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NEW YORK TAX INSIGHTS
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MORRISON FOERSTER

IN MEMORIAM
PAUL H. FRANKEL

Paul Frankel passed away on February 28, 2017. Paul was the longtime leader not only of Morrison & Foerster's state and local tax group but of the entire state and local tax field. He leaves a legacy of victories in state courts across the country and a network of practitioners and friends whose careers were shaped by working with Paul and by his passion, dedication, success and overall humanity. We extend our sympathy to his wife Dee, his children and grandchildren, and to everyone else who will miss him and honor his memory.

ALJ Finds CEO Changed Domicile from New York City to Texas

By Matthew F. Cammarata

A New York State Administrative Law Judge has held that the CEO of Match.com ("Match") changed his domicile from New York to Texas for New York State and City personal income tax purposes, despite his maintenance of substantial connections to New York during the years in question. *Matter of Gregory Blatt*, DTA No. 826504 (N.Y.S. Div. of Tax App., Feb. 2, 2017). The ALJ rejected the Department of Taxation and Finance's argument that Mr. Blatt's ownership of an apartment in New York City, and the substantial renovations made to the property, were indicative of his intent to remain domiciled in New York City.

Facts. Gregory Blatt was originally from Massachusetts and first moved to New York City in 1992 to attend Columbia Law School. Beginning in 2003, Mr. Blatt began work as the General Counsel for InterActiveCorp ("IAC"), a publicly traded corporation that owned multiple large Internet companies. In 2006, Mr. Blatt executed an employment agreement with IAC, pursuant to which his title was "Executive Vice President, General Counsel & Secretary," and specifying that his principal place of employment was in New York City. As General Counsel of IAC, Mr. Blatt oversaw a legal department of approximately 50 people.

For the first 13 years that he was resident in New York City, Mr. Blatt lived in the same rent-stabilized apartment that he occupied during law school. In late 2005, he purchased a multimillion-dollar condominium

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in downtown Manhattan. For the next 18 months, Mr. Blatt renovated the apartment, working closely with an architect on what Mr. Blatt described as "his own artistic creation." In addition to his home, Mr. Blatt owned a car in the city and kept a boat in the Hamptons.

Following a corporate restructuring in 2008, Mr. Blatt became dissatisfied with the scope of his employment at IAC and began searching for other opportunities. In February of 2009, Mr. Blatt accepted an offer from IAC to assume the role of CEO at Match, one of the Internet companies owned by IAC. Though Match was based in Dallas, Mr. Blatt negotiated with IAC to remain based in New York City and keep his corporate titles with IAC, allowing him to retain a "safety net" to explore his new role at Match without having to commit to a move to Texas.

In March of 2009, Mr. Blatt signed a one-year lease for a one-bedroom apartment in Dallas and leased a car in Texas. Despite his initial hesitation, Mr. Blatt enjoyed working at Match and the increased responsibility commensurate with his new role as CEO. Mr. Blatt also came to enjoy living in the Dallas area, and, after discussions with his superiors at IAC, he entered into a new employment agreement in November of 2009. Under the new employment agreement, Mr. Blatt relinquished his corporate titles with IAC, retaining only the title of CEO of Match. The agreement also specified that his principal place of employment would be Dallas, Texas.

Thereafter, Mr. Blatt took various steps to create a new lifestyle in Texas. He rented an apartment and spent over $10,000 furnishing it. He ceased completing continuing legal education courses required for practicing attorneys and did not renew his New York State Bar membership. Mr. Blatt also developed strong ties to the Dallas area and spent considerable time with the family of a close childhood friend who was also living in Dallas. He changed his address with the U.S. Postal Service, obtained a Texas driver's license, registered to vote in Texas, and changed his bank account information and doctors. Beginning in the fall of 2009, Mr. Blatt also listed his New York City condominium for sale, eventually selling the apartment in October of 2010. Finally, Mr. Blatt moved his dog to Texas in November of 2009, which was a significant event for him. The dog was a large, elderly dog that Mr. Blatt had rescued from the ASPCA. An email Mr. Blatt sent around the time of the move to Dallas noted specifically that the "[d]og is the final step that I haven't been able to come to grips with until now. So [Dallas] is my new home."

The terms of his employment agreement also changed the tax treatment of his travel expenses. Prior to July 2009, his reimbursed automobile expenses and rent in Texas were treated as travel expenses and not income. Following Mr. Blatt's move to Texas, the reimbursed expenses were treated as ordinary income and reflected as such in his form W-2.

During 2010, Mr. Blatt became aware of the opportunity to become CEO of IAC. In late 2010, as the possibility of that position became more certain, and having sold his condominium, Mr. Blatt leased an apartment in New York City. He ultimately accepted the CEO position, but made his intentions to remain in Dallas clear to IAC prior to accepting the job. Though he intended to remain in Dallas, the job of running IAC from Dallas proved too difficult, given that IAC's headquarters were in New York. Despite having renewed the lease on his Dallas apartment in February 2011, Mr. Blatt moved back to New York City in 2011 to work primarily from IAC's offices in New York City.

Reasoning that "the move of items near and dear tend[s] to demonstrate a person's intention," the ALJ found that "petitioner's dog was his near and dear item which reflected his ultimate change in domicile to Dallas."

Issue. Mr. Blatt filed New York State nonresident personal income tax returns for the tax years 2009 and 2010. Following an audit, the Department asserted that Mr. Blatt was a domiciliary of New York State and City, and issued a Notice of Deficiency, assessing additional personal income tax, interest, and penalties. Mr. Blatt was domiciled in New York State and City prior to July of 2009. The sole issue presented was whether Mr. Blatt had proven that he changed his domicile to Texas in 2009 and throughout 2010.

ALJ Determination. The ALJ held that Mr. Blatt had become a Texas domiciliary. The ALJ first noted that "domicile" is defined pursuant to regulation as "the place which an individual intends to be such individual's permanent home—the place to which such individual intends to return whenever such individual may be absent." *See* 20 NYCRR 105.20(d). The party alleging the change in domicile bears the burden of proof by clear and convincing evidence, and domicile is a question of fact that depends on a multitude of facts and circumstances that vary widely from individual to individual. *Matter of Newcomb*, 192 N.Y. 238, 250 (1908). Factors evidencing domicile include: retention of a permanent place of abode: the location of business activity; the location of family, social and community ties; and formal declarations of domicile.

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The Department urged the ALJ to consider Mr. Blatt's New York City condominium an "extremely significant factor," especially given his close involvement in the lengthy renovations to the property. Though the ALJ did consider the apartment as a factor, she concluded that the totality of factors, coupled with Mr. Blatt's intentions during the years in question, demonstrated that he intended to change his domicile to Texas. The ALJ found that Mr. Blatt's decisions regarding where to live revolved largely around his employment opportunities. Following IAC's restructuring in 2008, Mr. Blatt was professionally unfulfilled and prepared for a change. Beginning in 2009, Mr. Blatt began the process of relinquishing his titles and responsibilities at IAC and designated Dallas as his principal place of employment. Mr. Blatt then took various declarative steps evidencing his intent to change his domicile, including, among others, the sale of his New York City apartment and the development of social and community ties to Dallas. The ALJ took specific note of Mr. Blatt's "final step" in relocating to Dallas: relocating his dog. Reasoning that "the move of items near and dear tend[s] to demonstrate a person's intention," the ALJ found that "petitioner's dog was his near and dear item which reflected his ultimate change in domicile to Dallas."

Additional Insights.

Issues of domicile are fact-intensive and often involve intensely personal factual inquiries examining a person's habits. Moreover, the burden of proof in domicile matters is upon the party asserting the change, and the burden is high: clear and convincing evidence. However, where changes of domicile are supported by reliable contemporaneous evidence demonstrating an intention to permanently move and to relinquish one's existing domicile, taxpayers will be able to meet this demanding burden of proof. As the ALJ noted in this case, "[t]he steps taken to effectuate a change in domicile occurred in a logical and reasonable sequence of events." Mr. Blatt was able to substantiate his claims with contemporaneous evidence, including emails and changes of address, and provided affidavits from those in his professional and personal circle substantiating his intent to permanently change his domicile to Texas.

NYC Tribunal Upholds "Same Source Year Rule," But Allows NOLs to Include Non-Deducted Amounts

By Irwin M. Slomka

A recent New York City Tax Appeals Tribunal decision reinforces some of the long-standing obstacles for corporations claiming net operating loss deductions for general corporation tax purposes. However, the decision charts potentially new ground in permitting those net operating losses to include amounts incurred by the taxpayer, even where the deductibility of certain components of the NOL is limited for federal tax purposes. *Matter of Plasmanet, Inc.*, TAT(E) 12-17(GC) (N.Y.C. Tax App. Trib., Jan. 20, 2017).

Facts. Plasmanet, Inc., an Internet-based sweepstakes provider, claimed NOL deductions on its 2008 and 2009 General Corporation Tax ("GCT") returns equal to its NOL deductions claimed for federal purposes. Following a field audit, the Department of Finance issued a Notice of Determination disallowing a portion of Plasmanet's NOL deductions based on the "same source year rule." Under that rule, the NOL being applied for GCT purposes must relate to losses arising in the same year as in the federal NOL.

After the administrative hearing had concluded, the Department issued a revised Notice of Determination (the "Final NOD"), whereby it further reduced the claimed NOL deduction for 2008 and 2009 by the amount of Plasmanet's charitable contributions for the years 2006 through 2009 because Plasmanet did not actually deduct them for federal purposes. Although Plasmanet did make the charitable contributions, for federal purposes the deduction was limited to 10% of its taxable income, but available for carryforward, under Internal Revenue Code ("IRC") § 170(b)(2)(A). Since Plasmanet had no federal taxable income after its federal NOL deductions, it could not claim a charitable deduction in those years. The Department took the position that the statute of limitations for amending its federal returns to now claim the charitable deductions had expired.

In her determination, the Administrative Law Judge upheld the Department's Final NOD in its entirety, except that she abated a substantial understatement of tax penalty. Plasmanet then brought this appeal to the City Tribunal.

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City Tribunal decision. The City Tribunal held for the Department that the "same source year rule" required that the NOLs claimed for GCT purposes must arise in the same tax year as the losses that comprise the federal NOL deductions for the relevant years. In doing so, it rejected Plasmanet's claim that a 1989 amendment to the GCT law, which limited the NOL carryback deduction for GCT purposes to $10,000, constituted an implicit legislative rejection of the same source rule, arguably since it meant that the federal and GCT NOL deductions would necessarily be based on different source years.

However, partially reversing the ALJ, the City Tribunal ruled in favor of the taxpayer by holding that the charitable deductions should be allowed in computing Plasmanet's NOL deduction for GCT purposes. The City Tribunal first noted that the burden of proof had shifted to the Department with respect to the increased deficiency asserted in the final NOD, which was issued after Plasmanet had filed its Petition challenging the original NOD. The City Tribunal then noted that Plasmanet had disclosed the amount of its charitable contributions on its federal returns "to the greatest extent possible." It then concluded that the Department had failed to meet its burden of proof that the charitable deductions limited under IRC § 170(b)(2)(A) could not be taken into account in computing Plasmanet's NOL deduction for GCT purposes.

[T]he City Tribunal ruled in favor of the taxpayer by holding that the charitable deductions should be allowed in computing Plasmanet's NOL deduction for GCT purposes.

Additional Insights.

The Tribunal's decision upholding the "same source year rule" for NOLs is not particularly surprising in light of prior decisions by both the City and State Tax Appeals Tribunals. *See, e.g., Matter of Andal Corp.*, TAT(E) 93-179(GC) (N.Y.C. Tax App. Trib., June 30, 1995). Its decision here permitting charitable deductions to be taken into account in computing Plasmanet's NOL does seem reasonable, since the federal deductions would have been available but for the fact that Plasmanet's Federal NOL limited the deductibility of the charitable contributions. The City Tribunal stated that it reached this decision because the burden of proof had shifted to the Department, but did not elaborate on its rationale, possibly leaving open the question of whether it would have reached the same conclusion had the burden of proof not shifted to the Department because of the Final NOD.

It should be noted that, under corporate tax reform for both New York City and New York State corporate income tax purposes, a corporation's NOL deduction is no longer limited by the same source year rule or by the amount of the federal NOL deduction for tax years beginning after 2014.

ALJ Finds Gain on Sale of Property Subject to Personal Income Tax Despite Apparent Ownership by an ESOP

By Hollis L. Hyans

A New York State Administrative Law Judge has held that a gain on the sale of real property owned by a limited liability company, that was in turn 99% owned by an Employee Stock Ownership Plan ("ESOP"), was taxable income to the sole participants and beneficiaries of the ESOP. *Matter of Patrick Murphy and Kathleen Murphy*, DTA No. 825277 (N.Y.S. Div. of Tax App., Feb. 9, 2017). The ALJ rejected the argument that the Division of Tax Appeals' jurisdiction to hear the case was preempted by the Employee Retirement Income Security Act of 1974 ("ERISA") and found that the gain should be attributed to the petitioners because the ESOP was a "sham trust."

Facts. The gain in question arose from the 2006 sale of real property located at 948 Second Avenue in Manhattan for $5.5 million. At the time of the sale, the property was owned by JJF Associates LLC ("JJF Associates"), a limited liability company treated as a partnership for tax purposes. JJF Associates was owned 99% by JJF Realty Employees Stock Ownership and Plan Trust ("JJF ESOP") and 1% by Triune Foundation, Inc. Triune had been incorporated in 1994 as a not-for-profit corporation and was tax exempt under Internal Revenue Code § 501(c)(3). Petitioner Patrick Murphy was its president. Mr. Murphy was also the sole trustee of JJF ESOP at the time of sale, having succeeded Triune in that position, and Mr. and Mrs. Murphy were the only participants and beneficiaries of JJF ESOP.

The petitioners, Patrick and Kathleen Murphy, described JJF ESOP as a tax-exempt pension trust established for the benefit of the employees of JJF Realty Management, Inc. ("JJF Realty"), an entity wholly owned by JJF ESOP, and claimed they were employees of JJF Realty during the 2006 year in issue. They were also JJF Realty's

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president and secretary, respectively. JJF Realty's certificate of incorporation stated that its purpose was to own and operate the property. JJF Realty was dissolved by proclamation of the New York Secretary of State on June 25, 2003. Nonetheless, JJF Realty filed a New York State Corporation Franchise Tax Return for 2007, although not for 2006 or any previous year, signed by Mr. Murphy as its president. It reported $900 in assets as of the beginning of the year and $2,852,009 at the end, which were the same amounts shown on its 2006 federal income tax return. It reported no payroll.

In 1996, Triune contributed the real property to JJF Associates, which was done, according to testimony from Mr. Murphy, to allow for the property's management and generation of income for Triune, which was established to create educational programs such as funding scholarships. When the property was sold in 2006, JJF Associates recognized a gain of approximately $2.2 million on the sale and reported it on its New York State partnership return.

Federal Filings. Sometime prior to 2006, Triune stopped operating, and its tax-exempt status was revoked in 2011 for failure to file tax returns for the previous three years. The date of the creation of JJF ESOP was unclear, since the petitioners asserted it was created in 1999, but JJF ESOP's federal forms 5500-EZ indicated JJF ESOP first became effective on May 31, 2005. Both the 2006 and 2008 returns stated that the plan had no assets at the beginning of each year, but had $2,000,500 at the end of the year. However, JJF Associates' 2006 federal tax return showed JJF ESOP as having $3 million in assets. JJF ESOP's 2006 federal return reported a gain of $2,268.774 on the property and stated that, other than the petitioners, JJF Realty had no employees.

ESOP Documentation. During the audit, JJF ESOP provided a document entitled "JJF Realty, Inc. Employee Stock Ownership Trust" ("ESOP Trust Agreement") between JJF Realty, as the employer, and Triune, as the trustee. The ESOP Trust Agreement provides that JJF Realty established an employee stock ownership plan for the benefit of eligible employees of JJF Realty, to be administered by a committee appointed by the board of directors of JJF Realty. The trustee was required to report to the committee and furnish annual written reports. The ESOP Trust Agreement was signed by Mr. Murphy both on behalf of JJF Realty, in his capacity as president, and as trustee of Triune. No evidence supporting the existence of a committee or any written annual reports were submitted into the record. After issuance of a subpoena by the Division of Tax Appeals, which was upheld by the courts against challenge by the petitioners (including a challenge based on the argument that ERISA preempted the action), the Murphys also submitted a document entitled "JJF Realty Management Inc. Employees Stock Option Plan & Trust" ("JJF ESOP Plan"), which states that eligible JJF Realty employees included full-time employees, as well as those with at least 1,000 hours of service each year. JJF Realty made no contributions to JJF ESOP in 2006, there were no annual valuations of plan assets for JJF ESOP, and petitioners did not maintain separate individual pension accounts within JJF ESOP.

[T]he ALJ rejected the Murphys' argument that the Division of Tax Appeals' jurisdiction, and the personal income tax imposition statute, Tax Law § 601, were preempted by ERISA.

Issues and ALJ Hearing. After an audit of both JJF Associates and JJF ESOP, the Department of Taxation and Finance concluded that the gain on the sale of the property was taxable to petitioners because they were "ineligible participants" of JJF ESOP, since they were not employees of JJF Realty. A Notice of Deficiency was issued in November 2010. At the ALJ hearing, the Department added a new argument, contending that JJF ESOP should be disregarded as a "sham entity" with no economic substance.

The evidence at the hearing, in addition to that summarized above, included testimony from Mr. Murphy that title to the property was transferred from JJF Associates to JJF ESOP prior to its sale in 2006, although there was no record of any deed or contract, and that the property was transferred to JJF Realty and then back to JJF Associates as part of a "practical merger," done "in a very simplified way through corporate resolutions and other agreements…" although no resolutions or agreement were presented. There was also no favorable determination letter from the IRS confirming the qualification and tax exempt status of JJF ESOP. In affirmations, Mr. Murphy described his responsibilities as president of JJF Realty as including negotiating and contracting leases and filing tax returns; Mrs. Murphy's responsibilities as including billings for monthly rentals, maintaining rent rolls, and dealing with local agencies; and the responsibilities of both as including arranging for building maintenance, repairs, garbage and snow removal, and responding to tenant complaints.

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ALJ Determination. First, the ALJ rejected the Murphys' argument that the Division of Tax Appeals' jurisdiction, and the personal income tax imposition statute, Tax Law § 601, were preempted by ERISA. While acknowledging that ERISA contains a broadly worded preemption provision, the ALJ found that preemption applies only to statutes "that directly regulate[] the heart of ERISA plan administration," and not to state laws that only touch peripherally on retirement plans. The ALJ reviewed recent decisions, including U.S. Supreme Court decisions in *De Buona v. NYSA-ILA Medical & Clinical Services Fund*, 520 U.S. 806 (1997) and *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Insurance Co.*, 514 U.S. 645 (1995), and found that Tax Law § 601 does not attempt to regulate ERISA plans or interfere with federal regulation of such plans. He also found "particularly compelling" the Department's reliance on *Hattem v. Schwarzenegger*, 449 F.3d 423 (2nd Cir. 2006), in which the Second Circuit Court of Appeals found that California's unrelated business taxable income statutes were not preempted from application to an ERISA plan, since the laws were of general applicability, did not force plan trustees to act in any particular matter, and did not have a "reference to" ERISA but instead "functioned irrespective of the existence of ERISA plans."

The ALJ agreed with the Department that JJF ESOP was a sham trust, without economic substance.

Next, on the merits, the ALJ agreed with the Department that JJF ESOP was a sham trust without economic substance. The ALJ relied on federal authority that set out a four-part test to determine whether a trust lacked economic substance, *Sparkman v. Commissioner of Internal Revenue*, 509 F.3d 1149, 1155 (9th Cir. 2007), *citing Markosian v. Commissioner of Internal Revenue*, 73 T.C. 1235, 1243-44 (1980): (1) whether the taxpayer's relationship to the transferred property differed materially before and after the trust's creation; (2) whether there was an independent trustee; (3) whether an economic interest passed to other trust beneficiaries; and (4) whether the taxpayer respected the restrictions set forth in the trust documents. The ALJ found that JJS ESOP failed all four parts. First, the Murphys' relationship to the property did not change materially when the trust was created, since there was at all times an identity in ownership and control of the property and the gain from its sale. Mr. Murphy, as president of Triune and the trustee of JJF ESOP, controlled the two members of JJF Associates, and he and Mrs. Murphy were the sole beneficiaries of JJF ESOP, as well as the sole owners and officers of JJF Realty. Second, JJF ESOP did not have an independent trustee, there was no evidence of an independent committee having been created as contemplated by the trust documents, and therefore there was no "meaningful restriction" on the Murphys' use of trust property. Third, no economic interest passed to other beneficiaries of the trust, since none existed. Finally, the evidence showed that the Murphys had unrestricted use of the property, and the records lacked any explanation of numerous inconsistencies, such as the fact that for both 2006 and 2008, JJF ESOP had no assets at the beginning of each year but had over $2 million at the ends of the years, the absence of any accounting for the difference between the $2 million reported and the rest of the $2.268 million gain, and the absence of a bank account for JJF ESOP.

The ALJ also found the record to be "laden with contradictions," and described Mr. Murphy's testimony as "confusing, evasive, and contradictory," further supporting the finding of the sham trust, and noting such items as the different identifications of the effective date of JJF ESOP; the listing on JJF Associates' 2006 federal tax return of JJF ESOP having $3 million in assets while JJF ESOP's own return listed only $2 million; the fact that JJF Realty had no payroll; and the signature on the ESOP Trust Agreement only by Mr. Murphy both as president of JJF Realty and as trustee of Triune. The ALJ concluded that "petitioners seek the benefit of organizational formalities yet fail to establish that they observed them," finding such disregard "one of the hallmarks of a sham trust," and upheld the assessment of personal income tax.

Additional Insights.

The concept of federal preemption is certainly valid, and there does exist a broad preemption by ERISA of state regulation of pension plans subject to the federal statute. However, the cases in which preemption has been found generally involve statutes or state action directly applicable to federally regulated retirement plans, such as *Morgan Guaranty Trust Company of New York v. Tax Appeals Tribunal*, 80 N.Y.2d 44 (1992), or imposing tax on a plan asset itself, rather than on the income derived from the sale of an asset by another entity, as was the case in *Murphy*.

The facts seem to show numerous overlapping relationships between several commonly owned entities, including the ESOP, without any clear demarcation of different responsibilities requiring different duties. In any such small businesses, and particularly when seeking to claim the tax benefits that accrue to an

ESOP, it is critical to maintain strict adherence to all details of record-keeping, and to ensure that formalities are followed. Here, the trail of documents was so unclear and contradictory that what may have been a valid attempt to set up a proper ESOP was derailed by numerous record-keeping failures.

State Tax Department Revises Draft Article 9-A Nexus Regulations

By [Kara M. Kraman]

The New York State Department of Taxation and Finance has recently revised its draft Article 9-A nexus regulations. *Corporate Tax Reform Draft Regulations: Corporations Subject to Tax* (N.Y.S. Dep't of Taxation & Fin., amended Feb. 10, 2017). The revisions principally address foreign corporations that surrender their authority to do business, exceptions to corporate partner nexus, and the definition of "credit cards."

The revisions provide that a foreign corporation engaged in any one of the activities that would subject it to tax in New York State will be subject to tax even after it surrenders its authority to do business in New York State. While the previous draft of the regulations provided that a foreign corporation engaged in any one of the activities that would subject it to tax in New York State would be subject to tax regardless of whether it is *authorized* to do business in New York State, it did not specifically address corporations that *surrendered* their authority to do business.

The draft regulations were also revised to make clear that corporate general partners and corporate limited partners are subject to tax under Article 9-A unless the corporate partner is or would be subject to tax under Article 9 or 33. This revision is consistent with the provision in the draft nexus regulations pertaining to corporate members of limited liability companies, which provides that a corporate member of a limited liability company that is taxed as a partnership is not subject to tax under Article 9-A if it is or would be subject to tax under Article 9 or 33.

Finally, the regulations pertaining to nexus for corporations that issue credit cards in New York State were revised to include a cross-reference to the definition of "credit cards" contained in the draft apportionment regulations. The draft apportionment regulations define a "credit card" as including "credit, bank, travel and entertainment or pre-paid payment cards or products that can be presented at a physical point-of-sale terminal, electronically, or by telephone." *Corporate tax reform draft regulations: Business Apportionment Factor* (N.Y.S. Dep't of Taxation & Fin., amended Sept. 30, 2016).

As with the Department's prior releases of draft Article 9-A regulations, the revised draft regulations have not yet been formally proposed under the State Administrative Procedure Act. The Department is requesting that comments be submitted by May 11, 2017.

Governor Cuomo's 2017-18 New York State Executive Budget Contains Proposal to Centralize All Administrative Hearings Functions

By [Irwin M. Slomka]

Perhaps unnoticed by some, New York State Governor Andrew M. Cuomo's 2017-2018 Executive Budget—which contains several tax proposals—also includes a proposal that could ultimately result in the transfer of the New York State Tax Appeals Tribunal and the Division of Tax Appeals into a centralized administrative hearings division that would not be solely devoted to taxation. 2017 N.Y. Senate-Assembly Bill S02006, A03006. The proposal would create a new division of central administrative hearings headed by a Chief Administrative Law Judge appointed by the Governor.

Critically, the Chief ALJ would be given the authority to "establish, consolidate, reorganize or abolish any administrative hearing function" if the Chief ALJ concludes it is necessary for the efficient operation of the administrative hearings division. A Statement in Support of the proposal refers to "a national movement to consolidate State agency hearing processes," and sets out one of the goals as allowing ALJs to "be more adaptable, receiving training in multiple areas of the law."

The Tax Appeals Tribunal, which has been in existence for more than 30 years, is viewed by most taxpayers and practitioners as among the most respected state and local tax adjudicatory bodies in the United States, both for its expertise and for its independence. The Governor's proposal, if enacted in its present form, could result in significant changes to the structure and operations of the Tax Appeals Tribunal, unless the proposed legislation is modified to exclude from its application the Division of Tax Appeals. We see no reason to change the structure and operations of the current New York State tax adjudicatory system, and we view it as important that such an exclusion be made part of the legislation.

INSIGHTS IN BRIEF

Tribunal Denies Retroactive Volume Discounts to Reduce Sales Tax

Sustaining the decision of an Administrative Law Judge, the New York State Tax Appeals Tribunal has held that a vendor cannot reduce the sales tax due on prior sales to account for a volume discount later provided to customers. *Matter of Prima Asphalt Concrete, Inc.*, DTA No. 826280 (N.Y.S. Tax App. Trib., Feb. 9, 2017). Prima Asphalt Concrete offered volume discounts that were applied to customers' orders after they met particular volume goals, which could take one or more years for larger orders, and the original monthly invoices showed sales prices and tax without a discount; when volume discounts were later earned and applied to prior sales, the customer was issued a "credit memo" reflecting the discounted sales price and reduced sales tax. The Tribunal held that there was no authority in the statute or regulations to allow deductions under these circumstances, determining that the selling prices were fixed at the time of the initial sale, and tax was properly imposed on the full, original price.

Department Finds Fees to Analyze Specific Clients' Data Do Not Qualify for the Exclusion from Sales Tax for "Personal and Confidential" Data

The New York State Department of Taxation and Finance has found that an online information services company that provides clients with detailed reports of their potential customers' behavior, incorporating information personal to the client, is providing a taxable information service because the analyses also contain general information pertaining to the clients' industry. *Advisory Opinion*, TSB-A-16(33)S (N.Y.S. Dep't of Taxation & Fin., Dec. 7, 2016) (released Feb. 3, 2017). The Department's regulations provide that a service may be "personal and confidential" even if it incorporates a de minimis amount of data derived from public sources, and the Petitioner described the non-personal information as "inconsequential" to its services. However, since the Petitioner's website stated that its service provided the ability to "monitor competition and benchmark performance," which would not be possible without the use of non-personal information about a client's industry, the Department concluded that the use of non-personal information was an "integral component" of the service.

Bank's New York Office is Not a "Branch"

A recent Advisory Opinion concluded that a non-U.S. banking organization's New York office did not meet the definition of a "branch" under former Article 32 of the Tax Law. *Advisory Opinion*, TSB-A-16(7)C (N.Y.S. Dep't of Taxation & Fin., Dec. 16, 2016) (released Feb. 1, 2017). While the banking organization's New York office met three of the four criteria to be considered a "branch" — it was used on a regular and systematic basis to approve loans, disburse funds, and conduct one or more other functions of a banking business — it did not meet the fourth criterion because it did not accept loan repayments. Therefore, the New York office was not a "branch" within the meaning of the Tax Law, and the deposits from that office were not includable in the banking organization's deposits factor.

Individual Held Not Entitled to Claim Real Estate Losses Because He Did Not Prove He Qualified as a Real Estate Professional

A resident individual who claimed losses from real estate rental activities did not establish that he qualified as a real estate professional and therefore was held not entitled to deduct the losses for New York State personal income tax purposes. *Matter of Michael Strachan*, DTA No. 826530 (N.Y.S. Division of Tax Appeals, Feb. 9, 2017). The individual was a full-time employee architect, but he claimed that his job allowed him time to spend more than 750 hours performing real estate services, one of the federal income tax requirements for qualifying as a real estate professional. However, the ALJ concluded the individual's work logs and his testimony regarding work he allegedly performed for five rental properties were unreliable.

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- Nationwide: Tax Controversy
- New York: Tax

LEGAL 500 US 2016

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

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."

CHAMBERS USA 2015

"THEY DO A TERRIFIC JOB, THEY'RE VERY INFORMED AND REALISTIC."

CHAMBERS USA 2014

"THEY BRING A SUPERIOR DEGREE OF FLEXIBILITY AND EFFICIENCY."

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STATE + LOCAL TAX

WHAT SEPARATES US FROM THE REST?

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

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

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

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

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