have been found to lack standing, TENNY had submitted affidavits alleging specific injuries in exact dollar amounts, as a result of assessments on Class One homes at higher rates in certain neighborhoods than in others. An affidavit from Ms. Stark also stated that TENNY members in Class Two properties had suffered financial injury and, in one case, would have allegedly paid nearly $11,000 less in rental property taxes if the property had been eligible to receive the same abatement available to the owners of condos and co-ops. Therefore, the court concluded that TENNY members' injuries were more direct than those in other cases where organizational standing had been denied. It also found that any conflicts of interest among TENNY members, if they existed at all, were "minimal," and that New York's courts have allowed cases to proceed even when there are "minor discrepancies in organizational standing."

The court also denied the City Defendants' motion to dismiss claims under the New York Constitution, the Federal and State Equal Protection Clauses, and the RPTL, noting that, for purposes of motions to dismiss, the court must construe the pleadings "liberally," accept all facts alleged in the complaint as true, and give the plaintiff the benefit of every possible favorable inference. The court did grant the State Defendants' motion to dismiss certain equal protection claims for unequal assessments for Class Two properties, finding that the City is primarily responsible for those assessments, and to dismiss claims brought under the FHA, finding that TENNY did not allege any activities on these claims specific to the State Defendants.

ADDITIONAL INSIGHTS

Allegations of unfairness and inequality in New York City's property tax system have received much general attention, and TENNY's complaint attached many articles and public reports of the various issues that have been identified and discussed. Both the State and City Defendants argued in their motions to dismiss that the policy choices made by the legislature in how various properties are treated are political decisions not subject to review by the judiciary, but, at least so far, the court has not agreed, allowing the action to proceed to the next stage. It is not yet known whether the City or State Defendants will seek to appeal the trial court's decision to the Appellate Division. If not, the case will presumably proceed to discovery.

FEDERAL COURT DISMISSES PUTATIVE CLASS ACTION AGAINST COSTCO FOR CLAIMED SALES TAX OVERCHARGES

By Irwin M. Slomka

Yet another putative class action bought against a vendor for allegedly overcharging New York State and local sales tax on purchases, this time against Costco, has been dismissed by a federal district court judge. *Guterman v. Costco Wholesale Corp.*, No. 17-CV-4812 (KMK) (S.D.N.Y., Sept. 24, 2018). The opinion makes clear that the sole remedy for erroneously charged sales tax is to file a refund claim with the New York State Department of Taxation and Finance and pursue the refund administratively and, if necessary, in the New York courts.

Facts. The plaintiff claimed that Costco charged him sales tax on the full price for merchandise he purchased, rather

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than on the reduced price he actually paid using a Costco coupon that was not labeled as a "manufacturer's coupon." Rather than seek a refund of the allegedly overpaid sales tax directly from the Department — on the difference between the reduced price and the full price — the plaintiff filed suit in federal court individually and on behalf of a "class" of similarly situated Costco customers. The opinion goes into considerable detail regarding the terms of Costco's frequently changing coupon booklets, none of which proved to be germane to the court's decision.

The district court judge dismissed the plaintiff's action, concluding that "the text of the statute could not be more explicit" that the plaintiff's exclusive remedy was to apply for a refund from the Department.

Background. Special sales tax rules exist for computing taxable receipts where a customer uses a coupon in making a purchase. Where a manufacturer's coupon is used, entitling the purchaser to a credit against the purchase price, sales tax is due on the full unreduced sale price. Where the customer uses a vendor coupon entitling the purchaser to a discount, and where the vendor receives no reimbursement from the manufacturer or distributor, sales tax is due from the purchaser only on the discounted price. Where a vendor issues a coupon involving a manufacturer's reimbursement, but the vendor does not disclose that fact to the purchaser, the vendor may only collect sales tax from the customer on the reduced price but is required to pay sales tax on the manufacturer's reimbursement amount. 20 NYCRR 526.5. The plaintiff claimed that Costco received a manufacturer's reimbursement and, therefore, should not have collected sales tax on the reimbursement amount, only on what he actually paid for the merchandise.

Costco moved to dismiss the complaint on the grounds that Tax Law § 1139 — which provides that a taxpayer may seek a refund from the Department of sales tax that has been "erroneously, illegally or unconstitutionally" charged or collected — is, as prescribed in Tax Law § 1140, the "exclusive remed[y]" for such claims. Other New York district courts had previously reached the same conclusion and dismissed similar actions. *E.g.*, *Kupferstein v. TJX Cos.*, No. 15-cv-5881 (NG) (E.D.N.Y., Feb. 14, 2017) (a putative class action against TJX for overcharging sales tax on merchandise purchased at its Marshall's stores using coupons); *Estler v. Dunkin' Brands, Inc.*, No. 16 Civ. 932 (LGS) (S.D.N.Y., Oct. 3, 2016) (a putative class action against Dunkin' Donuts for overcharging sales tax on prepackaged bags of coffee), *aff'd*, 691 F. App'x 3 (2d Cir., 2017). Faced with this precedent that a customer's "exclusive remedy" is to seek a refund from the Department, the plaintiff argued that Tax Law § 1139(a)(ii), which allows a vendor to seek refunds from the Department, created "an implied private right of action" allowing an action to require that *Costco* seek refunds from the Department.

Decision. The district court judge dismissed the plaintiff's action, concluding that "the text of the statute could not be more explicit" that the plaintiff's exclusive remedy was to apply for a refund from the Department, subject to review by the Tax Appeals Tribunal and by the New York courts. Moreover, the judge found nothing in the Tax Law suggesting that a vendor, such as Costco, *must* refund to customers sales tax that was "erroneously, illegally, or unconstitutionally collected" from its customers. As for the plaintiff's claim that Costco should be required to request sales tax refunds from the Department, the court noted that it was unclear what Costco could even seek from the Department since Costco had remitted the correct total amount of sales tax.

The district court judge rejected the plaintiff's claim that the Tax Law provides for an "implied private right of action" against a vendor to seek sales tax refunds from the Department, finding that such an implied private right would be entirely inconsistent with the express statutory scheme. Therefore, the judge granted Costco's motion to dismiss with prejudice.

ADDITIONAL INSIGHTS

The decision is not surprising, since the federal courts have consistently held that the refund procedures contained in Tax Law § 1139 — whether the refund is being sought by a customer or by a vendor — are the exclusive remedies for recovering erroneously paid sales tax. Thus, any sales tax refund claims must be made by filing a refund claim with the Department and pursuing it through the prescribed administrative procedures.

Interestingly, other than for competitive business reasons, a vendor may not have much of an incentive to make sure it does not overcharge sales tax on its sales, since, once the vendor has remitted the tax to the Department, the vendor appears to be entirely relieved of any further responsibility with respect to those amounts. Similarly, the Department, having received the full amount of remitted sales tax from the vendor, may have little incentive to insure that the vendor has not collected excessive sales tax from its customer.

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NEW YORK CITY ISSUES GUIDANCE ON TREATMENT OF SECTION 965 REPATRIATION AMOUNTS

By Irwin M. Slomka

The New York City Department of Finance has now issued guidance for reporting federal deemed repatriation income under the Federal Tax Cuts and Jobs Act of 2017. "Tax Treatment of IRC § 965 Repatriation Amounts for Tax Year 2017 for Business Corporation Taxpayers," *Finance Memorandum* 18-7 (N.Y.C. Dep't of Fin., Sept. 25, 2018); "New York City Treatment of IRC § 965 Repatriation Amounts for Tax Year 2017 Under the General Corporation Tax, Unincorporated Business Tax, and Banking Corporation Tax," *Finance Memorandum* 18-8 (N.Y.C. Dep't of Fin., Sept. 25, 2018). As discussed in the September issue of *New York Tax Insights*, the New York State Department of Taxation and Finance has already issued guidance for reporting the repatriation amounts for State tax purposes, with which the two *Finance Memoranda* generally are consistent.

- *Business Corporation Tax*. *Finance Memorandum* 18-7 discusses how IRC § 965(a) repatriation amounts must be reported for City business corporation tax purposes. The reporting requirements are substantially identical to those under Article 9-A. In that regard, the repatriation amounts should qualify as Exempt CFC Income and, if they do, they are not includable in computing the corporation's receipts fraction used to apportion business income. To the extent the amounts qualify as Exempt CFC Income, however, corporations must add back interest deductions attributable to the repatriation amounts or make the 40% "safe harbor" election.

- *Unincorporated Business Tax*. Partnerships and individuals subject to the unincorporated business tax ("UBT") may also be required to recognize IRC § 965 repatriation amounts. *Finance Memorandum* 18-8 discusses the reporting requirements for repatriation amounts under the UBT.

  Unlike the business corporation tax, the UBT law does not contain an exemption for Exempt CFC Income, nor permit a taxpayer to elect to defer payment of the resulting tax on the repatriation amount. Thus, the tax consequences of § 965 repatriation amounts under the UBT are likely to be far more significant than those under the City business corporation tax. The *Finance Memorandum* also explains that partnerships subject to the UBT may elect, similar to the election available under IRC § 965(n), to forego taking § 965 income into account in determining their net operating loss deductions ("NOL") for the taxable year, and in determining NOL carryovers and carrybacks.

- *General Corporation Tax and Banking Corporation Tax*. These taxes, which are also discussed in *Finance Memorandum* 18-8, apply only to S corporations. It should be noted that while the repatriation amounts likely qualify as excludable income from subsidiary capital for S corporations subject to the GCT, S corporations that are subject to the banking corporation tax would only be entitled to exclude 60% of their income from subsidiary capital, without the ability to defer payment of the tax. The *Finance Memorandum* also allows S corporations to make an election to forego applying their NOLs against IRC § 965 income.

INSIGHTS IN BRIEF

PROFESSOR DID NOT PROVE THAT HE BECAME A FLORIDA DOMICILIARY FOLLOWING HIS RETIREMENT

The Tax Appeals Tribunal has rejected the claim of a retired NYU business school professor that he changed his domicile from Manhattan to West Palm Beach, Florida after settling a dispute with the school that lead to his retirement. *Matter of Jeremy Wiesen*, DTA No. 826284 (N.Y.S. Tax App. Trib., Sept. 13, 2018). The Tribunal found that the individual continued to use his historical Manhattan home as a residence after his retirement and even renewed his lease the following year. Moreover, since the taxpayer waived a hearing, he did not offer testimony regarding his intent to change his domicile to Florida, including evidence as to why he spent considerably more time in New York than Florida in one of the two years in issue, or to support his claimed social and other connections with Florida. The Tribunal did reverse the Administrative Law Judge's conclusion that the individual continued to maintain active business ties with New York, but that was insufficient to alter the conclusion that the individual remained a New York State and City domiciliary.

FEDERAL APPEALS COURT UPHOLDS DISMISSAL OF CHALLENGE TO NYS RESIDENCY DETERMINATION

The Court of Appeals for the Second Circuit, a federal appellate court, has upheld the dismissal of an action brought to enjoin the New York State Department of Taxation and Finance from treating the plaintiff husband as a New York domiciliary based on a domicile maintained by his wife. *Campaniello v. N.Y.S. Dep't of Taxation & Fin.*,

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No. 17-2500-cv (2d Cir., Sept. 20, 2018). The Campaniellos argued that they were married but living apart — he in Florida and she in New York — and that their treatment under New York's residency law interfered with their constitutional "right to live their marriage in the manner in which they desire." The appeals court found that the Tax Injunction Act, which bars challenges to state tax determinations as long as there is a "plain, speedy and efficient remedy in state court," deprived the federal courts of jurisdiction to hear the case, despite the plaintiffs' claim that they were not challenging an actual tax assessment but rather future application of a law claimed to be unconstitutional. The Department's residency determination for 2007 was recently upheld in state court by the Appellate Division, Third Department. *Campaniello v. N.Y.S. Div. of Tax Appeals Trib.*, 161 A.D.3d 1320 (3d Dep't, 2018).

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