

CORRECTED: NJ Asks State High Court To Revive \$1.8M UPS Tax Penalty

By **Joshua Alston**

Law360, New York (September 23, 2014, 5:33 PM ET) -- New Jersey on Tuesday urged the state Supreme Court to reinstate \$1.8 million in tax penalties assessed against UPS Co., arguing the shipping giant demonstrated bad faith in failing to pay taxes on cash transferred between its business units.

Senior Deputy Attorney General Marlene G. Brown, an attorney for the state Division of Taxation, told the justices that UPS is a highly sophisticated taxpayer that should have been aware of the tax implications associated with the centralized cash-management system it uses to fund its subsidiaries with cash transfers the state said qualify as demand loans. The Taxation Division has lobbied the high court to overturn the abatement of \$1.8 million in late payment and tax amnesty penalties against UPS.

"These taxpayers knew they were transferring cash and what that implied," Brown said. "The tax court found as a matter of law that these were demand loans. And UPS called them loans in their tax return. The division had the returns and said, 'We see loans, please explain.'"

Superior Court Judge Harold A. Kuskin, who heard the case in state tax court, also found that UPS' cash-management system constituted demand loans, but waived the late penalties after concluding that the director of taxation abused his discretion in assessing them.

UPS' cash-management system presented issues of first-impression, Judge Kuskin said, supporting UPS' claim its failure to pay was simply an honest mistake. As New Jersey's tax amnesty penalty only applies when tax obligations were or should have been known by the taxpayer, those fees were also waived.

Brown disagreed with Kuskin's ruling, which was later affirmed by the Appellate Division, saying Kuskin improperly concluded that a company with the sophistication of UPS could have made such a mistake, especially when it has a department solely responsible for compliance in tax matters.

"We have to link back to the reasonable cause standard of education, experience and knowledge of taxpayers," Brown said. "This is a very broad application of the amnesty statute, and because the audits were ongoing, the taxpayer should have known what its liability was and made a good-faith effort to satisfy it."

When Justice Anne Patterson pressed her on the issue, Brown said the state's position is that the tax amnesty statute operates like a strict liability statute for tax returns due.

UPS' attorney Mitchell A. Newmark of Morrison & Foerster LLP said the abatement should be upheld

because there's no evidence of bad faith, and because the high court can't apply the "arbitrary and capricious" standard of review to the tax court, which Newmark said was created by the legislature to operate as an independent forum.

"Four judges heard the issues in this case and they got it right," Newmark said. "If the legislature didn't want to make the tax court an independent body, it could have pointed over to the Administrative Procedure Act and we could have had direct appeal to the appellate division without going through the tax court."

The court said it would issue a ruling within the coming weeks.

According to the appellate decision, a UPS unit called General Services provided management services for other units within the UPS group, including UPS of America, UPS Co., UPS Telecommunications Inc. and UPS Worldwide Forwarding Inc.

General Services operated a centralized cash management system designed to keep each subsidiary funded for its daily operations and pay out expenses for each unit. Money that wasn't immediately needed for daily operations was invested, allowing UPS to get a maximum return on its operating capital.

Based on its findings in a routine audit, the Division of Taxation declared the cash transfers made between General Services and the subsidiaries constituted loan advances on which interest should have been imputed. That interest went as unreported income between 1991 and 1995, the division said.

The division assessed UPS late penalties on the unpaid taxes and also assessed penalties because it had failed to admit to the unreported income before the expiration of a tax amnesty program.

The appellate panel found no error in Judge Kuskin's waivers, and also said the amnesty penalty statute was written with ambiguous language and could not be applied to issues only discovered in the course of an audit.

"We defer to the finding of the tax court that plaintiffs 'in good faith, did not know and, by reasonable inquiry, could not have known that additional taxes were due, or that the director claimed additional taxes were due' during the amnesty period, until they received the director's assessment, issued after the amnesty period expired," the opinion said. "Although the controversy was ongoing and the audits extensive, tax liability was not finally determined until the assessments issued."

A UPS spokesman said the company does not comment on ongoing litigation.

The state is represented by Senior Deputy Attorney General Marlene G. Brown and Assistant Attorney General Lewis A. Scheindlin.

UPS is represented by Mitchell A. Newmark and Paul H. Frankel of Morrison & Foerster LLP.

The case is United Parcel Service General Services Co. v. Director, Division of Taxation, case number A-16/17-13, in the Supreme Court of New Jersey.

--Editing by Andrew Park.

Correction: An earlier story incorrectly stated the amount of the tax penalty. The error has been corrected.

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