Litigating a New York Tax Case, Volume 4: Tax Litigation in the New York Courts

by Timothy P. Noonan and Ariele R. Doolittle

Timothy P. Noonan

Ariele R. Doolittle

Timothy P. Noonan is a partner in the Buffalo and New York offices of Hodgson Russ LLP. This column is coauthored by Ariele R. Doolittle, an associate in the firm's Albany office, who previously served as a clerk in the New York State Division of Tax Appeals.

This article is the last in a four-part series discussing all phases of litigating a New York tax case. In this installment, the authors cover what happens when tax litigation reaches the New York state courts.

The fourth and final installment in our series brings us to the place you'd expect to see a lawyer: in court! Our first three articles focused on tax litigation in the administrative forums, which is often a prerequisite to bringing a tax case before the New York state courts. But now we move on to the fun stuff and cover the basics of tax litigation in "real court." We'll begin with a discussion of article 78 proceedings, which are the most commonly used vehicles for tax litigation. Then we'll cover some lesser-used but nonetheless important (and sometimes creative) means of litigating tax cases.

I. Article 78 Review of Tribunal Decisions

In our last installment, we reviewed the two-level administrative appeals process within the New York State Division of Tax Appeals and Tax Appeals Tribunal (collectively the DTA). As we explained, the DTA process culminates in the Tax Appeals Tribunal issuing a written decision. Unless the taxpayer files a timely appeal, the decision will "finally and irrevocably decide all the issues which were raised in proceedings before the division of tax appeals upon which such decision is based."[1] As such, the tribunal's decision is not subject to further administrative review — though it may be subject to judicial review if the taxpayer so elects. So that brings us to the first type of tax litigation in the New York courts: a review of an adverse tribunal decision.

A tribunal decision is subject to judicial review in the manner provided for by Tax Law section 2016, which specifies that such review is to occur as prescribed in article 78 of the Civil Practice Law and Rules (CPLR) "except as otherwise provided in this section." Only the taxpayer can seek judicial review under that method; the tax department cannot appeal an adverse tribunal decision.[2] In fact, when the DTA was established in the late 1980s, a deliberate decision was made to not allow the department to appeal an adverse tribunal decision.[3]

Thus, judicial review of a tribunal decision is accomplished through what's known as an article 78 proceeding. article 78 refers to the article of the CPLR titled "Proceeding Against Body or Officer." It authorizes "special proceedings" to be brought in court — typically in the state supreme court (the trial-level court) — to challenge the actions of an administrative agency.[4]

A. Procedural Matters

1. Statute of Limitations

Time limitations have been a recurring theme in this series. Under Tax Law section 2016, a four-month statute of limitations applies to challenging a tribunal decision. The four-month period is measured from the date on which the tribunal *serves* notice of its decision, not from the taxpayer's

[1] *See* N.Y. Tax Law section 2016.

[2] N.Y. Tax Law section 2016.

[3] Budget Report on Bills, Bill Jacket, approving of L 1986, ch. 282 at 2 ("all decisions of the Tax Appeals Tribunal would be published and reviewable by article 78 proceedings *except* that the Tax Department could not appeal a Tribunal decision" (emphasis in original); *see also* E. Parker Brown II, "State Taxation," 38 *Syracuse L. Rev.* 517, 528-529 n. 86 (1987) (observing that when Tax Law section 2016 was enacted, the tax department recognized it would be "procedurally awkward" if the department could appeal a tribunal decision under article 78).

[4] *See* CPLR sections 7801 and 506.

receipt of the notice. A month for those purposes is "computed by counting such number of calendar months from such day."[5] So if the tribunal's decision is mailed on January 2, the period of limitations expires on May 2. But if the decision is mailed on July 31, a four-month statute expires on November 30, not on December 1.

2. Venue

Article 78 proceedings challenging a tribunal decision must be brought in the appellate division, third department. That is a departure from standard article 78 procedure, which generally requires that the proceedings begin in state supreme court.[6] In other words, article 78 proceedings begin at the second level of the New York court system.

3. Pay to Play

Depending on the type of tax involved, the taxpayer may be required to deposit tax, penalty, and interest and file an undertaking before commencing the proceeding. That is a jurisdictional prerequisite for stock transfer, motor fuel, alcoholic beverage, cigarette, highway use, and sales and use tax disputes.[7] It is not a requirement in corporate or personal income tax cases.

4. Parties

The taxpayer is the petitioner. The petitioner's adversary is the respondents, specifically the tax appeals tribunal and the commissioner of taxation and finance. But the tribunal cannot participate in proceedings for judicial review. Instead, the tribunal and the commissioner are represented by the attorney general.[8]

5. Steps to Appeal

The proceeding is commenced by filing a notice of petition and verified petition with the third department. The return date for the notice of petition must be a Monday (or the next business day if Monday is a holiday) on at least 20 days' notice. Thereafter, the respondents must file an answer at least five days before the return date stated on the notice of petition. The answer must be verified and must state pertinent and material facts showing the grounds for the respondents' disputed action.[9]

The next step is to perfect the appeal by filing and serving copies of the briefs and the record on review.[10] The third department's rules of practice state that the appeal must be perfected within 60 days after the answer is filed. But as a practical matter, the petitioner actually has much longer. Indeed, the appeal can be perfected anytime within nine months of the day the petition was filed and served.[11]

Perfecting the appeal is generally accomplished by filing the brief with the record on appeal. The record should consist of:

- the DTA petition;
- the division's answer to the DTA petition;
- any reply to the answer;
- the tax appeals tribunal's decision;
- the administrative law judge's determination;
- if held, the transcript of the hearing and/or oral argument; and
- any exhibit or document submitted into evidence "upon which the [tribunal's] decision is based."[12]

And pay attention to the details, all the way down to the type of paper! The brief cannot exceed 50 printed or 70 typewritten pages and must be printed on "good quality, white, unglazed paper."[13] The contents of the brief must be in the following order: table of contents, question presented, nature of the case, the argument, and the conclusion.[14] A description of action must also be filed.[15]

Responsive briefs are filed after that, and then usually oral arguments are held before the third department in Albany. After that, usually within four to six weeks, the third department renders an opinion (in the more important matters) or a memorandum decision (in lesser disputes).

Depending on the outcome, one or both sides may wish to appeal to New York's highest court, the court of appeals. But unless an appeal lies "as of right" (only in situations in which two judges dissented at the appellate level or in which construction of the New York or U.S. constitution is directly involved), the would-be appellant must request leave to appeal.[16] And because New York's highest court is extremely busy, it is often difficult to get it to hear an appeal, especially on such an "exciting" subject like taxes.

B. Substantive Matters: How to Win!

1. Standard of Review

A few years ago when preparing one of those article 78 proceedings, we did some research to get a sense of our chances. Actually, the "we" was a summer associate here at Hodgson Russ, but regardless, we didn't like what we found. Based on the summer associate's research at the time (we ended up hiring the guy, so it's probably mostly right) of more than 300 proceedings brought under article 78 to

[5]N.Y. General Construction Law section 30.

[6]*Compare* N.Y. Tax Law section 2016 *with* CPLR section 506.

[7]N.Y. Tax Law sections 279-a, 288(5), 430, 478, 510, and 1138(a)(4), *as amended by* 1987 N.Y. Laws ch. 401 sections 3-7, 10, 11, and 6, respectively. 1985 N.Y. Laws ch. 65 section 83 amended Tax Law section 1138(a)(4) to exclude judicial review of officer assessments made under Tax Law section 1138(a)(3)(B) from deposit and bonding requirements.

[8]N.Y. Tax Law section 2016; and CPLR sections 7804(c) and 307.

[9]CPLR sections 402 and 7804(d).

[10]22 NYCRR section 800.2(c).

[11]*Compare* 22 NYCRR section 800.2(c) *with* 22 NYCRR section 800.12.

[12]N.Y. Tax Law section 2016.

[13]22 NYCRR section 800.8(a). The reply brief cannot exceed 15 typewritten pages.

[14]CPLR section 5528(a).

[15]CPLR section 5531.

[16]*See* CPLR sections 5601 and 5602.

review a tax appeals tribunal determination, it appeared that only around 40 had been successful.

That's a pretty low average. The reason has more to do with the standard of review than it does the merits or demerits of the various cases. Specifically, the third department's scope of review in those cases is limited to four specific questions: whether the tribunal "failed to perform a duty enjoined upon it by law"; whether the tribunal proceeded "without or in excess of jurisdiction"; whether the tribunal's decision was arbitrary and capricious or an abuse of discretion; or whether the tribunal's decision is supported by substantial evidence.[17]

Of the four previously listed questions that can be raised in the appeal, the most often applied standard is "substantial evidence" under CPLR section 7803(4), that is, "whether a determination made as a result of a hearing held, and at which evidence was taken, under direction by law is, on the entire record, supported by substantial evidence." The "arbitrary and capricious" test is applied from time to time as well, but the bottom line is that the courts give the tribunal wide deference; its decision really has to miss the mark if an appeal has any chance at succeeding.

2. Winning Examples

With that in mind, let's look at a few examples in which taxpayers have won, at the very least to offer up some sort of aspirational hope to potential litigants.

- ***Gaied v. Tax Appeals Tribunal*[18]: Statutory Construction, Rational Basis.** We'll start with our favorite, which is *Gaied*. Here, the question was whether the tribunal's interpretation of "permanent place of abode" comported with the meaning and intent of Tax Law section 605(b)(1)(B), specifically whether a person could be taxed as a statutory resident by virtue of an apartment maintained for his parents. The third department, in a split decision, confirmed the tribunal's decision against the taxpayer but recognized that "even though a contrary conclusion would have been reasonable based on the evidence presented, we are constrained to confirm, since our review is limited and the tribunal's determination is amply supported by the record." Thus, the third department reviewed the case under the "substantial evidence" standard of CPLR section 7803(4).[19] But the court of appeals reversed, finding that in view of the legislative history of section 605(b)(1)(B) and the regulations, there was "no rational basis" for the tribunal's interpretation.[20] The high court applied the "rational basis" test under CPLR section 7803(3). In essence, the court found that the tribunal simply misapplied the law.

- ***Emigrant Bancorp Inc. v. Commissioner*[21]: Statutory Construction, Pure Question of Law.** This case, like *Gaied*, shows that New York courts will not defer to the tribunal if they conclude that the tribunal just got it plain wrong. Indeed, a tribunal decision "will be accorded no deference when it merely resolves a question of law,"[22] which is to say that the issue is "one of pure statutory interpretation."[23]

  In *Emigrant Bancorp*, a bank appealed a tribunal decision sustaining a notice of deficiency. After a hearing, the ALJ canceled the notice of deficiency, but the tribunal reversed based on its interpretation of Tax Law section 1453. And since that was a pure matter of statutory construction and because the law itself was ambiguous, the court declined to defer to the expertise of the tribunal and held the petitioner met its heavy burden of demonstrating that its interpretation of section 1453 was the only reasonable construction.

  That is an important concept to keep in mind for any potential litigant. If your strategy is to argue that the tribunal got the facts wrong, misapplied some facts, or misjudged the credibility of a witness, good luck. It's unlikely such arguments will prevail. But if you are arguing that the tribunal simply got the law wrong, then you have a real shot. Indeed, that's likely the best recipe for a reversal.[24]

- ***Lake City Manufactured Housing Inc. v. Tribunal*[25]: Substantial Evidence Standard.** Taxpayers can sometimes win the hard way. In *Lake City*, the taxpayer commenced an article 78 proceeding to challenge a tribunal decision on a factual issue, namely whether the taxpayer met a sales tax exemption for installing mobile homes. The tribunal said it didn't, because the taxpayer failed to list installation costs on all of its invoices. But the tribunal found that despite some missing facts, the overall evidence illustrated that the same subcontractor installed all 85 homes. So the tribunal was simply applying a form-over-substance

[17] CPLR section 7803.

[18] *Matter of Gaied v. New York State Tax Appeals Trib.*, 22 N.Y.3d 592 (2014), *rev'g* 101 A.D.3d 1492 (3d Dep't 2012). The authors represented the taxpayer in that case.

[19] *Gaied*, 101 A.D.3d at 1494.

[20] *Gaied*, 22 N.Y.3d at 598.

[21] *Matter of Emigrant Bancorp Inc. v. Commissioner of Tax'n & Fin.*, 59 A.D.3d 30 (3d Dep't 2008).

[22] *West-Herr Ford Inc. v. Tax Appeals Tribunal*, 16 A.D.3d 727, 728 (3d Dep't 2005).

[23] *21 Club Inc. v. Tax Appeals Tribunal*, 69 A.D.3d 996, 997 (3d Dep't 2010), *citing Matter of Astoria Fin. Corp. v. Tax Appeals Trib. of State of N.Y.*, 63 A.D.3d 1316, 1318 (3d Dep't 2009).

[24] *Matter of EchoStar Satellite Corp. v. Tax Appeals Trib. of the State of N.Y.*, 20 NY3d 286 (2012); *British Land v. Tax Appeals Tribunal*, 85 N.Y.2d 13 (1995); *Newchannels Corp. v. Tax Appeals Tribunal*, 279 A.D.2d 164 (3d Dep't 2001); and *Raemart Drugs Inc. v. Wetzler*, 157 A.D.2d 22 (3d Dep't 1990).

[25] *Lake City Manufactured Housing v. State Tax Appeals Tribunal*, 184 A.D.2d 33 (3d Dep't 1992).

interpretation, and the third department held its decision was not supported by substantial evidence.

In any case, take those examples for what they are worth. The fact of the matter is that taxpayers can win those appeals, but it's not easy. Know what you are up against before diving in.

II. Getting Right to Court: Direct Court Actions

A. Declaratory Judgment Actions

Sometimes, of course, a taxpayer just wants to get right to court, essentially skipping the administrative phase altogether. Is that possible?

Usually, the answer is no. Taxpayers are normally required to exhaust their administrative remedies (that is, take their case through the division of tax appeals) as a prerequisite to commencing a declaratory judgment action or bringing any other litigation against the tax department.[26] But exhaustion is not required if the taxpayer is asserting that a taxing statute is unconstitutional on its face, a taxing statute is inapplicable to the taxpayer, or the taxing authority exceeded the scope of its jurisdiction.

1. Constitutional Claims

A taxpayer can bring a declaratory judgment action in supreme court challenging the constitutionality of a statute without having to exhaust administrative remedies.[27] Indeed, if administrative remedies and article 78 review are pursued when a constitutional question is involved, the court will generally convert the proceeding to an action for declaratory judgment.[28] The mere assertion of a constitutional right may not, however, excuse the failure to pursue administrative procedures.[29]

2. Statute Inapplicable

The claim that a taxing statute by its own terms does not apply in a given case can generally be reviewed in judicial proceedings other than those prescribed by statute, namely in a declaratory judgment action. Thus, a taxpayer will usually be permitted to maintain a declaratory judgment action in supreme court on the claim that a statute is wholly inapplicable.[30] The taxpayer can bring such an action without exhausting its administrative remedies provided for in the tax law.[31] If an article 78 proceeding is brought when the contention is that a taxing statute by its very terms does not apply, it may be converted to a declaratory judgment action.[32]

3. Scope of Jurisdiction Exceeded

The claim that the taxing authority exceeded the scope of its jurisdiction can be reviewed in judicial proceedings other than those prescribed by statute.[33] That also is true when an assessment is wholly fictitious and is made without any factual basis solely to extend a period of limitations.[34] Thus, a declaratory judgment action can be brought in supreme court on either of those claims,[35] and the taxpayer can bring such an action without exhausting the administrative remedies prescribed in the tax law.[36]

B. Article 78 Proceedings in State Supreme Court

One last little nugget here. Tax litigation may be ripe for article 78 review even without DTA reviewing the case first. In those cases, tax litigation begins as an article 78 proceeding in state supreme court or, as often happens, as a "hybrid" action under article 78 and article 30 (declaratory judgment actions) of the CPLR.

New York courts have allowed those sorts of hybrid actions to proceed when the mixture of relief requested straddles the less-than-clear boundaries that exist between article 30 and article 78. For example, in *Hodgson Russ v. Minnesota Department of Revenue*,[37] a law firm challenged the state of Minnesota's assertion of nexus under both article 30 and article 78.[38] The law firm sought a formal

---

[26] *See* CPLR section 7801(1).

[27] *Tenn. Gas Pipeline Co. v. Urbach*, 96 N.Y.2d 124 (2001); *Richfield Oil Corp. of New York v. City of Syracuse*, 287 N.Y. 234 (3d Dep't 1984); *Dun & Bradstreet v. City of New York*, 276 N.Y. 198 (1938); and *Top Tile Bldg. Supply Corp. v. New York State Tax Comm'n*, 94 A.D.2d 885, 886 (3d Dep't 1983), *appeal dismissed*, 60 N.Y.2d 653 (1983), *appeal dismissed*, 465 U.S. 1095 (1984). The authors represented the taxpayer in *Tenn. Gas Pipeline*.

[28] *See, e.g.*, *Tamagni v. Tax Appeals Tribunal*, 230 A.D.2d 417 (3d Dep't 1997), *aff'd*, 91 N.Y.2d 530 (1998); *Lundig v. Tax Appeals Tribunal*, 218 A.D.2d 268 (3d Dep't 1996), *rev'd on other grounds*, 89 N.Y.2d 283 (1997), *rev'd, remanded*, 522 U.S. 287 (1998); *Press v. County of Monroe*, 50 N.Y.2d 695, 702 (1980); and *Ames Volkswagen Ltd. v. State Tax Comm'n*, 47 N.Y.2d 345, 348 (1979).

[29] *See, e.g.*, *Pfaff v. Columbia-Greene Community College*, 99 A.D.2d 887 (3d Dep't 1984).

[30] *See Dun & Bradstreet*, 276 N.Y. 198; *Richfield Oil Corp.*, 287 N.Y. 234; *Slater v. Gallman*, 38 N.Y.2d 1 (1942); *Harcel Liquors Inc. v. Evsam Parking Inc.*, 48 N.Y.2d 503(1979); *Horner v. State*, 107 A.D.2d 64, 65 (3d Dep't 1985); and *Northville Indus. Corp. v. Dep't of Taxation & Fin.*, TSB-H-86(30)C (Sup. Ct., Suffolk Co. May 20, 1986).

[31] *Reader's Digest Ass'n*, 100 A.D.2d 871 (2d Dep't 1984).

[32] *See*, *e.g.*, *Building Contractors Ass'n v. Tully*, 65 A.D.2d 199 (3d Dep't 1978).

[33] *Dun & Bradstreet*, 276 N.Y. 198; *Hospital Television Sys. Inc. v. New York State Tax Comm'n*, 41 A.D.2d 576 (3d Dep't 1973); *see Niagara Mohawk Power Corp. v. City Sch. Dist. of Troy*, 59 N.Y.2d 262, 269, 271 (1983).

[34] *Slater*, 38 N.Y.2d 1 (citing *Brown v. New York State Tax Comm'n*, 199 Misc. 349 (Sup. Ct., Onondaga Co. 1950), *aff'd*, 279 A.D. 837 (4th Dep't), *aff'd*, 304 N.Y. 651 (1952).

[35] *Id.*; *Dun & Bradstreet Inc.*, 276 N.Y. 198.

[36] *Reader's Digest*, 100 A.D.2d 871.

[37] Erie County Supreme Court, Index 2014/000097. The authors' law firm was a party in this case.

[38] The law firm also requested relief under 42 U.S.C. sections 1983 and 1988.

declaration that it did not have substantial nexus with Minnesota for the tax years in question and that Minnesota's tax department had acted both in excess of its jurisdiction and in an arbitrary and capricious manner. The department moved to dismiss the claims, and Hodgson Russ cross-moved for summary judgment against the department. While Minnesota agreed to settle the matter by dropping any investigation or audit of the law firm for the disputed tax years, the supreme court entertained the viability of the law firm's hybrid claims in a single proceeding.

Because of the substantial overlap between article 78 and article 30, it is common for taxpayers to commence hybrid actions.[39] In fact, rarely will a taxpayer commence a nonhybrid article 78 proceeding in supreme court. But when no declaratory judgment relief is sought under article 30, a hybrid action should not be maintained. That situation is likely to arise in connection with the denial of a Freedom of Information Act request.[40] In that instance, an article 78 proceeding would be the appropriate vehicle for an appeal.

III. Conclusion

That was fun, wasn't it? We've taken you on a journey beginning with an audit letter and ending with (hopefully) a winning decision in New York's court of appeals. And in reality, of course, the most successful litigation is the one that never happens, so resolving your matter at the audit level is always preferable. Still, if you have to go all the way, we hope these articles provide some helpful guideposts. And if you have read all four in succession, email us with your thoughts (tnoonan@hodgsonruss.com; adoolitt@hodgsonruss.com). We'll be happy to respond to the ones with glowing reviews.■

[39] *Compare* CPLR section 7803 (article 78) *with* CPLR section 3001 (Article 30).

[40] *See* N.Y. Public Officer Law section 87; *Matter of New York Times Co. v. City of N.Y. Police Dept.*, 103 A.D.3d 405 (1st Dept. 2013); and *Goodson-Todman Enters. v. Town of Woodstock*, 133 Misc. 2d 12 (Sup. Ct., Ulster Cnty, 1986).