KILPATRICK TOWNSEND

5 TAKEAWAYS

New York Tax Litigation Update

On August 19th, Kilpatrick Townsend State and Local Tax Partner Jeff Reed presented on a panel entitled **New York Tax Litigation Update** during a HalfMoon webinar. The panel discussed reported New York tax decisions from 2019 and 2020.

Here are 5 key takeaways:

1

Recent Corporate Franchise Tax Cases Have Largely Concentrated on One Issue
Most of the recent New York Corporate Franchise Tax decisions have address whether royalty income from foreign affiliates is excludible from the New York tax base under the pre-2013 version of the addback statute. In 2013, the legislature changed the law to close a perceived loophole. To date, taxpayers have not been successful in arguing for the royalty income exclusion even prior to the law change. There have been several recent reported decisions on this issue, and there are ongoing appeals.

2

The Correct Treatment of Sales of Partnership Interests Continues to be a Hot Issue
At the New York City Tax Appeals Tribunal, there have been several recent cases addressing how gain from the sale of partnership interests should be treated for New York City purposes. There are two recent determinations from the Administrative Law Judge Division on this issue, and one of the cases is on appeal at the Appeals Division. There is not clear substantive or administrative guidance on this issue. In the absence of clear guidance, the Department of Finance has been taking the position that 100% of the gain from the sale of pass-through entities operating in the City is taxable by the City. This position has to date been upheld at the Administrative Law Judge Division, although, as noted, an appeal is pending.

3

Burden of Proof Issues are Increasingly Being Contested
It is clear that taxpayers generally have the burden of proof in challenging tax assessments. But how significant is that burden and does the nature of what is at issue matter? The New York Court of Appeals refused to recognize a distinction between a statutory exemption and exclusion, and held that a taxpayer has an equally-high burden of proof in either type of case (effectively, the taxpayer must show that its construction of the statutes is the only sensible construction). The Tax Appeals Tribunal held that a statutory tax cap was not analogous to an exemption or exclusion, and accordingly the taxpayer did not have to meet any special burden in arguing that it was entitled to the benefit of the cap. Overall, these cases show that taxpayers must often overcome difficult odds in challenging New York tax assessments; as a result, taxpayers should be careful with how they present their positions and the relevant facts, starting with how they respond to the very first audit notice they receive.

4

Sales Tax Continues to Trip Up Businesses Operating in New York
Looking at recent cases in the aggregate, it is clear that, relative to other states, New York is aggressive about issuing material sales tax assessments to small businesses. Auditors in some states exhort small businesses to correct sales tax issues (for example, advise businesses to start collecting sales tax on receipts from certain sales), whereas New York auditors will issue small businesses crushing sales tax assessments, plus penalties and interest. A colorful recent case discussed by the panel addresses whether charges to enter an area containing several haunted houses was a taxable entrance fee to a place of amusement or was rather a non-taxable charge for the use of amusement devices (use of the property within the haunted house areas). In light of the thin distinctions drawn in many New York sales tax cases, and the potential for crushing assessments, businesses operating in New York are admonished to seek professional help in considering sales tax issues and in responding to any sales tax notices they receive.

5

Recent Cases Show Increased Use of Tax Collection Enforcement Mechanisms
As seen in recent cases, the NY Tax Department's collections unit has several sticks to encourage payment of tax debts. One is suspending a taxpayer's New York driver's license until the tax debt is paid. In a recent case, a taxpayer was unsuccessful in challenging his driver's license suspension; the case discusses the procedural steps that must be taken to suspend the license and explains the difficult criteria that a taxpayer must satisfy to mount a successful challenge. Another stick is to refuse to grant a certificate of authority to anyone seeking to register a new business if the owner of the new business currently has New York tax debts; two recent cases address unsuccessful challenges by individuals who were refused certificates of authority to operate new businesses because they had outstanding New York tax debts.

For more information, please contact Jeffrey S. Reed: jsreed@kilpatricktownsend.com