NY Tax Minutes: Trump Tax Returns, New Corporate Tax Regs

By Timothy Noonan and Craig Reilly
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Timothy Noonan

Craig Reilly

Every year, magazines and newspapers across the country release summer's best beach reads — lists of what books and articles to pick up and read your way through vacation. But, if you're like us, don't you wish there was a list tailored just for tax professionals? Those of us looking for something relaxing to read on our summer vacations but that's also tailored just for you? Well for that, there's only one recommendation you need: this month's edition of NY Tax Minutes.

This month, we highlight the ongoing battle over President Donald Trump's New York State tax returns and take a deep dive into the state's recently updated corporation franchise tax apportionment regulations. We also look in on the past month's noteworthy state tax decisions and opinions, including a ruling on New York City's recently enacted congestion surcharge, as well as a pair of decisions from the state's Division of Tax Appeals, along with an administrative law judge determination addressing the state's residency and domicile rules. So enjoy the read, and don't forget your sunscreen.

The Headlines

Trump Sues to Protect Tax Returns After New York Governor Okays Release

After years of back and forth, involving freedom of information requests, lawsuits, campaign promises and battles in the press, the American public finally seemed on the verge of getting a look at Trump's personal income tax returns when, on July 8, 2019, New York Gov. Andrew Cuomo signed legislation authorizing the state to provide the president's state tax return information to Congress. We covered New York's proposed legislation in last month's NY Tax Minutes.

On July 23, however, Trump filed suit against the U.S. House Committee on Ways and Means, the New York state attorney general and the commissioner of the New York State Department of Taxation & Finance to prohibit Congress from obtaining his state tax information.[1] And so, we may have to wait a little longer to see what all the fuss has been about.

The president's lawsuit, which was filed in the U. S. District Court for the District of Columbia, argues that the House Ways and Means Committee has no legitimate legislative purpose to request his state tax returns. Trump goes on to argue that New York's recent legislation, authorizing the state to provide his state tax records, violates the First Amendment, as it was enacted in retaliation against the president's politics. The court has since ordered that the president's returns not be released while it considers initial motions in the suit.

Although our focus is New York tax news, lawsuits involving Trump's state tax returns appear to be a growing trend across the country. In California, for example, Donald J. Trump for President Inc. recently filed a lawsuit against the California secretary of state regarding that state's legislation, which requires presidential candidates to submit their tax returns to the state. The California suit claims that the law violates the presidential qualifications clause, the presidential electorate clause and the First Amendment of the United States Constitution.

Rest assured, if we do ever get a look at Trump's New York (or other) tax returns, we'll be sure to cover it here.

New York Updates Corporate Franchise Tax Apportionment Regulations

New York state has taken another step in its commendable efforts to issue detailed draft regulations[2] incorporating the changes made by the state's 2015 corporate tax reform legislation. This month, the state focused its efforts on business income apportionment, updating the draft regulations that apply to general business apportionment,[3] along with updating the specific rules for digital products[4] and other services and business activities.[5]

If you have receipts the from the sale of tangible personal property, digital property, financial products, other services — okay, if you have any receipts — from sales into New York state

or from sales to customers with New York operations, we highly recommend reviewing these new draft rules, along with the detailed examples contained in each set of regulations.

One of the biggest changes enacted as part of New York state's 2015 overhaul of its corporate tax rules, was the state's expansion of market-based sourcing to essentially all types of receipts, including services and intangibles, such as royalties. Under New York's new rules, the central question for sourcing most receipts is now where the customer receives the benefit of the item or service delivered. But in order to answer that question, the state has enacted detailed rules for allocating and apportioning several different categories of receipts (11 at last count).

And for two of those categories — sales of digital products and other business services/activities — New York has enacted a hierarchal set of sourcing rules, under which taxpayers must work their way down a list of methodologies, applying different rules depending on whether sales are made to business or individual customers. In working through the hierarchy, taxpayers must exercise annual due diligence (and document the steps taken) before abandoning a sourcing rule and moving on to the next.[6] In other words, the rules are detailed, and taxpayers should pay attention.

Below are two charts that outline the state's current hierarchal rules for sourcing these types of receipts:

Sourcing Other Service Receipts

Hierarchy	Business Customer	Individual Customer
1. Special rules for in-person services (*e.g.*, doctors); services to TPP; services to real property; and sales of intangibles	In-Person Services = Performance location; Services to TPP = TPP location; Services to Real Property = Property location; Sales of Intangibles = Where intangible value was accumulated	In-Person Services = Performance location; Services to TPP = TPP location; Services to Real Property = Property location; Sales of Intangibles = Where intangible value was accumulated
1-a. Special rules for management services to passive investment customers (*e.g.*, hedge funds)	Location where the passive investment customer decides to utilize the investment or management decisions. If, however, the taxpayer (*i.e.*, management service provider) has been granted authority to execute management decisions, the benefit is received where the taxpayer executes those decisions — *i.e.*, performance location.	Location where the passive investment customer decides to utilize the investment or management decisions. If, however, the taxpayer (*i.e.*, management service provider) has been granted authority to execute management decisions, the benefit is received where the taxpayer executes those decisions — *i.e.*, performance location.
2. Where the customer receives the benefit of the service	As indicated by the books and records of the taxpayer without regard to billing address, or through reasonable inquiries to customer; otherwise, use reasonable approximation.	Billing address or reasonable approximation.
3. Reasonable approximation	a. Sourced receipts method. b. General information — *e.g.*, population.	c. Sourced receipts method. d. General information — *e.g.*, population.
4. Delivery destination	Where the contract of sale is managed by the customer; otherwise, billing address.	Sales records or other evidence available to the taxpayer.
5. Prior year's sourcing for same type of receipts	Cannot apply this method in first tax year on or after Jan. 1, 2015.	Cannot apply this method in first tax year on or after Jan. 1, 2015.
6. Sourcing for current tax year	Apportionment percentages from other services or business activities that can be sourced using higher levels of hierarchy.	Apportionment percentages from other services or business activities that can be sourced using higher levels of hierarchy.
7. Intermediary transactions	Where the end consumer receives the benefit (no consumer inquiry required).	Where the end consumer receives the benefit (no consumer inquiry required).

Sourcing Digital Product / Digital Service Receipts		
Hierarchy	**Business Customer**	**Individual Customer**
1. Special rules for facilitation of in-person services (*e.g.*, ride sharing); services to TPP (*e.g.* apartment rentals); services to real property; and sales of computer software at retail locations	In-Person Services = Performance location; Services to TPP = TPP receipt location; Service to Real Property = Property location; Retail Software Sales = Retail location	In-Person Services = Performance location; Services to TPP = TPP receipt location; Service to Real Property = Property location; Retail Software Sales = Retail location
2. Where the customer primarily uses the digital property/digital service	As indicated by the books and records of the taxpayer without regard to billing address, or through reasonable inquiries to customer; otherwise, use reasonable approximation.	Billing address or reasonable approximation.
3. Reasonable approximation	a. Sourced receipts method. b. General information — *e.g.*, population.	c. Sourced receipts method d. General information — *e.g.*, population
4. Receipt location	Where the contract of sale is managed by the customer; otherwise, billing address.	Sales records or other evidence available to the taxpayer.
5. Prior year's sourcing for same type of receipts	Cannot apply this method in first tax year on or after Jan. 1, 2015.	Cannot apply this method in first tax year on or after Jan. 1, 2015.
6. Sourcing for current tax year	Apportionment percentages from other digital product or digital service receipts that can be sourced using higher levels of hierarchy.	Apportionment percentages from other digital product or digital service receipts that can be sourced using higher levels of hierarchy.
7. Intermediary transactions	Where the end consumer receives the benefit (no consumer inquiry required).	Where the end consumer receives the benefit (no consumer inquiry required).

If you're familiar with the state's original draft apportionment regulations, you'll notice that the July updates include several noteworthy changes. First, both the updated digital product regulations and the updated other services/business activity regulations add "special rules" for certain transactions (e.g., in-person services, sales of intangibles and management services to passive investment customers — i.e., hedge funds), and the new rules change the overall hierarchal structure so that the new special rules are now to be applied prior to the ordinary hierarchy.

In other words, if you're dealing with a receipts category that falls under a special rule, you'll have to first apply the special sourcing rules before invoking the general hierarchy. Additionally, both sets of updated regulations expand the reasonable approximation methodology (Step 3 in the charts above) in order to allow taxpayers to reasonably approximated the source of their receipts based on general information (e.g., population) if the taxpayers are unable to apply reasonable approximation based on any customer specific information. The state's prior draft regulations specifically prohibited the use of population for reasonable approximation.

In addition to these updates, the general apportionment regulations were also amended, including the state's decision to now include "unusual events" in the business apportionment factor formula. Under the original draft regulations, receipts from "sales of real, personal, or, intangible property that [arose] from unusual events [were] not included in New York receipts or everywhere receipts." That has now changed, and all receipts are to be included in the apportionment fraction, with added rules for allowing the Tax Department to make discretionary adjustments to the business apportionment factor where necessary.

The state has invited comments on all of the proposed updates and has specifically requested comments on the changes noted above. Comments on the draft rules related to digital products and to other services/business activities are due by Oct. 9, 2019, and the deadline for providing comments on the updated general apportionment regulations is Oct. 18, 2019.. We encourage anyone with thoughts on the proposed changes to offer your opinion.[7] This is one area where the state has done its part in an effort to deliver helpful guidance, now taxpayers and practitioners must do theirs.

The Cases

Each month, we highlight new and noteworthy cases from New York State's Division of Tax Appeals and Tax Appeals Tribunal, along with any other cases involving New York taxes. This month, we cover a New York trial court's dismissal of New York City medallion taxicab owners' challenges to the state's congestion surcharge and review two Tax Appeals Tribunal decisions — one addressing the state's bulk sale rules and the other dealing with the sales tax exemption benefits received by agents of Industrial Development Agencies. Lastly, we highlight an administrative law judge determination addressing the state's residency and domicile rules.

New York Court Upholds Congestion Surcharge

Back in February, we highlighted New York state's new congestion surcharge.[8] The surcharge was originally scheduled to go into effect on Jan. 1, 2019, but, as previously reported, collections were delayed due to a temporary restraining order filed in Taxifleet Management LLC v. State of New York.[9] On Jan. 31, 2019, however, the New York State Supreme Court lifted the temporary restraining order, and the Department of Taxation and Finance issued Important Notice N-19-2,[10] announcing that "all persons subject to the surcharge must begin to collect the surcharge from passengers beginning at 12:01 a.m. on Saturday, Feb. 2, 2019."

At the end of June, the fight continued with the trial court denying the taxicab medallion owners' subsequent request for a special proceeding, in which they sought a declaration that Article 29-C of the Tax Law (i.e., the congestion surcharge) was unlawful and unenforceable as a matter of law.

In the follow-up proceedings,[11] the medallion owners raised several arguments, which the court eventually dismissed. First, the medallion owners claimed that the congestion surcharge violates due process by depriving them of property interests without sufficient legal justification. The court acknowledged that the medallion owners do have a legitimate property interest that is affected by the congestion surcharge — i.e., their medallions — but the court held that the medallion owners "failed to state sufficient facts to show that the congestion surcharge was without legal justification." Moreover, the court noted that having the congestion surcharge apply only on trips originating, travelling through or ending below 60th Street in Manhattan was rationally related to the stated goal of decreasing vehicular traffic.

Second, the court denied the medallion owners' equal protection claims, noting that all vehicles (not just for-hire vehicles) will be subject to the surcharge by 2021. According to the court, the fact that "petitioners have been targeted first is rational given the ease of collecting a tax from them without the installation of any specific tolling devices or gateways, etc."

Lastly, the court dismissed the petitioners' claims that the congestion surcharge violated two sections of the New York State Constitution that (1) address discrimination against

corporations, and (2) involve the state's home rule provisions, with the court specifically rejecting the medallion owners' argument that transportation and mass transit in New York City is purely a matter of local concern.

As we mentioned back in February, both of your authors commute regularly between New York City airports and our firm's midtown office, so we know the frustration of sitting in bumper-to-bumper, rush-hour traffic and, at least for the time being, it appears that we'll continue to get to pay a little more for the pleasure of watching pedestrians rush by our taxis at the speed of light.

Tax Appeals Tribunal Finds Seller's Fraud Does Not Mitigate Bulk Sale Rules

In Matter Khayer Kayumi,[12] the state's Tax Appeals Tribunal found that a purchaser of a Popeye's Chicken franchise was liable for sales taxes due on (1) the transfer of tangible personal property acquired as part of his acquisition of the franchise, and (2) the seller's unpaid sales and use tax liabilities incurred prior to the transfer.

Although most states maintain some type of ''occasional or isolated sales'' exemption that taxpayers can often apply in order to avoid sales tax in business acquisitions (i.e., bulk sales), New York does not. Instead, sales of tangible personal property made in connection with the purchase of a business are generally subject to tax. New York also, like most states, requires purchasers to provide the Tax Department with notice of any proposed bulk sales and to escrow certain purchase funds in order to give the state the opportunity to review the seller's sales tax history before the seller closes shop.[13]

In Kayumi, the Tax Department received proper notice of the bulk sale and issued a letter to the purchaser indicating that the state had information suggesting that the seller had unpaid sales and use tax liabilities. The department therefore instructed the purchaser to place the entire purchase amount into escrow for the purpose of satisfying the unpaid liabilities.

Instead of escrowing the funds, however, the purchaser delivered a check to the seller, made payment to "New York state sales tax," and the seller contractually agreed to remit the funds to the state. Well, guess what. The seller ran off with the money and was eventually indicted for unlawful deception and theft. And what about the seller's unpaid sales tax liabilities?

Unfortunately for the purchaser, he failed to timely protest the successor liability assessment that the department issued. And because the purchaser failed to satisfy the state's bulk sale escrow requirements under Tax Law Section 1141(c), the purchaser was left on the hook for the seller's unpaid liabilities (although the seller's liabilities exceeded the purchase prices — under New York's law, the purchaser's liability is capped at the purchase price).

And even though the tribunal agreed that it appeared the seller had taken advantage of the purchaser (see, criminal indictment, above), the tribunal ruled that it was not these circumstances that led to the liability. Instead, it was the purchaser's failure to properly escrow the funds as required by law. So, no relief there.

As for the tax due on the transfer of assets under the sale, the tribunal first found that the Audit Division had failed to properly mail the notice associated with this liability to the purchaser, so it proceeded to the merits of the purchaser's claim despite his appeal coming more than 90 days after the assessment was allegedly issued. The tribunal, however, dismissed the purchaser's arguments for cancelling the assessment.

Specifically, the purchaser argued that because there was not transfer of title to the assets, nor approval of the purchase by the Popeye's franchisor, there was no bulk transfer. But as laid out by the tribunal, "[a] completed transfer of title is unnecessary to impose sales tax because sales tax is defined as a tax on the transaction resulting in the transfer of title or possession (or both) of tangible personal property."[14]

In the end, the purchaser was left to essentially pay for the business twice. Once through payments to the seller and again through payments to the state for the sellers unpaid sales tax liabilities. We're guessing a civil suit against the seller is forthcoming.

Tribunal Upholds Assessment Against Agent of Industrial Development Agency

In Matter of Jefferson Hotel Associates LLC,[15] the tribunal found that a hotel developer, acting as an agent for the County of Monroe Industrial Development Agency, or COMIDA, received sales and use tax exemption benefits in excess of the amount authorized by the agency, and the developer was therefore liable to pay back the excess benefits under General Municipal Law Section 875(3)(b).

Under New York's General Municipal Law, an industrial development agency, or IDA, is a public benefit corporation engaged in the promotion of economic development in its local community. As such, IDAs are authorized to undertake projects and to appoint agents or project operators to develop projects that will benefit economic development.

IDAs can then provide financial assistance to their agents, including sales tax exemptions. General Municipal Law Section 875(3)(b), however, directs IDAs to recover any sales tax exemption benefits that are taken by an agent in excess of the amount authorized by the IDA, and the law allows the Tax Department to issue an assessment for any amounts that are not repaid.

As relevant to Matter of Jefferson Hotel Associates, General Municipal Law Section 875 took effect on March 28, 2013, and the law applies to "any amendment or revision involving additional funds or benefits made on or after [March 28, 2013] to any project established, agent or project operator appointed, financial assistance provided, or payment in lieu of taxes entered into, prior to that date."

COMIDA first accepted the hotel developer's application and appointed the developer as its agent on Aug. 21, 2012. Accordingly, the issue arose of whether General Municipal Law Section 875, which took effect on March 28, 2013, applied to the excess benefits received by the developer.

As explained by the tribunal, however, the developer's appointment as COMIDA's agent was extended twice, including once by letter dated Feb. 24, 2014. Each extension included a revised Form ST-60, IDA Appointment of Project Operator or Agent for Sales Tax Purposes,[16] which re-listed the maximum allowable sales tax exemption benefit. Although the developer argued that its Feb. 24, 2014 extension should not "be construed as an additional benefit for purposes of determining whether General Municipal Law Section 875(3)(b) applies here," the tribunal disagreed, finding that the "benefit to petitioner was the opportunity to continue to purchase project property, free of sales tax."

The tribunal therefore concluded that "the granting of additional time to allow petitioner to maximize its monetary gain is properly construed as an additional benefit for purposes of [General Municipal Law Section 875(3)(b)]." And because the developer received sales tax exemption benefits in excess of the amounts originally authorized by COMIDA, the benefits were "properly subject to recapture" under the state's general municipal law.

ALJ Rules Taxpayer Fails to Prove Change of Domicile

When moving out of New York, the state's residency laws require taxpayers to show by "clear convincing evidence" that they have established a bona fide intention of leaving New York and making a fixed and permanent home somewhere else. We often refer to this as the "leave and land" concept. You have to both leave New York and land somewhere else. And it's often a failure to stick the landing that gets taxpayers into trouble.

In Matter of Yim,[17] the issue was whether a former New York resident taxpayer, Jeremiah H. Yim, had properly established a change of domicile from New York to Michigan in 2010.

At the administrative law judge hearing, Yim testified that he was a New York domiciliary from 1970 to 2009. In July 2009, Yim, a doctor, accepted a position at a Department of Veterans Affairs facility in Michigan. Once in Michigan, he bought a car, obtained a driver's license, registered to vote, joined a church and eventually rented an apartment. All good facts. But his wife remained in the couple's New York home and Yim eventually returned to New York in 2011 to accept a new job, before moving again to South Dakota and then Georgia.

While only spending a few years (or even a few months) in a new location should not itself prevent taxpayers from proving a change of domicile, the Tax Department is notorious for applying 20/20 hindsight when taxpayers leave their new home shortly after arriving. Moreover, Yim did not do himself any favors when he responded to certain questions at the hearing.

When asked, for example, what items he brought from New York when he moved to Michigan, Yim testified that he "only brought a backpack" and joked that "according to his wife, a lot of his belongings were trash, but they were near and dear to him and he kept them in New York." It's hard to stick the landing without any of your near and dear personal items.

Based on these facts, the ALJ found that Yim's "move to Michigan was never intended to be permanent" and therefore upheld the Audit Division's assessment, treating Yim as a New York resident. The ALJ probably got this one right.

It doesn't seem that Yim had established many significant or lasting connections in Michigan, and his own testimony (along with a decision not to file any briefs supporting his argument) likely didn't meet the clear and convincing standard. But one part of the ALJ's determination that does raise some concern is the judge's focus on Yim's employment as the basis for his move.

We often see the Tax Department take the position that work-related moves somehow don't support a change of domicile. This is nonsense. People move for many reasons. And the New York State Court of Appeals has said that "[a] change of domicile may be made through caprice, whim or fancy, for business, health or pleasure, or to secure a change of climate, or a change of laws, or for any reason whatever, provided there is an absolute and fixed intention to abandon one and acquire another and the acts of the person affected confirm the intention."[18]

So when the ALJ in Matter of Yim claims that "[c]learly, [Yim's] intention to move where the job opportunities took him in order to sustain his family in [New York] militates against the finding that he changed his domicile," we're left asking why. If a taxpayer wants to move for a job, so what? Taxpayers still need to prove their "absolute and fixed intention to abandon one [domicile] and acquire another." But if the driving force for the move is a new career, so be it. It's wrong for the Tax Department to be skeptical of these work-based moves.

Timothy P. Noonan is a partner and K. Craig Reilly is a senior associate at Hodgson Russ LLP. Noonan and Reilly are regular contributors to Tax Authority Law360.

[1] Trump v. Comm. on Ways & Means, United States House of Representatives et. al.; Case No. 1:19-cv-02173.

[2] https://www.tax.ny.gov/bus/ct/corp_tax_reform_draft_regs.htm

[3] https://www.tax.ny.gov/bus/ct/pending/gen%20apportionment%20rules%20draft%20reg%20-%207.18.19.pdf.

[4] https://www.tax.ny.gov/bus/ct/pending/digital%20products%20draft%20reg%207.3.19.pdf.

[5] https://www.tax.ny.gov/bus/ct/pending/sobr%20draft%20reg%207.11.19.pdf.

[6] 20 NYCRR 4-2.18(a)(1); 20 NYCRR 4-2.3(a)(1) (Draft as of July 3, 2019).

[7] Comments should be submitted to Kathleen D. O'Connell, Office of Counsel, Department of Taxation and Finance, W.A. Harriman Campus, Building 9, Room 200, Albany, NY 12227 or by email at tax.regulations@tax.ny.gov.

[8] Tax Law Article 29-C.

[9] Taxifleet Management LLC v. State of New York.

[10] https://www.tax.ny.gov/pdf/notices/n19-2.pdf.

[11] Taxifleet Management LLC, et. al. v. State of New York; Docket No. 1611920/18; 2019 NY Slip Op 31969(U).

[12] Matter Khayer Kayumi, DTA No. 825953, https://www.dta.ny.gov/pdf/decisions/825953.deconremand.pdf.

[13] N.Y. Tax Law § 1141(c).

[14] N.Y. Tax Law §§ 1101(b)(5), 1141(c) (emphasis added).

[15] Matter of Jefferson Hotel Associates LLC, DTA No. 827618, https://www.dta.ny.gov/pdf/decisions/827618.dec.pdf.

[16] https://www.tax.ny.gov/pdf/current_forms/st/st60_fill_in.pdf.

[17] Matter of Yim, DTA No. 827687, https://www.dta.ny.gov/pdf/determinations/827687.det.pdf.

[18] Matter of Newcomb's Estate, 192 N.Y. 238, 251 (1908).