

MOFO NEW YORK TAX INSIGHTS

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THE TOP 10 NEW YORK TAX HIGHLIGHTS OF 2014

By Irwin M. Slomka

2014 turned out to be a very eventful year in New York taxation. As we enter the New Year, here is our list of the Top 10 New York tax highlights of 2014.

- 1. Corporate Tax Reform legislation enacted.** In what is surely the most significant New York development of 2014, on March 31, 2014 comprehensive corporate tax reform legislation was enacted and signed into law, effective for tax years beginning after 2014. Part A, Ch. 59, N.Y. Laws of 2014. Sweeping in scope, the new law undoubtedly represents the broadest revision to Article 9-A since its enactment in 1944. The legislation not only substantially overhauled Article 9-A — such as by adopting economic nexus, unitary water's edge combination, market-based sourcing, and a 0% income tax rate for qualified New York manufacturers, and by eliminating the long-standing subsidiary income exclusion — it also merged the 30-year-old bank tax (Article 32) into Article 9-A. The corporate tax reform legislation was the culmination of a more than five-year initiative by the New York State Department of Taxation and Finance, and was carried out with the active participation of various industry groups. While the New York City general corporation tax was not amended, reportedly the City will attempt to enact similar legislation in 2015.
- 2. State Tribunal clarifies existing rules for permissive combination under Article 9-A in *IT USA* and *Knowledge Learning* decisions.** The New York State Tax Appeals Tribunal issued two significant decisions involving combined returns under Article 9-A. In *Matter of IT USA, Inc.*, DTA Nos. 823780 & 823781 (N.Y.S. Tax App. Trib., Apr. 16, 2014), the Tribunal upheld an Administrative Law Judge's decision permitting two New York taxpayers to file combined Article 9-A returns, even in the absence of substantial intercorporate transactions, because the taxpayers established not only the existence of a unitary relationship but also the lack of arm's length intercompany pricing. The Tribunal concluded that the furnishing of various intercorporate services at cost resulted in actual distortion. The case had been watched by many because of concerns that the State Tax Department was routinely decomposing long-standing State combined groups, and giving insufficient weight to the actual distortion basis for combination.

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Matter of Knowledge Learning Corp. and Kindercare Learning Centers, Inc., DTA Nos. 823962 & 823963 (N.Y.S. Tax App. Trib., Sept. 18, 2014) may be even more significant because it addressed a controversial conclusion by an ALJ last year that distortion was no longer a factor for combination after the 2007 statutory changes regarding the presumption of distortion (a conclusion that many taxpayers and practitioners believed was incorrect). The Tribunal reversed the ALJ decision, and permitted two related corporations to file combined returns. Although the Tribunal concluded that substantial intercorporate transactions were present — and therefore it did not need to consider whether actual distortion existed — it nonetheless reversed the ALJ's conclusion regarding the purported irrelevance of actual distortion, noting that combination still will be allowed if “necessary to properly reflect income and avoid distortion,” even in the absence of substantial intercorporate transactions. The two decisions should provide important clarity regarding permissive combination, at least until the new unitary combination rules take effect for tax years beginning after 2014.

3. **Court of Appeals reverses *Gaied* “Permanent Place of Abode” decision.** In *Matter of John Gaied v. Tax App. Trib.*, 22 N.Y.3d 592 (2014), the Court of Appeals took the rare step of addressing what constitutes a “permanent place of abode” for statutory residency purposes. Reversing the Appellate Division (and the Tribunal), the Court held that a New Jersey resident’s ownership and maintenance of a house in Staten Island occupied by his parents did not make it his “permanent place of abode.” Most important was the Court’s rejection of the State Tax Department’s position that a taxpayer need not “reside” in the permanent place of abode, but that “maintaining” the place of abode was sufficient. Instead, the Court established a “residential interest” requirement to constitute a permanent place of abode. The Department later revised its *Nonresident Audit Guidelines* to set forth its interpretation of what it means to have a “residential interest” in a place of abode. Some view the *Gaied* decision as a signal that the State’s highest court may be willing to address other controversial aspects of the statutory residency test.

4. **New York City ALJ rejects City’s forced combination of bank and its mortgage subsidiary.** The Chief Administrative Law Judge for the New York City Tax Appeals Tribunal held that a bank was not required to file a combined New York City bank tax return with its Connecticut subsidiary that held non-New York mortgage loans. *Matter*

of Astoria Financial Corporation & Affiliates, TAT (H) 10-35 (BT) *et al.* (N.Y.C. Tax App. Trib., Admin. Law Judge Div., Oct. 29, 2014). The ALJ found that the subsidiary had economic substance, was formed for legitimate business purposes, and conducted its transactions with the bank at arm’s length. Significantly, the ALJ rejected the City’s reliance on the controversial decision in *Matter of Interaudi Bank*, DTA No. 821659 (N.Y.S. Tax App. Trib., Apr. 14, 2011), where the State Tribunal upheld the forced combination of a bank and its investment subsidiary in order to avoid a “mismatching of income and expenses.” The ALJ concluded that the facts in *Interaudi* were distinguishable, and that *Interaudi* did not constitute binding precedent. The City has filed an Exception to the decision.

5. ***Qui tam* developments: “whistleblower” action is revealed; New York’s highest court will hear the *Sprint Nextel* appeal.** With no meaningful effort having yet been made to amend the 2010 legislative expansion of the New York False Claims Act, which permitted private “whistleblower” *qui tam* State tax actions, some glimmers of hope for limiting the scope of such actions did surface in 2014. First, in June 2014, after upholding a trial court decision allowing the New York Attorney General to bring a \$100 million *qui tam* lawsuit under the False Claims Act against Sprint Nextel, the Appellate Division, First Department, granted Sprint Nextel’s request to have the case heard by the Court of Appeals. *State of New York v. Sprint Nextel Corp., et al.*, 114 A.D.3d 622, *leave to appeal granted* (App. Div. 1st Dep’t, June 12, 2014).

Another *qui tam* action with even more far-reaching implications, originally filed under seal in 2013 and then unsealed in July 2014, has been brought in the New York courts by a lawyer formerly employed by (and terminated by) the Vanguard Group, Inc. The former Vanguard lawyer claimed that the company had evaded more than \$1 billion in federal taxes and more than \$20 million in New York State taxes. *State of New York ex rel. David Danon v. Vanguard Group, Inc.*, No. 100711-13 (Sup. Ct., N.Y. Cnty., May 8, 2013). Unlike in *Sprint Nextel*, the Attorney General declined to intervene in this case. In October 2014, Vanguard filed a motion to dismiss the Complaint, and to disqualify the plaintiff (and his attorneys) on ethics grounds.

6. ***Caprio* and *Luizza* decisions limit retroactive application of statutory amendments on Due Process grounds.** In a decision that could call into question the constitutionality of some retroactive

legislative enactments, the Appellate Division, First Department, held that a 2010 retroactive statutory amendment concerning the treatment of installment payments by nonresident shareholders of an S corporation violated the taxpayers' Due Process rights. *Caprio v. N.Y.S. Dep't of Taxation & Fin.*, No. 651176/11, 11231, 2014 NY Slip Op. 2399 (App. Div. 1st Dep't, Apr. 8, 2014). Later in 2014, an ALJ reached the same conclusion in *Matter of Jeffrey M. and Melissa Luizza*, DTA No. 824932 (N.Y.S. Div. of Tax App., Aug. 21, 2014). The *Caprio* decision is currently on appeal to the Court of Appeals, and an Exception has been filed in *Luizza*.

7. **ALJ upholds denial of sales tax refund due to vendor's failure to first refund the tax to customers.** Adhering to the strict language of the Tax Law for obtaining sales tax refunds, in *Matter of New Cingular Wireless PSC LLC*, DTA No. 825318 (N.Y.S. Div. of Tax App., July 17, 2014), a State ALJ upheld the denial of a more than \$100 million sales tax refund claim made by a telecommunications vendor because the vendor had not complied with the statutory requirement that the sales tax first be refunded to customers. The opposite conclusion had been reached in a 2014 New Jersey Tax Court decision involving a New Jersey sales tax refund claim made by the same taxpayer. As discussed elsewhere in this issue, the ALJ has now denied the taxpayer's request to reopen the hearing to introduce evidence that in August 2014, subsequent to his July 17, 2014 decision, the taxpayer deposited more than \$100 million of collected sales tax into a pre-refund escrow account.

8. **ALJ decision upholding partial liability of LLC members for LLC's sales tax may result in a new legal challenge to strict liability of LLC members.** A State ALJ upheld the State Tax Department's 2011 policy that a member of a limited liability company ("LLC") holding a minority interest in the LLC will be strictly liable for a portion of the LLC's sales tax liability. *Matter of Eugene Boissiere and Jason Krystal*, DTA Nos. 824937 & 824938 (N.Y.S. Div. of Tax App., Sept. 18, 2014). After the State Tribunal upheld, in *Matter of Santo*, DTA No. 821797 (N.Y.S. Tax App. Trib., Dec. 23, 2009), strict liability of an individual LLC member for the full amount of the LLC's sales tax liability, the State Tax Department issued *Technical Memorandum*, TSB-M-11(17)S (N.Y.S. Dep't of Taxation & Fin., Sept. 19, 2011), limiting the liability of LLC members with a less than 50% ownership interest who are not under a "duty to act" for the LLC with respect to sales tax, based on their percentage interest in the LLC.

The *Boissiere* action challenged *any* strict liability against an LLC member as being inconsistent with the New York LLC law — which limits an LLC member's liability — and as violating the taxpayers' Due Process rights. An Exception to the decision has now been filed, and the case may be a vehicle for an eventual judicial challenge to the imposition of any strict liability on LLC members.

9. **Decision holds that the First Amendment required the exercise of the Commissioner's discretionary authority for apportioning receipts.** In a noteworthy decision involving the First Amendment (freedom of the press), the Chief ALJ of the City Tribunal held that First Amendment principles mandated that the City exercise its discretionary authority to adjust a corporation's receipts factor for general corporation tax purposes. *Matter of The McGraw Hill Companies, Inc.*, TAT(H) 10-19(GC) *et al.*, (N.Y.C. Tax App. Trib., Admin. Law Judge Div., Feb. 24, 2014). The ALJ thus permitted McGraw-Hill's Standard & Poor's credit rating agency division to source its credit rating fees based on the location of the website viewers of its credit ratings, rather than under the statutory method based on where the services are performed. The last time the New York courts invoked the First Amendment in an apportionment case was nearly 25 years ago — in a case involving the same taxpayer. *McGraw-Hill, Inc. v. State Tax Commission*, 75 N.Y. 2d 852 (1990). The City has filed an Exception to the decision.

10. **HMO is held exempt from New York City corporate tax as an insurance corporation.** In one of the few decisions to address the scope of a 1974 legislative enactment that exempted insurance companies from the New York City general corporation tax ("GCT"), a City ALJ held that a health maintenance organization ("HMO") was exempt from the GCT as an insurance corporation, and therefore could not be included in Aetna, Inc.'s combined GCT return. *Matter of Aetna, Inc.*, TAT(H) 12-3(GC) and TAT(H) 12-4(GC) (N.Y.C. Tax App. Trib., Admin. Law Judge Div., July 22, 2014). The decision reached the opposite conclusion of the State Tax Department in a 1993 Advisory Opinion holding that HMOs are not engaged in an insurance business for State tax purposes. If upheld, the decision could also impact the State and City taxation of captive insurance companies, which both the State and City have sometimes attacked for allegedly not providing true insurance. The City has filed an Exception to the decision.

TRIBUNAL AFFIRMS THAT A CHARTER YACHT IS NOT EXEMPT FROM USE TAX AS A COMMERCIAL VESSEL

By Kara M. Kraman

The Tax Appeals Tribunal has affirmed an Administrative Law Judge determination holding that a yacht hired out for charter trips between New York State and Canada was subject to New York State compensating use tax based on the market value of the yacht when it was first used in New York State. *Matter of Stan Groman*, DTA No. 824274 (N.Y.S. Tax App. Trib., Dec. 4, 2014). The Tribunal also upheld the ALJ's denial of the taxpayer's motion to reopen the record, and the imposition of penalties.

In February 2004, while a resident of California, Mr. Groman purchased a yacht in Florida. Mr. Groman did not pay Florida sales tax on the purchase of the yacht because it qualified for exemption from the tax. Shortly after purchasing the yacht, Mr. Groman moved to New York State, where he planned to operate a small charter business with the yacht out of Alexandria Bay, New York.

The yacht was not brought into New York State until May 1, 2005, after undergoing extensive repairs in New Jersey. Soon after the yacht entered New York waters, it had an accident that necessitated another 16 months of repairs, this time in Brewerton, New York. Eventually, the yacht arrived in Alexandria Bay in June 2006, and Mr. Groman began advertising and operating it as a charter boat offering personalized charters either within New York or between New York and Canada. Mr. Groman did not register the vessel with the New York State Department of Motor Vehicles, and he did not pay New York State use tax on the vessel.

In general, New York law imposes use tax on New York residents on the use within New York of tangible personal property purchased at retail, except to the extent sales tax has been or will be imposed. Tax Law § 1110(a). In cases in which the taxpayer can show that the property was used outside the State for more than six months prior to entry into the State, the use tax is imposed on the basis of the market value of the item at the time of its first use in the State, rather than its original sales price. Tax Law § 1111(b).

Mr. Groman claimed the yacht was exempt from use tax as a “[c]ommercial vessel[] primarily engaged in interstate or foreign commerce. . . .” Tax Law § 1115(a)(8). The New York State sales tax regulations specify that a commercial vessel is primarily engaged in interstate or foreign commerce “when 50 percent or more of the receipts from the vessel’s

activities” are so derived, and that interstate or foreign commerce is “the transportation of persons or property between states or countries.” 20 NYCRR 528.9(a)(5).

At the hearing before the ALJ, Mr. Groman produced only three pages of the yacht's daily cruising log, and an affidavit of only one of several captains hired by Mr. Groman stating that some of the charters included locations in Canada. The ALJ held that use tax was due when the vessel first entered New York State waters, and that Mr. Groman did not prove entitlement to the exemption for commercial vessels primarily engaged in interstate or foreign commerce. The Tribunal affirmed, holding that the cruising log and affidavit, without more, were insufficient to meet the taxpayer's burden of proving that the yacht qualified for the exemption. The Tribunal also found that the ALJ properly denied Mr. Groman's motion to reopen the record after the hearing concluded so that he could submit additional evidence, both because the motion was not timely filed and because he presented no facts that would constitute a basis for reopening the record.

The Tribunal held that [the] failure to maintain and present records to support [the] claim was not consistent with reasonable cause or absence of willful neglect.

The Tribunal also affirmed the ALJ's determination that use tax was due on the market value of the yacht on the date it first entered New York State, since it was used for more than six months prior to such first use in the State, and the ALJ's determination that Mr. Groman failed to demonstrate reasonable cause or an absence of willful neglect that justified a waiver of penalties.

Additional Insights

This case illustrates a common pitfall when sales tax is not paid on the purchase of a vessel or an aircraft (which is subject to similar tax rules). While certain states either do not impose sales tax or provide sales tax exemptions for purchases of vessels and aircraft that are removed from the state within a certain period of time, the state where the vessel or aircraft is removed to will usually impose a compensating use tax.

In this case, the Tribunal's analysis upholding the imposition of penalties is also interesting. Specifically, regarding Mr. Groman's claim that the yacht was primarily engaged in interstate commerce, the Tribunal held that his failure to maintain and present records to support this

claim was not consistent with reasonable cause or absence of willful neglect. The Tribunal's holding drives home the importance of maintaining complete records. The decision suggests that the failure to do so may not only defeat the exemption claim, but may also deprive a taxpayer of the ability to have penalties waived, even where the taxpayer had reasonable cause at the time of the tax filing to claim an exemption from tax.

COURT OF APPEALS HOLDS CITY TRANSFER TAX DOES NOT APPLY TO "RECONSTITUTION" OF HOUSING COOPERATIVE

By Irwin M. Slomka

In a unanimous decision, the New York Court of Appeals has rejected the Department of Finance's attempt to impose New York City real property transfer tax when a residential cooperative corporation terminates its participation in the Mitchell-Lama Housing Program and "reconstitutes" as a cooperative corporation under the New York Business Corporation Law. *Trump Vill. Section 3, Inc. v. City of New York*, No. 221 (Court of Appeals, Dec. 17, 2014). The decision confirms that in order to constitute a taxable "deed," there must be an actual conveyance of real property from a grantor to a grantee.

Trump Village Section 3, Inc. ("Trump Village 3") is a Mitchell-Lama cooperative housing corporation that owns and operates three 23-story buildings in Coney Island, New York. It was formed in 1961 under what is now known as the Private Housing Finance Law. Under the Mitchell-Lama program, the cooperative corporation enjoyed substantial government benefits, while tenant-shareholders were restricted in their ability to make resales to third parties.

In 2007, the shareholders of Trump Village 3 voted to terminate its participation in the Mitchell-Lama program, which it was permitted to do after being in the program for 20 years. As a result, under the Private Housing Finance Law, Trump Village 3 "reconstituted" itself as a corporation under the Business Corporation Law. The "reconstitution" involved amending the corporation's certificate of incorporation. The shareholders, the number of shares, and the corporation's federal tax identification number all remained the same before and after the "reconstitution," and no deed was made or recorded.

In August 2010, the Department of Finance issued a \$21 million assessment against Trump Village 3 for real property transfer tax (RPTT), interest, and penalties.

The Department claimed that the transaction involved a conveyance of real property to a new corporation and thus there was a taxable "deed" under the RPTT law. Rather than challenge the assessment administratively through the New York City Tax Appeals Tribunal, Trump Village 3 brought a declaratory judgment action in the courts, asserting that the RPTT was inapplicable because there was no transfer of real property. Although the Department initially prevailed before a Kings County Supreme Court judge, that decision was later reversed by the Appellate Division, Second Department (discussed in the November 2012 issue of *New York Tax Insights*). The Appellate Division granted the Department leave to appeal to the Court of Appeals, which has now issued a unanimous decision agreeing with the Appellate Division that no taxable event had taken place, and applying the same analysis.

In its appeal, the Department continued to claim that the amendment to the certificate of incorporation was a taxable "deed" within the meaning of the RPTT law, which allegedly effectuated the conveyance of real property to a new corporation. The Court rejected this as a "strained interpretation" of the plain language of the RPTT law. It disagreed with the Department's claim that the "reconstitution" was the equivalent of a "reincorporation," and cited New York case law as far back as 1857 for the proposition that a reincorporation is regarded as a continuation of an existing corporation. The Court also rejected the Department's argument that the cooperative corporation "radically altered" its business under the reincorporation, and pointed out that "the RPTT does not tax changes in the business or purpose of the corporation owning real property, but taxes conveyances of property or an interest therein." As for the Department's assertion that the certificate of amendment was a "deed" because it conveyed real property rights, the Court found no factual or legal support for that interpretation. Finally, the Court rejected the Department's reliance on *East Midtown Plaza Housing Co. v. Cuomo*, 20 N.Y.3d 161 (2012), a decision under the Martin Act, where the Court held that the reconstitution of a Mitchell-Lama cooperative involved the "offering or sale of securities" that imposed certain disclosure requirements. The Court distinguished that decision as addressing the entirely different issue of shareholder rights. The Court concluded that the decision "lends no support" for taxing a Mitchell-Lama privatization.

Additional Insights

The Court of Appeals decision should finally end decades-long efforts by the Department to seek to tax the "reconstitution" of Mitchell-Lama cooperatives that leave the program. See *Joint Queensview Housing Enterprise, Inc. v. Grayson* (Sup. Ct. N.Y. Cnty., 1990), *rev'd on other grounds*, 179 A.D. 2d 434 (1st Dep't 1992) (where

a reconstitution of a Mitchell-Lama cooperative under a different section of the Private Housing Finance Law was also held not subject to RPTT). The unanimous Court of Appeals decision (which followed a unanimous Second Department decision) constitutes an emphatic rejection of the Department's legal position, and it is difficult to see how the reconstitution could possibly have constituted a "transfer" or "conveyance" of real property from a grantor to grantee under the RPTT. Moreover, even if there has been a transfer of real property, the transfer should have been exempt from RPTT as a "mere change in form," since there was no change in beneficial ownership of the cooperative (an issue not reached by the Court).

We understand that in a separate case being litigated administratively that involves the same issue, but for a different Mitchell-Lama cooperative, the Department has now withdrawn its Exception filed with the City Tribunal. *Matter of Trump Vill. Section 4, Inc.*, TAT(H) 10-34(RP) (N.Y.C. Tax App. Trib., Admin. Law Judge Div., July 11, 2013) (discussed in the August 2013 issue of *New York Tax Insights*). That ALJ decision concluded that there was no transfer of real property, but also addressed related issues, ruling that the reconstitution did not involve the transfer of an "economic interest" in real property and would have qualified for exemption as a "mere change in form," even if there had been a transfer, since there was no change in beneficial ownership of the cooperative corporation. By withdrawing its Exception, the Department properly acknowledges that the Court of Appeals decision is dispositive on whether there had been a transfer in the first place. However, the withdrawal will also mean that the ALJ's analysis of those related issues will not be considered precedential with respect to the other issues.

ALJ DENIES MOTION TO REOPEN THE RECORD

By Hollis L. Hyans

Last year, a New York State Administrative Law Judge upheld the denial of a sales tax refund of over \$100 million, finding that the vendor had not complied with the statutory requirement that the amount in issue must first be refunded to customers. *Matter of New Cingular Wireless PCS LLC*, DTA No. 825318 (N.Y. S. Div. of Tax App., July 17, 2014). Now, the same ALJ has denied the company's motion to reopen the record, holding that the evidence it sought to offer was created after the determination was issued and therefore was not "newly discovered" evidence that could justify reopening the record. *Matter of New Cingular Wireless PCS LLC*, DTA No. 825318 (N.Y.S. Div. of Tax App., Dec. 4, 2014).

Background. To resolve litigation claiming that New Cingular Wireless, now known as AT&T Mobility ("ATTM"), improperly collected and remitted sales tax on charges for Internet access, ATTM entered into a class action settlement agreeing to reimburse its customers, including New York customers, for the overcollected tax by filing a refund claim for their benefit. The agreement involved the creation of an escrow account to receive sales tax refunded by the states, with those funds to be distributed to the customers by an escrow agent under court supervision. In states like New York that require a vendor to refund the overcollected tax to its customers prior to receiving a refund from the state, ATTM agreed to fund a pre-refund escrow account. However, ATTM did not make any payments to the pre-refund escrow account with respect to the overcollected New York sales tax.

Here, the evidence was not "newly discovered," but instead was not in existence at the time of the determination, and thus did not fall within the rule [allowing the record to be reopened].

The ALJ determined that since ATTM had not repaid the tax to its customers, it could not obtain a refund because it failed to satisfy Tax Law § 1139(a), which provides that "[n]o refund or credit shall be made to any person of tax which he collected from a customer until he shall first establish to the satisfaction of the tax commission, under such regulations as it may prescribe, that he has repaid such tax to the customer." Although recognizing that the New Jersey Tax Court had reached the opposite result, in *New Cingular Wireless PCS, LLC v. Director, Division of Taxation*, 28 N.J. Tax 1 (2014), the ALJ distinguished the language of the New York statute from the one in New Jersey, concluding that the New Jersey statute, which stated that the vendor cannot receive an "actual" refund until it has repaid its customers, contained a "timing difference" that allows a refund claim to be filed before customers are paid, which did not exist in the New York statute. In his July decision, the ALJ also noted several times that ATTM had not in fact funded any escrow account with any monies related to the New York amounts.

Motion to reopen. In August 2014, ATTM filed a motion to reopen the record or for reargument, claiming that it had not funded the New York escrow account because the Department had informed it that the refund claim would nonetheless be denied on other grounds. After the ALJ's decision was issued, ATTM decided to fund the New

York escrow account, and sought to reopen the record to introduce evidence that it had now done so by entering into an agreement with a bank and depositing over \$106 million in August 2014.

The ALJ denied the motion. He noted that the Tribunal's Rules of Practice and Procedure provide that a record may be reopened only to allow the introduction of newly discovered evidence, which "would probably have produced a different result and which could not have been discovered with the exercise of reasonable diligence in time to be offered into the record." Tribunal Rules of Practice and Procedure, Section 3000.16. Here, the evidence was not "newly discovered," but instead was not in existence at the time of the determination, and thus did not fall within the rule. He relied in part on the decision in *Matter of Frenette*, DTA No. 816715 (N.Y.S. Tax App. Trib., Feb. 1, 2001), which stated that the Tribunal regulation on reopening the record is based on CPLR 5015, which sets forth the standards for reopening a judgment and which in turn was derived from Federal Rule of Civil Procedure 60(b)(2). In *Frenette*, the Tribunal, citing Appellate Division decisions under CPLR 5015, found that a judgment may be reopened only to allow admission of "evidence which was in existence and hidden at the time of the judgment." (emphasis in decision, citations and internal quotation marks omitted). The ALJ also found that payment into the escrow account "presents a different factual landscape and a new issue" not previously before the Division of Tax Appeals, and allowing the record to be reopened would be contrary to the goal of finality.

Additional Insights

It is usually difficult to convince an ALJ to consider additional evidence after the record has been closed and a decision has been entered. The *Frenette* Tribunal decision relied upon by the ALJ does indeed reach the conclusion that "newly discovered evidence" refers to evidence that was in existence at the time of the original judgment, and that magazine articles printed after the hearing could not be received in evidence. However, here the taxpayer claims that it did not make the escrow payment because it was advised by the Department that making the escrow payment would not have changed the Department's position, while the ALJ seemed to consider the absence of the escrow payment to be a significant fact. It is not clear from the decision whether ATTM was raising an actual claim of estoppel by arguing that it had originally relied on the Department's advice that funding the escrow account would be "futile," and then only later learned from the ALJ's decision that funding the account could have been relevant, and that the evidence should be admitted despite the general rule that "newly discovered evidence" does not include evidence that was not formerly in existence.

At press time, we understand that an exception is expected to be filed, and if so the Tribunal will have the opportunity to review both the July decision denying the refund and the December decision refusing the admission of new evidence.

STATE TAX DEPARTMENT OUTLINES POLICY ON TRANSACTIONS USING VIRTUAL CURRENCY

By Michael J. Hilkin

On the heels of Internal Revenue Service guidance addressing the federal tax consequences of using "convertible virtual currency," Notice 2014-21 (Mar. 25, 2014), the New York State Department of Taxation and Finance has released its own guidance on the issue in *Technical Memorandum* TSB-M-14(5)C, TSB-M-14(7)I, and TSB-M-14(17)S (N.Y.S. Dept of Taxation & Fin., Dec. 5, 2014). The Technical Memorandum defines "convertible virtual currency," and outlines the Department's policy regarding transactions involving convertible virtual currency for New York sales tax, corporation tax, and personal income tax purposes.

Convertible virtual currency. Consistent with the IRS Notice, the Technical Memorandum defines "convertible virtual currency" as "a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value," that either "has an equivalent value in real currency, or that acts as a substitute for real currency." The most commonly known convertible virtual currency is Bitcoin, a decentralized virtual currency that uses a peer-to-peer computer network to issue Bitcoins and account for transfers of Bitcoins. Currently, holders can use Bitcoins on a variety of websites as a form of payment similar to the U.S. dollar. For example, users may exchange Bitcoins to purchase products on Overstock.com and to pay a satellite television bill to DISH Network.

New York sales tax guidance. Although convertible virtual currency is often used as a substitute for other forms of currency, such as the U.S. dollar, according to the Department the payment of convertible virtual currency in exchange for goods or services is a barter transaction, and thus is treated under New York law as two separate transactions: (1) the sale of convertible virtual currency and (2) the sale of the goods and/or services received in exchange for the convertible virtual currency. With respect to the sale of the currency, no New York sales tax is due because, for New York sales tax purposes, convertible virtual currency is "intangible property" and the sale of such property is not subject to New York sales

tax. However, with regard to the second transaction, if the goods and/or services transferred are subject to New York sales tax, sales tax must be paid based on the market value of the convertible virtual currency at the time of the transaction, as calculated in U.S. dollars. Further, if the seller of goods or services gives the convertible virtual currency user a sales slip, invoice, or receipt as part of the transaction, it must separately state the sales tax due in U.S. dollars on that sales slip, invoice, or receipt. Finally, a seller of taxable goods or services in New York that accepts convertible virtual currency must register for sales tax purposes and properly record and report its convertible virtual currency transactions in U.S. dollars.

The Department has chosen to conform to the IRS's classification of convertible virtual currency in Notice 2014-21, which concluded that under federal tax law convertible virtual currency is property, rather than currency.

New York corporation tax and personal income tax guidance. According to the Department, New York corporation tax and personal income tax laws conform to the federal treatment of convertible virtual currency outlined in Notice 2014-21. In that Notice, the IRS classified convertible virtual currency as property, and stated that the general tax principles applicable to property transactions will apply to transactions involving the exchange of convertible virtual currency. Therefore, a taxpayer who receives virtual currency as payment for goods or services must include the fair market value of the virtual currency in computing gross income.

Additional Insights. Now that some major companies have begun accepting Bitcoin payments on their websites, the tax treatment of sales transactions involving convertible virtual currency has received attention from tax commentators and the financial press. The Department has chosen to conform to the IRS's classification of convertible virtual currency in Notice 2014-21, which concluded that under federal tax law convertible virtual currency is property, rather than currency. As such, for federal and New York State income tax purposes, basis in the virtual currency must be calculated upon receipt of the currency, and then that basis is used to determine gain or loss on any subsequent disposition of the currency.

INSIGHTS IN BRIEF

ALJ Dismisses Taxpayer's Petition Seeking Refund of Amounts Levied by Department Under Warrant

The State Tax Department's motion to dismiss a taxpayer's Petition for Hearing seeking a refund of amounts levied by the Department from the taxpayer's bank account as the result of a warrant was granted by a State Administrative Law Judge. *Matter of Strawberry Uniforms, Inc.*, DTA No. 826028 (N.Y.S. Div. of Tax App., Nov. 20, 2014). The ALJ held that the Division of Tax Appeals does not have jurisdiction over collection activities. The ALJ also noted that where, as here, the underlying statutory notices stem from late filed returns made without remittance of the amounts reported as due, a taxpayer is not entitled to a prepayment hearing.

ALJ Denies Motions for Summary Judgment on Passive Rental Losses

A New York State Administrative Law Judge has denied motions made by both the taxpayers and the State Tax Department, each seeking summary judgment on the question of whether the taxpayers were entitled to refunds based on claimed losses incurred in 2012 on properties they owned in New York and Pennsylvania. *Matter of Carlton P. and Pooi Stewart*, DTA No. 826178 (N.Y.S. Div. of Tax App., Nov. 26, 2014). The ALJ found that, as individual taxpayers, the Stewarts would be entitled to deduct their losses attributable to rental real estate if they "actively participated" in rental activity, which requires them to have owned at least a 10% interest in each property and to have participated in property management decisions. Since their exact interest was unclear, and no facts had been presented by either side to show the Stewarts' involvement in rental activity, there was insufficient evidence to grant summary judgment, and the matter will be set for a factual hearing.



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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
Astoria Financial v. New York City
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
DuPont v. Michigan
EchoStar v. New York
Express, Inc. v. New York
Farmer Bros. 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
IGT v. New Jersey
Intel Corp. v. New Mexico
Kohl's v. Indiana
Kroger v. Colorado
Lorillard Licensing Company v. New Jersey
Lorillard Tobacco Co. v. Michigan
McGraw-Hill, Inc. v. New York
MCI Airsignal, Inc. v. California
McLane v. Colorado
Mead v. Illinois
Meredith v. New York
Nabisco v. Oregon
National Med, Inc. v. Modesto
Nerac, Inc. v. New York
NewChannels Corp. v. New York
OfficeMax v. New York
Osram v. Pennsylvania
Panhandle Eastern Pipeline Co. v. Kansas
Pier 39 v. San Francisco
Powerex Corp. v. Oregon
Rent-A-Center v. Oregon
Reynolds Metals Company v. Michigan
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
Scioto Insurance Company v. Oklahoma
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
Thomson Reuters v. Michigan
Toys "R" Us-NYTEX, Inc. v. New York City
Union Carbide Corp. v. North Carolina
United States Tobacco v. California
UPS v. New Jersey
USV Pharmaceutical Corp. v. New York
USX Corp. v. Kentucky
Verizon Yellow Pages v. New York
Wendy's International v. Illinois
Wendy's International v. Virginia
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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