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MoFo New York Tax Insights

No Hearing Permitted Without a Notice of Deficiency or Refund Denial

By Hollis L. Hyans

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In *Matter of Mark A. Rothberg*, DTA No. 823318 (N.Y.S. Div. of Tax App., Mar. 29, 2012), a New York State Administrative Law Judge held that the Division of Tax Appeals lacked jurisdiction to provide a hearing when the taxpayer had received neither a notification of a tax deficiency nor denial of a refund application.

In Rothberg, the petitioner was a New York resident employed in New Jersey. He filed returns for the years 1994 through 2010, but according to the Department of Taxation and Finance did not make full payment of the amounts shown as due, or any payment in certain years. The Department did receive portions of federal income tax refunds owed to Rothberg by the Internal Revenue Service, and applied those payments as offsets to Rothberg's outstanding New York assessments. The Department applied them, as is its usual practice, first to tax, then to

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No Hearing Permitted Without a Notice of Deficiency

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penalties, and then to interest, starting with the oldest outstanding assessment.

The proceeding was commenced in response to a levy against Rothberg's bank account in June 1, 2009, based on outstanding warrants, and a notice of garnishment sent to his employer, seeking payment of approximately $100,000. Thereafter, the Department recalculated the amounts due, based on amounts credited from the IRS payments over the years, leaving a net difference of approximately $34,000.

Rothberg claimed that, in 2003, in connection with refinancing his apartment, he had been required to and did satisfy all outstanding tax obligations, and that this satisfaction was confirmed in a 2003 telephone conversation with a Department official. No documentation was provided, other than a satisfaction of one warrant for approximately $4,000. The ALJ noted that Rothberg "appears to assert" that none of the IRS payments should have been applied to periods prior to 2004, and that the payments were sufficient to offset all or most of the amounts owed for 2004 and thereafter.

Rothberg had commenced a proceeding in Supreme Court, the state's trial court, seeking to vacate the levy and warrants. That proceeding was dismissed for failure to exhaust administrative remedies. Rothberg then requested a conciliation conference, which was rejected on jurisdictional grounds, leading to a petition filed with the Division of Tax Appeals seeking a hearing.

The ALJ held that the Division of Tax Appeals lacked jurisdiction to provide a hearing. He found that the various provisions in the New York Tax Law regarding the right to hearing "limit the right of a taxpayer to file a petition to situations where a notice of deficiency has been issued or an application for refund of tax paid has been made and denied." Here, neither of those had occurred. The petitioner had filed tax returns, which are regarded as self-assessing the amount of tax shown to be due. The Department issued notices and demands for the tax shown due (or determined to be due based on math errors), which is not the same as the assertion of a "deficiency." Under Tax Law § 173-a(2), a notice and demand "shall not be construed as a notice which gives a person the right to a hearing…."

The ALJ then went on to note that, even if jurisdiction existed, Rothberg had failed to provide sufficient evidence to support his claims, since he presented no documentation that satisfaction of the one warrant in question eliminated all his outstanding liabilities, and that, even if all the claimed federal offsets were applied, the net result still left nearly half the assessed amounts unpaid.

Additional Insights. In 1994, the Appellate Division had held that no provision in the Tax Law, as it then was written, clearly provided that a notice and demand did not give rise to the right to a hearing. *Donal A. Meyers et al. v. Tax Appeals Tribunal*, 201 A.D.2d 185, (3d Dep't 1994). In 2004, the law was amended to clearly eliminate the right to a hearing before the Division of Tax Appeals when the taxpayer is challenging a notice or demand for unpaid tax, interest, and penalties resulting from a mathematical or clerical error, or from the failure to pay the tax shown due on a return.

UNDER TAX LAW § 173-a(2), A NOTICE AND DEMAND "SHALL NOT BE CONSTRUED AS A NOTICE WHICH GIVES A PERSON THE RIGHT TO A HEARING…."

More interesting is the fact that Rothberg first tried to bring his action in the state court, where it was dismissed, presumably on the State's motion, for failure to exhaust administrative remedies. Having achieved that dismissal, it appears that the Department then argued — successfully, thus far — that in fact Rothberg has no administrative pre-payment remedies, leaving him with only the potential remedy of paying all amounts claimed to be due and filing a claim for refund, another option not discussed at all in the decision.

Special Refund Authority Not Available for Claiming Time-Barred Resident Tax Credit

By Kara M. Kraman

A New York State Administrative Law Judge denied a couple's claim for a personal income tax refund resulting from a resident tax credit, filed after the statute of limitations had expired, because the couple failed to show the mistake of fact necessary for the Commissioner to invoke his special refund authority under Tax Law § 697(d). *Matter of Yang and Kyung H. Cho*, DTA No. 824624 (N.Y.S. Div. of Tax App., Mar. 22, 2012).

The Chos timely filed their 2006 New York State personal income tax return and paid the tax due. In March 2010, the Chos were

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Special Refund Authority Not Available

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notified by the New Jersey Division of Taxation that they owed New Jersey income tax for the 2006 tax year, which they did not contest. In May 2010, the Chos filed an amended 2006 New York return seeking a refund based on a resident credit for taxes paid to New Jersey.

The Department denied the Chos' claim for refund as untimely because the deadline for filing a refund claim expired on April 15, 2010, and the Division did not receive the refund claim until May 10, 2010. While the Chos conceded that their refund application was untimely, they asserted that, because of a "miscommunication with their accountant," they failed to timely file a refund claim and thus had made an erroneous payment of taxes to New York under a "mistake of fact." Therefore, they asserted the Commissioner's special refund authority under Tax Law § 697(d), which provides:

> Where no questions of fact or law are involved and it appears from the records of the tax commission that any moneys have been erroneously or illegally collected from any taxpayer or other person, or paid by such taxpayer or other person under *a mistake of facts*, pursuant to the provisions of this article, the tax commission at any time, without regard to any period of limitations, shall have the power . . . to cause such moneys so paid . . . to be refunded.

(Emphasis added.)

In determining whether this special refund authority was available for the Chos' refund claim, the ALJ needed to determine whether the money paid by the taxpayers was paid under a mistake of fact or a mistake of law. Citing *Matter of William M. and Judi L. Wallace*, DTA No. 818025 (N.Y.S. Tax App. Trib., Oct. 11, 2001), the ALJ noted:

> A *mistake of fact* has been defined as an understanding of the facts in a manner different than they actually are. A *mistake of law*, on the other hand, has been defined as acquaintance with the existence or nonexistence of facts, but ignorance of the legal consequences following from the facts.

(Emphasis added.)

Applying this definition, the ALJ found that the Chos' failure to report and pay the proper amount of tax to New Jersey, and then to claim the appropriate credit on their 2006 New York income tax return, was based on a mistake of law, not a mistake of fact. The ALJ first noted that the Chos were aware of all of the income at issue when they originally filed their returns. The ALJ then stated that the Chos did not provide any evidence or otherwise elaborate on why their "miscommunication" with their accountant was a mistake of fact and not law. Finally, the ALJ pointed out that the Chos were informed about their New Jersey deficiency on March 22, 2010, 24 days before the expiration of the New York statute of limitations, leaving them time to file a claim for refund.

Accordingly, the ALJ held that the special refund authority provided in Tax Law § 697(d) was not applicable and granted summary judgment to the Division.

Additional Insights. While the Chos could have filed a timely refund claim after being notified that they owed additional taxes to New Jersey before the statute of limitations expired, in some cases taxpayers are assessed tax deficiencies in other states *after* the statute of limitations has expired, leaving the taxpayer without a remedy for avoiding multiple tax. Although not binding precedent, the Division of Tax Appeals has previously ruled that where a taxpayer does not receive notice of taxes owed to another jurisdiction until after the statute of limitations to file a New York claim for refund has expired, the special refund authority does not apply because the taxpayers' mistake was one of law, and not fact. *Matter of Daniel B. and Dolores Bowden et al.*, DTA Nos. 813529 through 813538 (N.Y.S. Div. of Tax App., Aug. 22, 1996).

Tax Provisions Enacted in 2012-13 State Budget

By Irwin M. Slomka

The Legislature has now passed, and Governor Andrew Cuomo has signed into law, the 2012-2013 New York State Budget. S.6259-D, A.9059D. It contains several tax and tax credit provisions, with no tax increases. It is substantially similar, but not identical, to the Governor's Executive Budget proposed in January 2012 (discussed in the February 2012 issue of *New York Tax Insights*).

Among the more significant tax changes are the following:

- **Extends Gramm-Leach-Bliley Transitional Provisions.** The transitional provisions under Article 32 and Article 9-A relating to the Federal Gramm-Leach-Bliley Act have been extended through December 31, 2014. Only corporations meeting the definition of a banking corporation under Tax Law § 1452(a) will be allowed to remain an Article 32 taxpayer under these provisions.

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Tax Provisions Enacted in 2012-13 State Budget

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- **Provides Lower Metropolitan Commuter Transportation Mobility Tax Rates to Professional Employer Organizations.** In 2011, the Metropolitan Commuter Transportation Mobility Tax rates were reduced for small businesses. Effective for quarters beginning on or after April 1, 2012, the lower rates are also available to professional employer organizations. These organizations would not otherwise qualify for the lower rates because of their size, but typically furnish employer administrative services usually for employee benefits, to clients that are themselves small businesses.

- **Modifies Sales Tax Compliance Methods for Hotel Room Remarketers.** In connection with previously enacted sales tax legislation that applied to hotel room remarketers, the legislation contains several compliance provisions, effective September 1, 2012. They include: (i) providing a method for remarketers to compute the taxable portion of a bill when occupancy is provided together with other items for a single price; and (ii) allowing remarketers to report taxable occupancies for the filing period in which the occupancy ended, rather than in the sales tax period during which the consideration was collected.

- **Suspends STAR Exemption Benefits for Taxpayers with Past-Due Tax Liabilities.** The legislation suspends STAR property tax benefits to homeowners having past-due state tax obligations of at least $4,500. Beginning with the 2013-2014 school year, taxpayers owing state taxes will be notified of the possible suspension, and will be given the opportunity to satisfy their past due liability in order to lift the suspension. Any suspended STAR benefits will be offset against the taxpayer's past-due state tax obligations.

- **Extends Certain Electronic Filing and Sales Tax Compliance Provisions.** The amendments extend, for one year through 2013, the requirement that individuals using tax software to prepare their State personal income tax returns file their returns electronically. However, it *repeals* the $25 penalty for failure to file a tax return for individuals who do not comply, as well as the provision denying interest on overpayments or refunds claimed on a return until properly e-filed. It also extends through December 31, 2013 (rather than makes permanent as previously proposed) the Department's authority to require certain sales tax vendors to set up separate bank accounts, accessible to the Department, for depositing sales tax collections.

Several tax items that the Governor proposed in January were *not* enacted into the new law:

- A provision that would have allowed the Department to deny to a vendor a certificate of authority for sales and use tax if the vendor owes any unpaid tax, not solely unpaid sales tax.

- A prohibition against banks deducting bank processing fees from proceeds from bank accounts levied to collect delinquent State taxes or child support obligations.

- A proposal to tax all loose tobacco at the higher cigarette tax rate, rather than the lower tobacco products excise tax rate.

- A proposal to expand the personal income tax and sales tax credits for residential solar energy installations.

As expected, the Department's "corporate tax reform" proposal was also not part of the legislative enactment.

Exemption Favoring In-State Beer Held Unconstitutional

By Hollis L. Hyans

In a *Technical Memorandum* issued on April 13, 2012, the Department of Taxation and Finance explained the effect of an order that nullified an exemption from the alcoholic beverages tax on distributors and noncommercial importers of beer. TSB-M-12(1)M (N.Y.S. Dep't of Taxation & Fin., Apr. 13, 2012).

New York Tax Law § 424 imposes taxes on beer, wine, liquor, and other alcoholic beverages. Tax Law Section 424(6) also provides a broad exemption from the tax on the first 200,000 barrels of beer brewed in New York and sold or used in New York, in each calendar year, by a brewer whose principal executive office is located in New York. The law was challenged as violating the U.S. Constitution, and on March 28, 2012, the New York State Supreme Court entered a Stipulation of Settlement and Judgment, which provided that, with no admission on the merits by either party, Tax Law Section 424(6) is unconstitutional and of no force and effect. A settlement payment of $160,000 was also made to plaintiff and its attorneys. *Shelton v. N.Y.S. Liquor Authority,* Index. No 7893-06 (Sup. Ct. Albany Cty. Mar. 28, 2012).

The Department has now issued guidance explaining that the court's order "nullified" the exemption, and that, on or after March 28, 2012, all distributors are subject to the 14 cents per gallon tax on all beer sold or used in New York State, plus an additional tax of 12 cents per gallon on all beer sold or used in New York City.

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Exemption Favoring In-State Beer Held Unconstitutional

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The TSB-M also contains directions for completion of the Beer Tax Return, directing taxpayers not to include any beer sold on or after March 28 in computing the brewer's exemption, but allowing brewers to claim the exemption for sales completed or uses made prior to that date.

THE DEPARTMENT HAS NOW ISSUED GUIDANCE EXPLAINING THAT THE COURT'S ORDER "NULLIFIED" THE EXEMPTION [FOR BEER BREWED IN NEW YORK STATE].

Additional Insights. An exemption that, on its face, is available only to entities whose principal executive office is within the state seems to be an obvious violation of the Constitution. *See, e.g., Bacchus Imports, Ltd., et al. v. Dias, Dir. of Taxation of Hawaii*, 468 U.S. 263 (1984), in which the United States Supreme Court held unconstitutional a Hawaii statute that exempted locally produced alcoholic beverages from the liquor tax as violating the commerce clause, since the statute had both the purpose and effect of discriminating in favor of local products. Given that the Department entered into a Stipulation of Settlement and Judgment, and promptly issued guidance instructing taxpayers that the exemption is no longer available, it appears the Department chose not to seek to defend the statutory exemption as written.

Income from Contracts with Government Agencies is Subject to N.Y.C. General Corporation Tax

By Open Weaver Banks

A New York City Administrative Law Judge ("ALJ") held that income earned from the provision of security guard services to United States government agencies by a private company at offices located in New York City is not exempt from the City general corporation tax ("GCT"), which must be apportioned by application to entire net income of the City business allocation percentage ("BAP"), based on the proportion of property, receipts, and payroll attributable to New York City.

In *Matter of Alante Security Group, Inc.*, TAT (H) 09-40(GC) (N.Y.C. Tax. App. Trib., Admin. Law Judge Div., Feb. 10, 2012), the petitioner, a New York corporation, provided armed and unarmed security guard services to corporations and entities, including federal agencies located in federal buildings in the City. The petitioner participated in the City's 2003 amnesty program with respect to its GCT liability for the tax years 1992 through 2001, years for which the petitioner had not timely filed GCT returns. It subsequently filed GCT returns for the tax years 2002 through 2005. The Department of Finance audited the years 1997 through 2005 and assessed a deficiency based principally on adjustments to the receipts, payroll, and property factors.

Before the ALJ, the petitioner argued that income earned from providing guard services to the federal government was exempt from GCT and that the Department lacked jurisdiction to tax the income. The ALJ disagreed, reasoning that while federal instrumentalities are immune from direct imposition of the GCT, "this immunity does not extend to corporations which do business with the government agency."

The ALJ also rejected the petitioner's argument that its services were provided to a federal agency in a "federal enclave" where the City had no jurisdiction to tax. To the contrary, the ALJ found that the Buck Act of 1940, 4 U.S.C. § 106, specifically permits the imposition of the GCT in this instance. Under the statute, "[n]o person shall be relieved from liability for any income tax levied by any State, or by any duly constituted taxing authority therein, having jurisdiction to levy such a tax, by reason of his residing within a federal area or receiving income from transactions occurring or services performed in such area."

The ALJ also noted the direct conflict between the petitioner's claims of immunity from the GCT and its failure to dispute liability for State sales and use taxes computed on its receipts from providing security services to the federal government. The petitioner filed returns and paid State sales and use taxes for the tax years at issue, which the ALJ noted was consistent with the petitioner's contract with the federal government.

Finally, finding no authority to set aside the City's BAP methodology, which takes into account the portion of a taxpayer's property, receipts, and payroll attributable to the City, the ALJ also rejected the petitioner's position that its entire net income should instead be allocated using the percentage of City sales reported in the petitioner's State Sales and Use Tax returns for the years in issue.

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Income from Contracts with Government Agencies

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Additional Insights. Although not cited in the *Alante* opinion, in *United States v. New Mexico*, 455 U.S. 720 (1982), the United States Supreme Court considered whether private contractors with the federal government were entitled to "derivative" sovereign immunity from state taxation under the Supremacy Clause of Article VI, Section 2 of the United States Constitution. In that case, the United States sought a declaratory judgment that three of its contractors were entitled to the benefit of sovereign immunity and therefore were not obligated to pay gross receipts tax, compensating use tax, or sales tax imposed by New Mexico.

The Supreme Court held against the United States, and stated that "tax immunity is appropriate in only one circumstance: when the levy falls on the United States itself, or on an agency or instrumentality so closely connected to the Government that the two cannot realistically be viewed as separate entities, at least insofar as the activity being taxed is concerned." *Id*. at 735. Under this test, it is evident that the petitioner in *Alante Security Group* did not have a strong claim to derivative immunity from the GCT, since nowhere was it alleged that the petitioner acted in an agency capacity, nor did the petitioner "stand in the government's shoes." *United States v. Mexico*, 455 U.S. at 736.

With regard to the petitioner's "federal enclave" argument, Article I, Section 8, clause 17 of the United States Constitution grants Congress the power "[t]o exercise exclusive Legislation in all cases whatsoever . . . over all Places purchased by the Consent of the Legislature of the State in which the Same shall be, for the Erection of Forts, Magazines, Arsenals, dock-Yards, and other needful Buildings." However, as recognized by the ALJ in *Alante*, when Congress enacted the Buck Act in 1940, it gave the states the power to impose income taxes on persons (which include business entities) residing on federal land or on sales or uses occurring on land that would otherwise be within the exclusive jurisdiction of the United States. 4 U.S.C. §§ 105-110. For that reason, the ALJ rejected the petitioner's contention that its income was immune from the GCT simply because it provided its security services at locations otherwise within federal jurisdiction.

Insights in Brief

Department Fails to Show Timely Mailing

In *Matter of Maria Guzman*, DTA No. 824658 (N.Y.S. Div. of Tax App., Apr. 5, 2012), the petitioner sought redetermination of denial of a claimed refund of personal income taxes. The Division of Tax Appeals issued a Notice of Intent to Dismiss Petition, because the petition was filed two years and 19 days after the statutory refund denial notice was apparently issued, and thus was 19 days late, since a taxpayer ordinarily has two years from the issuance of a notice of disallowance to file a petition with the Division of Tax Appeals. However, the ALJ found that the Department had failed to meet its burden of demonstrating proper mailing, since all that it submitted was a one-paragraph letter from its representative "containing an unsubstantiated conclusory statement." In the absence of any proof of mailing of the notice of disallowance, no burden to disprove receipt ever shifted to the petitioner, and the petition was allowed to proceed.

Penalty Imposed on Taxpayer for Filing Frivolous Petition

An ALJ held that a taxpayer who asserted a position that has "been soundly rejected by the federal courts" and for which "absolutely no basis" could be found was subject to the $500 frivolous position penalty provided for by Tax Law § 2018. *Matter of William H. Dourlain*, DTA No. 823892 (N.Y.S. Div. of Tax App., Mar. 22, 2012). The taxpayer, who had failed to file New York personal income tax returns and claimed that his wages were not includible in gross income, cited a number of inapplicable or irrelevant provisions of federal law as support for his position, but provided no evidence in support of his claim.

Appellate Division Affirms Assessment of Unincorporated Business Tax on Payments to Pension Plan

The Appellate Division, First Department, unanimously affirmed a decision of the New York City Tax Appeals Tribunal that payments made to a pension plan for the benefit of retired partners in an unincorporated business are nondeductible payments to partners under Section 11-507(3) of the Administrative Code. *In re Murphy & O'Connell*, No. 7128, 2012 NY Slip Op. 2046 (1st Dep't., Mar. 20, 2012). The Appellate Division's decision also noted that the Tribunal had correctly determined that the Department of Finance was not required to promulgate a rule before applying the statute to the specific facts of the case.

ABB v. Missouri
Albany International Corp. v. Wisconsin
Allied-Signal, Inc. v. New Jersey
AE Outfitters Retail v. Indiana
American Power Conversion Corp. v. Rhode Island
Citicorp v. California
Citicorp v. Maryland
Clorox v. New Jersey
Colgate Palmolive Co. v. California
Consolidated Freightways v. California
Container Corp. v. California
Crestron v. New Jersey
Current, Inc. v. California
Deluxe Corp. v. California
DIRECTV, Inc. v. Indiana
DIRECTV, Inc. v. New Jersey
Dow Chemical Company v. Illinois
Express, Inc. v. New York
Farmer Bros. v. California
General Mills v. California
General Motors v. Denver
GMRI, Inc. (Red Lobster, Olive Garden) v. California
GTE v. Kentucky
Hair Club of America v. New York
Hallmark v. New York
Hercules Inc. v. Illinois
Hercules Inc. v. Kansas
Hercules Inc. v. Maryland
Hercules Inc. v. Minnesota
Hoechst Celanese v. California
Home Depot v. California
Hunt-Wesson Inc. v. California
Intel Corp. v. New Mexico
Kohl's v. Indiana
Kroger v. Colorado
Lanco, Inc. v. New Jersey
McGraw-Hill, Inc. v. New York
MCI Airsignal, Inc. v. California
McLane v. Colorado
Mead v. Illinois
Nabisco v. Oregon
National Med, Inc. v. Modesto
Nerac, Inc. v. NYS Division of Taxation
NewChannels Corp. v. New York
OfficeMax v. New York
Osram v. Pennsylvania
Panhandle Eastern Pipeline Co. v. Illinois
Panhandle Eastern Pipeline Co. v. Kansas
Pier 39 v. San Francisco
Powerex Corp. v. Oregon
Reynolds Metals Company
v. Michigan Department of Treasury
Reynolds Metals Company v. New York
R.J. Reynolds Tobacco Co. v. New York
San Francisco Giants v. San Francisco
Science Applications International Corporation
v. Maryland
Sears, Roebuck and Co. v. New York
Shell Oil Company v. California
Sherwin-Williams v. Massachusetts
Sparks Nuggett v. Nevada
Sprint/Boost v. Los Angeles
Tate & Lyle v. Alabama
Toys "R" Us-NYTEX, Inc. v. New York
Union Carbide Corp. v. North Carolina
United States Tobacco v. California
USV Pharmaceutical Corp. v. New York
USX Corp. v. Kentucky
Verizon Yellow Pages v. New York
Whirlpool Properties v. New Jersey
W.R. Grace & Co.—Conn. v. Massachusetts
W.R. Grace & Co. v. Michigan
W.R. Grace & Co. v. New York
W.R. Grace & Co. v. Wisconsin

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