MOFO
NEW YORK TAX INSIGHTS

Volume 6, Issue 12, December 2015

IN THIS ISSUE

NYC Tribunal Rejects Claim That First Amendment Requires Use of Audience Factor for Sourcing Receipts from Credit Ratings
Page 1

Trial Court Dismisses False Claims Act Suit Against Vanguard While Another Suit Against Citigroup Is Unsealed
Page 3

Department of Finance Releases "NYC Taxpayer Bill of Rights"
Page 5

Bulk Sale Assessment Canceled for Failure to Support Audit Methodology
Page 5

Insights in Brief
Page 7

EDITORS

Hollis L. Hyans
hhyans@mofo.com

Irwin M. Slomka
islomka@mofo.com

NEW YORK STATE + LOCAL TAX GROUP

Craig B. Fields
cfields@mofo.com

Paul H. Frankel
pfrankel@mofo.com

Hollis L. Hyans
hhyans@mofo.com

Mitchell A. Newmark
mnewmark@mofo.com

R. Gregory Roberts
rroberts@mofo.com

Irwin M. Slomka
islomka@mofo.com

Michael A. Pearl
mpearl@mofo.com

Rebecca M. Balinskas
rbalinskas@mofo.com

Matthew F. Cammarata*
mcammarata@mofo.com

Eugene J. Gibilaro
egibilaro@mofo.com

Michael J. Hilkin
mhilkin@mofo.com

Nicole L. Johnson
njohnson@mofo.com

Kara M. Kraman
kkraman@mofo.com

Eva Y. Niedbala
eniedbala@mofo.com

* Admitted only in Massachusetts

MORRISON FOERSTER

NYC TRIBUNAL REJECTS CLAIM THAT FIRST AMENDMENT REQUIRES USE OF AUDIENCE FACTOR FOR SOURCING RECEIPTS FROM CREDIT RATINGS

By Irwin M. Slomka

The New York City Tax Appeals Tribunal, reversing an Administrative Law Judge decision, has held that McGraw-Hill does not have a First Amendment right to source its credit ratings receipts for New York City general corporation tax purposes using an "audience-based" methodology similar to that available to publishers and broadcasters. The City Tribunal also rejected McGraw-Hill's claim that the receipts in question were "other business receipts," sourced to where the receipts are "earned," rather than arising from the performance of services and sourced to where the services were performed. *Matter of The McGraw-Hill Companies, Inc.*, TAT(E) 10-19 (GC) *et al.*, (N.Y.C. Tax App. Trib., Oct. 28, 2015).

Facts. McGraw-Hill, through its Standard & Poor's ("S&P") division, operates a credit rating agency to provide ratings, risk evaluations, and investment research. Debt issuers hire S&P to prepare credit ratings for use by investors, intermediaries, and the issuers themselves. S&P employs approximately 1,200 analysts who prepare the ratings. Upon approval by an S&P ratings committee, the ratings are communicated to the issuer, and then usually made public on the S&P website to registered users free of charge. The issuers, rather than the website users or investors, pay S&P for providing the credit ratings, usually based on a percentage of the offering amount, and also pay for follow-up monitoring.

For the tax years 2003 through 2007, McGraw-Hill filed general corporation tax ("GCT") returns, and in its receipts factor treated the credit rating fees of its S&P division as from the performance of services, sourced based on a place-of-performance method. In 2009, McGraw-Hill filed amended GCT returns, requesting refunds for those years totaling approximately $35 million. The refund claims were based on sourcing the credit rating receipts, which McGraw-Hill now reported as "other business receipts," to "customer" locations. The Department of Finance ("Department") disallowed the refund claims on the grounds that the credit rating fees were from the performance of services, sourced based on where the services were performed. McGraw-Hill filed its 2008 GCT return consistent with the

continued on page 2

Attorney Advertising

receipts factor reported in its amended returns and, following an audit, the Department issued a Notice of Determination for $3.2 million, also sourcing the credit rating fees based on place of performance.

ALJ decision. After an administrative hearing, in February 2014 the Chief ALJ held that, on First Amendment grounds (pertaining to freedom of the press), McGraw-Hill was entitled to a discretionary adjustment to source its credit rating receipts using an audience-based allocation methodology. The Chief ALJ held that as a financial information publisher, McGraw-Hill's S&P division "was entitled to the same [First Amendment] protections afforded other members of the press." She cited *McGraw-Hill, Inc. v. State Tax Commission*, 75 N.Y.2d 852 (1990), where the Court of Appeals affirmed a decision of the Third Department, holding that the State of New York could not for Article 9-A purposes source McGraw-Hill's revenues from advertisements in its magazines based on place of performance because this represented differential treatment between the print media and the broadcast media, in violation of the First Amendment. She also concluded that S&P's credit rating fees constituted "other business receipts" under Admin. Code §11-604(3)(a)(2).

Tribunal decision. The City Tribunal reversed the Chief ALJ's decision, and in doing so rejected each of McGraw-Hill's three principal arguments. First, the Tribunal held that the denial of use of an audience method did not violate McGraw-Hill's First Amendment rights. It addressed the First Amendment implications of the U.S. Supreme Court decision in *Leathers v. Medlock*, 499 US 439 (1991), which rejected a First Amendment challenge to application of an Arkansas gross receipts tax on a cable television provider's sales and services, even though receipts from subscriptions and over-the-counter sales of newspapers and magazines were exempt. The Tribunal concluded that, under *Leathers v. Medlock*, the First Amendment only bars disparate taxation based on the content of a taxpayer's speech. According to the Tribunal, McGraw-Hill did not show that it was similarly situated to broadcasters and publishers such that the denial of use of the audience method resulted in unconstitutional discrimination based on content. The Tribunal also distinguished the 1990 Article 9-A *McGraw-Hill* decision, decided on First Amendment grounds, finding that it was limited to advertising receipts and has no application to the sourcing of credit rating receipts.

McGraw-Hill also argued that S&P's credit rating receipts constituted "other business receipts," and not receipts from the performance of services, contending that they were "generated through the creation and communication of financial commentary to an audience." The City Tribunal disagreed, concluding that McGraw-Hill was compensated for its work in generating the ratings—which involved substantial investigation and analysis—and made its credit ratings available to users free of charge. Thus, the receipts in question were found to be from the performance of services.

According to the Tribunal, McGraw-Hill did not show that it was similarly situated to broadcasters and publishers such that the denial of use of the audience method resulted in unconstitutional discrimination based on content.

Finally, McGraw-Hill asserted that sourcing based on a place of performance method resulted in an improper reflection of McGraw-Hill's activities in New York City, and claimed that the City Tribunal should exercise discretionary authority and apply an audience-based method to more fairly allocate the credit rating fees. According to the Tribunal, McGraw-Hill did not establish that the sourcing of credit rating receipts based on the location of the S&P analysts who worked on the ratings did not properly reflect McGraw-Hill's activities in the City. Moreover, the Tribunal concluded that there was insufficient evidence to support a conclusion that the location of visitors to the S&P free website—the "customers" that McGraw-Hill used for its audience-based methodology—was a more reasonable means of sourcing those receipts.

Additional Insights

To a large extent, the City Tribunal's reversal is predicated on its conclusion that McGraw-Hill is not similarly situated to broadcasters and publishers with respect to its S&P credit rating services, and therefore the First Amendment was not implicated in this case. The Tribunal's decision may be appealed to the New York courts, as McGraw-Hill successfully did previously in pursuing its First Amendment constitutional challenge under Article 9-A with respect to its advertising receipts. If the decision stands, its impact under the new Article 3-A tax—which generally provides for the sourcing of receipts based on where the customer "derives the benefit"—is not entirely clear since S&P's paying "customer" is the issuer or intermediary, not the party viewing the ratings on the S&P web site.

continued on page 3

One interesting question presented is whether the City Tribunal has the authority to exercise the discretionary authority to adjust the receipts factor. Because it did not agree with the substance of McGraw-Hill's position urging the exercise of the Department's discretionary authority to apply the audience-based method, the Tribunal declined to address the claim that McGraw-Hill could not request such an exercise for the first time "on exception." While it is subject to dispute whether McGraw-Hill first sought such relief "on exception" —McGraw-Hill appears to have made such a request through an earlier aborted letter ruling request—the decision is a reminder that taxpayers should claim discretionary relief either during the audit process or at conciliation to avoid such a potential impediment.

TRIAL COURT DISMISSES FALSE CLAIMS ACT SUIT AGAINST VANGUARD WHILE ANOTHER SUIT AGAINST CITIGROUP IS UNSEALED

By Michael J. Hilkin

A trial court judge granted Vanguard Group, Inc.'s motion to dismiss a *qui tam* action filed by its former in-house tax counsel under New York's False Claims Act, on the basis that the in-house counsel violated the rules of attorney professional conduct in bringing the action. *State of New York ex rel David Danon v. Vanguard Group, Inc. et al.*, No. 100711/13 (N.Y. Sup. Ct., N.Y. Cnty. Nov. 13, 2015). Meanwhile, another New York *qui tam* action was recently unsealed, alleging that Citigroup wrongly claimed net operating loss deductions on its New York bank tax returns, even though such NOL deductions were related to deductions that were approved by the Internal Revenue Service. *State of New York ex rel Eric Rasmusen v. Citigroup, Inc.*, No. 100175/13 (N.Y. Sup. Ct., N.Y. Cnty. Jan. 24, 2013), *removed to federal court*, No. 15-cv-7826 (S.D.N.Y.Oct. 2, 2015).

Vanguard Case

Facts. As discussed in the September 2014 issue of *New York Tax Insights*, David Danon, a New York and Pennsylvania licensed attorney, filed a *qui tam* action against Vanguard Group, Inc. ("Vanguard") in 2013. Mr. Danon alleged that Vanguard has "operated as an illegal tax shelter for nearly forty years," arguing that Vanguard did not file tax returns before 2011, despite having nexus in New York; that, when Vanguard did begin filing returns, it did not follow New York's shareholder sourcing rules for apportionment; and that Vanguard "violate[d]" Tax Law § 211.5 and Internal Revenue Code § 482 by providing services to related parties—the Vanguard group of mutual funds—at artificially low prices. Mr. Danon also alleged that Vanguard entities conspired to fail to pay required taxes, and that he was retaliated against by being demoted and discharged. Mr. Danon sought damages of 25 to 30 percent of the proceeds of the action or settlement of the claims in his complaint. The New York State Attorney General ("AG") declined to convert the *qui tam* action into a civil enforcement action, so Mr. Danon continued to bring the action with the assistance of private counsel.

Vanguard moved to dismiss Mr. Danon's complaint, arguing, among other things, that: (1) Mr. Danon and his counsel should be disqualified from the action because Danon violated his duty of loyalty and confidentiality to Vanguard under New York's Rules of Professional Conduct applicable to attorneys ("Attorney Conduct Rules" or "Rules"); (2) Mr. Danon did not make proper retaliation or conspiracy claims; and (3) Vanguard did not knowingly submit a false claim to New York.

The Decision. The trial court dismissed Mr. Danon's action and disqualified Danon's counsel from bringing any subsequent related action. The court determined that Mr. Danon violated two Attorney Conduct Rules, Rules 1.6 and 1.9(c), under which "[a] lawyer shall not knowingly reveal confidential information . . . or use such information to the disadvantage of a [current or former] client or for the advantage of the lawyer or a third person." The court concluded that an exception to those Rules, allowing disclosure of confidential information "to prevent [a] client from committing a crime," was not applicable.

The court relied on *U.S. v. Quest Diagnostics Inc.*, 734 F.3d 154 (2d Cir. 2013), a case affirming the dismissal of a *qui tam* action under the federal False Claims Act brought by plaintiff entity with a general partner who was previously in-house general counsel for the defendant, with allegations based on confidential information obtained through the counsel's previous employment. The court in *Quest* rejected the argument that counsel did not violate the Attorney Conduct Rules because disclosure was necessary to prevent the commission of a crime, finding that the federal False Claims Act did not preempt attorney conduct rules, and that the plaintiff's disclosures went beyond what was necessary to prevent any alleged crime of the defendant.

Applying *Quest*, the court in *Vanguard* found that, even if Mr. Danon reasonably believed Vanguard intended to continue committing a crime, he had alternate means of preventing the alleged tax violations, including by providing Vanguard documents to the IRS, the

continued on page 4

Securities and Exchange Commission, and the AG—as Mr. Danon did prior to bringing his action. The court also highlighted allegations by Mr. Danon that were unrelated to an asserted ongoing crime, including alleged tax violations from 1999 and 2004, finding that the disclosures went well beyond those necessary to prevent a crime.

[T]he court in *Vanguard* found that, even if Mr. Danon reasonably believed Vanguard intended to continue committing a crime, he had alternate means of preventing the alleged tax violations.

The court also dismissed Mr. Danon's retaliation claim, finding among other things that Mr. Danon's internal complaints to Vanguard regarding its tax practices did not constitute "protected activity" under the New York False Claims Act ("New York FCA"). Separately, the court dismissed Mr. Danon's conspiracy claim on the basis that related entities cannot conspire to violate the New York FCA. However, the court made "no determinations as to the merits, or lack thereof" of Mr. Danon's allegations in general, and stated that the dismissal would not prevent a New York State agency from pursuing the allegations made by Danon.

Citigroup Case

A recently unsealed *qui tam* action brought by Indiana University professor Eric Rasmusen alleges that Citigroup failed to pay approximately $800 million in New York bank tax between 2010 and 2012 because the bank improperly deducted NOLs from taxable income "after undergoing ownership changes resulting from the federal government's purchase and sale" of Citigroup stock.

During the years at issue, New York allowed a bank to deduct NOLs from its taxable income, and such NOL deduction was "presumably" the same as the federal NOL deduction calculated under the IRC, with certain modifications. Former Tax Law § 1453(k-1). IRC § 382 limits a corporation's ability to use its NOL carry forwards after the corporation experiences an "ownership change." The policy purpose of § 382 is to prevent NOLs from being used to reduce taxes for corporate shareholders that did not actually bear the corporation's losses.

According to Mr. Rasmusen, Citigroup had two ownership changes for purposes of § 382, the first in 2008 when the U.S. Treasury purchased equity in Citigroup as part of the Troubled Asset Relief Program, and the other in 2010 when the U.S. Treasury sold its Citigroup equity. The IRS released three Revenue Notices stating that the § 382 limitation would not be triggered by the U.S. Treasury's purchase and sale of stock, but Rasmusen's complaint alleges that 2009 federal legislation expressly forbid the "special rules" provided in the Revenue Notices, and that Citigroup wrongfully relied on the Revenue Notices in calculating its federal and New York NOL deductions.

Like in the *Vanguard* case, the AG declined to convert Mr. Rasmusen's claim into a civil enforcement action, so he continued to pursue the case in his own name with the assistance of a New York law firm. The complaint was unsealed this year, and Citigroup has filed a notice to remove the case to federal court on the grounds that Mr. Rasmusen's claims require "resolution of a substantial question of federal law." In its filing for removal, Citigroup repeatedly highlighted that the Revenue Notices directly contradict Mr. Rasmusen's "dubious" claims.

Additional Insights

While the *Vanguard* decision acknowledges that there is no "absolute bar" to an attorney bringing a *qui tam* action against a client, it also affirms that an attorney who violates New York's Attorney Conduct Rules in bringing such an action will not be allowed to go forward with (and potentially profit from) attorney-client confidences. Further, the dismissal of Mr. Danon's wrongful termination action on summary judgement may suggest that the New York courts will be wary towards wrongful termination claims brought by attorneys against their employer-clients in the context of New York FCA actions.

Press reports indicate that Mr. Danon intends to appeal the dismissal of his New York action, and also that he has received a payment in connection with a Texas audit of Vanguard based on information he provided to that state's taxing authority.

In connection with the *Citigroup* action, Mr. Rasmusen has stated in published articles that he brought his action against Citigroup under the New York FCA because he could find no way to challenge Citigroup's federal tax filings or to force the U.S. Treasury to collect taxes that the IRS had decided were not due. The action raises the troubling possibility that the New York FCA could be used to force companies to litigate tax issues that are primarily federal in nature, and to do so in circumstances where the company obtained and adhered to formal federal advice.

continued on page 5

DEPARTMENT OF FINANCE RELEASES "NYC TAXPAYER BILL OF RIGHTS"

By Irwin M. Slomka

The New York City Department of Finance has released a new "NYC Taxpayer Bill of Rights" on its website. The Bill of Rights identifies 10 categories of taxpayer rights, and elaborates on those rights. Some of the rights reflect substantive changes in the Department's operations. For instance, one category is "the right to challenge the Department's position and be heard." Under that category, taxpayers now "have the right to receive, in writing, an explanation of why the Department of Finance does not agree with your position" or "does not accept your documents." The release of the new NYC Bill of Rights coincides with the creation of an Office of the Taxpayer Advocate and the recent appointment of Diana Leyden as the New York City Taxpayer Advocate.

The NYC Taxpayer Bill of Rights is a welcome and overdue initiative. Interestingly, the Department previously had a Taxpayer Bill of Rights for many years, but it inexplicably was removed from the Department's website a few years ago, causing some practitioners to wonder why. Unlike the more comprehensive Taxpayers' Bill of Rights contained in Article 41 of the Tax Law, which applies to taxes administered by the New York State Department of Taxation and Finance, the NYC Taxpayer Bill of Rights is not statutorily mandated. Committing it to law would be a worthwhile goal.

It is also interesting that certain rights in the former NYC Bill of Rights are changed in the new Bill of Rights. For instance, there is no longer an explicit right not to be subject to "collection quotas" by the Department. Also, under the former Bill of Rights, the only exception to the taxpayer's right to confidentiality was that taxpayer information could be shared with certain other government agencies "under strict legal guidelines." The new right to confidentiality contains an exception for taxpayer information that can be shared outside the Department as "allowed by law," but does not specify what those statutory exceptions are.

BULK SALE ASSESSMENT CANCELED FOR FAILURE TO SUPPORT AUDIT METHODOLOGY

By Hollis L. Hyans

A New York State Administrative Law Judge has held that an assessment against the purchaser of a restaurant arising out of an alleged bulk sale transaction should be cancelled because, while there had been a bulk sale, there was no evidence of a pre-existing tax liability on the part of the seller rather than his son, and even if there had been, the Department did not establish a rational basis for the underlying assessment. *Matter of Chang Liu Jiang*, DTA No. 826063 (N.Y.S. Div. of Tax App., Oct. 15, 2015).

Facts. Mr. Chang Liu Jiang, the petitioner, doing business as Sky Wok Chinese Restaurant, entered into a six-year lease agreement with Mr. Banke Tung as landlord for a premises in Brooklyn where he intended to operate a Chinese take-out restaurant. He heard of the opportunity from Mrs. Tung, the landlord's wife. The premises were fully equipped with appliances and equipment that could be used to operate the business. Petitioner has formerly operated his own nearby restaurant, and was interested in this lease as a "turnkey" business opportunity. He applied for and received a sales tax certificate of authority, and on his application identified the date the business would begin as March 1, 2012, the same date his tenancy began.

In November 2012, the Department's Bulk Sale Unit received a written communication from a Tax Compliance Agent that a bulk sale had occurred between petitioner and Mr. Fan Chuen Tung, the son of Banke Tung and the manager of the former restaurant located at the same address. The communication noted that the name of petitioner's business was New Sky Wok Kitchen, and the former business operated by Fan Chuen Tung had been called Sky Wok Garden Restaurant. No source for the information concerning the alleged bulk sale was identified, and no equipment list, inventory of the business, sales price, or appraisal of assets was provided. The agent did not indicate he had visited the premises or spoken with the alleged seller or buyer. No bulk sale notice had been filed by any party.

On December 4, 2012, the Bulk Sales Unit sent petitioner a request for more information and a warning that if he did not reply within 20 days, his liability for tax, penalties, and interest would be determined based on "'all available information.'" In response to the letter, the Bulk Sale Unit received, first, a phone call from an accounting firm

continued on page 6

"allegedly" representing petitioner advising that no bulk sale had occurred, and then a letter from petitioner in an envelope from the accounting firm stating that his business was a take-out restaurant that he leased from the landlord, and that he had not paid any consideration for or bought the business from the former occupant of the space. No documentation was provided.

The Bulk Sale Unit determined that a bulk sale had occurred because the two businesses were virtually identical, located at the same address, used the same telephone number, and had similar names. They also had the same accounting firm and reported similar sales, and no documentation had been provided of the "purchase of the business assets and inventory."

The Department had offered no evidence of any external index it may have relied upon to determine the seller's liability, produced no witness or documents to explain the audit methodology, and gave the petitioner no "opportunity to meaningfully question the audit performed or the derivative liability asserted."

There was an outstanding sales tax assessment against the alleged "seller," Fan Chuen Tung. Since petitioner failed to provide evidence that no bulk sale had occurred, or proof of the value of the assets allegedly "purchased," the Bulk Sale Unit issued a Notice of Determination assessing estimated tax against petitioner for the "seller's" sales tax.

At the hearing, petitioner explained that the name of the restaurant, chosen by the landlord, was deliberately similar to the former name to attract customers. He testified that the equipment at the premises, while functioning, was heavily used and worn, and that he purchased food inventory and supplies himself with cash. He paid monthly rent to the landlord which included utilities, consistent with the terms of the lease. In August 2013, he surrendered possession of the premises back to the landlord.

ALJ Decision. The ALJ first reviewed the bulk sale provisions of Tax Law § 1141, which require the purchaser to give notice at least ten days before taking possession or making payment, and then affords the purchaser protection against liability for the seller's unpaid sales tax obligations. A "bulk sale" includes a sale or transfer "in bulk of any part or the whole of business assets," and the term "sale" can include a lease. Here, the ALJ found that the petitioner leased the premises for a specific consideration, including tangible property necessary to operate a take-out restaurant. Therefore, the transaction constituted a bulk sale. However, the "seller" was not Fan Chuen Tung, who had been the manager of the previous restaurant, but Banke Tung, the landlord who actually transferred the business assets to petitioner along with the premises. The Department "offered no evidence of a sale between Fan Chuen Tung and petitioner," and the ALJ found that petitioner credibly testified he had learned of the opportunity from Mrs. Tung, leased the premise from Banke Tung, and received the equipment for the operation of the business from Banke Tung. Since the only bulk sale that occurred arose from the lease, the bulk sale seller was Banke Tung, and no sales and use taxes were due from Banke Tung; the assessment was based on taxes allegedly owed by his son, Fan Chuen Tung.

In addition, the ALJ found that even if there had been a bulk sale between Fan Chuen Tung and petitioner, the Department had not established a rational basis for issuance of the Notice of Determination, which indicated that it was estimated. The Department had offered no evidence of any external index it may have relied upon to determine the seller's liability, produced no witness or documents to explain the audit methodology, and gave the petitioner no "opportunity to meaningfully question the audit performed or the derivative liability asserted." In the absence of any such evidence, the ALJ concluded the assessment lacked a rational basis and canceled it.

Additional Insights

As described by the ALJ, the basis for the Notice of Assessment seems remarkably slim, relying as it did on surface similarities between the two businesses, including use of similar names at the same address, use of the same accounting firm, and reports of similar sales volumes. The lease agreement was entered into with Banke Tung as landlord, and the premises were later surrendered back to Banke Tung, with no apparent involvement by his son, who had the allegedly outstanding sales and use tax liability. Unlike most reported decisions, where the Department offers evidence of the method it used to compute liability, including reliance on external indices in the absence of adequate records, here the ALJ found no such support for the underlying assessment, noting that "it was incumbent upon the Division to identify the external index it used to establish a rational basis for the audit methodology" and that no such information had been provided. Under those circumstances there was nothing to justify an assessment.

continued on page 7

INSIGHTS IN BRIEF

Denial of Sales Tax Refunds Upheld Where Taxpayer Did Not Pay the Entire Tax After Earlier Consent to Audit Adjustments

A taxpayer that previously consented to proposed sales tax audit changes could not claim a credit or refund for the same period since it waived its right to contest the amount of any tax by failing to pay the full amount of the tax and file its refund claim within two years of such payment. *Matter of A-1 Premier Scaffolding, LLC*, DTA No. 825878 (N.Y.S. Div. of Tax App. Nov. 12, 2015). According to the Administrative Law Judge, the fact that the Department, in denying the refund claim, failed to recognize that full payment was a necessary precondition to the taxpayer's refund claim was of no consequence, since Tax Law § 1139(c) prohibited the refund application altogether.

Tribunal Affirms Denial of Charitable Deduction and Inclusion of Income Items

The New York State Tax Appeals Tribunal has upheld the decision of an Administrative Law Judge that a claimed charitable deduction was properly denied as unsubstantiated, and that certain amounts either included in salary reported on a W-2 or reported as miscellaneous income on a federal Schedule C must be included in New York taxable income. *Matter of Rabbi Milton Balkany and Sara Balkany*, DTA No. 823424 (N.Y.S. Tax App. Trib., Oct. 28, 2015). Rabbi Balkany claimed to have paid amounts to vendors and other obligees of a religious school for which he worked, and argued that other amounts owed to him by a third party were similarly paid to creditors of the religious school for its benefit. The Tribunal denied the deductions in the absence of any documentation, such as canceled checks or receipts from the charitable organization, noting that IRC § 170(a) requires a contemporaneous written acknowledgment by the organization for any contribution of $250 or more, and that even under the "less stringent" recordkeeping requirements of Treas. Reg. § 1.170A-13(a)(1), the proffered records were "grossly incomplete," and the ALJ had found the taxpayer's testimony "'completely unreliable.'"

Third Department Affirms Decision Dismissing Challenge to Fraud Penalty for Failure to Protest Within 30 Days

Rejecting an attempt to apply the doctrine of estoppel against the Department of Taxation and Finance, the Appellate Division, Third Department, has upheld a decision of the Tax Appeals Tribunal that the taxpayer's protest of a notice of deficiency asserting a fraud penalty had not been timely filed. *Ryan v. Tax App. Trib.*, No. 518257, 2015 N.Y. Slip Op. 08012 (3rd Dep't, Nov. 5, 2015). After pleading guilty to failing to pay income taxes for 2002 through 2007 and paying restitution, Mr. Ryan received a notice of additional liability dated October 19, 2011, asserting a fraud penalty, but failed to request a conciliation conference within 30 days as is required under Tax Law § 170 (3-a)(h) when a fraud penalty is asserted. He argued that the Department should be estopped from raising the 30-day deadline because the letter advising him of the additional liability stated that he had 90 days to request a conciliation conference. The Third Department rejected the argument, finding that the doctrine of estoppel does not apply in tax cases unless there is "manifest injustice," and that there could not have been any confusion since the notice clearly stated in boldface type the actual due date to protest of November 18, 2011.

Notice and Demand for Payment of Tax Due Does Not Give Rise to a Hearing Right

In *Matter of Euphoria Palace, Inc.*, DTA No. 827006 (N.Y.S. Div. of Tax App., Nov.12, 2015), a New York State Administrative Law Judge found that no administrative hearing was available to contest notices and demands for payment of tax due that had been issued by the Department of Taxation and Finance. In response to two notices and demands for payment of sales and use tax, interest, and penalty, Euphoria Palace filed a petition for a hearing with the Division of Tax Appeals, and opposed the Department's motion to dismiss for lack of jurisdiction, claiming that Euphoria Palace had never been served with a notice of determination, and that it should be permitted to proceed without payment because the Department had assessed "excessive penalties and interest without sending the notices" to it. The ALJ found that the notices were issued based upon Euphoria Palace's failure to pay sales and use tax indicated as due on its returns as filed, and that, under Tax Law § 173-a, applicable to notices and demands issued on or after December 1, 2004, taxpayers are not entitled to a hearing in response to such notices.

continued on page 8

CHAMBERS USA 2015

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

LEGAL 500 US 2015

- Domestic Tax
- Nationwide: Tax Controversy

U.S. NEWS – BEST LAWYERS® - BEST LAW FIRMS 2016

- Law Firm of the Year: Litigation - Tax
- National: Litigation – Tax (Tier 1)
- National: Tax Law (Tier 1)
- New York: Litigation – Tax (Tier 1)
- New York: Tax Law (Tier 1)
- Sacramento: Litigation – Tax (Tier 1)
- San Francisco: Litigation – Tax (Tier 1)
- San Francisco: Tax Law (Tier 1)
- Washington, D.C: Tax Law (Tier 1)

LAW360

- 2013 Tax Practice Group of the Year

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."

LEGAL 500 2013

"ONE OF THE BEST NATIONAL FIRMS IN THE AREA OF STATE INCOME TAXATION."

CHAMBERS 2012

"MOFO HAS THE TOP STATE AND LOCAL TAX PRACTICE IN THE COUNTRY. THE LAWYERS KNOW THEIR SUBJECT MATTER AND ALWAYS GET MY COMPANY GREAT RESULTS."

To ensure compliance with requirements imposed by the IRS, Morrison & Foerster LLP informs you that this publication has been prepared for general informational purposes only. None of the statements made herein constitute financial, accounting, tax or other professional advice of any kind. Please consult with your own advisors to discuss matters relevant to your specific situation. If you wish to change an address, add a subscriber, or comment on this newsletter, please email Hollis L. Hyans at hhyans@mofo.com, or Irwin M. Slomka at islomka@mofo.com, or write to them at Morrison & Foerster LLP, 250 West 55th Street, New York, New York 10019-9601.

© 2015 Morrison & Foerster LLP

MORRISON
FOERSTER

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 varied 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.

©2015 Morrison & Foerster LLP