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IN THIS ISSUE

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COURT ORDERS DEPARTMENT OF FINANCE TO RELEASE CORPORATE TAX RETURN RECORDS TO CITY COMPTROLLER

By Irwin M. Slomka

In an interesting case involving the New York City Comptroller's authority to subpoena general corporation tax records from the New York City Department of Finance, a New York State Supreme Court judge has issued an order holding that the Department of Finance must turn over tax records — including City corporate tax return data — to the Comptroller, pursuant to the Comptroller's audit authority over City agencies. In ordering disclosure, the judge rejected the Department of Finance's claim that the general corporation tax ("GCT") secrecy provisions prohibited it from disclosing the records to the Comptroller. *Comptroller of the City of N.Y. v. Dep't of Fin.*, No. 160842/2013, 2014 N.Y. Slip Op. 24309 (N.Y. Sup. Ct., N.Y. Cnty. Sept. 29, 2014), released for publication Oct. 7, 2014.

Facts. The Department of Finance ("Department") is a New York City Mayoral agency vested with authority over the administration and collection of most New York City taxes, including the GCT. City Charter § 1504. City Charter § 93(c) gives the City Comptroller (an elected official separate from the Mayor and Mayoral agencies) the "power to audit all [City] agencies." Another section of the Charter gives the Comptroller the "power to audit and investigate all matters relating to or affecting the finances of the city, including without limitation the . . . receipt and expenditure of city funds . . . ." City Charter § 93(b).

In January 2013, the City Comptroller began an audit of the Department's GCT collection practices. Following an unsuccessful attempt to compel the Department to produce GCT records for the five-year period 2008–2012, including tax returns, the Comptroller served the Department with a subpoena. The subpoena was accompanied by a proposed confidentiality agreement regarding the requested records. The Department, relying on a 1991 Corporation Counsel Opinion, notified the Comptroller that it would not comply with the subpoena. In that Opinion, the Corporation Counsel had written that, notwithstanding the Comptroller's clear statutory authority to audit City agencies, the tax secrecy provisions prohibited the disclosure of any confidential tax return information to the Comptroller.

continued on page 2

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In November 2013, the Comptroller commenced a lawsuit in New York County Supreme Court, seeking to compel the Department to comply with the subpoena. The Comptroller maintained that his audit authority over City agencies entitled him to access agency records that were necessary to carry out that audit function. The Department claimed that the GCT tax secrecy provisions prohibited it from disclosing tax returns and other confidential return information, unless disclosure was "otherwise provided by law," arguing that such a violation of tax secrecy could subject its employees to criminal penalties. It also took the position that although the tax secrecy provisions permit the disclosure of confidential tax information "as otherwise provided by law," the State Legislature (which enacted the GCT law in 1966) did not intend to make a local law such as the City Charter an "otherwise provided by law" exception to secrecy.

The Supreme Court judge ruled in favor of the Comptroller, rejecting the Department's tax secrecy arguments and ordering the Department to turn over the tax return information. According to the judge, the City Charter provision giving the Comptroller audit authority over City agencies was a "law" that "otherwise provide[s]" for the disclosure of GCT return information, which is an exception to tax secrecy under the GCT law. The judge pointed out that while the Department relied on the rationale contained in the 1991 Corporation Counsel Opinion, "that opinion has no precedential value."

[T]he Department's blanket denial of any GCT return information would have undoubtedly hampered the Comptroller's ability to conduct his audit of the Department's administration of the tax.

The judge concluded that denying access to the Comptroller frustrated his ability to exercise his audit authority, on which "the Comptroller . . . is accountable to[] the citizens of the City." She noted: "Indeed, it is difficult to imagine how the Comptroller can publish a statement 'regarding all taxes due and uncollected at the close of [each] fiscal year' (citation omitted) without obtaining access to the information demanded in the subpoena." Also rejected was the Department's claim that disclosure to the Comptroller would constitute a breach of GCT tax secrecy. The judge pointed out that the confidentiality agreement proposed by the Comptroller contained numerous protections against disclosure beyond the Comptroller's office.

Additional Insights

This unusual case illustrates the potential tension between the statutory oversight role of the Comptroller and the Department's role in administering the GCT (as well as the occasionally tense political relationship between them). While it appears there were bona fide legal arguments on both sides, the Department's blanket denial of any GCT return information would have undoubtedly hampered the Comptroller's ability to conduct his audit of the Department's administration of the tax. Moreover, the Department's tax secrecy claims were difficult to accept in light of the Comptroller's confidentiality agreement. We expect that the Department will appeal the judge's order.

ALJ UPHOLDS TAX DEPARTMENT POLICY ON PERSONAL LIABILITY OF LLC MEMBERS FOR SALES TAX

By Kara M. Kraman

A New York State Administrative Law Judge has upheld the New York State Tax Department's policy that a member of a limited liability company ("LLC") holding a minority interest in the LLC is liable for a portion of a sales and use tax assessment against the LLC itself. *Matter of Eugene Boissiere and Jason Krystal*, DTA Nos. 824467 & 824937 (N.Y.S. Div. of Tax App., Sept. 25, 2014).

Eugene Boissiere and Jason Krystal held 14% and 13% membership interests, respectively, in an LLC. Neither individual had managerial responsibility, knowledge or control over the LLC's financial affairs, or authority to sign the LLC's tax returns. The New York State Department of Taxation and Finance ("Department") performed a sales tax audit of the LLC, but neither individual participated in the audit or knew the basis of how the sales tax was computed.

The Department assessed sales tax, plus interest, against the company for the period June 1, 2004 through May 31, 2009. It appears that the LLC had ceased operations. The Department issued separate Notices of Determination to Mr. Boissiere and Mr. Krystal, each assessing the full amount of the sales tax, plus penalty and interest, for the period during which each held a membership interest in the LLC. After negotiations between the Department and the taxpayers, the Department reduced the individuals' liability for the sales tax to reflect their percentage of ownership in the business, plus interest.

Tax Law § 1131(1) imposes strict personal liability for sales tax on "any member of a partnership or limited liability company," regardless of whether that person is

continued on page 3

under a duty to act on behalf of the company. In contrast, the New York Limited Liability Company Law provides that a member of an LLC cannot be held personally responsible for an LLC's liabilities "solely based on their status as members." LLC Law § 609(a).

Messrs. Boissiere and Krystal challenged the assessments imposing personal liability for a percentage of the LLC's sales tax. They argued that the contradiction between the LLC Law, which limited an LLC member's liability, and the Tax Law, which provided for "unlimited" liability for LLC members, violated their due process rights.

The ALJ upheld the Department's assessments against the LLC members. As an initial matter, the ALJ found that the taxpayers' argument was inconsistent with the facts of the case, because the Department had limited the taxpayers' liability to their percentage of ownership interests in the LLC. This limitation of liability was consistent with Department policy as set forth in *Technical Memorandum*, TSB-M-11(17) (N.Y.S. Dep't of Taxation & Fin., Sept. 19, 2011), which provides that LLC members who have less than a 50% ownership interest, and who were not under a "duty to act" on behalf of the LLC in complying with the Tax Law, may have their personal liability for sales tax limited by their percentage of ownership in the LLC.

The ALJ also rejected the members' due process argument on the grounds that they chose to proceed as members of an LLC, and were therefore bound to accept the consequences of that choice of business organization.

Additional Insight

The ALJ's decision upholding an LLC member's strict liability for the LLC's sales tax obligation is in keeping with the New York State Tax Appeals Tribunal decision in *Matter of Santo*, DTA No. 821797 (N.Y.S. Tax App. Trib., Dec. 23, 2009). That decision upheld the imposition of strict liability on a member of an LLC for the full amount of the LLC's sales tax liability. After *Matter of Santo* was decided, and in the face of public concern over the decision's implications, the Department issued *Technical Memorandum*, TSB-M-11(17)S, in recognition of the fact that the application of strict liability might work a hardship to certain LLC members who, as in this case, were not involved in the financial aspects of the business. Many had believed that the controversy over strict liability for LLC members had dissipated after the Department limited the liability in most cases to the members' ownership percentage in the LLC. However, with this new legal challenge to the imposition of *any* strict liability, it seems likely that the Tribunal, and possibly the courts, will be asked to revisit this issue.

Taxpayers should be aware that TSB-M-11(17)S conditions limited liability on the LLC members' cooperation with the Department — including, among other things, identifying to the Department other potentially responsible persons. Moreover, the relief is limited to LLC members who hold less than a 50% interest in the LLC. It does not apply to partners in a limited liability partnership or to general partners in a partnership.

TAXPAYER REQUESTS FOR SPECIAL REFUND AUTHORITY RELIEF FROM STATUTE OF LIMITATIONS DENIED IN TWO SEPARATE CASES

By Michael J. Hilkin

In two separate cases, the New York State Tax Appeals Tribunal and a New York State Administrative Law Judge denied requests for relief under the special refund authority provided by Tax Law § 697(d), which authorizes personal income tax refunds for claims made after the general statute of limitations has expired if the tax was originally paid "under a mistake of facts." *Matter of Mayra Guffin*, DTA No. 825752 (N.Y.S. Tax App. Trib., Sept. 18, 2014); *Matter of Janet Yoell-Mirel*, DTA No. 825058 (N.Y.S. Div. of Tax App., Oct. 2, 2014).

Guffin Case

Facts. In April 2008, Mayra Guffin timely filed a 2007 New York State income tax return as a nonresident, reporting over $27,000 due in personal income taxes. Her attached W-2 showed New York State wages, and that an insufficient amount of tax had been withheld. In July 2012, Ms. Guffin filed an amended 2007 return claiming a refund, along with a corrected W-2 showing that she had actually earned no New York State wages in 2007. The Department denied the refund as untimely.

In her appeal to the New York State Division of Tax Appeals, Ms. Guffin acknowledged that she filed her refund claim after the expiration of the statute of limitations set forth in Tax Law § 687(a), which allows application for refund or credit within the later of two years after the tax was paid or three years after the return was filed. She claimed that she was due a refund on the basis that: (1) she did not live or work in New York State in 2007; (2) her employer erroneously issued her a W-2 reporting New York State wages, but she nonetheless filed a return and paid tax consistent with her W-2 in order to "avoid paperwork"; (3) she relied on advice of tax professionals that she needed a corrected W-2 prior to filing an amended return; (4) she requested such a W-2 shortly after filing her initial return, but her employer was "severely delayed" in issuing a corrected W-2; and (5) she

continued on page 4

filed an amended return and claim for refund as soon as she had received the corrected W-2.

The Department filed a motion for summary determination on the grounds that her refund claim was untimely, but Ms. Guffin did not file a response. Thus, the ALJ determined that Ms. Guffin had conceded there were no issues of fact in the case and granted the Department's motion dismissing the claim as untimely. The ALJ did not consider whether Ms. Guffin qualified for special refund authority relief, holding that she had not properly raised that issue.

The Tribunal decision. The Tribunal first concluded that Ms. Guffin had made a sufficient request for relief under the special refund authority in Tax Law § 697(d) because, under the facts she had pleaded in her original petition to the Division, special refund authority relief was the only relief for which she could have qualified. On the substance of the case, however, the Tribunal determined that Ms. Guffin was not entitled to special refund authority relief.

Citing Tax Law § 697(d), the Tribunal stated that Ms. Guffin could only be entitled to special refund authority relief if she paid the 2007 tax "under a mistake of facts." The Tribunal explained that, under New York State precedent, a mistake of facts is "an understanding of the facts in a manner different than they actually are," while a mistake in law exists when there is an "acquaintance with facts as they really are, but a mistaken belief regarding the legal consequences following from those facts." The Tribunal concluded that Ms. Guffin "did not . . . think that tax was due at the time she paid the tax, but rather proceeded under the misguided assumption that she could not take a position in contradiction of the W-2 issued by her employer." Such an assumption, according to the Tribunal, was "clearly a mistake of law" ineligible for special refund authority relief.

Yoell-Mirel Case

Facts. Janet Yoell-Mirel was a New York State resident in 2003. During that year, she sold real property located in New Jersey, resulting in a capital gain. At the time of the sale, no income tax was paid to the State of New Jersey and, following the advice of legal counsel, Ms. Yoell-Mirel did not file a New Jersey income tax return. In April 2004, Ms. Yoell-Mirel timely filed her 2003 New York State resident income tax return, reporting the capital gain from the New Jersey real property sale but claiming no credit for taxes paid to New Jersey, since none were paid.

After receiving letters from the New Jersey Division of Taxation in October 2007 and January 2008, which told Ms. Yoell-Mirel that she must file 2003 New Jersey income tax returns and pay appropriate tax on account of the New Jersey real property sale, in March 2008 she filed a 2003 New Jersey return and paid New Jersey tax. During that same month, Ms. Yoell-Mirel amended her 2003 New York State return to claim a credit for the taxes she paid to New Jersey, and requested a refund. Later in 2008, the Department denied her refund claim as untimely. Subsequent audit adjustments to the basis of the New Jersey real property decreased Ms. Yoell-Mirel's 2003 New Jersey income tax liability, which she reported in a second amended NYS return and refund request filed in July 2011. The Division did not respond to the second refund request, which was thus deemed denied six months later by operation of Tax Law § 689(c)(3). After her request for a conciliation conference was denied as untimely, Ms. Yoell-Mirel appealed to the Division of Tax Appeals contending, among other things, that she was entitled to special refund authority relief.

[U]nder New York State precedent, a mistake of facts is "an understanding of the facts in a manner different than they actually are," while a mistake in law exists when there is an "acquaintance with facts as they really are, but a mistaken belief regarding the legal consequences following from those facts."

The decision. The ALJ differentiated between a mistake of fact and a mistake of law in an analysis similar to that in the *Guffin* decison. The ALJ concluded that Ms. Yoell-Mirel was aware in 2003 of all of the facts surrounding the sale of the New Jersey real property, but was mistaken as to which jurisdiction was entitled to tax the gain on the sale. The ALJ concluded that this mistake was based upon an erroneous interpretation of the law by the taxpayer's legal counsel, and thus Ms. Yoell-Mirel's error on her 2003 New York State return was not a mistake of fact eligible for special refund authority relief.

Additional Insights

Special refund authority relief, outside the usual statute of limitations, is available to personal income taxpayers under Tax Law § 697(d) and to corporate franchise taxpayers under Tax Law § 1096(d). Such relief has rarely been granted, and is often rejected on the basis that a purported mistake in fact is actually a mistake in law. The *Guffin* case is a reminder that taxpayers with potential New York State tax refund claims should consider filing the claims even if all of the supporting documentation

continued on page 5

is not yet available, or else risk having the refund claims held to be time-barred. The *Yoell-Mirel* case highlights the fact that, unlike IRS changes in federal taxable income after audit, which generally can be reported to New York State for purposes of requesting a refund after the statute of limitations has otherwise closed, adjustments made by other states will not reopen the New York State statute of limitations for purposes of claiming credits.

STATE TAX DEPARTMENT ADDS NEW CORPORATE TAX REFORM FAQS

By Irwin M. Slomka

New guidance on the New York State corporate tax reform legislation, set to go into effect for tax years beginning after 2014, has recently been added to the Corporate Tax Reform FAQs that appear on the Department of Taxation and Finance website. http://www.tax.ny.gov/bus/ct/corp_tax_reform.htm. The new FAQs include the following general guidance:

- *Unitary Business*. The Department will consider the "facts and circumstances" in determining whether a corporation acquired by a taxpayer is "instantly unitary."
- *Credit Carryforwards*. Credit carryforwards from years prior to 2015 (other than the minimum tax credit) are not affected by corporate tax reform and can continue to be used in 2015 and thereafter under the same rules as before the law change.
- *Mandatory First Installment of Estimated Tax*. The mandatory first installment of estimated tax starting in 2015 will still be based on the prior year's tax — i.e., the tax prior to corporate tax reform.
- *Corporate Partners*. The aggregate principles applied in taxing a corporate partner deriving a distributive share of partnership income, as well as taxing gain arising from sales of the partnership interest itself, will continue under corporate tax reform.
- *40% Election*. A taxpayer's 40% safe harbor election for attributing interest expense to investment income and other exempt income cannot be overridden by the Department on audit.
- *Income Not Apportionable Under the U.S. Constitution*. The Department has announced that it will not issue guidance explaining the circumstances under which income from debt obligations or other securities cannot be apportioned to the State under the U.S. Constitution.

FINANCE DEPARTMENT ISSUES GUIDANCE ON TREATMENT OF FILM IN THE PROPERTY FACTOR

By Hollis L. Hyans

The New York City Department of Finance ("City Finance") has released a Statement of Audit Procedure ("SAP") to explain its position on whether companies in the business of broadcasting films and television programs may include the value of licensed films and television programming in the property factor of their business allocation percentage. Statement of Audit Procedure GCT-2014-01, *Computation of the Property Factor for Corporations Engaged in the Business of Broadcasting* (N.Y.C. Dep't of Fin., Oct. 2, 2014). City Finance is taking the position that a taxpayer may not include any licensed film, television, or video program in its property factor for general corporation tax ("GCT") purposes for any tax period.

Background. Tangible personal property is included in the property factor of a New York City general corporation taxpayer if the property is owned or rented by the taxpayer. Admin. Code § 11-604(3)(a)(1). New York State's statute is similar and, as acknowledged in the SAP, before 2008 the New York State Department of Taxation and Finance ("State DTF") had long treated film, whether rented or owned, as tangible personal property, and included its value in the property factor. Effective in 2007, the property factor was eliminated under Article 9-A, and a single sales factor method of apportionment was used for purposes of the corporation franchise tax. The following year, the State DTF announced that it would follow a new position for determining the apportionment factor for the MTA surcharge, applied to taxpayers in New York City and nearby counties, which still retained a property factor, and would no longer allow the value of licensed film to be included in the property factor, "since it is not considered to be tangible personal property." *Computation of the MTA Surcharge for Corporations Engaged in the Business of Broadcasting*, TSB-M-08(6)C (N.Y.S. Dep't of Taxation & Fin., June 4, 2008) ("2008 TSB"). The 2008 TSB also stated that licensed film obtained via satellite or over the Internet had "always" been considered an intangible right or license to use property and not includible in the factor.

The State DTF also attempted to exclude licensed film from the property factor for years prior to 2008, but this attempt was rejected in *Meredith Corporation v. Tax Appeals Tribunal*, 102 A.D.3d 156 (3d Dep't 2012). In *Meredith*, the State DTF argued that film transferred via satellite, rather than on tape or other physical media, was not properly includible in the property factor for the years

continued on page 6

1998 through 2000, and relied in part on the unsupported statement in the 2008 TSB-M that film delivered via satellite had always been excluded. The State DTF also argued that all licensed film was an intangible right – an argument in clear conflict with its longtime position of including licensed film in the property factor – and for this position purported to rely on the Appellate Division decision in *Disney Enters., Inc. v. Tax App. Trib.*, DTA No. 818378 (N.Y.S. Tax App. Trib., Oct. 13, 2005), *confirmed*, 40 A.D.3d 49 (3d Dep't 2007), *aff'd. on other grounds*, 10 N.Y.3d 392 (2008). However, in *Disney* the issue was not whether licensed film was includible in the property factor – the case concerned film owned by Disney, which all parties had agreed was included – but rather whether Disney could increase the value of that film from its cost to its fair market value, by using the huge fair market value of the Walt Disney name and characters in licensing transactions as the measure of the value of the film property. The Tax Appeals Tribunal rejected this valuation method, and was affirmed by the Appellate Division, but the company's original inclusion of film in the property factor was not disturbed.

The court in *Meredith* held that licensed film, no matter how it was delivered, was included in the property factor in 1998 through 2000 – implicitly rejecting the State DTF's argument that licensed film was an intangible right – and that the State DTF's position would be an invalid retroactive application of a new policy. Since neither the MTA surcharge nor the years after 2008 was before it, the court did not reach the issue of whether the 2008 policy change was valid prospectively.

New York City's new position. Under its new SAP, City Finance, while acknowledging that since 1982 it has also allowed taxpayers to include the value of films and television programs produced by the taxpayers in the GCT property factor, will not allow the inclusion of any licensed film or video program, regardless of how obtained. City Finance states that, while it had adopted the State DTF's position with regard to owned programming, it has "always" treated licensed film as intangible property. Purporting to rely on the finding in *Meredith* that film transferred by satellite is no different than film transferred on tangible media, City Finance will not allow, prospectively and for all open years, *any* licensed film to be included in the property factor, which remains a part of the City apportionment method through 2017.

Additional Insights

The SAP includes no explanation of why licensed film is treated as intangible property, while film produced by a taxpayer itself is included as tangible property. The statute defining property to be included in the factor clearly covers both owned and rented property. Perhaps recognizing that the *Disney* case, on which the State DTF tried to rely in *Meredith*, contains no such support, the SAP does not cite *Disney* or any other authority for the proposition that films are intangible when licensed but tangible when owned.

The validity of the State DTF's change of position in the 2008 TSB – which City Finance is now adopting – has not been tested in the Division of Tax Appeals or any court, and the 2008 TSB contains no citation or other support for its conclusion that all licensed film became intangible in 2008. Whether any City taxpayers will try to challenge City Finance's new SAP is not yet known, but questions remain as to why owned film should be treated differently from licensed film, since the statute clearly includes both owned and rented property in the property factor.

INSIGHTS IN BRIEF

Tribunal Upholds Dismissal of Petitions

The New York State Tax Appeals Tribunal has affirmed an Administrative Law Judge determination dismissing petitions because (1) they were received by fax transmission and (2) both protested notices had been sustained in separate proceedings. *Matter of Charles L. Kyte*, DTA Nos. 825337 & 825338 (N.Y.S. Tax App. Trib., Oct. 9, 2014). The Tribunal found that, despite being advised on several occasions that petitions filed by fax were not in the proper form, and being offered opportunities to cure the defect, Mr. Kyte failed to respond. The Tribunal also found that both protested notices had been sustained, one in a Tribunal decision and the other in an ALJ determination that was not appealed, and that the validity of the notices could not be relitigated.

Tribunal Upholds Responsible Officer Withholding Tax Penalties, Rejecting Claim That the Assessment Was Untimely

The State Tax Appeals Tribunal has upheld the imposition of withholding tax penalties against a responsible officer of a tax preparation firm who had conceded that he was a responsible person for a portion of the tax periods, but claimed to have no affiliation with the firm prior to purchasing it from his brother during the tax periods. *Matter of Jose L. Taveras*, DTA No. 824348 (N.Y.S. Tax App. Trib., Oct. 9, 2014). The Tribunal noted that the ALJ's determination rested significantly on the lack of credibility of the witnesses, which the Tribunal found no grounds to disturb. The Tribunal also rejected the taxpayer's claim that part of the assessment was barred by the three-year statute of limitations, noting that the three-year limitations period did not apply to responsible-person penalties imposed under Tax Law § 685(g).

continued on page 7

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DuPont v. Michigan
EchoStar v. New York
Express, Inc. v. New York
Farmer Bros. v. California
General Motors v. Denver
GMRI, Inc. (Red Lobster, Olive Garden) v. California
GTE v. Kentucky
Hair Club of America v. New York
Hallmark v. New York
Hercules Inc. v. Illinois
Hercules Inc. v. Kansas
Hercules Inc. v. Maryland
Hercules Inc. v. Minnesota
Hoechst Celanese v. California
Home Depot v. California
Hunt-Wesson Inc. v. California
IGT v. New Jersey
Intel Corp. v. New Mexico
Kohl's v. Indiana
Kroger v. Colorado
Lorillard Licensing Company v. New Jersey
Lorillard Tobacco Co. v. Michigan
McGraw-Hill, Inc. v. New York
MCI Airsignal, Inc. v. California
McLane v. Colorado
Mead v. Illinois
Meredith v. New York
Nabisco v. Oregon
National Med, Inc. v. Modesto
Nerac, Inc. v. New York
NewChannels Corp. v. New York
OfficeMax v. New York
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USV Pharmaceutical Corp. v. New York
USX Corp. v. Kentucky
Verizon Yellow Pages v. New York
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Wendy's International v. Virginia
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