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Inside

New York State Administrative Law Judge Rejects Forced Combination and State's Attack on Taxpayer's Transfer Pricing

By Paul H. Frankel, Irwin M. Slomka & Behir A. Sabban

A New York State administrative law judge ("ALJ") has issued a determination rejecting an attempt by the New York State Department of Taxation and Finance to forcibly combine an out-of-state manufacturing corporation with its in-state affiliated distribution company for New York State corporation franchise tax purposes, finding that the taxpayer successfully proved that its intercompany pricing was consistent with Internal Revenue Code § 482 principles. The ALJ held that the taxpayer successfully rebutted a presumption of distortion by showing that its intercompany pricing, which was consistent with a contemporaneous transfer pricing study and supported by the testimony and reports of its expert witness, was in accordance with § 482. *In re Hallmark Marketing Corporation*, DTA No. 819956 (N.Y.S. Div. of Tax App. Jan. 26, 2006).

Hallmark Cards, Inc. is engaged in the design, manufacture and sale of social expression products, all of which is conducted outside New York State, principally in Missouri and Kansas. Its subsidiary, Hallmark Marketing Corp., was its exclusive sales agent in the United States. Hallmark Marketing

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After taking no action on the § 482 report for 15 months, and with the statute of limitations about to expire, the State's auditor determined that the report was "weak," and the State forcibly combined Hallmark Cards with Hallmark Marketing.

purchased the social expression products from Hallmark Cards and then sold them principally to third-party retailers throughout the United States, including New York State, in its role as a distributor. The purchase price was set based on a contemporaneous transfer pricing study ("§ 482 report") prepared by a CPA firm. The § 482 report employed the comparable profits method ("CPM"), one of the prescribed valuation methods under the § 482 Treasury regulations. An arm's-length price was arrived at by analyzing the profits earned by comparable uncontrolled companies similar to Hallmark Marketing, and setting the price so that Marketing's profitability would be consistent with that of the comparable companies.

Hallmark Marketing filed its own New York State corporate tax return and, having set its intercompany pricing consistent with the § 482 report, did not file a New York combined return with Hallmark Cards.

During the course of the State's audit of Hallmark Marketing's corporate tax return, the taxpayer gave the auditor a copy of the § 482 report to show there was no distortion in its having filed a separate return without Hallmark Cards. After taking no action on the § 482 report for 15 months, and with the statute of limitations about to expire, the State's auditor determined that the report was "weak," and the State forcibly combined Hallmark Cards with Hallmark Marketing. (New York State does not have an advance pricing program that would allow a taxpayer to obtain advance approval of its intercompany pricing.)

Under the New York Tax Law and regulations, in order for a corporation to be required to file on a combined basis with another corporation, three elements must be present: (i) substantial ownership; (ii) a unitary relationship between the corporations; and (iii) distortion of the taxpayer's New York income by filing on a separate company basis. Only the distortion element was in issue in *Hallmark Marketing*. The regulations create a presumption of distortion when the related entities engage in substantial intercorporate transactions. The New York State Tax Appeals

Tribunal has consistently held that this presumption may be rebutted by proof that the intercompany transactions are at arm's-length, such as by showing they are consistent with § 482 principles. *See, e.g., Matter of Silver King Broadcasting of N.J., Inc.,* DTA No. 812589 (N.Y.S. Tax App. Trib., May 9, 1996); *Matter of New York Times Co.*, DTA No. 809776 (N.Y.S. Tax App. Trib., Aug. 10, 1995); *Matter of Sears, Roebuck & Co.*, DTA No. 801732 (N.Y.S. Tax App. Trib., Apr. 28, 1994); *Matter of Medtronic, Inc.*, DTA No. 800306 (N.Y.S. Tax App. Trib., Sept. 23, 1993).

At the hearing, the State's two expert witnesses — both of whom had testified for the State in other cases where forced combination was upheld — testified that the taxpayer's § 482 report was flawed. The experts did not themselves perform a functional analysis or otherwise prepare a transfer pricing report to arrive at what they considered a fair price. Instead, they attempted to raise doubts on the reliability of the taxpayer's proof. The ALJ held that the taxpayer rebutted the presumption of distortion because the § 482 report conclusively established that the intercompany transactions were conducted at arm's-length prices.

Upcoming Conferences

Following is a list of SALT conferences through July 31, 2006, in which Morrison & Foerster attorneys will be participating.

MARCH 3, 2006
COST Sales Tax Conference
Tuscon, AZ
Paul H. Frankel

MARCH 13, 2006
Houston TEI School
Houston, TX
Paul H. Frankel and Craig B. Fields

MARCH 14, 2006
Morrison & Foerster: Annual SALT Conference "East"
New York, NY
Craig B. Fields, Paul H. Frankel, Hollis L. Hyans, and Irwin M. Slomka

MARCH 27-31, 2006
ABA-IPT Advanced Income Tax Seminar
Atlanta, GA
Paul H. Frankel, Charles J. Moll, and Craig B. Fields

APRIL 4, 2006
Morrison & Foerster: Annual SALT Conference "West"
San Francisco, CA
Eric J. Coffill, Hollis L. Hyans, Peter B. Kanter, Charles J. Moll, and Thomas H. Steele

APRIL 24, 2006
TEI School
Dallas, TX
Paul H. Frankel

MAY 2, 2006
Energy Tax Association, 2006 Annual Meeting
Lake Charles, LA
Craig B. Fields

MAY 3, 2006
PLI Program on State & Local Taxation
New York, NY
Hollis L. Hyans, Chair, and Thomas H. Steele

MAY 4, 2006
COST Income Tax Conference
Atlanta, GA
Paul H. Frankel

MAY 4-6
American Bar Association Section of Taxation
Washington, DC
Charles J. Moll

MAY 5, 2006
New England TEI State Tax Day
Boston, MA
Paul H. Frankel

MAY 17, 2006
Georgetown Advanced State and Local Tax Conference
Washington, DC
Hollis L. Hyans

MAY 19, 2006
Georgetown Advanced State and Local Tax Conference
Washington, DC
Paul H. Frankel

MAY 22, 2006
COST Income Tax Conference
Philadelphia, PA
Paul H. Frankel

MAY 24, 2006
Denver TEI State Tax Day
Denver, CO
Paul H. Frankel

JUNE 22, 2006
Deloitte & Touche Center for Multi-state Taxation, 10th Annual Multi-state Tax Institute
Milwaukee, WI
Paul H. Frankel and Craig B. Fields

JULY 11, 2006
New York University
New York, NY
Charles J. Moll

One of the State's expert witnesses claimed that Hallmark Marketing performed many activities beyond that of a traditional "distributor." In particular, he testified that Hallmark Marketing was responsible for creating "retail and brand equity" in the Hallmark name through, among other things, its distribution network and its skilled workforce. The ALJ found that the record did not support a conclusion that Marketing held nonroutine intangible organizational assets, noting that those assets were part of the creative function performed by Hallmark Cards, not Hallmark Marketing. The ALJ found material flaws in the witness' failure to differentiate between theoretical economic theory and the legal reality that Hallmark Marketing itself did not perform some of the functions that the expert claimed it performed, and rejected the expert's theory as speculative. He also pointed out that the State's expert repeatedly misconstrued the crucial role played by Hallmark Cards in its role in designing greeting cards, advertising, and owning and controlling the Hallmark trademarks. According to the ALJ, the expert's failure to distinguish between the activities of the respective legal entities resulted in incorrect conclusions on whether Hallmark Marketing actually created value that it allegedly was not being compensated for.

The State's experts attacked each of the comparables selected for the § 482 report, claiming that Hallmark Marketing was more than a mere distributor, that the comparables were not of a comparable size, and that certain comparables operated in foreign markets. The ALJ rejected these attacks, noting the various steps taken by the CPA firm in carefully selecting the comparables. He pointed out that the study employed adequate screens for size and that the comparable companies that operated in foreign markets also operated in the U.S. market. Moreover, the additional functions allegedly performed by Hallmark Marketing were the type of value-added services one would expect from any high-volume distributor.

The ALJ pointed out that while the Tax Appeals Tribunal in *In re Tropicana Product Sales, Inc.* (N.Y.S. Tax App. Trib., June 12, 2000) acknowledged the importance of carefully chosen comparables, he found the facts in the instant case to be clearly distinguishable from those in *Tropicana*. First, he found that Hallmark used a sophisticated transfer pricing methodology that it continually updated. Moreover, the § 482 report used by Hallmark Marketing to set the transfer price was a far more exacting

The State's experts attacked each of the comparables selected for the § 482 report, claiming that Hallmark Marketing was more than a mere distributor, that the comparables were not of a comparable size, and that certain comparables operated in foreign markets.

and thorough mechanism than the report in *Tropicana*. Finally, unlike in *Tropicana*, the § 482 report was contemporaneous and was given to the State during the audit, not shortly before the hearing.

Perhaps most important was the ALJ's recognition that the central inquiry was whether the taxpayer's intercompany pricing was "consistent with the *reasonable and flexible approach* suggested by IRC § 482, which recognizes the difficulty taxpayers face when trying to meet an arm's-length standard." (Emphasis added.) In rejecting an approach that would otherwise impose an all but impossible burden for proving adherence to § 482 principles -- and a standard that would likely exceed the standards actually employed by the Internal Revenue Service -- the determination shows that reasonable adherence to § 482 principles should avoid forced combination. ■

This article appeared in State Tax Notes.

Paul Frankel and Irwin Slomka represented Hallmark Marketing in this case.

Assessment Appeals Board Finds Cost Does Not Equal Value for the San Francisco Giants' Possessory Interest in SBC Park

By Peter B. Kanter & Troy M. Van Dongen

The San Francisco Assessment Appeals Board ("Board") issued its findings of fact for assessment appeals brought by the San Francisco Giants challenging the 2001, 2002, and 2003 assessments of the team's possessory interest in SBC Park. While the case involved many issues that are unique to the assessment of major league ballparks, the Board ultimately resolved the difficulties by relying on the fundamental appraisal principle that cost does not necessarily equal value. The Board's decision, as described in this article, recognized that when there is substantial evidence that the market in general will not pay what a particular taxpayer has paid to develop a property, the cost approach is not a reliable indicator of value because it ignores the discrepancy between the historical cost and what typical investors in the marketplace would be willing to pay. In addition, the Board's decision recognized that for properties that are usually developed through a partnership of public and private financing, the total costs of the project do not reflect the assessable value of the private possessory interest in that property.

Without question, major league ballparks are unique special purpose properties. Only 30 such properties are currently in use by major league baseball teams, and since the cost to develop such properties can be prohibitive, these projects are usually undertaken as joint endeavors between the team and the local governmental entities. Indeed, during the hearing on the assessment of SBC Park, the parties presented evidence showing that the costs of constructing major league ballparks on average are split 70/30, with local governments paying roughly 70 percent of the development costs and the teams picking up the balance. As noted by the Board, based on the evidence presented at the hearing, the reason communities pay such a significant portion of the costs is because "most communities believe there are substantial positive economic and fiscal benefits generated by retaining or acquiring a major league ball club, and by the development of a new ballpark. In addition … the community receives non-economic benefits from having a major league team, such as community cohesion, pride and public entertainment." Board Findings, p. 26:1-5.

Thus, a fundamental question presented in this case was whether the owner of a possessory interest in a major league ballpark should be assessed on the total cost of development, when only a portion of those costs is justified by the benefits that flow to the team. In the case of SBC Park, the issue of allocating value was particularly important, because, unlike every other ballpark constructed since 1962, SBC Park was funded almost exclusively by the team. Therefore, if an appraiser were to base his or her assessment of SBC Park exclusively on the development costs incurred by the Giants, then the appraiser would have to account somehow for the value of that project that inured to the benefit of the community — value that typically has been paid for by local governments in the development of other ballparks, but which was paid for by the Giants in the case of SBC Park.

Nevertheless, at the hearing, the Assessor presented a valuation based solely on the costs incurred by the Giants to build the ballpark, making no adjustment for economic obsolescence and no allocation for the value of the project that would inure to public's benefit (*e.g.*, the development, economic stimulation, and resurgence of the surrounding area). In essence, the Assessor's cost approach simply took the total cost to develop the project and depreciated that cost over a projected economic life for the ballpark, yielding assessed values of $322,733,000 for 2001, $326,587,000 for 2002, and $323,083,000 for 2003.

The taxpayer disputed the Assessor's exclusive reliance on the cost approach, and also argued that the Assessor's cost approach was flawed because it failed to account for substantial economic obsolescence and the fact that the costs incurred by the Giants to build SBC Park were not typical of the market, and therefore, reflected the team's unique "investment value" rather than fair market value. Thus, the taxpayer presented an appraisal based on all three approaches to value — *i.e.*, the comparative sales approach, the income approach, and the cost approach.

Under its comparative sales approach, the taxpayer demonstrated that the market does not consider development costs when valuing major league ballparks. The taxpayer presented evidence showing that the Toronto SkyDome, which was constructed in 1989 at a cost of roughly $476 million US, sold for a small fraction of its construction costs in subsequent years. Thus, just four years after construction, the SkyDome sold for $109 million US (less than a quarter of its original cost), and in 1999, the property sold again for just $54.4 million US (less than an eighth of its original cost). Then, in 2004 the SkyDome sold a third time for roughly $28 million US (a sale occurring after the lien date, but nevertheless illustrative of the dramatic distinction between cost and market value).

The taxpayer argued that the market data evidenced by the sales of the SkyDome, as well as sales of baseball franchises with their ballpark possessory interests, demonstrated that the market does not value a team's possessory interest in its major league ballpark based on the costs of construction. The taxpayer explained that this was market evidence of "economic obsolescence," which is reflected by the difference between what the market will pay for a property and its replacement cost new less the other forms of depreciation.

Under its income approach to value, the taxpayer presented an analysis based on the typical occupancy costs incurred by major league teams at 15 similarly situated ballparks. As noted above, major league ballparks are usually built as joint ventures between the public and private sectors — therefore, the lease terms for these properties often allocate operating costs and revenues between the two interests. However, the specific terms of each lease vary from ballpark to ballpark (*e.g.*, one team may pay more in base rent or shared revenues — *i.e.*, percentage rent — and less in upfront development costs, while another team will pay more in upfront development costs but less in base rent and percentage rent). Therefore, in order to equalize the lease terms of the comparable ballparks, the taxpayer argued that an appraiser must first equalize the leases by converting them all to a "full service gross lease" basis, similar to the full service gross lease adjustments that appraisers make to compare various office leases when the degree of expense sharing fluctuates between leases. The taxpayer's experts did such a full service gross rent conversion to arrive at the "total occupancy costs" incurred by the other major league teams, and relied on those occupancy costs as the true economic rents for comparable properties in their income approach.

Finally, the taxpayer's cost approach to value was determined in much the same fashion as the Assessor's cost approach, with one major exception — the taxpayer included an adjustment for economic obsolescence. As indicated above, the Giants funded development of SBC Park almost exclusively on their own. Since the vast majority of other ballparks (and all that have been built since 1962) have been constructed with both public and private funds, the Giants' costs for SBC Park exceeded those of the market in general for similar properties, and as such, the cost approach needed to reflect the aberrational costs incurred by the taxpayer for the property. This difference between what a single investor has paid for a property in excess of what the market in general pays for similar properties can be described by various appraisal concepts, including the concept of investment value versus market value. The Giants' experts explained that it can also be described as economic obsolescence — *i.e.*, the difference between replacement cost new less other forms of depreciation, and what the market is willing to pay for a property. Thus, the Giants' appraisers adjusted the Giants' construction costs by the average amount of local government contribution to the construction of the other recently built ballparks. Reconciling the three approaches, the taxpayer's experts concluded that the value of the ballpark should be \$162.5 million for 2001, \$167 million for 2002, and \$170 million for 2003.

In its decision, the Board held that the Assessor's cost approach was unreliable, because it failed to reflect the reality that the marketplace values possessory interests in major league ballparks at a value far less than the total costs of construction. The Board stressed that it is a fundamental principle in the appraisal field that cost does not necessarily equal value, and, in this case, that maxim applied because the developer chose to pay a much higher construction cost than what the market in general would pay. As the Board explained, "[i]n such cases, the property may have a value to its particular developer that is not shared by the market in general, *i.e.*, 'investment value.' Yet, the market value of such property (*i.e.*, the value not to that

MoFo Tax Attorney News

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Prior to joining Morrison & Foerster, Ed served as a trial attorney in the U.S. Department of Justice, Tax Division. Ed's practice focuses on federal tax controversies. ■

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particular developer, but to the market in general) would still be below the construction costs, and the assessment should be based on that market value, not the costs paid by that particular taxpayer.'" Board Findings, p. 24:6-11 (citing *DeLuz Homes, Inc. v. County of San Diego*, 45 Cal. 2d 546 (1955); *Pacific Mutual v. County of Orange*, 187 Cal. App. 3d 1141 (1985)).

To illustrate this concept, the Board cited an example given by one of the taxpayer's witnesses wherein a 15-theater multiplex would cost $15 million to construct. If, based on the income projections, the private market in general would only spend $10 million to develop the project, then the assessable value would only be $10 million — even if the local municipality paid for the additional $5 million development costs to help revitalize the area. "[T]he fact that it may actually cost $15 million to construct the multiplex was irrelevant for purposes of assessment, because the private market would ignore the municipal subsidy in placing a value on the property." Board Findings, pp. 24:27-25:1.

Thus, it follows that since all other major league ballparks built over the past 40 years were constructed using joint financing from both the public and private sectors, an assessment of such a ballpark based solely on the total cost of construction would be erroneous, because the approach would ignore the public subsidy typically contributed in these types of projects. As such, the Board found that exclusive use of the cost approach is not reliable to determine the fair market value of SBC Park.

The Board also rejected the use of the comparative sales approach. Although the Board found the sales of the Toronto SkyDome[1] illustrative of the dramatic disparity between cost and value for major league ballparks, since the number of comparative sales was limited, the Board held that the data was insufficient to form a reliable comparative sales indicator.

Consequently, the Board ultimately relied on an income approach to value. Based on the evidence presented at the hearing, the Board used an income approach first to determine the total value of all of the Giants' tangible and intangible assets (*i.e.*, the Giant's major league baseball team and their possessory interest in SBC Park combined), and then subtracted from that value an amount allocated to the team based on an inflation of the team's prior acquisition cost. By subtracting the intangible value attributed to the team from the total asset value based on an income approach, the Board determined the fair market value of the possessory interest in SBC Park. In the end, the Board determined that the value of SBC Park was $230 million for the 2001 lien date, $240 million for 2002, and $236 million for 2003.[2]

Although this case may be viewed by some as a narrow decision given the unique nature of major league ballparks, as indicated above, the Board reconciled a number of the complexities by acknowledging the simple appraisal principle that cost does not always equal value. This case is instructive for appraisers and boards of equalization examining other properties in order to recognize that when reliable evidence shows that the market value of a type of property is less than its replacement cost new less physical and functional obsolescence, then the cost approach should not be used unless an adjustment is made to reflect the discrepancy between how the market values that property and its cost of development. ■

[1] The SkyDome was renamed the Rogers Center on February 2, 2005, after its sale in 2004 to Rogers Communications, Inc.

[2] The Assessor has filed a petition for writ of administrative review challenging the Board's decision. The parties expect that the court will hear the Assessor's petition sometime in June 2006.

Peter Kanter and Troy Van Dongen represented the San Francisco Giants in this case.

Failure By Tax Division to Follow Mailing Rules Proves Fatal to Collection of Tax

By Paul H. Frankel, Michael A. Pearl & Amy F. Nogid

Mr. Justice Holmes stated: "Men must turn square corners when they deal with the Government."[1] The Court has also recognized – as it should – that "'It is no less good morals and good law that the Government should turn square corners in dealing with the people than that the people should turn square corners in dealing with their government.'"[2] Recently, the New York State Tax Appeals Tribunal (the "Tribunal") held the New York State Division of Taxation (the "Division") to that doctrine, finding that a notice mailed to the wrong address, and not received in sufficient time to file a protest, was invalid.[3]

THE FACTS

OfficeMax, Inc. ("OfficeMax") the well-known retailer of office supplies throughout the United States, was audited by the Division with respect to its sales and use tax liabilities. OfficeMax used its address in Ohio on its sales and use tax returns. The Ohio address was also the location the Division's auditor visited on 16 occasions during the course of the audit. Statements of Proposed Audit Changes were mailed to that address. Payment confirmations by the Division were mailed to the Ohio address. The Notice of Determination at issue, dated June 2, 2000, however, was *not* mailed to OfficeMax. It was mailed to an unrelated lessor, Idealease, located in Illinois. That address was obtained from a highway use tax return that was filed by Idealease in connection with a single truck rented by OfficeMax, after indications that the Ohio address was bad or invalid appeared on the Division's computer. No one in the Division knew precisely why a bad address was noted on OfficeMax's account, acknowledging that the notations could have resulted from an interface in the computer. The Idealease address was plucked by the computer by use of an algorithm; no person ever reviewed the new address that was selected to ensure that it was a proper address.

After being contacted by OfficeMax regarding its non-receipt of the notice, the Division remailed the notice, which, although postmarked August 30, 2000, was not received by OfficeMax until September 21, 2000, beyond the 90-day period from the June 2, 2000 mailing within which OfficeMax could have filed a timely protest. The remailed notice was sent to OfficeMax's Ohio post office box. The statute of limitations on assessment for the years at issue ran on June 20, 2000.

THE MAILING RULES

A Notice of Determination is required to be mailed by certified or registered mail to the person for whom it is intended "at the address given in the last return filed by him [*i.e.*, the taxpayer] pursuant to [Article 28] or in any application made by him."[4]

Perhaps most important was the ALJ's recognition that the central inquiry was whether the taxpayer's intercompany pricing was "consistent with the *reasonable and flexible approach* suggested by IRC § 482, which recognizes the difficulty taxpayers face when trying to meet an arm's-length standard."

If the Division follows these mailing directions, there is a presumption of receipt of the deficiency notice by the person to whom it is addressed.[5] However, no such presumption exists if the Division does not properly address the notice.

THE DIVISION'S POSITION

The Division took the position that the assessment was valid, despite the fact that the notice was mailed to the wrong address and was not received by OfficeMax in time to file a petition. In particular, the Division argued, *inter alia*, that: (1) Idealease was OfficeMax's agent; (2) the address of Idealease was "a current address used by Petitioner"; (3) the Division was not required under the statute, Tax Law section 1147, to use a specific address if a taxpayer had multiple addresses; and (4) OfficeMax was not prejudiced by its receipt of the notice after the time within which to protest had passed, since "Petitioner's rights to challenge the assessment were preserved."

OFFICEMAX'S POSITION

OfficeMax argued that the notice was improperly mailed under Tax Law section 1147(a)(1), and was therefore invalid, and that the Division's remailing of the notice on August 30, 2000, which was not received within the 90-day period to file a protest, was barred by the statute of limitations on assessment.

THE HEARING

The Division presented the testimony of four witnesses to describe its computer systems and the procedures it uses to address and mail notices: a Task Process Manager, a Supervisor of Data Processing, the Principal Clerk, and the Principal Mailroom Supervisor. No one was able to explain why the Idealease address was used. The Division merely argued that it was justified in utilizing computerized address files to monitor address changes, given the large number of New York taxpayers.

The Division also called the auditor, who acknowledged receiving inquiries from OfficeMax regarding the whereabouts of the June 2 notice, but did not take affirmative action regarding remailing the notice until late August.

OfficeMax called its Fleet Manager, who testified that OfficeMax leased one truck in New York from Idealease, which was large enough to require the filing of Highway Use Tax ("HUT") returns. Idealease prepared and filed the HUT returns on behalf of OfficeMax as required under its lease agreement with OfficeMax; the quarterly payments were approximately $50 each. The Fleet Manager, who was OfficeMax's primary contact with Idealease, testified that no one from Idealease contacted him regarding receipt of the notice and he and a Tax Analyst for OfficeMax testified that Idealease was not authorized to act as agent for OfficeMax. The Division presented no evidence to support its claim that Idealease was OfficeMax's agent.

THE ADMINISTRATIVE LAW JUDGE ("ALJ") DETERMINATION

The ALJ found that the Division ignored the plain language of Tax Law section 1147(a)(1), which required that notices be sent to the address on the "last return filed by him [*i.e.*, the taxpayer] pursuant to the provisions of this article," and found the Division's argument that it was free to use any address if a taxpayer had multiple addresses as "lack[ing] any legal support." The Division's assertion that Tax Law section 1147(a)(1) provides flexibility in addressing notices to the address either in the last return filed or in any "application" filed by the taxpayer was rejected.

Likewise, the ALJ rejected the Division's argument that Idealease was OfficeMax's agent, finding that "uncontradicted evidence" established that the contrary was true. Finally, the ALJ agreed with OfficeMax that the notice was invalid, since the evidence in the record established that the notice was received after the time to file a protest had run.

THE TRIBUNAL'S DECISION

The Tribunal agreed with the ALJ that the notice was improperly mailed, since it was not mailed to the address required by law – the address on the last sales and use tax return filed by OfficeMax – not the location of a company from whom it merely rented a truck. Relying on the "credible evidence" that the notice was received after the time to file a protest had passed, the Tribunal concluded that the notice was invalid.

FOOD FOR THOUGHT

It is troubling that the Division took a position contrary to the plain language of the statute and forced OfficeMax to litigate the viability of the misdirected notice. As numerous cases rejecting improperly and late filed returns, refund claims, and protests attest, taxpayers must comply with the law or face the consequences. The onus should fall on the party in control. Here, the failure to identify such an obvious error in OfficeMax's address was preordained by a system described by the Division's witnesses in which the addressing and mailing of assessment notices is totally automated, with no human verification or intervention at any stage of the process. Having chosen to eliminate human intervention from the notice issuance process, the Division rightfully paid the price.

In procedural and substantive matters, the Division demands that taxpayers turn square corners in their compliance with the terms of the Tax Law. The Division should be held to the same standard – no more and no less. ■

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[1] *Rock Island, A. & L. R. v. United States*, 254 U.S. 141, 143 (1920).

[2] *Heckler v. Community Health Servs. of Crawford County, Inc.*, 467 U.S. 51, 61 n.13 (1984) (citation omitted). *See also Gastime, Inc. v. Director, Div. of Taxation*, 20 N.J. Tax 158, 166 (2002) (holding that the square corners doctrine required that the government "'comport itself with compunction and integrity'" (citation omitted)).

[3] *Matter of OfficeMax, Inc.*, DTA Nos. 818769 & 818770 (N.Y.S Tax App. Trib., Mar. 24, 2005). This case involved the validity of two notices, one dated June 2, 2000 (DTA No. 818770), which asserted use tax, penalty and interest, and another notice, dated June 12, 2000 (DTA No. 818769), which asserted interest and penalty on the sales tax portion of the audit. Both notices were mailed to the wrong address. The June 2, 2000 notice was not received by OfficeMax within the 90-day period for protesting the notice; the June 12, 2000 notice was received on September 5, 2000, a few days short of the 90 days within which to file a petition for hearing. The Tribunal held that the June 12, 2000 notice was valid. That portion of the Tribunal's decision is on appeal and the June 12, 2000 notice is not addressed in this article.

[4] N.Y. Tax Law § 1147(a)(1).

[5] *Id.*

This article appeared in State Tax Notes.

Paul Frankel and Michael Pearl represented OfficeMax in this case.

This newsletter addresses recent state and local tax developments. Because of its generality, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations. If you wish to change an address, add a subscriber, or comment on this newsletter, please write to: Mitchell A. Newmark at Morrison & Foerster LLP, 1290 Avenue of the Americas, New York, New York 10104-0050, or Pilar M. Sansone at Morrison & Foerster LLP, 425 Market Street, San Francisco, California 94105-2482, or e-mail them at mnewmark@mofo.com or psansone@mofo.com.