MOFO
# NEW YORK TAX INSIGHTS

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## IN THIS ISSUE



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# Appellate Court Holds That Furnishing of Pricing Information Is Not a Taxable Information Service

By Irwin M. Slomka

The Appellate Division has issued a potentially important decision regarding the sales tax exclusion for information services that are "personal and individual in nature." Reversing the Tax Appeals Tribunal, the Appellate Division has held that the furnishing of retail grocery store pricing information, although based on data that was publicly available, nonetheless qualified for the "personal and individual" exclusion because the information was both tailored to the customer's specifications and separately maintained by the provider exclusively for the particular client. *Matter of Wegmans Food Markets, Inc. v. Tax Appeals Trib., et al.*, Case No. 523287 (3d Dep't, Nov. 22, 2017). The decision calls into question the Department's policy that whenever the source of the information being furnished is accessible to the general public, even if not obtained from a common database or substantially incorporated into reports furnished to others, the "personal and individual" exclusion does not apply.

Wegmans Food Markets, Inc. ("Wegmans"), a regional supermarket chain, retained RetailData, LLC, to provide "competitive price audits." RetailData collected competitor pricing information on specified retail products, which it then compiled into reports furnished to Wegmans. The pricing information was obtained from publicly available sources, *i.e.*, the prices of goods on display on the sales floors and shelves of competitors' stores, which Wegmans used for its own pricing strategies.

Following an audit, the Department assessed sales tax against Wegmans on the grounds that it purchased a taxable information service for the period June 2007 through February 2010 (the Department also assessed sales tax against RetailData). An information service is not taxable if it is (i) personal and individual in nature to each client and (ii) may not be substantially incorporated into reports furnished to others. Tax Law § 1105(c)(1).

continued on page 2

An Administrative Law Judge held that the information services were not "personal and individual" in nature and therefore were subject to sales tax. The Tax Appeals Tribunal affirmed the ALJ's decision, concluding that it is the source of the information that determines whether the information qualifies for the "personal and individual" exclusion, and the fact that the information did not come from a common database, government database, or a published database was not relevant, nor was the fact that no two reports were likely to be the same because they were customized for each client.

**"[T]o allow for the Tribunal's denial of the subject tax exclusion based solely on the fact that the information ultimately furnished [was] derived from a public source would, under the circumstances presented, serve to defeat the purpose of the exclusion."**

*Appellate Division decision.* The Appellate Division reversed, holding that the pricing information furnished to Wegmans did not derive from a widely accessible common source or database as that test has previously been applied by the courts. The court distinguished these services from those involved in such decisions as *ADP Automotive Claims Services, Inc. v. Tax Appeals Trib.*, 188 A.D.2d 245 (3d Dep't, 1993), *appeal denied*, 82 N.Y.2d 655 (1993) (upholding the imposition of sales tax on the furnishing of cost estimates for automobile repairs using information obtained from a widely available auto part database) and *Allstate Insur. Co. v. State Tax Comm'n*, 115 A.D.2d 831 (3d Dep't, 1985), *aff'd*, 67 N.Y.2d 999 (1986) (involving the provision of information obtained from motor vehicle reports accessible from the Department of Motor Vehicles).

The court found it significant that the pricing information was maintained by RetailData in a separate and unique database solely for use in preparing a written report for Wegmans and that the information was not substantially incorporated into reports furnished to others. The court concluded: "[T]o allow for the Tribunal's denial of the subject tax exclusion based solely on the fact that the information ultimately furnished [was] derived from a public source would, under the circumstances presented, serve to defeat the purpose of the exclusion."

## Additional Insights

The Appellate Division decision is potentially significant in its clear rejection of the Department's narrow interpretation of the "personal and individual" sales tax exclusion. Under that interpretation, the exclusion was unavailable any time the *source* of the information being furnished was publicly available, regardless of whether it was obtained from a common *database* or substantially incorporated into reports furnished to other clients. While there is case law holding that the provision of information obtained from a publicly accessible common database does not qualify as "personal and individual," the Tribunal in *Wegmans* expanded on this precedent by holding that *any* source of publicly available information cannot qualify for the exclusion.

Unless an appeal is sought by the Department and accepted by the Court of Appeals, the decision may require that the Department re-evaluate its policy regarding the "personal and individual" exclusion, including its policy as set forth in its *Technical Memorandum*, TSB-M-10(7)S (N.Y.S. Dep't of Taxation & Fin., July 19, 2010).

Another interesting aspect of the decision is the court's clear embrace of the rule of statutory interpretation establishing that where a tax *exclusion* rather than a tax *exemption* is involved, any ambiguity must be construed in favor of the taxpayer. There has been considerable confusion regarding the distinction between the two, and the court's clarification that tax exclusion provisions are interpreted in favor of the taxpayer should be welcomed by many taxpayers and practitioners.


continued on page 3

# ALJ Upholds Taxpayer's Interpretation of Its Alternative Apportionment Agreement with the Department

By Hollis L. Hyans

A New York State Administrative Law Judge has accepted a taxpayer's interpretation of an agreement permitting use of an alternative apportionment method, and canceled a Notice of Deficiency seeking additional tax and interest that was based on the Department's interpretation. *Matter of S&P Global, Inc., f/k/a The McGraw-Hill Companies, Inc.*, DTA No. 825598 (N.Y.S. Div. of Tax App., Nov. 16, 2017). The issue in dispute concerned whether reduction of the company's "MTA surcharge"—the additional tax applied to businesses operating in the Metropolitan Commuter Transportation District ("MCTD")—was included in the amounts of "tax savings" that had been capped under the terms of the agreement or whether the reduction in the MTA surcharge was a separate benefit not subject to the cap.

*Facts*. Although the years in issue in the case were 2002 through 2005, the relevant facts began in 1997, when S&P Global, Inc. ("S&P"), then a division of The McGraw-Hill Companies engaged in the business of rating debt offerings, was considering whether to keep its headquarters in New York or move to New Jersey to reduce costs. At the time, S&P had approximately 3,000 employees, primarily working in lower Manhattan, and certain of its leases for office space in New York City were due to expire in 1997 and over the next few years. S&P had been offered a package of tax incentives from New Jersey in exchange for relocating there, and its corporate tax burden in New York was substantially higher than it would have been in New Jersey. S&P estimated that moving to New Jersey could result in approximately $5.8 million in annual savings and approximately $108 million in savings over 20 years.

S&P and its representatives approached the Department in an effort to reduce its New York tax costs. S&P's internal tax executives and external consultants met and corresponded with senior representatives from the Department, including then-Commissioner Michael Urbach, then-Deputy Commissioner and Counsel Steven Teitelbaum, and then-Director of the Corporation Tax Audit Bureau Dominick Sciortino. S&P presented models calculating amounts of annual tax savings that could be achieved under various alternative scenarios, which included moving the S&P division to New Jersey, creating a Delaware trademark subsidiary that the Department would agree not to include in a combined return, using destination sourcing rather than cost-of-performance sourcing for S&P's debt rating receipts, or some combination of these alternatives. Annual savings of $6.8 million was identified as a "target" amount during the parties' negotiations.

**[T]he Commissioner exercised his discretionary authority . . . to adjust S&P's BAP in specified ways, including sourcing debt rating receipts on a destination basis . . . and calculating the numerator of the sales fraction at 50% of the amount determined under the revised sourcing method.**

The Department responded with letters proposing a discretionary adjustment to S&P's business allocation percentage ("BAP"), on the basis that the reported BAP did not fairly reflect S&P's business activity in New York. No specific mention was made of the MTA surcharge, and the S&P representatives who testified at the hearing could not recall specifically discussing the MTA surcharge. The negotiations eventually resulted in a draft agreement proposed by S&P that included two possible alternatives, and also included a provision that limited the annual savings that would be allowed. Both proposed models included destination sourcing of debt rating receipts, and other potential percentage decreases to the calculation of the property and payroll factor numerators of the BAP. A final "Implementing Agreement" was reached,



continued on page 4

dated June 13, 1997, pursuant to which the Commissioner exercised his discretionary authority under Tax Law § 210.8(d) to adjust S&P's BAP in specified ways, including sourcing debt rating receipts on a destination basis, calculating the numerators of the property and payroll fractions at 25% of the ordinarily calculated amounts, and calculating the numerator of the sales fraction at 50% of the amount determined under the revised sourcing method. A savings cap was put in place, so that the annual savings arising from the described methodologies could not exceed $6.8 million, which would be adjusted annually by an Applicable Growth Factor referred to as the future value of $6.8 million ("FV $6.8 million") with certain carry forwards being available if the savings in any one year were less than the available cap amount.

**The ALJ . . . noted that . . . there is no . . . authority for the Department to allow or impose discretionary adjustments to the MCTD apportionment fractions for corporate franchise taxpayers such as S&P.**

During the years 1996 through 2003, S&P's Director of State and Local Taxes computed S&P's New York State corporation franchise tax liability in accordance with the apportionment provisions set forth in the Implementing Agreement, and also computed the liability as it would have been without the destination sourcing and BAP fraction numerator adjustments, and compared the two amounts to determine the amount of the annual savings. She computed S&P's MTA surcharge liability using the statutory formula without adjustment to reflect the BAP changes under the agreement, and also by computing the amount of the MTA surcharge base (which is, under Tax Law § 209-B(1), (2), equal to a taxpayer's § 209 tax liability), and then, if the total annual tax savings for both the § 209 tax and the MTA surcharge exceeded the permitted savings cap, increased the tax due to the Department accordingly.

However, for the years 2004 and 2005, after review of the Implementing Agreement by a senior manager at its outside accounting firm, S&P adopted a new method for applying the limitation on annual tax savings. S&P concluded that the tax savings limitation did not apply to the MTA surcharge, and, starting in 2004, S&P applied the FV $6.8 million limitation on annual tax savings only to the savings of § 209 liability and did not limit the MTA surcharge savings. It also changed its method of computing its MTA surcharge and no longer applied the BAP numerator reductions to reduce its MCTD apportionment numerators, on the theory that the MTA surcharge was not specifically mentioned as included in the Implementing Agreement. For 2004 and 2005, S&P's § 209 tax liability was adjusted upward so that the savings did not exceed the available FV $6.8 million tax savings. The reductions to the § 209 liability, although not as great as they would have been without the FV $6.8 million limitation, also resulted in a reduction to S&P's MTA surcharge, since the base amount used to determine the MTA surcharge is the company's tax liability under § 209.

*The Audit and the Parties' Positions.* The Department audited S&P's Article 9-A returns for 2002 through 2005 and took the position that there was no basis for the change in the computational method adopted in 2004, arguing that the discretionary adjustments in the Implementing Agreement not only reduced S&P's § 209 tax liability, but also reduced its MTA surcharge tax liability, and asserted that both were subject to the total savings limitation in the Implementing Agreement. Based on its interpretation of the Implementing Agreement, the Department issued a Notice of Deficiency for approximately $2.6 million plus interest, which included both a § 209 component and an MTA surcharge component.

S&P argued that the savings contemplated in the limitation were only the reductions of its § 209 liability, since the adjusted BAP is relevant only to determining § 209 liability; that the BAP adjustments do not, as the Department claims, "flow through" to the MCTD allocation percentage; and that the MTA is a separate tax imposed in addition


continued on page 5

to the § 209 tax, citing *Matter of Kaiser Aerospace Electronics Corp.*, DTA No. 812828 (N.Y.S. Tax App. Trib., Jan. 16, 1997) (where the Tribunal held that the statute of limitations on assessment of the MTA surcharge did not begin to run until the separate MTA return was filed, regardless of the filing of the taxpayer's franchise tax return). The Department took the position that the reference to "any New York tax savings" in the Implementing Agreement was broad enough to encompass both taxes.

*ALJ Decision.* The ALJ agreed with S&P's interpretation of the agreement and canceled the Notice of Deficiency.

First, however, the ALJ rejected S&P's argument that the MTA surcharge is a separate tax from the § 209 tax. He found that the Tribunal's decision in *Kaiser* stands only for the proposition that the limitation period on assessment of the MTA surcharge does not begin to run until the separately required MTA surcharge return is filed, but does not stand for the "broader proposition" that the MTA surcharge is not a New York State franchise tax imposed in addition to the § 209 tax.

The ALJ then reviewed the methods imposed by the statutes for calculating § 209 liability and the MTA surcharge, as modified by the Implementing Agreement, and found that it provided for alternative apportionment to calculate the § 209 tax, which the Commissioner was authorized to invoke by Tax Law former § 210.8(d). The ALJ concluded that the discretionary adjustments were specifically applicable to the calculation of S&P's BAP and did not automatically flow through to the calculation of S&P's MCTD allocation percentage. The Implementing Agreement specifically required applying the discretionary adjustments in computing S&P's BAP but contained no similar language calling for those adjustments to be applied to compute S&P's MCTD allocation percentage. The ALJ also noted that, while the Tax Law expressly provides authority for the Department to adjust a corporation's BAP when necessary to properly reflect income, there is no similar authority for the Department to allow or impose discretionary adjustments to the MCTD apportionment fractions for corporate franchise taxpayers such as S&P.

The ALJ determined that the calculation of S&P's MTA surcharge was not dependent upon or impacted by the discretionary adjustments in the Implementing Agreement, but was dependent only upon the actual amount of S&P's § 209 liability. He further determined that the MTA surcharge tax savings were "realized simply as the mechanical result of applying the statutory MTA surcharge tax calculation . . . without adjustments under the Implementing Agreement, to the actual (correctly computed) amount" of S&P's § 209 liability. Since the MTA surcharge tax savings did not result from application of the discretionary adjustment methods of the Implementing Agreement, the savings achieved by S&P did not fall within the limitation imposed by the language of the savings cap and were not required to be reduced by the amount of that cap. Therefore, the ALJ canceled in full the Notice of Deficiency.

## Additional Insights

This case sheds interesting light on the Department's exercise of its power to grant discretionary adjustments, a process that is usually invisible to anyone other than the company involved and the Department, since public record litigations seldom result. Here, S&P, a large New York taxpayer, successfully reached a resolution with the Department in an agreement contemplated to last for over 20 years, resulting in significant reduction of S&P's corporation franchise tax liability, and at least one of the factors apparently considered by the Department was the State's interest in keeping S&P—and the many jobs and other economic benefits it provided—in New York City. The decision also highlights the importance of carefully drafting agreements to consider all eventualities, since the ALJ's determination turned on the language of the agreement, and the fact that it included explicit references to adjustment of the BAP with regard to the § 209 liability reduction, but no such language with regard to the MTA surcharge.

As of this writing, the Department's time to seek review of the ALJ's decision by the Tax Appeals Tribunal has not yet run, so there may well be further developments if the Department files an appeal.


continued on page 6

# ALJ Partially Denies Refund Claim Relief Under the Taxpayer Bill of Rights

By Kara M. Kraman

A New York State Administrative Law Judge partially denied a tobacco wholesaler and distributor's tobacco products tax refund claim on the grounds that the statute of limitations had expired for part of the tax period for which the refunds were requested. The ALJ also held that the wholesaler and distributor was not entitled to relief under the portion of the Taxpayer Bill of Rights that requires the disclosure of overpayments made by the taxpayer. *Matter of Globe Wholesale Distributors, Inc.*, DTA No. 826617 (N.Y.S. Div. of Tax App., Nov. 2, 2017).

*Facts.* Globe Wholesale Distributors, Inc. ("Globe") is a licensed New York State wholesaler and distributor of tobacco products. The New York State Department of Taxation and Finance audited Globe for the tobacco products tax for the audit period May 2009 through April 2012. During the course of the audit, the Department determined that Globe had made several errors in its calculation of the tax. As a result, on July 5, 2013, the Department issued a Notice of Determination assessing additional tax due of $55,965, plus interest, for the tax period August 1, 2011, through April 30, 2012, but did not assert any additional tax due for any other portion of the audit period. Globe timely filed a petition with the Division of Tax Appeals.

On December 5, 2013, after it issued the Notice of Determination to Globe, the Department issued a Technical Memorandum providing new guidance for determining a distributor's wholesale price of cigars when an established price or manufacturer's invoice price is not available. *Technical Memorandum*, TSB M 13(12)M (N.Y.S. Dep't of Taxation & Fin., Dec. 5, 2013) (the "TSB-M"). The TSB-M stated that it was "[e]ffective for cigars imported into New York on or after December 1, 2013." Having concluded that under the TSB-M it would be entitled to refunds, on December 19, 2013, Globe filed a protective refund claim for the entire audit period. On July 2, 2015, Globe filed a second refund claim for the audit period.

In September 2015, the Department issued a notice allowing Globe a partial refund. The notice granted Globe's refund claims for November 2011 through April 2012, but denied Globe's refund claims for August 2011 and September 2011 on the grounds that the two-year statute of limitations had already expired for those periods. (No refund was claimed by Globe for October 2011.) As a result, the only periods at issue at the hearing before the ALJ were August 2011 and September 2011. There was no dispute regarding the periods November 2011 through April 2012, as refunds had already been issued to Globe for those periods, and the Department did not assert that additional tax was due.

**The ALJ also concluded that Globe was not entitled to relief under the Taxpayer Bill of Rights provision that requires the Department to disclose to the taxpayer overpayments discovered during the course of an audit.**

*Law.* Tax Law § 476 provides that, where the tobacco products tax is paid in error, a taxpayer is entitled to a refund of the amount of tax paid, provided the refund claim is filed within two years after the tax was paid. Separately, the Taxpayer Bill of Rights provides that the Department must disclose to a taxpayer "all instances of overpayment of tax by such taxpayer discovered by the [D]epartment during the course of an audit, assessment, collection or enforcement proceeding." Tax Law § 3004-a(a).

*ALJ Decision.* The ALJ determined that the Department properly denied Globe's refund claims for August 2011 and September 2011. The ALJ held that, since Globe had filed its protective refund claim on December 19, 2013, it was only entitled to a refund for taxes paid within two years of that date — that is, on or after December 19, 2011. The



continued on page 7

ALJ noted that, although the Department granted Globe's refund claims for the audit period November 2011 through April 2012, by its terms the TSB-M was only applicable prospectively beginning in December 2013, after the tax periods in issue.

The ALJ also concluded that Globe was not entitled to relief under the Taxpayer Bill of Rights provision that requires the Department to disclose to the taxpayer overpayments discovered during the course of an audit. The ALJ noted that, since the TSB-M was not issued until after the audit was completed, and only applied to cigars imported into New York after December 2013, Globe failed to show that the Department discovered any overpayment during the course of the audit that it was required to disclose.

### Additional Insights

This decision deals with—but finds inapplicable—a rarely invoked provision in the Taxpayer Bill of Rights that imposes an affirmative duty on the Department to disclose to the taxpayer any overpayment of tax discovered during the course of an audit, assessment, collection, or enforcement procedure. The taxpayer then has 120 days from the date of the disclosure to file a refund claim, but the 120 days does not reduce the time during which a taxpayer may otherwise file a refund claim. Tax Law § 3004-a(b). The disclosure requirement does not require or permit the payment of a refund with respect to a period that, at the time the overpayment is discovered by the Department, is closed by virtue of the expiration of the statute of limitations. Tax Law § 3004-a(c). In this case, the ALJ found that the disclosure requirement did not apply, both because the TSB-M on which the refunds were based was not issued until *after* the audit concluded and because the TSB-M was not retroactive in nature. However, even if the TSB-M had been made retroactive, the result would have likely been the same, since, at the time it was issued in December 2013, the statute of limitations for refunds had already expired for August 2011 and September 2011.

# INSIGHTS IN BRIEF

### NYS ALJ Finds Petitioner Failed to Prove Qualification as a Real Estate Professional

A New York State ALJ has rejected a claim that the petitioners, a married couple, were entitled to claim a deduction in 2009 for expenses incurred in connection with real estate activities, finding the petitioners had failed to establish an exception to the rule generally denying such deductions because they had not established that either of them qualified for the exception to the rule available to a real estate professional. *Matter of Alexander & Christina Les*, DTA No. 827190 (N.Y.S. Div. of Tax App., Nov. 2, 2017). The ALJ found that the petitioners had failed to establish their claim that Mrs. Les was a real estate professional, concluding there was a lack of credibility in testimony and insufficient evidence on the hours spent related to real estate activities, and that there were inconsistencies between testimony at the hearing and correspondence and other documentary evidence. The ALJ also noted that the petitioners' position as to which spouse qualified as the real estate professional had changed during the course of the audit, since the original audit responses identified Mr. Les, not Mrs. Les, as the real estate professional, and included correspondence in which Mr. Les claimed to manage by himself the whole process of real estate rental in which the couple was engaged.

### Petitioner Found Liable for Sales and Use Tax as a Responsible Party

In *Matter of Martin M. Hopwood, Jr.*, DTA No. 827112 (N.Y.S. Div. of Tax App., Nov. 16, 2017), a New York State Administrative Law Judge upheld the assessment of sales and use tax against the petitioner, an officer and shareholder of a family business engaged in the mechanical contracting business. The company had encountered financial difficulties, arising from a bid on a $15 million project that had been underestimated by the petitioner's brother by approximately $4 million,


continued on page 8

causing the business to file a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. The ALJ found that Mr. Hopwood had not demonstrated that he was not responsible for the activities of the business, but had relied solely upon arguments that the business was in a dire financial situation, which did not absolve an otherwise responsible person from liability for unpaid sales tax. The ALJ also noted that Mr. Hopwood had relied on the hearing record from a prior proceeding involving the same business for earlier years, in which Mr. Hopwood had been found to be a responsible party.

### ALJ Grants Department's Motion to Withdraw a Subpoena on Public Interest Privilege Grounds

A New York State ALJ granted the Department's motion to withdraw a subpoena for documents, issued at the petitioner's request, relating to the Department's deliberative process within the context of its audit and policy functions — documents that were earlier held by the Appellate Division to be protected from disclosure under the Freedom of Information Law ("FOIL") exemption for certain inter- or intra-agency materials. *Matter of Moody's Corp. & Subs.*, DTA No. 827396 (N.Y.S. Div. of Tax App., Nov. 16, 2017). Although the ALJ acknowledged that the FOIL-based exemption was not dispositive as to disclosure by subpoena, he determined that the public-interest privilege, which protects confidential communications between public officers from disclosure where the public interest requires that the communications not be divulged, did apply. In reaching his conclusion, the ALJ noted that, in this case, the public interest in ensuring full, frank, and candid discussions between agency personnel involved in audit matters outweighed the taxpayer's interest in having the documents disclosed.

### Estate Not Required to File Amended Estate Tax Return Disclosing Newly Discovered Assets

Where more than 10 years after the death of the decedent, beneficiaries of the estate discovered additional assets in the Comptroller's Unclaimed Property records, the estate was not required to file an amended estate tax return. *Advisory Opinion*, TSB-A-17(1)M (N.Y.S. Dep't of Taxation & Fin., Oct. 6, 2017). The Department concluded that, since the additional assets were not discovered until 10 years after the estate tax return had been filed, the three-year statutory period to assess had passed. The Department further ruled that, even if the unclaimed property had been discovered within six years after the original estate tax return had been filed, the extended six-year period applicable to amounts omitted from the estate tax return that are in excess of 25% of the total estate would not have applied, because the omitted amount did not meet the 25% threshhold.

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