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IN THIS ISSUE

ALJ Holds That a Retailer Must File on a Combined Basis with a Related Intellectual Property Licensing Company
Page 1

NYC Tribunal Decision Denying UBT Deduction for Management Fee Paid to Corporate Partner Affirmed
Page 3

Tribunal Affirms Finding of "Abusive Tax Avoidance Transaction"
Page 4

LLC Members Liable for Unpaid Sales Tax Despite Yielding Control over Company's Financial Affairs to Creditor
Page 6

Insights in Brief
Page 7

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ALJ HOLDS THAT A RETAILER MUST FILE ON A COMBINED BASIS WITH A RELATED INTELLECTUAL PROPERTY LICENSING COMPANY

By Michael J. Hilkin

A New York State Administrative Law Judge has held that a retailer must file combined corporate franchise tax returns with a related company to which it paid royalties. *Matter of Whole Foods Market Group, Inc.*, DTA No. 826409 (N.Y.S. Div. of Tax App., July 14, 2016). In reaching his conclusion, the ALJ rejected the retailer's contention that it should instead add back to its taxable income the deductions associated with the royalties paid to the related company.

Facts. Petitioner, Whole Foods Market Group, Inc. ("WFMG"), operated retail stores selling natural and organic food products throughout the United States, including in New York. WFMG licensed certain trademarks and intellectual property from Whole Foods Market IP, LP ("WFMIP"), a limited partnership that elected to be treated as a corporation for income tax purposes. WFMG and WFMIP were brother-sister entities owned by a common parent corporation. WFMG had nexus in New York, but the Department stipulated that WFMIP did not have New York nexus.

WFMG paid royalties to WFMIP for the use of WFMIP's intellectual property. During the fiscal years 2008 through 2010 (the "Years in Issue"), these royalties constituted more than 50% of WFMIP's total receipts. WFMG deducted the royalties it paid to WFMIP on its federal income tax returns, but for New York corporate franchise tax purposes added back the royalties to its entire net income. On audit, the Department determined that, rather than adding back the royalties paid to WFMIP, WFMG instead should have filed a combined report with WFMIP. The Department assessed WFMG additional tax and assessed penalties for a "substantial understatement of tax" under Tax Law § 1085(k).

Franchise Tax Law. During the Years in Issue, the corporate franchise tax was imposed on the highest of four bases, one of which was entire net income. In computing entire net income, a taxpayer started with its federal taxable income and made certain state-specific adjustments. Tax Law § 208(9). Specifically, a taxpayer was required to add back to its entire net income royalty payments made to a related member that were deductible in calculating federal taxable income. Tax Law

continued on page 2

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§ 208.9(o)(2)(A). Effective for tax years beginning on or after January 1, 2007, the royalty addback statute was amended to provide that the addback requirement would apply "[e]xcept where a taxpayer is included in a combined report with a related member . . . ." *Id.*

The 2007 change in the addback statute coincided with a change in the combined reporting statutes. Prior to 2007, corporations were required to file combined returns when three requirements were met: (1) they were substantially related by ownership; (2) they engaged in a "unitary business"; and (3) the failure to file combined returns would cause distortion of the companies' income taxable by New York. Distortion was presumed to exist when there were "substantial intercorporate transactions" between the companies, but such presumption could be rebutted by a showing that the intercorporate transactions were conducted in exchange for arm's length charges. *See Matter of Silver King Broadcasting of N.J.*, DTA No. 812589 (N.Y.S. Tax App. Trib., May 9, 1996). After the 2007 change, the third combined reporting requirement would be irrebuttably satisfied when substantial intercorporate transactions existed among related corporations "regardless of the transfer price for such intercorporate transactions." Tax Law former § 211(4)(a).

Departmental guidance stated that substantial intercorporate transactions would be present when, during a taxable year, "50% or more of a corporation's receipts included in the computation of entire net income (excluding nonrecurring items) are from one or more related corporations." TSB-M-08(2)C (N.Y.S. Dep't of Taxation & Fin., Mar. 3, 2008). Such guidance was subsequently included in a Department regulation. *See* 20 N.Y.C.R.R. 6-2.3(b)(3)(i)(a)(1) (as amended in 2012).

The Decision. The ALJ concluded that the Department properly required WFMG and WFMIP to file a combined return even though WFMG had added back the royalty payments. While WFMG conceded that it was related to, and engaged in a unitary business with, WFMIP, it contended that there were no substantial intercorporate transactions between itself and WFMIP, because it had added back the royalty payments. Although WFMIP received over 50% of its receipts from WFMG during the Years in Issue, WFMG reasoned that for franchise tax purposes it was first required to apply the royalty addback requirement, and only then determine whether substantial intercorporate transactions between the related companies existed in absence of any royalties determined to be subject to the addback requirement.

The ALJ instead determined that the "first analysis" for franchise tax purposes is whether corporations should file on a combined basis and "[o]nly if it were concluded that combination was not warranted would the addback requirement be activated." The ALJ further rejected WFMG's contention that the Department's application of New York law would lead "to a distortion" of WFMG's and WFMIP's entire net income subject to New York taxation. The ALJ pointed out that "[o]nly that portion of WFMIP's income determined" by a combined apportionment factor would be subject to franchise tax and, since a combined apportionment factor "would only reflect the New York activities of the companies, with other intercorporate receipts eliminated," the combined reporting method would "yield[] an accurate reflection" of WFMG's and WFMIP's income.

[T]he "first analysis" for franchise tax purposes is whether corporations should file on a combined basis and "[o]nly if it were concluded that combination was not warranted would the addback requirement be activated."

Separately, the ALJ also sustained the substantial understatement penalties imposed by the Department under Tax Law § 1085(k). WFMG argued that the penalties should be abated because its franchise tax returns were prepared in good faith and were consistent with the legislative intent behind the relevant New York statutes, and it had consistently applied the royalty addback statute since the statute was enacted. After establishing that a taxpayer has the burden "to demonstrate that reasonable cause exists for the waiver of penalties," the ALJ concluded that WFMG had failed to provide evidence of its good faith effort to comply with New York law, including evidence of any "professional advice, informal advice from the [Department] or the request for a [Department] advisory opinion."

Additional Insights

The primary issue in this case was whether the application of the royalty addback rule eliminated the royalty payments from WFMG to WFMIP for purposes of determining whether there were substantial intercorporate transactions between WFMG and WFMIP for purposes of the combined reporting rules. Since the statute does not require that the addback must be applied before determining whether substantial intercorporate transactions exist, the ALJ did not accept WFMG's argument.

continued on page 3

The ALJ's analysis of this issue will be of limited continuing application since, for years beginning on or after January 1, 2015, New York State has adopted unitary combined reporting and the distortion test, including the substantial intercorporate transactions test, has been eliminated. Nonetheless, the issue of when substantial understatement penalties will be assessed is of continuing significance. This case serves as a reminder that, in order to have such penalties waived, a taxpayer should present evidence of good faith efforts to properly calculate New York tax, including obtaining professional advice, separate from any substantive argument that the Department wrongly assessed tax.

NYC TRIBUNAL DECISION DENYING UBT DEDUCTION FOR MANAGEMENT FEE PAID TO CORPORATE PARTNER AFFIRMED

By Irwin M. Slomka

In a summary decision, the Appellate Division, First Department, has affirmed a decision of the New York City Tax Appeals Tribunal which held that an investment advisor partnership subject to the New York City unincorporated business tax ("UBT") must add back a management fee paid to its corporate general partner for services of employees of the corporate partner who were also limited partners of the partnership. *Tocqueville Asset Mgmt. L.P. v. N.Y.C. Tax App. Trib., et al.*, Case No. 39/15 (1st Dep't, July 5, 2016).

Tocqueville Asset Management L.P. ("Tocqueville") was an investment advisor limited partnership subject to the UBT. Since it had no employees of its own, all of its activities —the management of client investment portfolios and the performance of related research—were performed by the employees of its sole general partner, Tocqueville Management Corp. ("TMC"). Many of the employees of TMC performing the services were also limited partners in Tocqueville. Tocqueville paid TMC an annual management fee based on TMC's expenses incurred to provide the services, approximately two-thirds of which consisted of compensation paid to its employees. On its UBT return for 2005, Tocqueville claimed deductions for the portion of TMC's operating expenses that related to the management fee Tocqueville paid to TMC, including compensation paid by TMC to its own employees.

The Department of Finance disallowed Tocqueville's UBT deduction for compensation paid (in the form of the management fee) to its general partner. The deduction was disallowed as constituting nondeductible "amounts paid or incurred to a proprietor or partner for services or for use of capital." Admin. Code § 11-507(3).

At the administrative hearing, Tocqueville took the position that the UBT regulations do not require the addback of payments to a corporate partner for the services of employees of the partner, even where the employee is also a partner in the taxpayer partnership. In making the argument, Tocqueville relied on the UBT regulation which permits a deduction for amounts paid to a corporate partner "which reasonably represent the value of services provided the unincorporated business *by the employees of such partner*." 19 RCNY § 28-06(d)(1)(ii)(D) (emphasis added).

The ALJ rejected Tocqueville's argument, concluding that the management fees paid by Tocqueville were compensation for services provided by partners in Tocqueville, and therefore were not deductible. On appeal, the City Tribunal affirmed the ALJ's determination, holding that Tocqueville's interpretation "produces a result directly at odds with the plain language" of the addback statute and ignores another regulation, 19 RCNY § 28-06(d)(1)(ii)(A), which provides that, in determining whether a payment is a nondeductible payment to a partner, it is irrelevant that the person receiving payment was not performing the services in his or her capacity as a partner. *See New York Tax Insights* (Vol. 6, Issue 7, July 2015) for a discussion of the City Tribunal decision.

Tocqueville appealed, but in a particularly brief decision, the Appellate Division has now affirmed the City Tribunal's decision on the grounds that it was supported by substantial evidence and had a rational basis in law.

Additional Insights

The Appellate Division's affirmance is not surprising, given that the UBT law denies deductions for payments to a partner for services, and the management fees in question were paid directly to Tocqueville's corporate general partner for services performed by individuals who were also Tocqueville's limited partners. The Appellate Division also applied a deferential "substantial evidence" and "rational basis" standard of judicial review of the City Tribunal's decision. On the other hand, the Department's regulations have long recognized that it is unreasonable to require the addback of *all* payments to a corporate partner—particularly when they are for services performed by employees of that corporate partner. Since the UBT regulation in question does not specifically deny a UBT deduction for payments made to a corporate partner for the services of its employees who are also limited

continued on page 4

partners of the taxpayer, it could also have reasonably been concluded that the Department should be bound by its own regulation and the exception to the addback allowed.

Among the UBT addback questions that remain is whether the amounts would have been deductible had the employees been employed by the taxpayer directly, and had the employees been stockholders of the corporate partner rather being limited partners in the partnership.

TRIBUNAL AFFIRMS FINDING OF "ABUSIVE TAX AVOIDANCE TRANSACTION"

By Hollis L. Hyans

In *Matter of Marc S. Sznajderman and Jeannette Sznajderman*, DTA No. 824235 (N.Y.S. Tax App. Trib., July 11, 2016), the New York State Tax Appeals Tribunal affirmed an Administrative Law Judge decision upholding an assessment arising from investments in oil and gas partnerships. The Tribunal found the investments constituted abusive tax avoidance transactions under the Tax Law and therefore were governed by a six-year statute of limitations for assessment, making the Department's assessment timely.

Facts. Petitioner Marc Sznajderman, an experienced investor, became a general partner in Belle Isle Drilling Company, a New York general partnership formed in 2001. The partnership, created and controlled by an individual named Richard Siegal, was engaged in oil and gas drilling ventures, which were designed to generate deductible intangible drilling costs ("IDCs") in the first year of operation. Investors were required to be general partners, which exposed them to greater risk. Mr. Sznajderman investigated the potential investment, including review of statements prepared by investment firms and a review by his accountants who, although they were not specialists in oil and gas, advised that the documents did not appear to be out of the ordinary or raise any undue concern. Mr. Sznajderman's financial expert advised that Mr. Sznajderman had a "reasonable opportunity to both make and lose money" on the investment and that the investment was structured in a manner consistent with arrangements in the oil and gas industry.

A critical part of the deal was a "turnkey arrangement," under which the driller accepts a fixed fee for developing wells up to the point at which they enter production. Belle Isle entered into a turnkey contract with SS&T Oil Co., Inc. ("SS&T"), an entity also controlled by Mr. Siegal, under which Belle Isle agreed to pay SS&T $10.8 million, partially in cash and partially in an interest-bearing note in the principal amount of approximately $7 million. Pursuant to an assumption agreement, Mr. Sznajderman assumed responsibility for a portion of the loan that the partnership had taken from SS&T. The pricing for the turnkey contract entered into by Belle Isle had been determined by Mr. Siegal, and Mr. Sznajderman did not know how the price had been determined.

Mr. Sznajderman signed a subscription agreement to purchase three units for $840,000, payable in cash of $300,000 and a full recourse subscription note of $540,000, with an 8% interest rate. Interest on the note was payable quarterly the first year, and thereafter payable from his share of Belle Isle's net operating revenue; to the extent the revenue was insufficient, interest accrued.

Mr. Sznajderman also was required to execute a separate collateral agreement, requiring him to purchase municipal bonds that could be used toward the repayment of his subscription note. The collateral agreement gave him the option to pay the partnership 15% of the face value of the subscription note, payable from his partnership distributions, which SS&T "guaranteed to invest at 7.88% compounded so that at the end of 25 years the sum would be equal to the principal amount" of the note. Mr. Sznajderman, like most of the other investors, chose this guaranteed option. He also received a letter from Mr. Siegal providing that he could assign 60% of his distributions from Belle Isle for a period of up to five years or until such assigned income equaled 15% of the face value of his subscription note, and providing that SS&T would make up any shortfall in the bonds by reinvesting the proceeds. Mr. Sznajderman was assured in another letter from Mr. Siegal that "'no one has ever been required to pay any portion of their notes'" since he began structuring these transactions in 1981.

For 2002 through 2011, Belle Isle generated substantial income from oil and gas production, accrued and reported interest income due on its partners' subscription notes, and accrued and deducted interest due on the turnkey note. It made quarterly cash distributions to its partners.

The Audit. In 2006, the Department of Taxation and Finance began investigating approximately 200 oil and gas partnerships, including Belle Isle, all of which had used the same accounting firm to prepare their partnership returns. The Department also worked with the Internal Revenue Service and taxing authorities in California to gather information on the structure of the

continued on page 5

partnerships designed by Mr. Siegal, and concluded that the partnerships constituted "tax avoidance transactions."

In 2005, the New York legislature had enacted new requirements mandating disclosure of information relating to certain tax shelter transactions, imposing penalties for nondisclosure, extending the statute of limitations for abusive tax shelter transactions to six years from the usual three years, and creating a Voluntary Disclosure Initiative ("VCI"). *See* TSB-M-05(4)I (N.Y.S. Dep't of Taxation & Fin., June 1, 2005). In order to come within the extended six-year statute of limitations, the Department issued a Notice of Deficiency to Mr. Sznajderman for 2001 on March 14, 2008, assessing personal income tax and imposing penalties for failure to participate in the VCI. In 2009, Mr. Sznajderman participated in the VCI, choosing the option that allowed him to retain the right to file a claim for credit or refund.

[T]he Tribunal found that Mr. Sznajderman's stated capital contribution was substantially inflated over his real capital contribution, and therefore he had failed to establish that his primary purpose was not tax avoidance.

As permitted under the terms of the VCI, Mr. Sznajderman filed a Petition challenging the assessment, claiming that the six-year statute of limitations was inapplicable, because his investment in the Belle Isle partnership was not an abusive tax avoidance transaction that had tax avoidance as a principal purpose. He argued that the Department had allowed his cash investment as deductible IDC, that his debt was genuine, and that the investment and the partnership transactions had economic substance and significant nontax purposes. The Department argued that the chief purpose of the investment was to avoid or evade income tax and that therefore the six-year statute applied.

The ALJ Decision. The ALJ reviewed the many documents and details surrounding the partnerships, as well as the federal tax cases that had investigated the same transactions. Relying on the U.S. Tax Court's examination of what the ALJ concluded was the same investment format as the one in Belle Isle in *Zeluck v. Comm'r of Internal Revenue*, 103 T.C.M.(CCH) 1537 (2012), which found that the underlying subscription note and the assumption agreement constituted genuine debt, the ALJ similarly concluded that the debt was valid. Nonetheless, the ALJ found that the terms of the turnkey contract also had to be considered, and that because Mr. Sznajderman failed to meet his burden to establish how the turnkey price was calculated or that it was reasonable, that failure amounted to "convincing evidence that the transaction had tax avoidance as its primary motive."

Tribunal Decision. The Tribunal made another careful review of the facts and reached the same result as the ALJ but on a different basis. The Tribunal found that, despite the form of the subscription note and guarantee, Mr. Sznajderman's payment of 15% of the stated principal for the purchase of bonds effectively protected him from any realistic possibility of liability with respect to the remaining 85% of the principal amount. The Tribunal also found that Mr. Sznajderman's payment of first-year interest on the stated principal did not establish that the debt was genuine, since interest was paid only sporadically after the first year, even though operating revenues were available to make larger payments, and it appeared that the "priority" was to use those revenues to effectively reimburse Mr. Sznajderman for the first-year interest payment he did make. The Tribunal also noted that, to the extent its conclusion differed from that of the ALJ, and his reliance on *Zeluck v. Comm'r*, the facts in that case were distinguishable. Despite involving a similar Siegal oil and gas partnership, in which a partner acquired his interest by a combination of cash and a subscription note, the Tax Court's decision in *Zeluck* makes no reference to any option for the taxpayer in that case to satisfy his obligation through the purchase of bonds, which effectively reduced the principal amount of Mr. Sznajderman's subscription debt.

The Tribunal also found that the turnkey contract lacked economic reality. Since nearly all partners paid their subscription note liability by paying 15% of the principal amount to purchase bonds, those bond payments also satisfied each partner's turnkey note liability. Therefore, the 2001 losses, nearly all of which were claimed as IDCs, were not matched by any real economic losses to Mr. Sznajderman, or nearly all the other investors, to the extent of 85% of the face value of the subscription and turnkey notes.

The Tribunal expressly recognized that Belle Isle made a real investment in the oil and gas interest; had acquired fractional working interests in 37 undrilled oil and gas sites, incurring substantial costs; and made quarterly distributions to its partners of over $2 million, of which $1.2 million was distributed directly to the partners in cash. However, following language in Treas. Reg. 1.6662-4(g)(2)(ii), the Tribunal found that economic substance was not sufficient to establish that a transaction was not

continued on page 6

a tax shelter if other factors indicated it was a tax shelter. Here, the Tribunal found that Mr. Sznajderman's stated capital contribution was substantially inflated over his real capital contribution, and therefore he had failed to establish that his primary purpose was not tax avoidance.

The Tribunal also upheld the imposition of penalties, concluding that Mr. Sznajderman "knew or should have known" that his first-year partnership deduction could not have exceeded his actual capital contribution because of the bond purchase option.

Additional Insights

The Tribunal decision relied heavily on the detailed terms of the collateral agreement and concluded that the economic reality of the transactions limited Mr. Sznajderman's risk to his initial out-of-pocket investment, particularly since he had been assured in writing that no investors had ever had to pay any portion of their notes since 1981. The fact that the business actually existed, had drilled for oil and returned profit, and therefore had economic substance, was not enough to insulate it from being held an "abusive tax shelter" when the Tribunal determined that investors were claiming benefits out of all proportion to their actual risk.

LLC MEMBERS LIABLE FOR UNPAID SALES TAX DESPITE YIELDING CONTROL OVER COMPANY'S FINANCIAL AFFAIRS TO CREDITOR

By Irwin M. Slomka

Personal liability for sales tax for members of a limited liability company has again been placed in issue in a case involving individual members who were precluded from exercising any involvement in the company's business affairs that would have enabled them to comply with the company's sales tax responsibilities. An Administrative Law Judge rejected the claim that this absolved them of personal liability, holding that their inability to pay sales tax stemmed from their voluntary decision to relinquish such involvement to a creditor of the LLC. *Matters of James W. Henrie and Michael M. McBride*, DTA Nos. 825871 and 825872 (N.Y.S. Div. of Tax App., July 14, 2016).

Facts. Namwest, LLC, purchased a Holiday Inn hotel in Niagara Falls, New York. It then formed NS Partners, LLC, for the purpose of converting the hotel to a Crowne Plaza hotel. The two individual petitioners in question (Messrs. Henrie and McBride) eventually became members of NS Partners, and from the decision they appear to have exercised considerable control over its activities for several years, including signing various legal documents on its behalf. Although the ownership of NS Partners changed over time, during the periods in issue (three sales tax quarters in 2008) Messrs. Henrie and McBride each owned a one-third membership interest.

In March 2007, NS Partners refinanced a $30 million loan with its creditor, Grammercy Capital Corp. ("Grammercy"), on which the two individuals were made personally liable. Under the refinancing arrangement, Grammercy obtained a first-priority perfected security interest in the monies deposited into the LLC's bank accounts from the hotel operations.

In March 2008, NS Partners defaulted on its loan. Pursuant to the loan agreement, Grammercy stopped releasing funds from a lockbox to the NS Partners' operating account and, together with its affiliate, Grammercy assumed complete control over the hotel's operations and revenues. Although NS Partners made Grammercy aware that NS Partners was obligated to remit sales taxes to the State of New York, Grammercy did not release funds to NS Partners for that purpose. As a result, NS Partners continued to file quarterly sales tax returns but was unable to remit the sales taxes reported as due. The LLC's sales taxes due for three sales tax quarters during 2008 were never paid, and the Department issued notices of determination to Messrs. Henrie and McBride for the unpaid sales tax, penalty, and interest of the LLC.

Following an audit of the personal income tax returns of Messrs. Henrie and McBride, which allowed them substantial refunds, the Department proceeded to apply those refunds against the sales tax liabilities asserted in the notices of determination. Messrs. Henrie and McBride then filed refund claims for the offset income tax refunds. Their refund claims were denied on the grounds that, as members of the LLC, they were *per se* liable for the LLC's unpaid sales tax under Tax Law § 1131(1). This appeal followed.

Tax Law § 1131(1) defines a "person required to collect" sales tax, which results in strict personal liability, to include "any member of a partnership or limited liability company." The Department has interpreted this provision as a *per se* member liability arising regardless of the member's involvement in the LLC business or of its duty to act on the LLC's behalf, a position that was upheld by the Tribunal in *Matter of Santo*, DTA No. 821797 (N.Y.S. Tax App. Trib., Dec. 23, 2009).

Decision. At the administrative hearing, Messrs. Henrie and McBride claimed that they should not be held liable for the LLC's sales tax obligations, despite being members of the LLC, because they were precluded from exercising any involvement in the hotel business after Grammercy seized control of the business in March 2008.

continued on page 7

The Division did not dispute that the individuals lacked control over the business, but maintained that NS Partners voluntarily relinquished control to Grammercy under its loan agreement. The ALJ held that, while a person who is precluded from acting on behalf of a business through no fault of his or her own will not be found personally liable for the sales tax liability of the business, in this case Messrs. Henrie and McBride were previously directly involved in the management and financial affairs of the LLC. The ALJ concluded that NS Partners *voluntarily* entering into an arrangement with its creditor that ultimately caused it to be unable to pay its sales tax liability was determinative of the outcome of the case. Under Tribunal precedent, including *Matter of Button*, DTA No. 817034 (N.Y.S. Tax App. Trib., Jan. 28, 2002), since the relinquishment of control over the management and financial affairs of the LLC "was a situation of NS Partners' own making," the ALJ held that the lack of control did not absolve NS Partners or its members from liability for unpaid sales tax.

Messrs. Henrie and McBride also claimed relief under *Technical Memorandum* TSB-M-11(17)S (N.Y.S. Dep't of Taxation & Fin., Sept. 19, 2011), under which in certain circumstances an LLC member's *per se* sales tax liability is limited to the member's percentage interest in the LLC. This would have limited their derivative sales tax liability to their respective one-third interests. The ALJ declined to invoke the TSB-M-11(17)S limitation, however, since by its express terms it did not apply to an LLC member having substantial involvement in the financial affairs and management of the business. According to the ALJ, since the individuals had substantial authority over the business until the event of default, the limitation was inapplicable. The ALJ distinguished the facts from those in *Matter of Boissiere and Krystal*, DTA Nos. 824467, *et al.* (N.Y.S. Tax App. Trib., July 28, 2015), where the Department did apply the TSB-M limitation to LLC members having no managerial or financial authority over the business.

Additional Insights

It is interesting that even though the Tax Law provides strict liability for all members of an LLC, regardless of their duty to act, this decision principally focused on the LLC members' actual inability to act on behalf of the LLC. Ultimately, the decision did uphold the imposition of full liability on the part of the LLC's members, although seemingly not on the basis of *per se* member liability. It is also interesting that the ALJ declined to provide the TSB-M limitation of liability because the individuals were involved in the business, despite the fact that for the tax periods in issue they were no longer permitted to be involved in the business. As an aside, it should be noted that the Department applied the taxpayers' personal income tax refunds against their sales tax liabilities, presumably based on its authority under Tax Law § 686(a) regarding the crediting of income tax overpayments against a taxpayer's liability for other New York State taxes.

INSIGHTS IN BRIEF

Publisher of Financial Periodicals Held Liable for Sales Tax for Failing to Prove That It Was Not Bundling Its Charges for Periodicals

The publisher of financial periodicals failed to meet its burden of proof to show that it did not bundle its sale of nontaxable periodicals with sales of taxable products such as information services and, therefore, was held liable for estimated additional sales tax on its subscription charges. *Matter of Institutional Investor, Inc.*, DTA No. 826331 (N.Y.S. Div. of Tax App., June 23, 2016). The taxpayer claimed that it primarily sold a print version of a financial newsletter, along with an online PDF version of the newsletter, but the Department found that various other products were also being offered, and the taxpayer failed to adequately respond to audit inquiries about those products. The ALJ also rejected the claim that the Department should be estopped from assessing additional sales tax based on the results of a prior audit, noting that no evidence was adduced by the taxpayer to prove that subscription sales were reviewed by the Department in that prior audit.

Unauthorized Non-Life Insurance Corporations Ruled Subject to Franchise Tax Under Article 33, Not Premiums Tax

The Department of Taxation and Finance has ruled that an unauthorized foreign non-life insurance corporation, which writes surplus lines policies for property and casualty insurance risks through licensed excess lines brokers in New York, is subject to tax under Tax Law § 1501(a) (Article 33 tax), and not under Tax Law § 1502-a (a tax on premiums applicable only to *authorized* insurers), for tax periods beginning after 2002. *Advisory Opinion*, TSB-A-16(4)C and TSB-A-16(5)C (N.Y.S. Dep't of Taxation & Fin., June 10, 2016). Therefore, the unauthorized non-life insurance corporation must compute its tax on the highest of four alternative tax bases, plus a tax on allocated subsidiary capital. The Department specifically concluded that this did not result in "double taxation" of premiums as between the premiums tax on excess lines brokers and the tax on the unauthorized insurance company.

continued on page 8

ALJ Upholds Determination of Statutory Residency

In *Matter of Carl Ruderman*, DTA No. 826242 (N.Y.S. Div. of Tax App., July 14, 2016), a New York State Administrative Law Judge held that the Florida domiciliary petitioner, who maintained a permanent place of abode in New York City, was a statutory resident of New York State and City. The ALJ found that Mr. Ruderman, a publishing executive, failed to prove through contemporaneous records, such as a diary or other credible evidence, that he had not spent more than 183 days in New York. Although Mr. Ruderman submitted multiple affidavits from individuals, including his hairdresser, personal assistant, and concierges at his Florida residence, all stating that Mr. Ruderman was in Florida for periods ranging from weeks to months, the ALJ found the affidavits lacked specificity and were contradicted by other evidence, including credit card charges and telephone records of calls made from his New York premises on more than 200 days during the year at issue.

Assessment of MTA Surcharge Not Barred by Statute of Limitations

In *Matter of Arrow Park, Inc.*, DTA No. 826879 (N.Y.S. Div. of Tax App., July 14, 2016), an Administrative Law Judge held that a Notice of Deficiency asserting liability for the MTA surcharge was not barred by the statute of limitations, finding that, although Arrow Park had filed forms CT-4 (the short form franchise tax return) for the tax years in issue, it had not included the CT-3M/4M (the MTA surcharge return) so the statute of limitations for the MTA surcharge never started running. The ALJ rejected Arrow Park's argument that, because it had filed franchise tax returns for the years in issue, and had been assessed for a previous year's MTA surcharge, the Department was on notice that the MTA surcharge was due and had sufficient information to assess it. The ALJ found that Arrow Park's argument was foreclosed by the Tax Appeals Tribunal's decision in *Matter of Kaiser Aerospace Electronics Corp*, DTA. No. 812828 (N.Y.S. Tax App. Trib., Jan. 16, 1997), which held that the MTA surcharge return is a separate return, and that the filing instructions for the CT-3M/4M make clear that it is a separate return with independent statutory filing obligations, so that the filing date of the CT-3/CT-4 does not control.

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- Nationwide: Tax Controversy
- New York: Tax

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- New York: Litigation – Tax (Tier 1)
- New York: Tax Law (Tier 1)
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