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NEW YORK TAX INSIGHTS
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EDITORS

Hollis L. Hyans hhyans@mofo.com
Irwin M. Slomka islomka@mofo.com

NEW YORK STATE + LOCAL TAX GROUP

Craig B. Fields cfields@mofo.com
Paul H. Frankel pfrankel@mofo.com
Hollis L. Hyans hhyans@mofo.com
Mitchell A. Newmark mnewmark@mofo.com
R. Gregory Roberts rroberts@mofo.com
Irwin M. Slomka islomka@mofo.com
Michael A. Pearl mpearl@mofo.com
Rebecca M. Balinskas rbalinskas@mofo.com
Matthew F. Cammarata* mcammarata@mofo.com
Michael J. Hilkin mhilkin@mofo.com
Nicole L. Johnson njohnson@mofo.com
Kara M. Kraman kkraman@mofo.com
Eva Y. Niedbala eniedbala@mofo.com
Michael P. Penza** mpenza@mofo.com

* Admitted only in Massachusetts
** Admitted only in New Jersey and Pennsylvania

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NEW YORK CITY TRIBUNAL REJECTS CITY'S ATTEMPT TO FORCIBLY COMBINE BANK AND ITS MORTGAGE SUBSIDIARY

By Irwin M. Slomka

The New York City Tax Appeals Tribunal, affirming a determination of the Chief Administrative Law Judge, has held that Astoria Bank, which engaged in a banking business in New York City, was not required to include in its combined New York City bank tax returns its Connecticut investment subsidiary that principally held non-New York mortgage loans. *Matter of Astoria Financial Corporation & Affiliates*, TAT (E) 10-35 (BT) *et al*. (N.Y.C. Tax App. Trib., May 19, 2016).

Under the former New York City bank tax law, a nontaxpayer subsidiary of a taxpayer bank or bank holding company cannot be included in a combined bank tax return unless it is necessary "to properly reflect the [bank tax] liability . . . because of intercompany transactions or some agreement, understanding, arrangement or transaction . . . ." Admin. Code § 11-646(f)(2)(i). In *Astoria Financial*, the mortgage investment subsidiary that the Department of Finance sought to combine was not itself subject to bank tax. The subsidiary conducted its activities from its office in Connecticut and qualified as a Connecticut "passive investment company" under the Connecticut tax law.

The City Tribunal concluded that the subsidiary had a sufficient business purpose apart from the acknowledged tax benefits and had economic substance. The Tribunal also concluded that the subsidiary's transactions with the bank and/or a bank affiliate—which included regular purchases of newly originated mortgage loans and the payment of fees in exchange for loan servicing consistent with industry standards—were conducted at arm's length.

The City Tribunal also rejected the Department's claim that the bank's income was "improperly or inaccurately reflected" (*i.e.*, that actual distortion existed) so as to permit combination on that basis. The Department took the position that the City Tribunal was bound to follow as precedent the State Tax Appeals Tribunal decision in *Matter of Interaudi Bank*, DTA No. 821659 (N.Y.S. Tax App. Trib., Apr. 14, 2011), where the State Tribunal found distortion resulting from a "mismatch of income and related expense" between a bank and its Delaware investment subsidiary justifying combination with the subsidiary under the former State bank tax.

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The City Tribunal concluded, however, that *Matter of Interaudi Bank* was inapplicable because the facts were materially distinguishable. Notably, in that case, the subsidiary acquired investment assets from its parent bank as a capital contribution shortly before the tax years at issue, and at a time when the bank was significantly undercapitalized, demonstrating a "clear shift" of income to the subsidiary and that the contributed assets were purchased with the proceeds of deposits on which the parent claimed interest deductions. In contrast, in *Astoria Financial*, the subsidiary's mortgage loans were initially contributed by a *nontaxpayer* and the contribution of mortgage loans to a predecessor entity, made nearly a decade earlier, did not support a conclusion that there was a "mismatch of income and expenses." The Tribunal found the testimony of the City's expert witness, who had previously testified for New York State in the *Interaudi Bank* case, "unpersuasive on the issue of distortion."

The Department of Finance cannot appeal decisions of the New York City Tax Appeals Tribunal.

Astoria Bank was represented by Irwin M. Slomka and Kara M. Kraman.

COURT DISMISSES ACTION CHALLENGING ANTICIPATED APPLICATION OF *BAUSCH & LOMB* DECISION TO A GAIN

By Hollis L. Hyans

Two actions brought by a taxpayer against the New York State Department of Taxation and Finance and the New York City Department of Finance to challenge anticipated results on audit have been dismissed by the Supreme Court, New York County. *SunGard Capital Corp. v. New York State Dep't of Finance*, Index No. 155041/2015 and *SunGard Capital Corp. v. New York City Dep't of Finance*, Index No. 155042/2015 (Sup. Ct. N.Y. Cnty., May 20, 2016).

SunGard Capital Corp. brought its actions against both the State Department of Taxation and Finance ("DOTF") and the New York City Department of Finance ("DOF"), asking for declarations that gain it incurred on the sale of two subsidiaries in 2012 should be excluded from its entire net income for both State and City purposes, consistent with how it filed its combined State franchise tax return and combined City general corporation tax return for that year. In its two complaints, SunGard alleged that it expected both the DOTF and the DOF to argue, pursuant to the decision in *Matter of Bausch & Lomb, Inc.*, DTA No. 819883 (N.Y.S. Tax App. Trib., Dec. 20, 2007), and the DOTF's subsequent guidance in a *Technical Service Bulletin*, TSB-M-08(3)C (N.Y.S. Dep't of Tax. and Fin., Mar. 10, 2008), that the gain should have been included in SunGard's 2012 entire net income. SunGard made two legal arguments: first, that under former Tax Law § 211(4)(b)(2) and Admin. Code § 11-605(4)(b)(2), gain from the sale of a subsidiary should be excluded from the calculation of entire net income even if the subsidiary had been a member of a combined tax return; and second, alternatively, that if the gain from the sale of a subsidiary is not excluded, then the gain should be characterized as investment income rather than as business income, under Tax Law §§ 208(6)(a), 208(8), 208(1-B)(5)(a), 208(1-B)(6)(a), and 210(2), and Admin. Code § 11-602(c)(5).

Background. In *Bausch & Lomb*, the New York State Tax Appeals Tribunal agreed with the taxpayer and held that a loss from the sale of a subsidiary that had been included in the taxpayer's New York combined return was not attributable to subsidiary capital and therefore was includable in the computation of entire net income. Bausch & Lomb had argued that the language "in computing combined subsidiary capital intercorporate stockholdings shall be eliminated," contained in former Tax Law § 211(4)(b)(2), meant that a subsidiary included in a combined return was not considered a "subsidiary" and, therefore, the loss was not attributable to subsidiary capital. The DOTF had argued that Bausch & Lomb's stock in the subsidiary did not lose its character as subsidiary capital when the subsidiary joined the combined group because Section 211(4)(b)(2) does not redefine terms defined elsewhere in the Tax Law and thus does not affect what items are included or excluded in computing entire net income. In rejecting the DOTF's position, the Tribunal held that the add back of losses attributable to subsidiary capital did not apply to the loss from the sale of a combined subsidiary because the elimination of intercorporate stockholdings prescribed by Section 211(4)(b)(2) applies in determining what constitutes "income, gains and losses from subsidiary capital" in computing entire net income on a combined return.

The DOTF then issued TSB-M-08(3)C, setting out its position that the holding in *Bausch & Lomb* also applies to gains from the sale of stock of a corporation included in a combined return.

Motions to Dismiss. Both the DOTF and the DOF moved to dismiss SunGard's complaints on the ground that the court lacked jurisdiction, since no audit had yet been completed and no tax had yet been determined,

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and therefore there was no "justiciable controversy" for the court to resolve. They also argued that, even if additional tax were to be assessed under the theories outlined in SunGard's complaints, SunGard would be required to exhaust its administrative remedies—by filing appeals with the State Division of Tax Appeals and the City Tax Appeals Tribunal—before it could bring an action in court. Both taxing authorities also argued that it was not yet even clear that SunGard had properly filed a combined return, or that SunGard's calculation of tax was correctly based on entire net income rather than on one of the alternate bases that would apply if that basis resulted in a higher tax. Finally, the City DOF noted that it was not bound by the State's TSB-M applying *Bausch & Lomb* to gains, and that the DOF has issued no letter ruling to SunGard or any other taxpayer setting forth its position on how it would treat gain on the sale of a subsidiary. SunGard countered that the position of both taxing agencies was already determined, that there were no facts in issue, and that it was facing a "direct and immediate" "threat of harm" entitling it to declaratory relief.

Decision. The Supreme Court, New York County, issued two nearly identical short decisions dismissing both of the actions, but expressly did so "on the condition that [the DOTF and the DOF] review the relevant tax return[s] and issue . . . final determination[s] within 120 days."

Additional Insights

Unless an appeal is filed (which had not occurred as we went to print), there may be no further public activity for some time, if in fact either or both of the taxing agencies do eventually issue assessments to SunGard and appeals are filed with the two administrative agencies. The next public decision may be a determination by a State or City Administrative Law Judge, which could take at least a year, and any such ALJ decision could be appealed to the respective Tax Appeals Tribunal, and only then—if SunGard is ultimately unsuccessful—would there be an appeal to the Appellate Division of the State court system. And no matter what the result in any appeal, the issue is eliminated for years beginning after January 1, 2015.

The decision demonstrates how difficult it can be to proactively bring tax disputes into court and avoid the administrative remedies set forth for protesting assessments in both the State and the City statutes. Here, SunGard argued that the Tribunal's holding in *Bausch & Lomb* and the DOTF's interpretation of that holding were clear, and that the City is bound to follow State Tribunal decisions, so that a "present and actual controversy exists" involving "pure statutory interpretation." Nonetheless, the court was apparently reluctant to take action in advance of any tax assessment actually having been issued. While there are recognized exceptions to the requirement of exhaustion of administrative remedies—when a taxpayer argues a statute is unconstitutional, or that the statute simply does not apply to it—both the DOTF and the DOF argued that neither of these exceptions applied, and the court apparently agreed.

COURT OF APPEALS HOLDS THAT OWNER IS NOT REQUIRED TO FILE ANNUAL PETITIONS CHALLENGING AMOUNT OF TEN-YEAR PROPERTY TAX EXEMPTION

By Michael J. Hilkin

In *Matter of Highbridge Broadway, LLC v. Assessor of the City of Schenectady et al.*, 2016 N.Y. Slip. Op. 03544 (N.Y., May 5, 2016), the New York Court of Appeals reversed the Appellate Division and held that a taxpayer that filed a petition challenging the amount of the ten-year business investment exemption under Real Property Tax Law ("RPTL") § 485-b was not required to file annual petitions while the initial petition was pending.

Background Regarding Real Property Tax Law Business Investment Exemption. RPTL § 485-b provides a partial ten-year exemption from property tax, commonly referred to as the "business investment exemption," for certain improvements made to commercial, business, or industrial real property. The amount of the exemption in each of the ten years is calculated using an exemption base, which is the difference between the pre-improvements value of the property and the post-improvements value of the property, as determined by the "assessment roll" applicable during the initial year of the exemption. For the initial year, the exemption base is multiplied by 50 percent to calculate the actual exemption amount. In the nine subsequent years, the exemption base is multiplied by a decreasing percentage.

Factual and Procedural Background. Highbridge Broadway, LLC ("Highbridge") applied for the business investment exemption with respect to a property in the City of Schenectady (the "Property") in March 2008. In July 2008, the City of Schenectady Assessor ("Assessor") published the assessment roll for the year 2008—*i.e.*, the year relevant to determining the exemption base. Highbridge subsequently filed a petition challenging the assessed value of the Property on the 2008 assessment roll and the amount of the business investment exemption that was granted,

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arguing that the assessed value of the property was too high and that the amount of the exemption was too low. While the petition only named the Assessor, Highbridge served both the Assessor and the Schenectady City School District ("School District")—one of the ultimate recipients of property tax funds—because the RPTL required Highbridge to serve the school district in which the Property was located. The School District did not intervene in the proceeding.

"[W]hen a computational error based on a single assessment roll results in the miscalculation" of the business investment exemption, it would be "a waste of resources for all involved, including the courts, to require a property owner to bring a challenge addressing the same error in each and every year."

Nearly three years later, in June 2011, the trial court granted summary judgment to Highbridge on the amount of the business investment exemption and recalculated the exemption for the years 2008 through 2014. The trial court also directed the Assessor to issue refunds to Highbridge for a portion of previously paid taxes. The trial court's order, which was sent to the Assessor and the School District, was not appealed. The Assessor complied with the order, but the School District refused to issue refunds. Highbridge subsequently brought another action to collect from the School District, also seeking costs, sanctions, and attorneys' fees. In this subsequent action, the trial court ordered the School District to issue refunds consistent with the order issued in the initial action, holding that the plain language of RPTL § 485-b only required a single action to be brought to obtain the exemption in all applicable years. The court did not hold the School District in contempt, however, because the order in the initial action did not specifically reference the School District.

On appeals made by both Highbridge and the School District, the Appellate Division reversed, holding that, in order to preserve its claims, Highbridge should have filed separate petitions challenging each annual property tax assessment while its 2008 petition was pending.

The Decision. The Court of Appeals reversed the Appellate Division, specifically reinstating the trial court's order that the School District issue refunds on any taxes collected in excess of the amount Highbridge would have paid if the properly calculated business investment exemption had been applied in the applicable years.

The Court of Appeals reasoned that since under RPTL § 485-b the business investment exemption is provided for ten years, and the amount of the exemption in each year is calculated based on the same single year's assessment roll, the plain language of RPTL § 485-b establishes that a single petition challenging the business investment exemption suffices. "Put another way," the Court of Appeals explained, "when a computational error based on a single assessment roll results in the miscalculation" of the business investment exemption, it would be "a waste of resources for all involved, including the courts, to require a property owner to bring a challenge addressing the same error in each and every year the exemption applies."

As support for its decision, the Court of Appeals cited the legislative history of RPTL § 485-b. The statute initially required the business investment exemption to be recalculated each year based on annual increases in the assessed value of the improved property, but was amended in 1985 so that the exemption would be calculated for its entire period based on a single assessment roll. The Court of Appeals concluded that this method of calculating the exemption, which continues to be required under RPTL § 485-b to this day, "creat[ed] greater certainty during the ten-year duration of the exemption for taxpayers, assessors, and school districts alike, and remove[d] the need for annual challenges."

Additional Insights

One Court of Appeals judge dissented, maintaining that the Court's ruling deviates from the general rule that a taxpayer challenging an assessment must commence annual proceedings to protest subsequent assessments while the initial proceeding is pending in order to preserve the right to a refund for taxes paid in any additional years. Indeed, in most circumstances, a taxpayer challenging an assessment or refund denial related to any type of tax should file separate appeals for assessments or refund denials for each subsequent period, even if an initial challenge is still pending. Nonetheless, taxpayers in a property tax case should closely examine the relevant property tax statutes and consider whether the applicable statutes similarly rely on a base year calculation for later years. If so, the *Highbridge* case could provide support for an argument that subsequent appeals are not necessary to preserve their claims.

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TRIBUNAL DECISIONS ON NEW YORK DRIVER'S LICENSE SUSPENSION PROGRAM RAISE QUESTIONS ON SCOPE OF PROGRAM

By Irwin M. Slomka

Recent decisions issued by the New York State Tax Appeals Tribunal have upheld the suspension of individuals' New York State driver's licenses under a controversial New York State statute enacted in 2013 that authorizes the suspension of an individual's driver license by the State as a tool to enforce delinquent New York State tax liabilities of $10,000 or more.

Background on N.Y. License Suspension Law. Under Tax Law § 171-v—a 2013 law that was modeled after a New York State license suspension law for the enforcement of delinquent child support payments—an individual with more than $10,000 in unpaid State tax assessments (inclusive of interest and penalties) who receives a notice of driver's license suspension must within 60 days challenge the amounts assessed or else have his or her New York State driver's license suspended until the amounts are paid.

There are six narrow grounds on which to challenge the license suspension, none of which involve financial hardship to the taxpayer or give the taxpayer the ability to contest the underlying tax deficiency. Among the permissible grounds for protesting the license suspension is that the individual receiving the 60-day notice is not in fact the taxpayer, or that the past-due tax liabilities have already been satisfied.

Recent Tribunal decisions highlight the limited remedies available to delinquent taxpayers under the State driver's license suspension program.

Since the failure to protest within 60 days results in the imminent suspension of a taxpayer's driver's license, the law creates a strong incentive to protest the proposed suspension, since the protest halts suspension for the duration of the taxpayer's challenge, even if the taxpayer does not fit within any of the six grounds on which to challenge it. Presumably, many taxpayers receiving 60-day notices will file protests with the hope that by the end of the administrative appeal process, the taxpayer will have resolved his or her tax delinquencies. Given the broad restrictions on challenging a license suspension, however, it is not surprising that most taxpayers so far have been unsuccessful in challenging their suspensions.

After a driver's license has been suspended, the only remedies are to try to negotiate a payment arrangement "satisfactory to the Commissioner" or else to seek a restrictive-use license (*e.g.*, permitting the taxpayer to drive only to or from work or school).

Recent Tribunal Decisions. Recent Tribunal decisions highlight the limited remedies available to delinquent taxpayers under the State driver's license suspension program.

In *Matter of Jeffrey S. Balkin*, DTA No. 826366 (N.Y.S. Tax App. Trib., Feb. 10, 2016), the Tribunal had upheld a driver's license suspension against a claim that the law was being applied retroactively in violation of the individual's due process rights for taxes that became due prior to the 2013 enactment of the statute. The Tribunal relied on U.S. Supreme Court precedent in *League v. State of Texas*, 184 U.S. 156 (1902), where the Court held that a state may constitutionally adopt "new remedies" to enforce already delinquent tax liabilities. In *Matter of Juan Kip Lenoir*, DTA No. 826389 (N.Y.S. Tax App. Trib., Mar. 18, 2016), the Tribunal held that a driver's license is not a "fundamental right," and that the need to collect past-due liabilities constituted a rational basis for suspending the driver's licenses of those with unpaid past-due tax liabilities in excess of $10,000.

Most recently, in *Matter of Mary E. Jacobi*, DTA No. 826332 (N.Y.S. Tax App. Trib., May 12, 2016), the Tribunal rejected a taxpayer's due process challenge alleging that the Department unreasonably failed to accept her offer in compromise—at a small fraction of the tax liabilities being asserted—and that she must be given an opportunity to be heard on the reasonableness of the rejection of her proposal. The Tribunal held that the law does not permit challenges to a license suspension based on the alleged unreasonableness of the Department's rejection of an offer in compromise. The Tribunal thus sustained a 60-day Notice of Proposed Driver's License suspension.

Policy Concerns and Possible Remedies. Although the State should have the right to enforce collection of delinquent taxes, the suspension of a driver's license, particularly for a relatively small threshold amount of $10,000 which, because it includes penalties and interest, means that the triggering tax delinquency

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can be significantly less than $10,000, can have harsh consequences on some taxpayers. Given the broad scope of the license suspension statute, the Department and the Tribunal have only a limited ability to prevent those harsh consequences. Thus, there have been suggestions made that the license suspension law should be amended to provide for a taxpayer hardship exemption or to increase the $10,000 threshold for suspension (although it should be noted that the Governor's 2015–16 proposed budget would have lowered the threshold to $5,000, a proposal that was not enacted).

In the short term, there will likely be more protested cases—and more Tribunal decisions upholding license suspensions—unless the law is amended to ameliorate some of the harsher aspects of the program, or unless an appellate court holds that certain aspects of the law are unconstitutional either facially or as applied.

TRIAL COURT HOLDS THAT FALSE CLAIMS ACT ALLEGATIONS ARE NOT TIME-BARRED

By Hollis L. Hyans

A judge of the New York State Supreme Court has held that allegations of failure to collect and remit sales tax were extended by tolling agreements between the taxpayer and the Department of Taxation and Finance, and therefore were also timely when asserted under the False Claims Act. *People of the State of New York v. Sprint Communications, Inc., f/k/a Sprint Nextel Corp.*, Index No. 103917/2011 (Sup. Ct. N.Y. Cnty., May 4, 2016).

Background. In 2011, the New York State Attorney General brought an action against Sprint Nextel Corp. ("Sprint"), alleging that Sprint had fraudulently failed to collect and remit sales tax on charges for certain bundled wireless telephone services. In October 2015, the Court of Appeals denied Sprint's motion to dismiss the case, noting that for purposes of the motion to dismiss, the court was required to accept as true all facts alleged in the complaint, and holding that the Attorney General had stated a cause of action that should proceed to trial. Sprint's petition for *certiorari* to the United States Supreme Court was denied. *People of the State of New York et al. v. Sprint Nextel Corp.*, 26 N.Y.3d 98 (2015), *cert. denied*, No. 15-1041 (U.S., May 31, 2016).

In 2013, the court had dismissed the claims against Sprint concerning alleged sales tax obligations that arose prior to March 31, 2008 on the grounds that those claims were barred by the three-year statute of limitations, since the complaint had been filed on March 31, 2011. No tolling agreements had been submitted to the court at that time. An amended complaint was filed in November 2015, attaching tolling agreements that had been entered into between the Department and Sprint. Sprint moved to dismiss the claims as time-barred, claiming the tolling agreements were signed only by the Department, not the Attorney General; that they only apply to "determining" the tax due, which is the term used in the Tax Law to refer to the Department's audit process; and that they only extended the period for the "assessment" of additional tax, not the period for bringing a civil enforcement action.

The trial court judge rejected each of these arguments. He found, first, that the agreements did not limit the Department's ability to recommend to the Attorney General that assessments be asserted in a civil complaint, to be determined by a court rather than an administrative tribunal, and that there is nothing in the agreements that restricts the authority of the Department to "to choose to have a court determine the amount of tax that is owed to the State." Since the Attorney General is the State's lawyer, acting on its behalf, the Attorney General was held to be entitled to enforce the terms of the agreements between Sprint and an authorized Department official. The judge also found that "[t]his is not a case where Sprint is likely to have fears that as time passes . . . the difficulty of defending its interests will increase," because "Sprint took that 'difficulty' into account" at the time it signed the tolling agreements.

FRANCES HENN APPOINTED NYC TAX TRIBUNAL COMMISSIONER

Frances J. Henn has recently been appointed a Commissioner of the New York City Tax Appeals Tribunal. Ms. Henn previously held positions with the Tax and Bankruptcy Division of the New York City Law Department—which represents the Department of Finance in tax proceedings before the Tribunal—most recently as senior tax counsel. She joins Tribunal President and Commissioner Ellen E. Hoffman and Commissioner Robert J. Firestone. We extend our best wishes to Commissioner Henn in her new position.

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INSIGHTS IN BRIEF

Buyer Found Liable for Seller's Sales Tax Liability Under Bulk Sales Rules

A New York State Administrative Law Judge has sustained an assessment of sales tax due from a seller against a purchaser in a bulk sale transaction. *Matter of Khayer Kayumi*, DTA No. 825953 (Div. of Tax App., Apr. 21, 2016). Mr. Kayumi had purchased the business assets, inventory, accounts receivable, and goodwill of a restaurant business in Brooklyn, NY, and filed a Notification of Sale, Transfer or Assignment in Bulk. However, despite having received notice from the Department that there was a possible sales tax liability and that, in order to limit his liability to the amount of the purchase price, he needed to place the purchase amount in escrow, he failed to do so, and instead sent a check intended for sales tax to a shareholder of the seller, which was apparently diverted, resulting in an action for unlawful deception and theft. Because Mr. Kayumi had failed to follow the requirement that the purchase amount be placed into escrow, he was not protected by the Bulk Sales rules and was found personally liable for the entire amount of the seller's unpaid sales tax.

Protest Held Untimely Since Not Filed Within 90 Days of Actual Receipt of Notice

In *Matter of Gregg M. Reuben*, DTA No. 827052 (N.Y.S. Div. of Tax App., May 12, 2016), a New York State Administrative Law Judge agreed with the petitioner that four notices of determination dated December 5, 2014, had not been sent to his last known address, despite their bearing the correct building address, since they had been directed to the wrong apartment number. Therefore, the 90-day period for filing a conciliation conference request or petition for a hearing before the Division of Tax Appeals was tolled until he actually received the notices. However, the Department established by affidavit and certified mail responses that the notices were delivered to and actually received by the petitioner on December 22, 2014. Since the request for conciliation conference was not filed until April 29, 2015—more than 90 days after the date of actual receipt—it was held to be untimely, and the Department's motion for summary judgment dismissing the petition was granted.

Individual Is Collaterally Estopped from Challenging Income Tax Liability Based on Criminal Tax Fraud Conviction

A resident individual's conviction for criminal tax fraud resulting from her failure to report a substantial gain from the sale of a Monet painting resulted in her being collaterally estopped from challenging an assessment of New York State and City personal income tax and fraud penalties relating to the same issue. *Matter of Vilma Bautista*, DTA No. 827182 (N.Y.S. Div. of Tax App., May 5, 2016). The New York State Administrative Law Judge also found that even if the individual was not collaterally estopped, she nonetheless failed to meet her burden of proof that the asserted deficiency was incorrect. Finally, the ALJ held that the Department was justified in relying on the criminal tax fraud conviction and an accompanying restitution order as the basis for its notice of deficiency for income tax due.

Advisory Opinion Discusses Application of Sales Tax on Services Relating to Computer Hardware and Software

According to a recently issued Advisory Opinion, charges by a service provider to furnish repair services for computer hardware and software products for customers in New York State are fully subject to State and local sales tax, unless the portion of the charges relating to nontaxable software repair services is reasonable and separately stated on the invoice provided to the purchaser. In that case, the charge for the nontaxable repair service will be exempt from sales tax. *Advisory Opinion*, TSB-A-16(9)S (N.Y.S. Dep't of Taxation & Fin., Mar. 18, 2016) (released May 2016).

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