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## A YEAR IN REVIEW: CLIENT VICTORIES ABOUND

By [Craig B. Fields](#) and [Rachel D. Trickett](#)

The past year will be remembered as exciting for many tax, as well as non-tax, reasons. From the tax standpoint, we are happy to report that our clients had many victories. While most victories were achieved without the need to file a challenge in court and, therefore, are not publicly known, a number of successes were public.

In New York, we successfully litigated a combination case in *Matter of Astoria Financial Corporation & Affiliates*.<sup>1</sup> In that case, the New York City Department of Finance sought to combine Astoria Bank with its investment subsidiary that principally held non-New York mortgage loans.<sup>2</sup> The New York City Tax Appeals Tribunal (“Tribunal”) affirmed the determination of the Chief Administrative Law Judge that held that the subsidiary had a business purpose apart from tax benefits, had economic substance, and conducted its transactions with Astoria Bank at arm’s length.<sup>3</sup> The Tribunal also held that the 2011 New York State Tax Appeals Tribunal decision in *Matter of Interaudi Bank*,<sup>4</sup> in which the New York State Tax Appeals Tribunal found distortion

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# Upcoming Speaking Engagements

## February 2

### The 2017 National Multistate Tax Symposium

Orlando, Florida

- “Intercompany Transactions – Preparing for Continued Scrutiny”  
Craig B. Fields

## February 27

### Council on State Taxation, Sales Tax Conference/Audit Session

San Antonio, Texas

- “Penalties as Revenue Raisers”  
Mitchell A. Newmark
- “Hot Topics, Important Legislation, and Recent Litigation East of the Mississippi”  
Craig B. Fields

## March 3

### Federal Bar Association Tax Law Conference 2017

Washington, D.C.

- “Nexus - Quill Physical Presence and the Race to the U.S. Supreme Court”  
Craig B. Fields

## March 23

### Council on State Taxation, Mid-Atlantic Regional Meeting

Charlotte, North Carolina

Craig B. Fields  
Mitchell A. Newmark

## April 26

### Tax Executives Institute

- “East Coast/West Coast Update”  
Hollis L. Hyans

## May 8

### Council on State Taxation, Mid-West Regional Meeting

Chicago, Illinois

Craig B. Fields  
Mitchell A. Newmark

resulting from a “mismatch of income and related expense” between a bank and its investment subsidiary, was inapplicable because the facts were materially distinguishable.<sup>5</sup>

The outcome in *Matter of Astoria Financial Corporation* was significant because it reinforced the fact that the Department can only forcibly combine a bank’s non-bank, non-taxpayer subsidiary in a New York City bank tax return where the subsidiary lacks a business purpose and economic substance or where it would otherwise result in the distortion of income.<sup>6</sup>

Also in New York, in a case of first impression, a State Administrative Law Judge agreed that the New York State Real Estate Transfer Tax could not be imposed against our client, GKK 2 Herald LLC, because its sale to a co-member of a 45% membership interest in a limited liability company that owns real property in New York represented a mere change of identity or form of ownership (not taxable) and not a transfer of a controlling interest (taxable).<sup>7</sup> Therefore, no additional tax was due.<sup>8</sup>

To ensure compliance with requirements imposed by the IRS, Morrison & Foerster LLP informs you that, if any advice concerning one or more U.S. federal tax issues is contained in this publication, such advice is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing, or recommending to another party any transaction or matter addressed herein.

In New Jersey, the New Jersey Supreme Court denied certification in *Lorillard Licensing Company LLC v. Director, Division of Taxation*, making the Appellate Division’s decision final.<sup>9</sup> The Appellate Division affirmed the Tax Court and held that the State cannot increase a company’s tax owed to New Jersey by applying a broad nexus standard for purposes of New Jersey taxability but a different, narrower nexus standard for purposes of other states’ taxability.<sup>10</sup> The Appellate Division held that because New Jersey successfully asserted an economic nexus standard for Corporation Business Tax constitutional subjectivity purposes, in applying the Throwout rule that same standard must also apply for other states’ subjectivity.<sup>11</sup> This victory concluded a long dispute regarding the proper application of the Throwout rule in New Jersey.

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**[P]enalties were designed to punish taxpayers who willfully ignored the law, not penalize those taxpayers who acted reasonably.**

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In Massachusetts, the Massachusetts Appellate Tax Board (“ATB”) issued a decision abating penalties imposed against Reynolds Innovations Inc. by the Massachusetts Commissioner of Revenue.<sup>12</sup> Penalties

must be abated when the failure to file returns or pay tax is due to reasonable cause.<sup>13</sup> Here, the ATB held that the imposition of penalties and the failure to abate the penalties was inappropriate.<sup>14</sup> The Commissioner did not appeal the ATB's decision and the ATB did not issue a Findings of Fact and Report. This outcome is especially significant at a time when states are more often imposing penalties and refusing to abate them. As the ATB's decision supports, penalties were designed to punish taxpayers who willfully ignored the law, not penalize those taxpayers who acted reasonably.

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## [R]einforces the fact that the Colorado Department of Revenue is bound by its own regulations.

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Further, in Colorado, a Denver District Court agreed with us that the Colorado Department of Revenue cannot forcibly combine a corporation's subsidiary, a holding company that derived its income solely from investments in foreign entities, with Agilent Technologies, Inc.<sup>15</sup> The court ruled that the Department was bound by its own regulation, which provided that a corporation without any property or payroll of its own cannot be included in a Colorado combined return.<sup>16</sup> The court also ruled that neither an Internal Revenue Code Section 482-type Colorado statute, nor the economic substance doctrine, gave the Department the authority to include the subsidiary in its parent's Colorado combined return.<sup>17</sup>

This decision illustrates that holding companies are to be respected and that states can't disregard them merely because doing so will generate more taxes. It also reinforces the fact that the Colorado Department of Revenue is bound by its own regulations.

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## [Mississippi's] dividends received deduction violates the Commerce Clause of the United States Constitution.

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In Michigan, the Department of Treasury assessed use tax against Thomson Reuters America Corporation based on the theory that the company's sale of subscriptions to *Checkpoint*<sup>®</sup> was a taxable sale of tangible personal property.<sup>18</sup> The Michigan Court of Appeals ruled, in an unpublished opinion, that sales of subscriptions to *Checkpoint*<sup>®</sup> were primarily sales of a nontaxable service.<sup>19</sup> The Department of Treasury sought leave to appeal the Court of Appeals' ruling before the Michigan Supreme Court.<sup>20</sup> The Department of Treasury ultimately withdrew its application for leave to appeal and Thomson Reuters' victory became final.<sup>21</sup> This development had a significant impact on a large number of other Michigan taxpayers, many of whom filed claims for and obtained refunds of tax that was collected and remitted pursuant to the Department of Treasury's incorrect interpretation of the law.

# SAVE THE DATE

## Annual State + Local Tax East Coast Update

**April 7, 2017**

8:30 a.m. – 3:30 p.m.  
New York, New York

### Topics to be discussed include:

- Tri-State News: New York, New Jersey and Pennsylvania
- Hot Topics and Issues in California and Other Western States
- SALT Litigation and Other Developments Around the Country

For more information, contact Taylor Birnbaum at [tbirnbaum@mofo.com](mailto:tbirnbaum@mofo.com).

Finally, the Mississippi Supreme Court recognized the amicus brief that we filed on behalf of Sysco Corporation and R.J. Reynolds Tobacco Company and agreed that the State's dividends received deduction violates the Commerce Clause of the United States Constitution.<sup>22</sup> The issue is now concluded as the Department of Revenue did not file a petition for certiorari with the U.S. Supreme Court. This is a significant win for many taxpayers who filed their Mississippi returns excluding the dividends from all subsidiaries.

In addition to these public wins, we assisted our clients in securing a string of nonpublic victories, including in a northeastern state where the state tax authorities agreed to cancel, in full, two assessments against individual, non-residents regarding gains on the sale of interests in corporations. The individuals were granted 100% relief on a seven figure assessment. In another state, a state tax authority agreed that a multi-national insurance and reinsurance broker was entitled to apportion its income because the company was doing business both within and outside of the State. Further, a state tax authority issued a determination agreeing with our argument that none of a financial institution's sales should be removed from its sales factor and, rather than owing additional tax, the company was entitled to a refund.

In a western state, a state tax authority agreed to completely reverse a proposed adjustment, which incorrectly attempted to deny our client the use of millions of dollars in net operating losses. Lastly, the state tax authority in a southern state granted our protest and agreed with our position that fees for access to our client's offerings on the Internet are not taxable sales of digital property.

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## We look forward to continuing to advocate on our clients' behalf in 2017 and seeing additional client successes.

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1. *Matter of Astoria Fin. Corp. & Affiliates*, TAT (E) 10-35 (BT) (N.Y.C. Tax App. Trib., May 19, 2016).
  2. *Id.*
  3. *Id.*
  4. *Matter of Interaudi Bank*, DTA No. 821659 (N.Y.S. Tax App. Trib., Apr. 14, 2011).
  5. *Id.*
  6. *Matter of Astoria Fin.*, TAT (E) 10-35 (BT).
  7. *Matter of GKK 2 Herald LLC*, DTA No. 826402 (N.Y.S. Div. of Tax App., May 26, 2016).
  8. *Id.*
  9. *Lorillard Licensing Co., LLC v. Dir., Div. of Taxation*, 141 A.3d 297 (N.J. 2016).
  10. *Lorillard Licensing Co., LLC v. Dir., Div. of Taxation*, 29 N.J. Tax 275, 282-83 (N.J. Super. Ct. App. Div. 2015).
  11. *Id.*
  12. *Reynolds Innovations Inc. v. Comm'r of Revenue*, Dkt. Nos. C314648, C314649 (Mass. App. Tax Bd., Feb. 29, 2016).
  13. Mass. Gen. Laws ch. 62C, § 33(f).
  14. *Reynolds Innovations*, Dkt. Nos. C314648, C314649.
  15. *Agilent Technologies, Inc. v. Dep't of Revenue of the State of Colo., et al.*, No. 2014CV393 (Colo. Dist. Ct., Jan. 20, 2016).
  16. *Id.*
  17. *Id.*
  18. *Thomson Reuters Inc. v. Dep't of Treasury*, No. 313825 (Mich. Ct. App., May 13, 2014).
  19. *Id.*
  20. *Thomson Reuters Inc. v. Dep't of Treasury*, No. 313825 (Mich. Ct. App., May 13, 2014), *appeal docketed*, No. 149902 (Mich. Aug. 12, 2014).
  21. *Thomson Reuters (Tax & Accounting), Inc.*, 872 N.W.2d 687 (Mich. 2015) (final order entered December 30, 2015).
  22. *Miss. Dep't of Revenue v. AT&T Corp.*, 202 So. 3d 1207, 1213 n. 3, 1226, 1229 (Miss. 2016); Brief of R.J. Reynolds Tobacco Company and Sysco Corporation, as Amici Curiae Supporting Appellee, *Miss. Dep't of Revenue v. AT&T Corp.*, No. 2015-CA-00600 (Miss. Dec. 17, 2015).

This newsletter addresses recent state and local tax developments. Because of its generality, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations. If you wish to change an address, add a subscriber, or comment on this newsletter, please write to Nicole L. Johnson at Morrison & Foerster LLP, 250 West 55<sup>th</sup> St., New York, New York 10019, or email her at njohnson@mofo.com, or write to Rebecca M. Balinskas at Morrison & Foerster LLP, 250 West 55<sup>th</sup> St., New York, New York 10019, or email her at rbalinskas@mofo.com.



# MORRISON FOERSTER

## STATE + LOCAL TAX

# WHAT SEPARATES US FROM THE REST?

**OUR EXPERIENCE.** We've been doing it longer, have more experience and published decisions, and have obtained a greater number of favorable settlements for our clients than the rest.

**OUR TRACK RECORD OF PROVEN SUCCESS.** We've successfully litigated matters in nearly every state, and have resolved the vast majority of matters without the necessity of trial.

**OUR NATIONAL PERSPECTIVE.** We approach state and local tax issues from a nationwide perspective, taking into account the similarities and differences of SALT systems throughout the United States.

**OUR DEPTH.** Our team is comprised of a unique blend of public and private backgrounds with experience spanning various industries. We're nationally recognized as a leading practice for tax law and tax controversy by *Chambers*, *Legal 500* and *Law360*. In fact, we've been referred to as "one of the best national firms in the area of state income taxation" by *Legal 500 US* and were rated Law Firm of the Year for Litigation – Tax by the 2016 "Best Law Firms" Edition of *U.S. News & World Report – Best Lawyers*.

For more information about Morrison & Foerster's State + Local Tax Group, visit [www.mofo.com/salt](http://www.mofo.com/salt) or contact Craig B. Fields at (212) 468-8193 or [cfields@mofo.com](mailto:cfields@mofo.com).