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NEW YORK TAX INSIGHTS

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IN THIS ISSUE

THE TOP 10 NEW YORK TAX HIGHLIGHTS OF 2017

By Irwin M. Slomka

As we look forward to an exciting new year, here is our annual list of what we viewed as the Top 10 New York Tax Highlights of 2017.

1. **Appellate Division finds error in denial of sales tax refunds to wireless carrier, and holds that the record should have been reopened to allow proof that sales tax was deposited in escrow account.** The Appellate Division held that the Tribunal abused its discretion in not reopening the evidentiary record to admit evidence that a wireless carrier funded a pre-refund escrow account established to facilitate repayment to customers of improperly collected sales tax. *New Cingular Wireless PCS, LLC v. Tax Appeals Trib.*, 153 A.D.3d 476 (3d Dep't, Aug. 3, 2017). The Tribunal had upheld the denial of more than $100 million in claimed sales tax refunds because the carrier had not established that it first refunded the sales tax to customers, as required under the sales tax law. The Third Department remitted the case back to the Tribunal in light of the evidence that an escrow account had been funded, and clearly indicated that in its view the denial of refunds would result in a "windfall" to New York State.

2. **Appellate Division holds that pricing information, though publicly available, qualified for the "personal and individual" exclusion under the sales tax.** In a second significant Third Department decision, the Appellate Division held that the furnishing of grocery store pricing information qualified for the sales tax exclusion for information services that are "personal and individual in nature." *Matter of Wegmans Food Mktg., Inc. v. Tax Appeals Trib., et al.*, 2017 Slip Op. 08225 (3d Dep't, Nov. 22, 2017). According to the Third Department, while the pricing information was publicly available, it was tailored to the customer's specifications and separately maintained by the service provider solely for the particular client. The decision calls into question the Department's sales tax policy, expressed in a 2010 TSB-M pronouncement, that the "personal and individual" exclusion can never apply if 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.

3. **First Department upholds application of federal "step transaction" doctrine to NYC real property transfer tax.** The taxation of transfers of economic interests in real property became murkier

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after a First Department decision allowing the New York City Department of Finance to invoke the federal "step transaction" doctrine in order to impose New York City real property transfer tax on the transfer of a 45% membership interest in an LLC that owned a Manhattan office building. *GKK 2 Herald LLC v. City of N.Y. Tax Appeals Trib.*, 154 A.D.3d 213 (1st Dep't, 2017). The decision may well lead to considerable uncertainty regarding the taxation of transfers of minority economic interests. It may also have sanctioned a significant narrowing of the "mere change in form" exemption, further complicating many real estate transactions in New York City involving entity transfers.

Meanwhile, a case remains pending before the New York State Tribunal on the applicability of the New York State real estate transfer tax to the same transaction. The case involves an appeal by the State Tax Department of a decision of an Administrative Law Judge holding that the transaction was not taxable because under the Department's own regulations the transfer or acquisition of a minority economic interest cannot be aggregated with one constituting a nontaxable "mere change in form." *Matter of GKK 2 Herald LLC*, DTA No. 826402 (N.Y.S. Div. of Tax App., May 26, 2016).

4. **NYS Tribunal holds that the Tax Department impermissibly discriminated against foreign unauthorized insurance companies.** Interpreting the scope of a U.S.-Germany tax treaty, the New York State Tribunal reversed two Administrative Law Judge decisions, and held that the Tax Department's use of an alternative apportionment formula for insurance franchise tax purposes impermissibly discriminated against two foreign insurers not authorized to engage in an insurance business in New York. *Matter of Bayerische Beamtenkrankenkasse AG*, DTA No. 824762 (N.Y.S. Tax App. Trib., Sept. 11, 2017); *Matter of Landschaftliche Brandkasse Hannover*, DTA No. 825517 (N.Y.S. Tax App. Trib., Sept. 11, 2017). The decisions are noteworthy in that the Tribunal agreed that the Department's application of an alternative non-premiums-based allocation formula was proper, but nonetheless found that its application was impermissible because it contravened the nondiscrimination provision of a federal tax treaty.

5. **ALJ holds that executive changed his domicile to Paris and was not a New York resident.** In the most interesting residency decision in recent memory – and a compelling love story – an individual who retired as chief financial officer of a Fortune 500 company in New York City in order to immediately move to Paris to be with his new wife, a French domiciliary with whom he rekindled a relationship after more than 40 years apart, was found by an Administrative Law Judge to no longer be a New York City domiciliary. *Matter of Stephen C. Patrick, et al.*, DTA Nos. 826838 & 826839 (N.Y.S. Div. of Tax App., June 15, 2017). The fact that the taxpayer maintained a penthouse apartment in New York City, and continued to spend a significant amount of time in New York, did not change the result. The Tax Department did not file an exception with the Tribunal, and the decision is now final.

6. **NYS Tribunal upholds denial of deductions for insurance payments made to captive insurance company.** The New York State Tribunal, affirming a decision of an Administrative Law Judge, held that a corporation could not deduct insurance payments made to its wholly owned captive insurance company under Article 9-A because the payments did not qualify as bona fide insurance premiums for federal income tax purposes. *Matter of Stewart's Shops Corp.*, DTA No. 825745 (N.Y.S. Tax App. Trib., July 27, 2017). The Tribunal held that the federal criteria for what qualifies as "insurance" – which requires evidence of risk-shifting and risk-distribution – were controlling for New York purposes, and by the taxpayer's own acknowledgment were unmet. In November 2017, Stewart's Shops filed an Article 78 appeal with the Appellate Division, Third Department.

7. **Appellate Division confirms NYC Tribunal decision that HMOs are not insurance corporations and thus can be included in a combined return.** The Appellate Division, First Department, confirmed a NYC Tribunal decision holding that health maintenance organizations are not "insurance corporations" for general corporation tax purposes because they are not "doing an insurance business," and therefore they can be forcibly included in a combined general corporation tax return with their parent holding company. *Matter of Aetna Inc. v. N.Y.C. Tax Appeals Trib.*, 154 A.D.3d 542 (1st Dep't, 2017). While insurance corporations have not been subject to the GCT for decades, surprisingly the issue of whether an HMO qualified as an insurance corporation had not previously been the subject of a judicial challenge.

8. **$2.4 billion *qui tam* suit against Citigroup dismissed by NY Supreme Court judge.** In a welcome and significant taxpayer victory, a New York State Supreme Court judge, ruling from the bench, granted Citigroup's motion to dismiss a $2.4 billion

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false claims ("*qui tam*") action brought by an Indiana college professor challenging Citigroup's use for New York State purposes of net operating loss deductions that the Internal Revenue Service had expressly ruled were permitted for federal purposes. *State of New York ex rel. Eric Rasmusen v. Citigroup Inc.*, No. 100175/2013 (Sup. Ct. N.Y. Cnty., May 17, 2017).

9. **New York State follows New York City in precluding broker-dealer sourcing for "associated persons" of a registered securities broker-dealer.** The New York State Tax Department issued a *Tax Guidance* that scaled back the availability of broker-dealer sourcing under Article 9-A for tax years beginning prior to 2015, providing that an LLC's status as a registered broker-dealer does not entitle its indirect owner to qualify for broker-dealer sourcing, even though the LLC is a disregarded entity for income tax purposes. *Receipts Factor Methodology for the Owners of Single Member Limited Liability Companies that are Registered Broker-Dealers*, NYT-G-17(2)C (N.Y.S. Dep't of Taxation & Fin., Aug. 2, 2017). The *Guidance*, following on the heels of an earlier New York City pronouncement that reached a similar conclusion, rendered unclear at least one prior unpublished pronouncement where the Department invoked its discretionary authority to adjust a business allocation percentage by allowing a taxpayer to use broker-dealer sourcing for its share of receipts from an "associated person" of a registered broker-dealer, in order to avoid an improper reflection of the taxpayer's income.

10. **New York State files first appeal of adverse Administrative Law Judge decision involving Tax Department's policy on "other business receipts."** Yet a third New York State Administrative Law Judge held that, for tax years prior to 2015, the Tax Department had no authority to characterize a corporation's receipts from services delivered to customers electronically as "other business receipts" and source them based on customer location, rather than where the services were performed. *Matter of Catalyst Repository Systems, Inc.*, DTA No. 826545 (N.Y.S. Div. of Tax App., Aug. 24, 2017). The ALJ rejected the Department's claim that a relevant factor was the lack of "human involvement" at the time of sale, finding the tax law did not predicate classification of services receipts on whether there was "human involvement" at the moment of sale. Unlike in the earlier *Expedia* and *CheckFree* ALJ decisions, however, the Tax Department has appealed the *Catalyst* decision to the Tribunal.

Honorable mention: As we went to press, the signing into law of sweeping federal tax reform legislation (H.R. 1) on December 22, 2017, which dramatically changes the U.S. approach to domestic and international taxation, will undoubtedly lead to many New York tax highlights in the coming year.

APPELLATE COURT UPHOLDS DENIAL OF SALES TAX CREDIT FOR HOTEL MEALS

By Hollis L. Hyans

The Appellate Division, Third Department, has confirmed the New York State Tax Appeals Tribunal's decision that a Manhattan hotel may not treat as purchases for resale continental breakfasts purchased from a restaurant on its premises and made available to hotel guests as part of their room charges. *Washington Square Hotel LLC v. Tax Appeals Tribunal*, 155 A.D. 3d 1477 (3d Dep't, 2017).

Factual History and Decisions Below. From December 1, 2007 through February 29, 2012, the years in issue, the Washington Square Hotel LLC (the "Hotel") owned and operated a hotel on Waverly Place in New York City. It provided its guests with a continental breakfast that it purchased from Café C-III, a restaurant located on its premises. The cost of the breakfasts was included in the hotel rental room fees paid by guests. The Hotel paid Café C-III regardless of whether guests consumed the breakfasts, and hotel guests were not separately billed for the breakfasts.

The Hotel had paid sales tax to Café C-III on the purchases and then requested credits for the amount paid, claiming it had purchased the breakfasts for resale. Prior to 2002, the Hotel had not paid sales tax when purchasing the breakfasts, but had provided the seller with a resale certificate. During an audit of the restaurant in 2002, the Department's auditor had indicated that the restaurant should charge sales tax, although it was unclear from the hearing record whether the auditor also expressly advised the Hotel to claim a credit for the sales tax paid to Café C-III. The Hotel was later audited for the period September 1, 2003 through May 31, 2006, periods during which it had also claimed the sales tax credit, and no issues were raised with this treatment during the audit.

The Administrative Law Judge denied the Hotel's entitlement to any credit, and her decision was upheld by

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the Tax Appeals Tribunal. The ALJ found that although Tax Law § 1101(b)(4)(i), commonly known as the "sale for resale" exclusion, allows an exclusion from tax for amounts paid to purchase tangible property for resale, the exclusion only applies when the property is resold "as such" or as a component part of other tangible personal property, or is used in performing certain specified services. Since the service of providing hotel rooms for occupancy is not included within the specified qualifying services, the sale of continental breakfasts as part of the service of providing hotel rooms does not fall within the sale for resale exclusion in Tax Law § 1101(b)(4)(i)(B). She also found that the record contained no evidence that a continental breakfast was actually sold to guests or that the price for each breakfast was separately stated, relying primarily on *Matter of Helmsley Enterprises, Inc.* (N.Y.S. Tax App. Trib., June 20, 1991), *aff'd*, 187 A.D.2d 64 (3d Dep't, 1993), *appeal denied*, 81 N.Y.2d 710 (1993), in which a hotel's purchase of furniture, guest room supplies, and in-room amenities were not considered purchases for resale because the items were furnished to guests not as a resale of tangible personal property, but "as a component part of an overall package of services."

[T]he court found that the breakfasts were provided to guests as part of the hotel rental rate and not resold to them, and that the Tribunal's determination that the Hotel could not claim the benefit of the resale exemption had a rational basis and was supported by substantial evidence.

The Tribunal agreed, relying on the Department's regulation, 20 NYCRR § 527.9(h)(1)(iii), which provides that "the entire charge" for a hotel room "is subject to tax as rent for the occupancy," and on the decision in *Helmsley*, 187 A.D.2d at 69, for the proposition that "property used in providing a hotel service is not resold as such to guests, but is inseparably connected to the provision of the service." The Tribunal rejected the Hotel's argument that the breakfasts were substantively different from the items in *Helmsley*, finding that the breakfasts were an "amenity incidental to" the provision of services to the guests.

Both the ALJ and the Tribunal rejected the Hotel's argument that the Department should be estopped from denying the credit since it accepted the same credit in an earlier audit.

Appellate Division Decision. The Appellate Division has now confirmed the Tribunal's decision in all respects, finding that the Hotel had not met its burden of showing that the breakfasts were purchased for the "one and only one purpose" of resale. The court noted that the Hotel paid Café C-III whether or not a guest consumed the breakfast, and that, "[m]ore critically," hotel guests were not separately billed for the breakfasts. Therefore, the court found that the breakfasts were provided to guests as part of the hotel rental rate and not resold to them, and that the Tribunal's determination that the Hotel could not claim the benefit of the resale exemption had a rational basis and was supported by substantial evidence.

The Appellate Division also rejected the Hotel's equitable estoppel argument, finding that the doctrine of equitable estoppel does not apply in tax cases absent "unusual circumstances" that would support a finding of "manifest injustice," which were not present here. The court concluded that the fact that the Hotel in a prior audit had not been assessed additional tax even though it claimed the same tax credit did not rise to the level of "manifest injustice," particularly when each audit stands on its own and does not bind a subsequent audit cycle.

ADDITIONAL INSIGHTS

In *Helmsley*, the Tax Appeals Tribunal found, and the Appellate Division agreed, that purchase of items such as guest room furniture, furnishings, and guest consumables "were not sales of tangible personal property for purposes of resale *as such* and were subject to sales tax." 187 A.D.2d at 68. The Appellate Division found a distinction between the property provided in *Helmsley* and the holding in "container cases" such as *Matter of Burger King, Inc. v. State Tax Commission*, 51 N.Y.2d 614 (1980), where purchases of food wrappers were held to be "resold as such" since the wrappers retained their separate identity when used as containers for food and drinks sold at Burger King restaurants. In light of that precedent, the Hotel in this case bore a heavy burden to demonstrate it was buying the breakfasts for resale, and both the Tribunal and the Appellate Division were swayed by the fact that the price of the breakfast was not separately stated and that the room rate was the same whether or not guests ate the breakfasts.

With regard to equitable estoppel, this is a difficult argument for a taxpayer to sustain, and demonstrating the existence of a "manifest injustice" is a challenging burden, unlikely to be satisfied in the absence of written contrary advice from the taxing authority on which a taxpayer reasonably relied to its detriment. In the absence of such extraordinary circumstances, equitable estoppel is not likely to be imposed against a taxing authority.

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TRIBUNAL HOLDS THAT LLC MEMBERS ARE LIABLE FOR UNPAID SALES TAX

By Kara M. Kraman

The New York State Tax Appeals Tribunal affirmed an Administrative Law Judge's decision holding that an LLC, and thus the individual LLC members, were liable for the LLC's unpaid sales tax despite the fact that a creditor had seized control of the business. *Matters of James W. Henrie and Michael M. McBride*, DTA Nos. 825871 & 825872 (N.Y.S. Tax App. Trib., Nov. 22, 2017). The Tribunal rejected the members' claim that the LLC's inability to cause the sales tax to be paid absolved them of personal liability, holding that the LLC's inability to pay the sales tax stemmed from its voluntary decision to relinquish control to a creditor.

Facts. Namwest, LLC purchased a Holiday Inn hotel in Niagara Falls, New York. It then formed NS Partners, LLC (the "LLC") for the purpose of converting the hotel to a Crowne Plaza Hotel. James W. Henrie and Michael M. McBride were members of the LLC, and exercised considerable control over its activities for several years, including signing various legal documents on its behalf. Although the ownership of the LLC changed over time, during the periods in issue (three sales tax quarters in 2008) Messrs. Henrie and McBride (the "LLC members") each owned a one-third membership interest.

In March 2007, the LLC refinanced a $30 million loan with its creditor, Gramercy Capital Corp. ("Gramercy"). In March 2008, the LLC defaulted on its loan. Pursuant to the loan agreement, Gramercy thereafter assumed complete control over the hotel's operations and revenues. Although the LLC made Gramercy aware that the LLC was obligated to remit sales taxes to the State of New York and the LLC continued to file quarterly sales tax returns, the LLC did not pay the sales taxes due for three sales tax quarters during 2008. As a result, the Department issued notices of determination to the LLC members for the unpaid sales tax, penalty, and interest of the LLC. Following an audit of the personal income tax returns of the LLC members, which allowed them substantial income tax refunds, the Department applied those refunds against the members' sales tax liabilities asserted in the notices of determination.

Tax Law § 1133(a) imposes liability for sales and use taxes on all "persons required to collect such taxes." Tax Law § 1131(1) defines "[p]ersons required to collect tax" as "every vendor of tangible personal property or services" and "every operator of a hotel," which includes "any member of a partnership or limited liability company" that is required to collect such taxes.

[T]he Tribunal held that a person required to collect sales tax is not relieved of liability where, as here, a creditor takes action pursuant to an agreement with the business and such action results in the nonpayment of sales taxes.

Decision. Affirming the determination of the ALJ, the Tribunal rejected the LLC members' argument that they should not be held liable for the LLC's sales tax obligations because the LLC was no longer a vendor or the operator of a hotel after Gramercy took control of the hotel in March 2008. Citing its decisions in *Matter of Button*, DTA No. 817034 (N.Y.S. Tax App. Trib., Jan. 28, 2002) and *Matter of Kieran*, DTA No. 823608 (N.Y.S. Tax App. Trib., Nov. 13, 2014), the Tribunal held that a person required to collect sales tax is not relieved of liability where, as here, a creditor takes action pursuant to an agreement with the business and such action results in the nonpayment of sales taxes. The Tribunal noted that any "preclusion from action" on the part of the LLC was its "own creation" and was one of the "risks [the LLC] chose to take in running [its] business enterprise." Accordingly, the Tribunal concluded that the LLC remained liable for the collection and payment of sales tax during the period at issue.

The Tribunal also rejected the LLC members' claim for relief under *Technical Memorandum*, TSB-M-11(17)S (N.Y.S. Dep't of Taxation & Fin., Sept. 19, 2011), which limits an LLC member's sales tax liability to the member's percentage interest in the LLC if, among other things, the member can show (i) that his or her ownership interest and profit and loss interests are less than 50%, and (ii) that the member was not under a "duty to act" for the LLC in complying with the Tax Law. The Tribunal found that the members did not qualify for relief under TSB-M-11(17)S because, under the precedent set forth in *Matter of Kieran* and *Matter of Button*, corporate officers and similarly responsible persons are not relieved of their "duty to act" because a creditor takes action pursuant to a voluntary agreement with the business.

ADDITIONAL INSIGHTS

While the Tax Law clearly imposes liability for sales tax on "every vendor of tangible personal property or services" and "every operator of a hotel," it is interesting that the decision does not mention the creditor's potential liability for the sales tax after it took complete control of the operation of

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the hotel and its operating revenues during the periods at issue. Presumably, if the creditor was operating the hotel, and had the ability to direct its operations and ensure that the tax was collected and remitted, it should also be liable for sales tax. Nevertheless, despite the creditor's potential liability, under the case law, businesses that voluntarily enter into loan agreements that contemplate loss of control of the business in the event of default are not relieved of sales tax liability whether or not they continue to operate the business, nor (in the case of an LLC) are their members. Consequently, a business that enters into a loan agreement that contemplates the creditor taking over the business operations in the event of a default should make sure that the loan agreement provides that in the event of a takeover of the business, the creditor will register as a vendor and be responsible for collecting and remitting any sales taxes that thereafter become due.

TRIBUNAL FINDS INDIVIDUAL LIABLE FOR SALES TAX BASED ON PRIOR GUILTY PLEA

By Hollis L. Hyans

The New York State Tax Appeals Tribunal has affirmed the decision of an Administrative Law Judge that an individual was liable for unpaid sales and use taxes and that he was collaterally estopped from relitigating the issue due to his entry of a guilty plea in a criminal proceeding in which he was charged with falsifying business records with fraudulent intent to avoid paying sales tax. *Matter of Michael Silverstein*, DTA Nos. 826824 & 826825 (N.Y.S. Tax App. Trib., Dec. 7, 2017).

Facts and Issues. The Department began an audit of one company engaged in the business of automobile sales, Crest Auto Leasing, Inc. ("Crest") for the period December 1, 1998, through November 30, 2007, having discovered that the last sales tax return filed by Crest was for the period ending August 31, 1998. During the course of the audit, a related entity, Metro Auto Leasing, Inc. ("Metro") was identified, and information was requested regarding Metro as well. After Metro and Crest failed to provide any information, the Department issued subpoenas for bank records and information from the Department of Motor Vehicles ("DMV"), including MV-50 forms, which are provided by the DMV to car dealers to record car sales; license plate data; registration data; and print-outs of information from DMV electronic records. Upon review of the third-party data, the Department determined that a number of MV-50 forms filed by Metro and Crest were incomplete and/or inconsistent, so it solicited information from other sources, including sending questionnaires to customers, and determined that Crest and Metro did not properly report their transactions to the DMV. Based on those preliminary findings, the matter was referred to the Revenue Crimes Bureau, which subsequently referred the matter to the Queens County District Attorney for potential criminal prosecution.

A criminal complaint and indictment were filed against Mr. Silverstein, Metro, and Crest. Pursuant to the investigation subsequently conducted, a search warrant was executed on Metro's and Crest's shared business premises, and records were obtained, including information about car sales, MV-50s, copies of checks, bank deposits, titles, and customers' insurance and driver's licenses.

To resolve the criminal matter, Mr. Silverstein entered into a plea agreement in October 2012 with the Queens County District Attorney's Office, which he signed individually and on behalf of Crest and Metro. Mr. Silverstein agreed to pay restitution for sales tax in the amount of $393,000 and signed an agreement acknowledging that the stated amount may not resolve all of the civil sales tax liability, which the Department remained free to seek to collect. Mr. Silverstein's plea agreement admitted, among other elements, that he acted "with the intent to defraud in order to avoid paying sales tax," and that he "knowingly and deliberately failed to cause Crest and Metro to report and remit sales tax" they had collected. During his court appearance to enter his guilty plea, Mr. Silverstein admitted that he was a responsible person for Crest and Metro.

Following the criminal proceeding, the Department again requested books and records from Metro and Crest, but received no response, so it conducted an audit based on the documentary evidence obtained from third parties and the records seized from the businesses in the execution of the search warrant. Two notices of determination were issued to Mr. Silverstein, seeking tax, interest, and penalties together totaling over $10.6 million. At the hearing held before an Administrative Law Judge, the auditor testified to the laborious reconstruction of 847 transactions and the audit method that was used, which reviewed and analyzed the DMV and customer information, matched third-party information to bank deposits and canceled checks in order to determine taxable sales, and excluded transactions where the auditor was unable to obtain documentation linking customer and vehicle information to a bank deposit.

ALJ Decision. The ALJ found that Mr. Silverstein's claim that he was not a responsible person was contradicted by his guilty plea in the criminal proceeding, and that under the doctrine of collateral estoppel he could not later argue the contrary. The ALJ also found that, even in the absence of collateral estoppel, the record supported a finding that

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Mr. Silverstein was a person required to pay tax on behalf of the two businesses, and that he had failed to establish the contrary by clear and convincing evidence. She found that the audit method employed was reasonable, in the absence of both returns and the production of records despite written requests, and that the audit methodology was reasonably based on a variety of third-party records. In addition, she rejected a variety of other arguments, including that the assessments were time-barred, since no returns had been filed for the period; a challenge to the imposition of fraud penalties; and a claim that the amounts assessed were improper because they exceeded the amounts in the plea agreement, pointing to language in the plea agreement that specifically advised that the civil sales tax liabilities are not limited.

[T]he Tribunal agreed with the ALJ that Mr. Silverstein failed to meet his burden to show by clear and convincing evidence that he was not a person required to collect tax [and] that he was estopped from so claiming by his plea agreement . . . .

Tribunal Decision. The Tribunal affirmed the ALJ's decision in all respects. It recognized that the mere holding of corporate office does not *per se* impose liability for sales tax and that the law requires all surrounding circumstances to be considered, including status as an officer, knowledge and control over the financial affairs of the corporation, and whether the party had the requisite authority to ensure payment of the tax. However, the Tribunal agreed with the ALJ that Mr. Silverstein failed to meet his burden to show by clear and convincing evidence that he was not a person required to collect tax; that he was estopped from so claiming by his plea agreement, since the exact same issue was determined and resolved by his guilty plea; and that he had had a fair opportunity to litigate the issue during the criminal proceeding. The Tribunal also agreed with the ALJ that, even in the absence of estoppel, the record did not support an argument that Mr. Silverstein was not a responsible person, noting his status as a stockholder, officer and director, and authorized signatory for Crest, and his status as an officer and signatory to a banking agreement on behalf of Metro. The Tribunal also found that the audit method employed by the Department was reasonable and that Mr. Silverstein had failed to produce any testimony or business records in support of his contrary arguments.

With regard to the fraud penalties challenged by Mr. Silverstein, the Tribunal again agreed with the ALJ. Although the imposition of fraud penalties imposes a significant burden on the Department to prove that acts were committed deliberately, knowingly, and with specific intent to violate the Tax Law, the Tribunal concluded that the Department met this burden by direct evidence, particularly Mr. Silverstein's admission to fraudulent conduct with the intent to defraud in order to avoid paying sales tax, as recited in his plea agreement. The Tribunal also agreed that, should the fraud penalty be successfully challenged on further appeal, the negligence penalty under Tax Law § 1145(a)(1) would be proper, since, with regard to this penalty, the burden was on Mr. Silverstein to demonstrate failure to pay was due to reasonable cause and not willful neglect, and he offered no evidence in support of this position.

Finally, the Tribunal rejected the argument that the penalty violated the excessive fines clause (Art. I, § 5) of the New York State Constitution. While lacking the power to hold that a statute is unconstitutional on its face, the Tribunal determined the penalty was not unconstitutional as applied, finding it was not grossly disproportionate to the seriousness of the offense, given the significant number of transactions for two corporate entities over many years, the amount of unreported tax, the effort expended in the audit, and the admission of an intent to commit fraud in the criminal proceeding.

ADDITIONAL INSIGHTS

Having admitted under oath that he committed fraud in an attempt to evade sales tax, and that he was a responsible party for the unpaid tax, the petitioner in this case obviously faced a heavy burden in avoiding the imposition of personal responsibility and civil penalties. While the amount of tax that was apparently at issue in the criminal proceeding, for which Mr. Silverstein agreed to pay restitution, was much more modest than that eventually assessed by the Department, the plea agreement clearly advised that the Department reserved the ability to pursue further collections, which was explicitly acknowledged by Mr. Silverstein in an exchange with the trial court during the plea proceedings.

NYC COMMERCIAL RENT TAX REDUCED FOR QUALIFYING SMALL BUSINESSES

by Kara M. Kraman

On December 22, 2017, New York City Mayor Bill de Blasio signed local legislation that amends the commercial rent tax law to provide a credit against the tax for businesses that pay an annual rent of under $550,000 and have total

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annual income of less than $10 million, effective July 1, 2018. Local Law 254.

Under the current law, the commercial rent tax ("CRT") is imposed on commercial tenants that pay an annual rent of at least $250,000 in Manhattan south of the center line of 96th Street. The amended law provides a credit that eliminates CRT liability for tenants that have total annual income of $5 million or less and pay annual rent of $500,000 or less, and reduces CRT liability for tenants that do not meet the above criteria but pay an annual rent of between $250,000 and $550,000 and have total income of less than $10 million. The amount of the credit, which depends on a tenant's rent and income levels, is calculated by multiplying the CRT paid by both an "income factor" and a "rent factor," with the resulting amount being the credit allowed:

- *Income factor*. Tenants that pay an annual rent of between $250,000 and $550,000 and have total income in the immediately preceding taxable year of not more than $5 million will have an "income factor" of one, while tenants that pay an annual rent of between $250,000 and $550,000 and have total income of more than $5 million but not more than $10 million will have a fractional "income factor" of less than one, with the value of the fraction (and thus the credit) increasing at lower income levels and decreasing at higher income levels.

- *Rent factor*. Tenants that pay an annual rent of between $250,000 and $500,000 and have total income of less than $10 million will have a rent factor of one. Tenants that pay an annual rent of more than $500,000 but not more than $550,000, and have total income of more than $5 million but not more than $10 million, will have a fractional rent factor of less than one, with the value of the fraction (and thus the credit) increasing at lower rent levels and decreasing at higher rent levels.

Only tenants that pay an annual rent of between $250,000 and $550,000 and have total income of $10 million or less are eligible for the credit. The credit will be allowed beginning July 1, 2018, and for all CRT tax years beginning thereafter.

INSIGHTS IN BRIEF

APPELLATE DIVISION HOLDS THAT CHARGES FOR SCRIP AT ADULT ENTERTAINMENT CLUB ARE SUBJECT TO SALES TAX

Confirming the decision of the New York State Tax Appeals Tribunal, the Third Department has held that charges for scrip used to purchase dances from entertainers and for tips at an adult entertainment club are taxable admission charges and not excluded from tax as charges for admission to a "theatre, opera house, concert hall or other hall or place of assembly for a live dramatic, choreographic or musical performance" as defined by Tax Law § 1101(d)(5). *HDV Manhattan, LLC v. Tax Appeals Trib.*, 2017 NY Slip Op. 08559 (App. Div. 3d Dep't, Dec. 7, 2017). The Appellate Division found that, although the scrip could not be used for admission to the club, the Tribunal could reasonably have concluded that a customer purchased both scrip for the dancer and a separate charge for admission to a VIP room in the club, and therefore the scrip formed part of the admission charge to the VIP rooms. The court also declined to disturb the Tribunal's finding that the performances did not qualify for treatment as nontaxable as "dramatic or choreographic," finding that the club failed to demonstrate that the venue where performances occurred was of the same type as those listed in the statute, and that the Tribunal had found the club failed to demonstrate the "private dance experience in sufficient detail to establish [it] as dramatic or choreographic."

DEPARTMENT ISSUES TECHNICAL MEMORANDUM ON MTA SURCHARGE RATE INCREASE

A pronouncement by the New York State Department of Taxation and Finance explains a regulation amendment raising the MTA surcharge rate under Article 9-A from 28.3% to 28.6% for tax years beginning in 2018. *Technical Memorandum*, "MTA Surcharge Rate and Deriving Receipts Thresholds for 2018," TSB-M-17(4)C (N.Y.S. Dep't of Taxation & Fin., Dec. 4, 2017). Under the Tax Law, the Department must annually set the surcharge rate to ensure that receipts from the surcharge will meet, but not exceed, the projected surcharge revenues for the State's current fiscal year that began last April 1. The Department has not, however, adjusted the annual threshold for deriving receipts from activities in the Metropolitan Commuter Transportation District (generally at $1 million or more of receipts from activities within the district) that subjects a corporation to the surcharge.

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- Nationwide: Tax Law (Tier 1)
- New York: Tax Law (Tier 1)
- San Francisco: Tax Law (Tier 1)
- Washington, D.C.: Tax Law (Tier 1)

Chambers USA 2017

- California: Tax
- Nationwide: Tax Controversy
- New York: Tax

Legal 500 US 2017

- U.S. Taxes: Contentious
- U.S. Taxes: Non-Contentious

U.S. News – Best Lawyers® BEST LAW FIRMS 2016

- Law Firm of the Year: Litigation – Tax

Chambers USA 2017

"THEY ARE ALWAYS AVAILABLE AND RESPONSIVE TO OUR NEEDS AND REQUESTS, AND PROVIDE OUTSTANDING ANALYTICS BEHIND THE ISSUES AND VERY GOOD SOLUTIONS."

"THEY PROVIDE OUTSTANDING CLIENT SERVICE AND GOOD VALUE FOR FEES."

"THEY ARE PARTICULARLY GOOD AT GUIDING AND ORGANIZING DISCOVERY AND DEVELOPING CASE STRATEGY."

Legal 500 US 2017

"'OUTSTANDING' DEDICATED SALT PRACTICE."

"SOLID EXPERTISE IN DEVELOPING AND IMPLEMENTING COMPREHENSIVE AND INNOVATIVE SOLUTIONS."

Chambers USA 2016

"VERY GOOD HANDLING, I VIEW THEM AS THE TOP STATE AND LOCAL TAX FIRM IN THE USA."

"THEY HAD THE EXPERTISE I NEEDED AND I RECEIVED EXCELLENT CLIENT SERVICE."

Legal 500 US 2016

"VAST KNOWLEDGE OF THE TAX ISSUES AND EXPERIENCE WITH OPPOSING ATTORNEYS."

"VERY HIGH COMFORT LEVEL ON THE BIG-DOLLAR, HIGH-RISK ISSUES."

"PUT THEIR CLIENTS FIRST AND ARE ALWAYS AVAILABLE WHEN NEEDED."

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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 or contact Craig B. Fields at (212) 468-8193 or cfields@mofo.com.