NEW YORK STATE TAX UPDATE

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presented by

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I. NEW LEGISLATION

A. Corporate Tax Changes Effective January 1, 2015 – See TSB-M-15(1)C

1. Bank Taxes Eliminated and Merged into Article 9A.

2. Nexus

   a. Corporate tax nexus expanded to all out-of-state corporations with $1 million or more New York receipts (using customer sourcing). $10,000 if receipts of a related corporation exceed $1 million. Is this constitutional? Current challenge is LL Bean v. Tax Commissioner, Ohio Board of Tax Appeals (March 6, 2014).

   b. Must combine taxpayers in a unitary group. Is there a flow of value between entities? May also impact holding companies.

   c. Credit card companies are doing business if they have over 1,000 customers or contracts with over 1,000 merchants in New York.

   d. Repeals the exception for inventory held in a fulfillment house. Now those out-of-state businesses will be subject to tax.

   e. Corporations that are partners in a partnership doing business in New York are subject to tax.

3. New Bases for Corporate Tax

   All corporations will compare the taxes on business income, business capital and the fixed dollar minimum tax, and pay the largest one. The alternative minimum tax and the tax on subsidiary capital have been repealed.

   a. Starting Point – Federal taxable income. No add-back of foreign taxes paid. No exemption for income from subsidiary capital. No 50% dividend deduction. Most other modifications are continued.
b. Business Income - Use business allocation percentage (receipts only). Start with entire net income minus investment income and exempt income.

c. Investment Income - No tax. Investment income represents investments in stock of a non-unitary (20% of voting stock safe harbor) corporation (not unitary entities) held over one year and not sold in the ordinary course of business. Must qualify under IRC § 1221 and be identified as “held for investment” before the end of the day the stock was acquired. See TSB-M-15(4)C. This will generally cover dividends and capital gains, but investment income cannot exceed 8% of ENI. Investment income no longer includes bonds, debt instruments, other corporate securities or cash. These are all now business income.

d. Exempt Income - No tax. This generally represents exempt CFC income and exempt unitary dividends. Includes subpart F income from unitary corporations and dividends from unitary corporations not included in a combined group (businesses taxable under Article 9 or 33).

e. Allocation of interest expenses. For investment income and other exempt income, quantify the interest incurred directly and indirectly or use a 40% reduction as a safe harbor. If you make the safe harbor election, it must apply to both categories, not just one. The election must be made on the taxpayer’s original return. The good news is that all non-interest expenses can now be used to reduce business income.

f. Business Capital - Represents all assets less investment capital. It now includes subsidiary capital and cash.

4. Market-Based Sourcing

Single sales factor using market-based sourcing. The rules do not change for sales of tangible property (sourced to the location of the customer) and data/information delivered on-line (location of customer’s access). Services, however, will now be sourced to the location where the services are delivered, not where the services were performed. If the delivery or access point is unknown, the customer’s billing address/zip code can be used. Last year’s apportionment factor can be used as a last resort.
Here’s an overview of the rules:

**Market-Based Sourcing**

<table>
<thead>
<tr>
<th>Type of Income</th>
<th>Old Rule</th>
<th>New Rule</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales of TPP</td>
<td>“Ship to” address</td>
<td>Customer’s location</td>
</tr>
<tr>
<td>Services</td>
<td>Where are services performed</td>
<td>Hierarchy: 1) Location where services delivered 2) Customer’s billing address 3) Zip code 4) Last year’s apportionment schedule</td>
</tr>
<tr>
<td>Online sales of data, software, or information</td>
<td>Where customer accesses/uses property/information</td>
<td>Hierarchy: 1) Locations of access 2) Customer’s billing address 3) Customer’s zip code 4) Last year’s apportionment schedule</td>
</tr>
</tbody>
</table>

Note: Current sourcing rules still apply to advertising and sales or leases of property.

### 5. Rates - Entire Net Income (ENI) Base/Business Income Base

<table>
<thead>
<tr>
<th>Type of business</th>
<th>Tax Year 2014</th>
<th>Tax Year 2015</th>
<th>Tax Year 2016</th>
<th>Tax Year 2017</th>
<th>Tax Year 2018 and Thereafter</th>
</tr>
</thead>
<tbody>
<tr>
<td>Qualified New York Manufacturers¹</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Qualified Emerging Technology Companies (QETCs)</td>
<td>5.9%</td>
<td>5.7%</td>
<td>5.5%</td>
<td>5.5%</td>
<td>4.875%</td>
</tr>
<tr>
<td>Small Businesses (under 100 employees)²</td>
<td>6.5%</td>
<td>6.5%</td>
<td>6.5%</td>
<td>6.5%</td>
<td>6.5%</td>
</tr>
<tr>
<td>Remaining Taxpayers</td>
<td>7.1%</td>
<td>7.1%</td>
<td>6.5%</td>
<td>6.5%</td>
<td>6.5%</td>
</tr>
</tbody>
</table>

¹Includes eligible qualified New York manufacturers. Either all or $1 million of manufacturing property in New York. Over 50% of receipts from manufacturing. Limited to property “principally used by the taxpayer in the production of goods by manufacturing, processing, assembling, refining, mining, extracting, farming, agriculture, horticulture, floriculture, viticulture, or commercial fishing”. See TSB-M-15(3)C and TSB-M-15(3.1)C

²For the 2014 and 2015 tax years, current law graduated rates apply to small businesses with income over
The fixed dollar minimum amounts were reduced for most C corporations and are unchanged for S corporations.

**Capital Tax:** The following represents the schedule for the tax rate on capital:

<table>
<thead>
<tr>
<th>Type of Business</th>
<th>Tax Year 2014</th>
<th>Tax Year 2015</th>
<th>Tax Year 2016</th>
<th>Tax Year 2017</th>
<th>Tax Year 2018</th>
<th>Tax Year 2019</th>
<th>Tax Year 2020</th>
<th>Tax Year 2021 and Thereafter</th>
</tr>
</thead>
<tbody>
<tr>
<td>Qualified New York Manufacturers &amp; QETCs</td>
<td>0.136%</td>
<td>0.015%</td>
<td>0.106%</td>
<td>0.085%</td>
<td>0.056%</td>
<td>0.038%</td>
<td>0.019%</td>
<td>0%</td>
</tr>
<tr>
<td>Cooperative Housing Corporations</td>
<td>0.04%</td>
<td>0.04%</td>
<td>0.04%</td>
<td>0.04%</td>
<td>0.04%</td>
<td>0.04%</td>
<td>0.025%</td>
<td>0%</td>
</tr>
<tr>
<td>Remaining Taxpayers</td>
<td>0.15%</td>
<td>0.15%</td>
<td>0.125%</td>
<td>0.1%</td>
<td>0.075%</td>
<td>0.05%</td>
<td>0.025%</td>
<td>0%</td>
</tr>
</tbody>
</table>

- For tax year 2014, the tax is capped at $350,000 for qualified New York manufacturers including QETCs, and $1 million for all other taxpayers.
- For tax years beginning on or after January 1, 2015, the tax is capped at $350,000 for qualified New York manufacturers and QETCs, and $5 million for all other taxpayers.
- Small business taxpayers are exempt from the capital base tax in their first two years.

6. **Net Operating Losses** – Will now be computed without reference to federal net operating losses. Losses incurred after 2014 can be carried back three years (not before 2015) and forward 20 years. The net operating loss carry forward will equal the current year's loss times the business allocation percentage for that year. Beginning in 2015, a taxpayer will not be able to deduct any losses incurred in prior years or when the taxpayer was not a New York taxpayer. Instead, there will be a new prior net operating loss conversion subtraction (PNOLCS) - A company's net operating loss will be computed on the last day of 2014 and multiplied by the base year (usually 2014) apportionment and divided by 6.5% (or 5.7% for...
manufacturers)\(^1\) to equal the total PNOLCS for the future. Taxpayers can claim one-tenth a year for up to the next 20 years (with a carryover if unused) or use one-half in 2015 and one-half in 2016 (with no carryover if unused).

Note that the PNOLCS cannot reduce the tax on business income lower than either of the tax on business capital or the fixed dollar minimum.

7. MTA Surcharge - Still uses 3-factor formula and is increased to 25.6%. Use economic nexus and customer sourcing.

8. Combined Reporting – Water’s Edge Method. Ownership test reduced to 50% of the voting power. Still requires a unitary business, but distortion and substantial intercorporate transactions are no longer required. Is there a flow of value between companies? It allows alien corporations with effectively connected income to be included, but does not include S corporations, Article 9, or 33 businesses.

Taxpayers can also make an election to combine if they meet the 50% test. The group must include all unitary and non-unitary businesses. The election must be made on the original return and is irrevocable for 7 years and includes any new members. If the election is terminated after 7 years, there is a 3-year waiting period.

9. Transitional rules can be found in TSB-M-15(2)C.

10. New York City Tax Reform

a. New York City GCT now conforms with New York State rules. This eliminates the tax on subsidiary capital, changes the combined return rules to 50% stock ownership test, applies new NOL provisions, exempts investment income, etc. New nexus rules were not adopted.

b. Does not apply to S corporations. They are taxed like C corporations, but cannot use the new rules!

c. Does not apply to the unincorporated business tax – same rules as before.

d. Major financial institutions (over $100B in assets) will have their tax rate increased from 8.85% to 9%.

\(^1\) The law provides the 5.7% rate, but the actual value is 0% since qualified manufacturers have a 0% tax rate on ENI for 2014.


1. Tax Rate – Generally unchanged. Still maximum of 16%.

2. Exclusion Amount.

   The budget bill gradually increases the estate tax exclusion for a decedent's gross estate until 2019, when it is expected to equal the federal exclusion.

<table>
<thead>
<tr>
<th>Deaths On or After</th>
<th>Exclusion</th>
<th>Full Phase Out</th>
</tr>
</thead>
<tbody>
<tr>
<td>April 1, 2014</td>
<td>2,062,500</td>
<td>2,165,625</td>
</tr>
<tr>
<td>April 1, 2015</td>
<td>3,125,000</td>
<td>3,281,250</td>
</tr>
<tr>
<td>April 1, 2016</td>
<td>4,187,500</td>
<td>4,396,875</td>
</tr>
<tr>
<td>April 1, 2017</td>
<td>5,250,000</td>
<td>5,512,500</td>
</tr>
<tr>
<td>January 1, 2019</td>
<td>Federal Amount</td>
<td>Federal Amount Plus 5%</td>
</tr>
</tbody>
</table>

Portability: None.

Warning. The estate tax exclusion phases out as a taxable estate increases from 100% to 105% of that year's exclusion amount. As a result, the phase out can exceed 100% of the estate additional value! And the tax savings by a gift can exceed the gift’s value!

   a. Example: D dies on September 1, 2017 with a taxable estate of $5,512,500 and owes a tax of $452,300, even though the estate only exceeded the exclusion amount by $262,500. This represents a marginal tax rate of 172%.

3. Gifts - While not technically a gift tax, all gifts made by a decedent within 3 years of death will be added back to the gross estate. Gifts made while the decedent was not a resident are excluded. 2015 legislation provides that gifts of real and tangible out-of-state property will not be added back. This rule applies to gifts made after March 31, 2014 and is scheduled to sunset on January 1, 2019.

5. Alternate valuation follows federal (unless no federal return required).

6. QTIP Election - Must follow federal (unless no federal return required).

7. Nonresidents can now limit New York estate tax liability to New York assets, not a percentage of worldwide assets.

8. A SMLLC does not create an intangible asset if it owns New York property. TSB-A-15(1)M. An S corp, however, should work. TSB-A-08(1)M.

9. Trusts - Effective for income earned after January 1, 2014 and paid after June 1, 2014, income tax is imposed on the New York beneficiary of a previously exempt resident trust on any accumulated income that is distributed to the beneficiary. Income accumulated before the beneficiary became a New York resident is excluded. If a trust is set up as an incomplete gift to an intentionally defective grantor trust (usually set up in Delaware or Nevada), the trust's income is taxable to the New York grantor. Special credits are available to insure that there is no double taxation. Note: New York City follows these rules. See TSB-M-14(3)I.

C. Income Tax – See TSB-M-15(1)I and (2)I

1. Extends charitable deduction limitations. AGIs from $1M to $10M get 50% of charitable gifts. Income over $10M gets a 25% deduction.


3. MCTMT - Filing dates conform with personal income tax due dates. See TSB-M-14(1)MCTMT. Effective in 2015, IT-2105 voucher will be used for estimating, and regular income tax forms will be used to report liability. Group returns available using IT-203-GR. MTA-599 becomes obsolete. Same with quarterly estimates. See Bulletin March 16, 2015.

4. E-Returns – For E filings for returns filed after January 1, 2014, the tax preparer must keep a copy of the taxpayer signature authorization form (TR-579-IT).

5. New York City income tax surcharge extended through 2017 (Laws of 2014, Chapter 338).

D. Sales Tax

1. Yachts – See TSB-M-15(2)S.
a. Amounts over $230,000 for purchase of a vessel exempt from tax (less any credits for taxes paid to other states)

b. No use tax on vessels used in New York unless they are registered in New York or used for over 90 consecutive days.

c. Effective for deliveries after May 31, 2105.

2. Aircraft – See TSB-M-15(3)S.

a. New exemption for all aircraft used in civil aviation, but not commercial aircraft used to transport persons or property for hire.

b. Effective for deliveries after August 31, 2015.

3. Beer tasting exemption from use tax for licensed breweries and cider producers – Hallelujah!

E. Miscellaneous Provisions

1. Workers With Disabilities Tax Credit – Effective January 1, 2015, there will be a nonrefundable credit equal to 15% of qualified wages for qualified full-time employees (maximum* $5,000 per employee) and 10% of the qualified wages for qualified part-time employees (maximum $2,500 per employee). Unused credits can be carried forward for 3 years. Full-time employment is defined as working at least 30 hours per week. This credit is available for qualified wages paid after January 15. In order to participate, taxpayer must apply to the Department of Labor by November 30 of the prior year to become a qualified employer.

2. Family Tax Relief Credit – This $350/family credit for taxpayers with AGI of between $40,000 and $300,000 will become a credit on the taxpayer’s personal income tax return in 2015 and 2016. See TSB-M-13(4)I.

* A qualified individual is a developmentally disabled individual who is receiving rehabilitation services.

3. Repeal of organization tax, tax on changes of capital and license/maintenance fees on foreign corporations.

4. There is also a new refundable income tax credit for qualified manufacturers equal to 20% of the real property taxes paid.

5. Enhancement to Youth Works Tax Credit. This enhancement provides an additional $1,000 tax credit for each youth retained in full-time status for one more year and an
additional $500 for each youth retained in part-time status for one more year. It also lowers the part-time hourly threshold from 20 hours to 10 hours for full-time high school students.

6. Excelsior Jobs Program can include entertainment and music companies

F. What Didn’t Pass

a. Expand sales tax collection requirements to marketplace vendors
b. Disregard SMLLCs for sales tax purchases
c. Disallow related party leases
d. Eliminate the sales tax exemption for contributions of property to new ventures
e. Reduce the tax liability threshold to $5,000 to suspend a taxpayer’s driver’s license.

II. 2015-2016 TAX DEPARTMENT COMPLIANCE INITIATIVES

A. Whistleblower Rules

1. Whistleblower (qui tam) provisions now allow individuals to bring an action and share in the recovery (from 15% to 20%). Treble damages are possible against a taxpayer with over $1,000,000 in net sales (or income) where the damages exceed $350,000. There is a 10-year statute of limitations! For more on New York’s new tax whistleblower law see W. Comiskey and T. Noonan, Calling All Tax Whistleblowers – New York Wants You!, Tax Analysts’ State Tax Notes, January 31, 2011. In March 2012, New York’s Attorney General brought the first action under this law, a $300 million lawsuit against Sprint for failing to correctly collect sales taxes. See People of the State of New York, et al v. Sprint Nextel Corp, et al. The first concluded case resulted in the arrest, conviction, and $5.5 million settlement against a prominent tailor who was also sentenced to one-three years in prison. See Attorney General Press Release, March 5, 2013.

2. Tough rules for tax shelters. New penalties and a six-year statute of limitations. Burden is on the taxpayer to show that there was a valid business purpose for the transaction other than tax savings. See Sznajderman (ALJ March 6, 2014). See also Francoforte (ALJ February 19, 2015).

3. Driver’s License - This program suspends New York State driver’s licenses of taxpayers with past-due tax liabilities of at least $10,000. See Carroll (ALJ March 19, 2015). Suspensions under the program require at least a 60-day notice and will be lifted once the taxpayer either pays the outstanding liabilities or enters into an installment
payment agreement or similar arrangement. Individuals whose licenses are suspended under the program may obtain restricted use licenses to allow them to travel to work, school, and medical appointments. At least five other states have similar programs.

- 8,900 driver’s licenses suspended by August 2014. $61,000,000 recovered as part of program targeting people who owe over $10,000. Press Release, March 17, 2014.


1. New tax preparer regulation begins in 2014 for unlicensed preparers of 10 or more returns - $100 registration fee. Does not apply to CPAs, EAs or attorneys.

2. New “self-audit” letters based on ratios and “typical” use tax liabilities.

3. Increased coordination with other states and federal agencies. See e.g. employment tax initiative between the IRS and New York’s Departments of Taxation and Finance and Labor. IR-2007-184. Recent IRS letter stated: “Our records show differences in income on your state sales tax returns compared with your federal income tax returns for the tax period 2004 through 2011. Please explain…”.

4. CISS Program - New York has adopted a case identification selection system (CISS) used to identify audit candidates for income tax cases. The system transformed New York’s “pay and chase” approach to handling cases of income tax refund fraud to one where fraud is detected through a real time, computer-driven analysis of returns as they are received. The moment the Department receives an income tax return seeking a refund, CISS matches the data in the return with the Department’s enormous databases and uses powerful data analytics built by IBM to score the return.

By April of 2015, the CISS program had saved New York taxpayers an estimated $3 billion! Big Brother is here. See Mark S. Klein, New York is Watching: The Data-Driven Revolution, Tax Stringer, February 2014.

5. CISS Implementation:

-- analyze returns as filed
-- immediately link to third-party data
-- link returns to industry norms
-- immediately assign returns to be audited
-- coordinate with other government agencies
-- monitor taxpayers with a history of tax problems
-- "learn" as audit results are fed back into the CISS system ("bad apple" theory).
-- profile preparers of questionable returns

6. CARP – Crimes Against Revenue Program – used to fund local district attorney offices based on recoveries.

7. Top “Hot Button” Issues:
   -- home repair services (income and sales tax issues)
   -- purchaser of used cars who under-report price paid to DMV
   -- “off the books” workers in construction and food services (implicating withholding taxes, unemployment taxes, workers’ comp, etc.)
   -- reported sales on corporate vs. sales tax returns
   -- licensed professionals who don’t file (even taxi medallion licenses)
   -- visiting executives who don’t file NOTE: felony charges for a nonresident who failed to allocate income to New York. See Press Release, June 28, 2012
   -- same taxable percentage on every return
   -- liquor distributor, insurance company & franchisor (or shopping mall) reports.
   -- lottery traffic vs. low sales
   -- cash/credit card ratio out of sync with similar businesses
   -- interview tax preparer - Was taxpayer warned about residency issues? Why was the “no” box checked?
   -- mortgage application
   -- Facebook (thumbs up?)

   a. $1,000 per return penalty for each return filed without a reasonable belief that the tax treatment was more likely than not the proper treatment.
   b. $5,000 per return if understatement of tax is due to willful, intentional, or reckless disregard for rules and regulations.
   c. By August 2014, penalties in excess of $10 million had been accessed.

9. New York City Data Mining and Models. The Department of Finance has created over 200 models to identify potential tax cheats, including (1) checking to ensure that a
business’s receipts are accurately reported on its business tax return if the business is flagged on a sales tax audit for significantly underreporting taxable receipts, and (2) verifying that Schedule C filers are complying with the UBT. The Finance Department has also created audit tools that allow for data mining through information-sharing agreements with the New York State Department of Taxation and Finance and the IRS. The Finance Department will also have access to FinCEN (Financial Crimes Enforcement Network, U.S. Department of Treasury) records as an audit tool.

10. Still Targeting Accountants - See Comiskey, Taking Aim at Tax Professionals Who Coach Their Clients to Cheat (State Tax Notes, January 4, 2010). The new administration at the Department has made clear that it remains determined to use undercover operations to expose fraud. Also looking at restaurants. See Eateries in Tax Crackdown, Wall Street Journal, May 18, 2010. Investigators even assume identity of local businesses. During the Fall of 2012, 85 accountants were examined and 40%(!) had committed fraudulent behavior.

11. There is no such thing as a “good” result in a criminal case. David Monsour is cautionary tale. Tax Fraud Charges Against Queensbury Businessman Dropped. Post Star, April 5, 2012.

Note: Lying to a Tax Department investigator is a crime. Tax Law § 1803(3).

12. Careful of “Domino Effect” - In Bok Hui Nam, the taxpayer’s acquiescence to a sales tax liability based on unreported income created an income tax liability that was “clearly proper and appropriate”. (TAT September 24, 2009) In Peitio (TAT October 17, 1991), a sales tax liability triggered a corporate tax liability which triggered an income tax liability. The ALJ found the controlling shareholders diverted the unreported income to themselves triggering a constructive dividend. Even a contested sales tax audit can trigger a corporate tax audit. MediaBuss System (TAT March 18, 2014).

C. New York Voluntary Disclosure and Compliance Programs - In an attempt to bolster tax compliance, legislation created a statutory framework for voluntary disclosure, where taxpayers can voluntarily approach the Tax Department to report past delinquencies and obtain a certain degree of amnesty. Eligible taxpayers who file a disclosure statement and execute a Voluntary Disclosure and Compliance Agreement with the Tax Department will avoid incurring any civil penalties and will not be subject to any criminal proceedings. Taxpayers will not be able to enter such an agreement if: 1) they are currently under audit or a party to a criminal investigation; 2) the Department has already identified the disclosed deficiency; or 3) the taxpayer is disclosing participation in a tax avoidance transaction that is a federal or New York State reportable or “listed” transaction.

Flavors of program:

i. Six-year lookback for unremitted trust funds,
ii. Six years for tax fraud or evasion, and for non-filing in excess of 20 years.

iii. Almost everything else – 3-year lookback.

This program is also available to taxpayers who disclose a delinquent tax liability that was deliberately or fraudulently evaded. An automated process is available at http://www.tax.state.ny.us/e-services/vold/program_info.htm. See TSB-M-08(6)I, (11)C, (6)M, (4)R and (10)S. In September 2014, the Department informed us that the program has resulted in collections of about $526M to date, and that the program is currently bringing in about $100M each year! Altogether more than 8,700 taxpayers have signed disclosure agreements to pay old taxes and comply in the future. The program was especially valuable as a vehicle for those with off-shore accounts to report and become compliant. From this group alone, the Department has collected over $170M. The improper denial of acceptance into the program can be appealed to the Division of Tax Appeals. Khinji (ALJ May 14, 2015).

D. Offers in Compromise are back

<table>
<thead>
<tr>
<th>Year</th>
<th>Cases Accepted</th>
<th>Percentage Accepted</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>214</td>
<td>25%</td>
</tr>
<tr>
<td>2010</td>
<td>246</td>
<td>29%</td>
</tr>
<tr>
<td>2011</td>
<td>460</td>
<td>46%</td>
</tr>
<tr>
<td>2012</td>
<td>698</td>
<td>58%</td>
</tr>
<tr>
<td>2013-2014</td>
<td>2,500</td>
<td>69%</td>
</tr>
</tbody>
</table>

E. New York Administrative Appeal Update

1. Bureau of Conciliation and Mediation Services
   -- Intermediate appeal forum
   -- 7,000 cases filed annually
   -- Agreement reached in 75% of cases
   -- 67% of cases resolved within 6 months
   -- 88% consent rate
   -- 7.6% petition to DTA

2. Division of Tax Appeals
III.  HOT CORPORATE TAX ISSUES

A.  Recent Cases

1.  New initiative – De combination.  This can be defeated by demonstrating significant distortion.  *Sungard Capital Corp.* (TAT May 19, 2015),  *IT USA* (TAT April 16, 2014), and  *Knowledge Learning Corp.* (TAT September 18, 2014).

2.  If a federal S corporation is doing business in New York, it must affirmatively elect New York S status or else it is a New York C corporation.  *MediaBuss Systems, Inc.*  (ALJ January 10, 2013).  A federal S corporation that is not doing business in New York is ineligible to make an S election.  Therefore, it is automatically treated as an S corporation for New York purposes.  *Chaim Kofinas*, TSB-A-08(7)C.

3.  Note that New York City’s resident shareholders of S corporations may still be subject to double taxation (GCT and at individual level).  *See Gael De Brousse* (TAT March 11, 1999).  The credit for City resident shareholders of S corporations applies only in 2014 and 2015 and is limited to taxpayers with taxable income under $100,000.  *See § 11-1706 of NYC Adm. Code (2013).*

4.  Internet advertising, like all advertising, is to be sourced to New York based on the percentage of New Yorkers who read or view the ad.  If the taxpayer has no way of knowing the percentage, a reasonable method to estimate can be devised.  *SmarTax LLC*, TSB-A-09(8)C.

5.  Prior to 2015, on-line travel reservation business receipts were sourced where the services were provided – by humans, as well as computers.  *Expedia* (ALJ February 5, 2015).

6.  Advertising income generated by “click fees” should be allocated to New York when a New York subscriber “clicks” on the ad.  If viewship is the income trigger (cost per thousand impressions), the allocation is based on the percentage of New York subscribers to total subscribers.  *WTAS LLC*, TSB-A-09(5)C.

B.  Public Law 86-272 - Nexus and Doing Business Rules

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1. An out-of-state company may employ a representative in their New York home office and still qualify under Public Law 86-272. However, once the out-of-state company has consigned inventory in New York (even if maintained by independent contractors), the company is subject to corporate tax. TSB-A-13(4)C.

2. Annual visits by six to eight employees on nine or ten occasions for two or three days at a time is not enough, by itself, to be considered “doing business” for corporate tax purposes. TSB-A-13(6)C.


4. A business is not subject to the MCTMT if it is not conducting business in the District. The residence of employees, who did not work from home, is irrelevant. TSB-A-13(2)MCTMT.

5. A foreign business is not subject to tax if it has no effectively connected U.S. income, even if it has an office in New York State. TSB-A-15(5)C.

6. MCTMT liability is not created by using professionals (business manager and an accountant). TSB-A-14(1)MCTMT.

7. A company dissolved voluntarily or by proclamation that is a mere record title holder of New York real property as nominee for the benefit of others, and is otherwise inactive, owes no tax after the dissolution. TSB-A-15(2)C.

C. Withholding Taxes

1. Withholding tax audit guidelines allow 14-day safe harbor for employer’s withholding. But this does not apply to any deferred compensation or payments made to public speakers, athletes, or entertainers. TSB-M-12-(5)I.

2. Entities must issue a statement within 30 days whenever taxes are required to be withheld for nonresident partners and members. However, federal forms (like W-2s) cannot be used for this purpose. See Instructions to CT-2658.

3. New York State audit initiative for 2015-16 will look at:

   -- New York nonresident high wage earners based outside of New York

   -- Payments to nonresidents for prior services (e.g. deferred compensation or stock options)
-- New York State residents working in other states - New York withholding on the difference between rates
-- New York City residents working in other states - New York City withholding on 100% of compensation.

4. New York auditors have been imposing interest and penalties on businesses that fail to correctly withhold, even if New York received all of the tax it was due! See Harrison (TAT, February 20, 1997).

5. Liability for withholding taxes applies to any individual who willfully fails to collect or remit this tax. Tan (TAT October 16, 2014).

D. Investment Tax Credit

1. The acquisition costs of an entire building can qualify for the ITC if at least 50% of the usable space is used in a qualifying activity. TSB-A-10(9)C. Equipment qualifies if it is used in a qualifying activity more than 50% of its operating time. However, loan originations, without the sale of the resulting securities are not a qualifying activity. Astoria Financial Corporation, __NYS2d__ (3d Dep’t., June 11, 2009).

2. A natural gas distribution system does not qualify for the credit. It does not produce or process gas, it merely routes it. Brooklyn Union Gas v. Tax Appeals Tribunal __NYS2d__ (3d Dep’t. 2013). Same result for boiling water to create steam. Look at the final result, not the intermediate steps. Constellation Nuclear Power v. Tax Appeals Tribunal __NYS3d__ (3d Dep’t. 2015).

3. But machinery used to cut, reshape, and polish stone slabs qualifies for the ITC. TSB-A-13(9)C.

4. A lease of property eliminates the ability of either the lessor or the lessee to take the credit. This rule applies even if a single taxpayer owns/controls the lessee and the lessor. Gropper v. Tax Appeals Tribunal, __NYS2d__ (3d Dep’t. 2004). But the use of a single member LLC works fine. Deutsche Bank, TSB-A-04(11)C.
E. Miscellaneous

1. Empire Zones – New York’s highest court refused to apply changes to the Empire Zone Program to prior tax years. Taxpayers cannot be “punished for behavior that had already occurred and that they could not retroactively alter”. *James Square v. Tax Appeals Tribunal* (June 4, 2013).


3. NOL deduction not required if taxpayer used different tax base. *TD Holdings II* (ALJ January 22, 2015).

4. New York net operating losses (NOLs) are limited to federal NOLs. It does not matter that the discrepancy is based on New York’s decoupling from federal bonus depreciation. *Five Star Equipment* (TAT April 15, 2015).

5. PILOT payments are not eligible for the QEZE credit. *The Golub Corp. v. NYS DTF _NYS3d_* (3d Dep’t. 2014). Same result for special assessments and ad valorem taxes. These are not “eligible real property taxes”. *Stevenson v. Tax Appeals Tribunal* (3d Dep’t. 2013). *See also Piccolo v. Tax Appeals Tribunal __NY2d__* (3d Dep’t. 2013) and *Herrick v. Tax Appeals Tribunal __NY2d__* (3d Dep’t’ 2013). However, special agreements with the IDA can allow PILOT programs to qualify. *Falso* (TAT May 23, 2013).

6. Tax reduction credit is based on all of the income that flows through to a shareholder – not limited to New York source income. *Batty & Pennefeather* (ALJ April 11, 2013) *Henson & Hamel* (ALJ April 10, 2014).

IV. HOT PERSONAL INCOME TAX ISSUES

A. Recent Developments

1. Is *Wynne* (Sup. Ct. 2015) a win for New York taxpayers?


3. NYC-RPT Form requires the name and Social Security number of every member and general partner of an LLC or partnership selling or acquiring real property. Effective May 18, 2015.
4. We’re #1!, according to the Tax Foundation.

B. Statutory Residence

1. Legality

   a. New York’s statutory residency rules (that have the potential of taxing domiciliaries of another state twice on the same income) do not violate the commerce clause of the U.S. Constitution nor New York’s own constitution. *Noto v. Department of Taxation and Finance* (Sup. Ct. Suffolk Co. 2014). New York’s statutory residence rules require a permanent place of abode and presence for more than 183 days. Is this still valid after *Wynne*?

   b. Check out *Sobotka* (ALJ Order, August 20, 2015).

2. Day Count


   b. Proof covering every day is not necessary. *Lepley* (ALJ June 19, 1997). However, credible testimony is crucial. *Julian Robertson* (TAT September 23, 2010), where the Tribunal stated:

   “the standard of proof is not that the petitioner must establish, via an independently and objectively verifiable document or documents, his absence from New York City so as to eliminate any possibility of such presence. Rather, the question is whether all of the available evidence, taken together, supports the conclusion that petitioner was somewhere other than in New York City on the days in issue”

   c. A diary or other contemporaneous documentation is critical. No one remembers where they were every day, and a charge in Connecticut does not prove you did not enter New York. *Puccio* (ALJ January 27, 2011).


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2 New York residents pay the highest state and local taxes in the United States.
3. Permanent Place of Abode

a. New York’s highest court has spoken: An abode must be used for residential purposes, not as an abode for others. “To qualify as a statutory resident, there must be some basis to conclude that the dwelling was utilized as the taxpayer’s residence”. Gaied v. Tax Appeals Tribunal. 22 NY3d 592 (2014).

b. A vacation home with no heating system was not a permanent place of abode (PPA) since it was “no longer suitable for year-round use.” TSB-A-11(5)I.

c. But a vacation cottage was a PPA where the taxpayers used it 10-15 days a year and it was located in a resort community. It was useable all year long, and that’s all that counts. Barker (TAT January 13, 2011).

d. Taxpayers did not maintain a permanent place of abode where they were legally (by contract) bound to turn over the keys to the real estate agent, remove all their personal belongings, and agree not to live in the apartment during the sales process. The taxpayers did not have “unfettered access” to an abode. TSB-A-11(9)I.

e. Failing to check the “Did you maintain living quarters” box supports the imposition of negligence penalties. Campaniello (ALJ June 25, 2015).

C. Temporary Stay Rule - Applies to undergraduate students only.

D. Domicile


2. Guidelines – New version issued in June 2014. New residency audit guidelines limit domicile review to five primary factors. They are: housing, business ties, “near and dear”, time and family ties (limited to immediate family). Although these factors are not binding on ALJs, most judges focus on them. Secondary factors (e.g. licenses, voting, automobile registration, wills, social clubs, etc.) are no longer critical. See Noonan and Klein, The Nuts and Bolts of a Residency Audit. State Tax Notes (December 2008). New guidelines include rules for foreign domicile and a review of the availability of credits for taxes paid to other jurisdictions.

3. “Leave and Land”. Domicile is established by physical presence coupled with an intent to establish a permanent home. Ingle (TAT December 1, 2011)
4. A taxpayer’s existing domicile continues until a new one is acquired, but the law does not require ownership of a home at the new location. A taxpayer can move, live with family or friends, or rent a new home in the new location and still not be considered to have changed domicile. See Jeter, (ALJ November 8, 2007). Domicile is not predicated on a real estate closing if the taxpayer has already “moved” to the new location. Reichstetter (ALJ October 31, 2002).

5. Special Exceptions for Domiciliaries:

a. 30-Day Rule - Tax Law § 605(b)(1)(A)(i) – Domiciliaries who (1) maintain a permanent place of abode outside New York during the year, (2) do not maintain a permanent place of abode in New York during the year, and (3) spend no more than 30 days in New York during the year.

b. Foreign Country Rule – Tax Law § 605(b)(1)(A)(ii) – For taxpayers who are outside the United States for 450 out of 548 days and where neither the taxpayer nor his spouse or minor children spend over 90 days in New York during the 548-day period. Note that any consecutive 548-day period is allowed, but that special ratios apply to any short-year periods.

i. A “minor” is a person who has not attained the age of 18 years. TSB-A-12(5)I.

ii. If the taxpayer is legally separated, the spouse and minor children’s New York time is irrelevant (unless the taxpayer has custody). TSB-A-12(3)I. See also TSB-A-12(3.1)I (April 11, 2013).

iii. Note that the day count rules (“any part of a day”) apply here as well. TSB-A-11(3)S.

iv. A foreign citizen who is a statutory resident must pay tax on all federal adjusted gross income from Form 1040NR. TSB-A-10(7)I.
6. Recent domicile cases:

   a. *Eileen Taylor* (TAT December 8, 2011). A move to a foreign country, even coupled with giving up a New York home, will be strictly scrutinized. It is very difficult to demonstrate a change of domicile to a foreign country. The Tribunal did not believe that the taxpayer abandoned her New York domicile when the taxpayer had a series of one-year (renewable) contracts with her employer. It also didn't help that the taxpayer received a housing stipend during her stay in London.

   b. But in *May* (ALJ January 8, 2015), a New York resident and his family moved to London for an “exciting adventure” and changed his general habit of life to the U.K. This represented a change of domicile.

   c. No change of domicile where taxpayer did not prove they actually moved and spent time in their new home, nor where taxpayer failed to demonstrate a single tie to Florida. *Varzar* (ALJ April 2, 2015).

   d. *Cooke* (ALJ November 15, 2012). Taxpayer was able to establish domicile in Hamptons in spite of spending just as much time in New York City as on Long Island. The taxpayer’s minor children attended elementary and high school New York City prior to the years at issue but had completed school by the time the audit was opened. The real key to this case was persuasive testimony from the taxpayer and family members about the location of their "true" home.

   e. *Campaniello* (ALJ June 25, 2015). No change of domicile where there is no change in lifestyle or travel pattern. ALJ also mentioned use of New York physicians and dentists. And it didn’t help that the taxpayer’s spouse continued to reside in New York.

7. Be careful what address you use on tax returns. A New York home address on a Form 1040 creates a presumption that the taxpayer is a New York domiciliary. *Eckhardt* (ALJ April 4, 2014).

E. Residency – Top 10 Errors

1. Nobody moves on January 1
2. Statutory residence trumps domicile
3. The “Living Quarters” box
4. Consistency!
5. Husbands and wives usually share a domicile
6. Correct W-2s, 1099s and K-1s with old address

7. Don’t let client “chat” with auditors

8. Credits for taxes paid elsewhere

9. Understand the burden of proof

10. Never amend a return under audit


F. The Convenience Rule

1. The convenience rule is not unconstitutional, even though it can create double taxation. *See Edward and Doris Zelinsky v. Tax Appeals Tribunal __NY2d__ (2003)* regarding a law school professor who taught in New York three days a week and worked at home the rest of the time. A “reverse convenience” rule may also be available. According to the Court of Appeals, a taxing scheme is not unconstitutional simply because a taxpayer can be taxed twice on the same income. Cert. den. __ U.S. __ (April 26, 2004). *See also Huckaby v. New York State Division of Tax Appeals (__NY3d__ 2005)* Cert. den. __US__ (October 31, 2005). Note that in *Maxine Allen v. Commissioner of Labor, __NY2d__ (July 2, 2003)*, New York’s highest court denied an unemployment insurance claim by a Floridian who telecommuted from her home for a New York employer. Apparently, it is only New York income for purposes of paying New York tax, not receiving New York unemployment benefits.

2. Other Cases: In *Louis & Florence Friedman* (TAT March 2, 2000), an ALJ found that no work done in or out of New York could be characterized as “wages” performed in both jurisdictions. In *Unterweiser* (TAT July 31, 2003), a taxpayer’s New York desk job was eliminated and she was only allowed to continue to work if she stayed at her home and telecommuted. In spite of the fact that she had no office available to her in New York, the Tax Appeals Tribunal held that the convenience rule applied.

3. Note that wages will not be allocated to New York (under the convenience test) even if the individual continues to be employed by his New York-based employer, if he performs no services in New York. *Kumar* (ALJ May 6, 2010).

G. Post-Employment Remuneration

1. Federal legislation was enacted to prohibit states from taxing a nonresident partner’s retirement income. *See P.L. 109-264 (H.R. 4019)*. This includes distributions from a nonqualified deferred compensation plan as long as there is: (1) a written plan, (2) substantially
equal payments, (3) paid out at least annually, and (4) over a period of at least ten years. See TSB-A-11(10)I.

2. Annual non-qualified deferred compensation paid to New York residents can qualify for the $20,000 exemption if paid out in the form of an annuity. TSB-A-13(7)I.

3. The beneficiaries of a decedent’s IRA step into the decedent’s shoes for purposes of determining the availability of the $20,000 annuity exclusion. The beneficiaries do not need to be at least 59½ years old. Multiple beneficiaries split the $20,000 exemption. Markman, TSB-A-07(3)I. But, in order to qualify, the taxpayer must remain the beneficiary of the IRA. If a spouse elects to become the owner, they lose the ability to use the decedent’s age for the $20,000 exemption. TSB-A-11(2)I.

4. SUNY employee’s TIAA/Cref proceeds lost their exempt status on amounts in excess of the rollover once they were rolled over into an IRA. Kane (ALJ March 20, 2014).

5. The World Bank is not an instrumentality of the United States. TSB-A-15(1)I.

6. Direct trustee-to-trustee transfers from an IRC § 401(a) and 403(b) to an IRA were exempt when the employer was SUNY. TSB-A-15(3)I.

7. New York still has an annuity rule that exempts certain payments to nonresidents: In order to qualify, the plan must be in writing and the benefits must be:

   - paid in cash (not securities)
   - payable at a certain rate
   - paid in equal annual installments over a period of at least ½ of the recipient’s life expectancy. 20 NYCRR § 132.4(d).

H. The Accrual Rule

1. Change of Residence - Recent rules revise the New York (State and City) tax treatment of taxpayers who change their residence. The new provisions require:

   a. application of the accrual rules to statutory residents;

   b. proportionate accruing to an individual’s resident period for income or loss from partnerships and S corporations; and

   c. Allowance of a taxpayer’s (or if the Tax Department requires) election to determine gain or loss for a partnership or S corporation to reflect the actual date of gain or loss. See Important Notices N-05-2, 3 & 4
The accrual rule can apply to a taxpayer who moves into New York, but there is no accrual until the transaction is “closed”. Michaels (ALJ April 2, 2012). This may allow New York City residents to move out of the City before the closing, sell their New York City home and avoid all New York City taxes.

I. Losses and Credits

1. Tough rules for gambling deductions - A net loss can end up as a gain. Karlsberg _NYS 3d_, (3d Dep’t., 2011).

2. Similar rule for real estate losses coupled with a bonus depreciation add-back. Federal losses are limited to passive income. There is no additional loss that can be taken to offset the bonus depreciation. TSB-A-(11)6I. See also TSB-A-09(12)I.

3. The credit for taxes paid to other states uses the New York rules for sourcing income. Goldman (ALJ June 26, 2014). (Massachusetts taxes paid on sale of interest in Massachusetts partnership).

4. New audits target credits taken by New York residents for taxes paid to other states.

J. New York Source Income

1. A nonresident’s disability benefits are taxable when they are related to personal New York services. TSB-A-13(9)I. And compensation for services performed in New York are taxable. There is no foreign service officer exemption. TSB-A-14(2)I.


3. A nonresident cannot allocate a capital loss from the disposition of a partnership interest to New York. The partnership interest, itself, was not used in a trade or business. It’s an intangible. Olsheim (TAT amended decision November 13, 2014).

4. Similarly, a nonresident’s sale of a partnership interest or S corp stock is not taxable unless over 50% of the entity’s assets consist of New York real estate. But even then, interest on the installment note is exempt from New York tax. TSB-A-15(5)I.


7. The New York source income of a partnership is usually based on payroll, property and receipts. But income and deductions associated with the sale of real property are not subject to allocation. Instead, they are allocated entirely to the location of the real estate. This also applies to real estate operated as a business (e.g. a hotel). *Linde* (TAT May 24, 2012).

8. A nonresident, non-equity partner of a law firm who never worked in New York was subject to New York tax based on the partnership’s business allocation percentage. The partner was held out to the public as a “partner”. It didn’t help that the “partner’s” income was characterized as a guaranteed payment on his K-1. *Tosti* (TAT May 12, 2011). See *When is a Partner a Partner for New York Tax Purposes, State Tax Notes*, August 9, 2010.

9. But an attorney admitted pro hac vice in Florida was not taxable when 100% of his work was from Florida. *Carr* (ALJ July 23, 2105).

10. For allocation purposes, a full travel day is a non-New York workday, even if the trip begins and/or ends in New York (this includes weekends). In order to be treated as a New York work day, some services must be rendered in New York. 2014 Nonresident Allocation Guidelines.

K. Miscellaneous

1. Remember the 120 day rule for audits.

2. Statutes of limitations are based on the individual taxpayer’s filing date, not that of the partnership they own. *Wilmorite Inc.* __NYS3d__ (3d Dep’t. 2015).


4. A sales tax audit finding can, itself, be used to justify an assessment for corporate or personal income tax. *MediaBuss Systems* (ALJ November 29, 2012).

5. Taxpayer’s silence construed against him. *Babel* (TAT March 18, 2014). Oh, the irony!

6. The historic homeownership rehabilitation credit can apply to a remainder interest as long as the taxpayer also lives in the premises. TSB-A-14(1)I.

7. New York continues to audit “above the line” issues. See *e.g.*, *Conte* (ALJ March 12, 2015), discussing hobby losses and *Brandvold* (ALJ March 19, 2015), applying the passive activity loss rules of IRC § 469.
V. HOT SALES TAX ISSUES

A. Sales Tax Audit “Nuts and Bolts”

1. Auditors look at three areas:
   
a. Expenses - usually recurring - use of test period or statistic sample preferred.

b. Sales - usually sampled, depends on level of sales activity: guest checks - register tapes - taxable ratio.

c. Capital acquisitions - full detail usually preferred, items usually reconciled with cash disbursements journal and federal depreciation schedule.

2. Major Audit Issues:
   
a. Where to hold audit

b. Responsible officer questionnaire

c. Access to information

d. Consent to extend

e. Statute of Limitations

f. Test period consent

g. AU-346 - 60-day rule

h. Penalties: regular (30%), interest (14.5%) and omnibus (10%)

i. Exemption certificate issues

Note: Vendor Registration - The Tax Department can refuse to issue a taxpayer a certificate of authority if there is an outstanding tax liability. *Winners Garage, Inc. v. Tax Appeals Tribunal* ___NYS3d___ (3d Dep’t. 2011) Mtn. lv. app den 18 NY3d 807 (2012).
B. **Top Sales Tax Audit Issues**

1. Cloud computing
   
   a. Is it SaaS? Does it involve a license of software?
   
   b. Is it a an information service?
   
   c. Are there any “soft dollar” issues?
   
   d. Is it the electronic delivery of other tangible property?
   
   e. Remember allocation and overlapping audit rules.

2. Cheeseboard consultants

3. Catering rules

4. Bulk sales rules (derivative liability)

5. Contractors

6. Sales to residents – delivered out of State

7. Club Dues

8. Amazon legislation

9. Cash businesses

C. **Shameless Plug** - CCH has published the *New York Sales and Use Tax Answer Book*, co-authored by yours truly.
VI. DIVISION OF TAX APPEALS 2013-2014 CASE DISPOSITION STATISTICS

A. Small Claims Cases -
   68% Sustained Tax Department’s deficiency
   16% Cancelled Tax Department’s deficiency
   16% Modified deficiency (reduced tax, penalty, etc.)

B. ALJ Cases -
   79% Sustained Tax Department’s deficiency
   5% Cancelled Tax Department’s deficiency
   16% Modified deficiency (reduced tax, penalty, etc.)

C. Tax Appeals Tribunal -
   79% Affirmed the ALJ’s determination
   4% Reversed the ALJ’s determination
   8% Modified the ALJ’s determination
   8% Remanded to ALJ

The Tribunal granted a taxpayer’s exception 13% of the time while it partially granted the Tax Department’s exception 100% of the time (although there was only one case). Oral argument is granted 67% of the time.

VII. IMPORTANT PHONE NUMBERS AND INTERNET ADDRESSES

Business Tax Information and Forms - 1-800-972-1233
College Choice - 1-877-NYSAVES and www.nysaves.org
Department of Taxation and Finance - www.tax.state.ny.us
Division of Tax Appeals - www.nysdta.org
General Tax Information - 1-800-225-5829
New York City Department of Finance - www.ci.nyc.ny.us/finance
Office of State Comptroller - www.osc.state.ny.us
STAR Information – 1-518-457-2036
Tax Forms and Publications - 1-800-462-8100
Department of Labor - www.labor.state.ny.us
Metropolitan Commuter Transportation Mobility Tax Inquiries – 1-518-485-2392
Taxpayer Rights Advocate – 1-518-530-4357
Practitioner Hotline – 1-518-457-5451
Tax Fraud “Tip” Fax Line – 1-518-435-8523
090115 (inc566)