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The Six-Month Period for Issuing a Decision

By: Glenn Newman

The most noteworthy recent case was about, rather than by, the New York State Tax Appeals Tribunal. In *Matter of Bray Terminals, Inc. v. New York State Tax Appeals Tribunal* (decided March 12, 1998, and reported in the New York Law Journal on March 17, 1998),[1] the court found that the requirement for the Tribunal to issue a decision within the six-month period provided in Tax Law Search7RH2006(7) was not mandatory, but merely directory. Only upon a showing of substantial prejudice would the failure have any consequence.

The issue arose because during a four-month period two vacancies on the Tribunal caused no decisions to be issued. As a result, the decisions in approximately forty cases were delayed beyond the six-month period provided in the Tax Law. Bray Terminals' contentions that (1) the violation of the six-month rule and that (2) two of the three Commissioners who ultimately participated in the decision had not heard the oral arguments invalidated the Tribunal's decision were rejected by the Appellate Division.

As recently as February 1998, another decision of the Tribunal dealt with a motion by a taxpayer for recusal of two Tribunal Commissioners that, if granted, would have left only one Commissioner to decide the case. In *Matter of New York Fuel Terminal Corporation* (decided February 12, 1998), the taxpayer moved for recusal of one Commissioner on the grounds of personal bias or prejudice, alleging that Commissioner had been an advocate in a different case involving similar issues involving a registered motor fuel distributor and motor fuel tax. Another Commissioner voluntarily recused himself on the grounds that the answer submitted by the Division of Taxation in this matter had been prepared by him while he was in the Office of Counsel.

No Evidence of Bias

Denying the motion to recuse, the Tribunal stated that there had been no evidence introduced showing actual bias or prejudice. Further, citing *Matter of General Motors Corp. v. Rosa*,[2] the Tribunal stated that under the Rule of Necessity, where the dispute cannot otherwise be heard, there is justification to continue, notwithstanding a bona fide claim of bias. The same issue was raised in *Matter of Manhattan & Queens Fuel Corp.* (decided May 22, 1997), in which the Commissioner whom the taxpayer sought to have recused had actually litigated on behalf of the Division of Taxation in a different case involving the same taxpayer.

The Tribunal has proposed legislation that would permit the designation of deputies to act in the event another situation arises leaving it without a quorum of Commissioners to decide cases. In view of the fact that all three current State Tax Appeal Tribunal Commissioners previously were either Administrative

Law Judges or in the Office of Counsel of the Department of Taxation and Finance, the enactment of the Tribunal's proposal to provide for some means of dealing with conflicts is essential.

Personal Income Tax—The State Tribunal has spent a great deal of time deciding cases in which taxpayers claimed refunds of State income tax paid on Federal pensions. The New York Tax Law exempts State and local government employee pensions from State and local income tax; however, retired Federal employees' pensions are subject to tax. The U.S. Supreme Court decided that a similar provision in Michigan law unconstitutionally discriminated against federal retirees in *Davis v. Michigan*[3] and the New York Courts followed in *Duffy v. Wetzler*.[4]

After *Davis*, the Department of Taxation & Finance was inundated with refund claims made by federal retirees. The Tribunal was later subjected to a large volume of cases, since the Department denied many claims submitted after the statute of limitations for issuing refunds had expired (normally 3 years from the date of the return or 2 years from the date of payment, whichever is later).

The Tribunal has now dealt with almost all of the cases, listening to the variations on the theme expressed recently in *Matter of Reuben and Ruth Spiegel* (decided January 29, 1998). The Spiegels claimed that they were entitled to a refund of the tax that was unconstitutionally collected and that an employee of the Department had told them that they need not file a timely claim because their refund would be automatically processed when pending legislation authorizing payment was passed.

The Tribunal affirmed the Administrative Law Judge's denial of the refund claim, citing *Matter of Jones* (decided January 9, 1997). *Jones* held that New York's income tax procedure requiring the filing of refund claims within fixed time limits was a "constitutionally sound scheme which rectified any unconstitutional deprivation while simultaneously protecting the State's fisc." The issues surrounding what might have been said by one of several thousand Department of Taxation and Finance employees handling numerous telephone inquiries, did not change the fact that statutes of limitations are strictly construed.

In another series of cases involving tax-exempt pensions, the Tribunal decided that pensions received by retirees of the Long Island Railroad, *Matter of Langlan* (decided September 4, 1997), and the Manhattan and Bronx Surface Transit Operating Authority, *Matter of Jackson* (decided March 5, 1998) and *Matter of Byrne* (decided March 26, 1998),[5] also qualify for the exemption from State and local income tax as being paid by an agency of the State.

Commodity Straddles

In a different area of the personal income tax, the Tribunal dealt with the fallout from the IRS' efforts to attack tax shelters marketed in the mid 1970s, specifically in this instance, commodity straddles. In *Matter of James and Judith Boyle* (decided February 26, 1998), the taxpayers had been audited by the IRS for the years 1975 and 1976 and reached a settlement with the IRS (embodied in a closing agreement in 1983) resulting in a disallowance of a loss in 1975 and nonrecognition of a gain in 1976 resulting from the straddle. However, the taxpayer did not report the Federal change in income to the State. Having failed to make such a report, the State was permitted to and did assert a deficiency for the 1975 tax year based upon the disallowance of the loss in the closing agreement. The taxpayers did not complain about that adjustment, but wanted to offset the State tax deficiency with the refund that would have been due for 1976 under the closing agreement. The Division of Taxation objected to the offset, claiming that the statute of limitations on claiming a refund for 1976 had expired due to the failure of the taxpayer to seek it within the time set forth in the Tax Law.

The Administrative Law Judge held that the offset was available under the doctrine of equitable recoupment, which permits an otherwise time-barred overpayment to be used to offset a deficiency. The ALJ held that the criteria for allowing equitable recoupment (*i.e.*, that the claim involves the same type of tax, is paid during the same period, and involves the same transaction as the deficiency) were present. The Tribunal reversed the ALJ, holding that the taxpayer was not entitled to equitable recoupment since multiple transactions involving separate "legs" of the straddle were involved in generating the gains and losses in the two years and so the same transaction requirement of equitable recoupment did not apply.

Corporate Franchise Tax—The State Tribunal decided another case involving Federal changes, but this one in the corporate tax area. In *Matter of McDonnell Douglas Corporation* (decided January 8, 1998), the Tribunal interpreted a provision that states that during the additional period to assess a State tax due to a Federal change "[n]o change of the allocation of income or capital upon which the taxpayer's return . . . was based shall be made." Tax Law Search7RH1083(c)(7). McDonnell Douglas reported a federal change to the amount of its income and also changed its income allocation to New York to reflect the federal change. The Division of Taxation argued that the statutory bar to changing the allocation of income to New York applied to both the government and the taxpayer. The Tribunal rejected that argument and held that only the government is prohibited from changing the allocation percentage; taxpayers are not.

It is unusual, but not unheard of, for the tax laws to have 'one way' streets, that is, options open for only the government or the taxpayer, but not both. Certainly, there are elections that taxpayers may make on their returns that have been held to be one-sided; and, in most cases, only the taxing authority may look through the form of a transaction and consider the substance. It has been held that a taxpayer usually may not challenge the form it has chosen. *Sverdlow v. Bates*.[6] Interpreting Tax Law Search7RH1083(c)(7) as a 'one way' street for taxpayers provides a route for tax savings if the change in allocation is beneficial for the taxpayer, who would not propose a change to allocation if it would have an adverse effect.

It should also be noted that since the State Tribunal's decision was one of statutory interpretation of a provision with an almost identical counterpart in the New York City General Corporation Tax Law [Administrative Code Search7RH11-674.3(g)], the City Tax Appeals Tribunal may very well be bound to follow the State Tribunal's ruling as binding precedent. N.Y.C. Charter Search7RH170.d.

High-Profile Case

Real Property Transfer Gains Tax—One case under the now-repealed Real Property Transfer Gains Tax ("Gains Tax") decided by a State Administrative Law Judge involved high profile people (Donald Trump and the Helmsleys) and an even higher profile property (the Empire State Building).

In *Matter of NS 1999 American Company, as Nominee for the NS 1991 American Trust* (decided February 19, 1998), the Division of Taxation asserted a Gains Tax liability based in part on newspaper reports that an entity controlled by Donald Trump had "arranged equity financing for NS America in return for a 50 percent ownership" of a partnership that owned the fee to the Empire State Building. The building is subject to a long-term lease held by various entities that were controlled by the late Harry Helmsley. In April, 1994, a Gains Tax questionnaire was filed showing a transfer of the fee to the Empire State Building Partnership, with NS 1999 American Co. ("NS American") and Trump Empire State, Inc. ("Trumpco") as its partners. The questionnaire and a subsequent tax return indicated that NS American had retained over 99% of the ownership interest, and was eligible for the mere change in form exemption from tax because it transferred to Trumpco less than 1%.

Trumpco agreed to make a small capital contribution to the new partnership and provide expertise and day-to-day management services to the partnership. In exchange, Trumpco would get 50% of any increase in rents above the existing level (in the event the Helmsley leases were renegotiated or terminated). Also, Trumpco was to receive 50% of the income or gain on the sale of the partnership property in excess of NS American's capital contribution (set at $45,000,000).

The Division of Taxation pointed to the quoted language in the newspaper article. Also, it noted a magazine article in which it was reported that some people had said Mr. Trump did not own half of the Empire State Building. In response, the article quoted Mr. Trump as saying "the ultimate answer is that I own 50 percent of the building. It's a complicated formula. A case could be made that I actually own 50 percent. It's just a very complicated formula."

The Division proceeded to try to make the case that Trumpco had received a 50 percent interest in the partnership and, therefore, a taxable transfer of a controlling interest had taken place and the Gains Tax was due. The ALJ stated that there were no Tribunal or court cases that address how to determine each party's interest in a partnership. The Gains Tax statute, and the State and City transfer taxes, as well, define controlling interest as fifty percent or more of the capital, profits or beneficial interests in such partnership. Here, there were special allocations of income and gain that did not fit neatly into the statute.

In the end, the ALJ looked to the cases dealing with the mere change in form exemption and examined the economic realities of the transactions. The ALJ found that, all in all, Trumpco did not receive a 50 percent ownership interest in the partnership, notwithstanding the press reports. Trumpco had only received an interest in the potential 'upside' in the event the partnership prospered. This case highlights the many difficult issues that arise under the various transfer taxes that are still in effect when sophisticated partnership transactions involving special allocations of income, gain, and loss among the partners are presented.

Unincorporated Business Tax—The New York City Tax Appeal Tribunal has recently decided two noteworthy cases under the City's Unincorporated Business Tax ("UBT"). One involved Donald Trump, who was apparently keeping both Tax Tribunals busy. In this matter it was Mr. Trump's own UBT at issue. For the year 1984, Mr. Trump filed a Schedule C (Profit or Loss from Business) attached to his Federal income tax return and also filed a Schedule D (Capital Gains and Losses) with his Form 1040 showing a $2,365,352 gain from the sale of a condominium unit. On his UBT return, Mr. Trump reported the loss shown on his Schedule C, but did not report the gain shown on his Schedule D. The condominium was purchased under a joint venture agreement between Equitable Life Assurance and Mr. Trump to develop Trump Tower. The agreement granted each venturer options to purchase units. Mr. Trump exercised his option and purchased one unit for $634,648. Nineteen days later, he sold the unit for $3 million. The City claimed that the option was issued in connection with Mr. Trump's unincorporated business and that the resulting capital gain was subject to the UBT.

The City Tribunal agreed that UBT was payable on the gain. The Tribunal referred to the fact that Mr. Trump provided management and development services to the joint venture and that, in partial compensation therefor, he received the option. The Tribunal cited its decision in *Matter of 680 Realty Partners and*

CRC Realty Capital (decided April 26, 1996), for the proposition that a partner may be engaged in an unincorporated business if he provides management services to his partnership and is compensated for such services.

Another UBT matter dealt with the closely-watched issue of when is someone subject to UBT and when does someone qualify as an employee, exempt from UBT. In *Matter of Frances Frankel* (decided December 19, 1997), the taxpayer worked under a contract with a geriatric center to provide nursing services to its clients. The taxpayer filed a Schedule C with her Federal income tax return claiming various deductions, including contributions to a Keogh plan.

The taxpayer did not file a UBT return. Upon receiving an inquiry letter from the City seeking a UBT return or an explanation as to why a return should not be required, the taxpayer filed a UBT return and then sought a refund of the tax paid.

There is a long history regarding the interplay between filing a Federal Schedule C and a City UBT return. Years ago, in response to the City's argument that the filing of a Schedule C showing Profit (or Loss) from Business in NYC requires the filing of a UBT return, the Appellate Division held that that was not the rule in *Matter of Goldman*.[7] In *Goldman*, the dissent specifically sought to have the factor of whether the taxpayer received a W-2 statement of wages or a Form 1099 and filed a Schedule C be determinative of the UBT status. However, the majority disagreed, and litigation to determine whether someone is subject to the UBT continues.

The Tribunal decided that a full review of all factors relevant to establishing an employer-employee relationship was called for. The essential elements of direction and control over the job to be done and the means of performing the job determines the individual's status as an employee not subject to UBT or an independent contractor liable for UBT. In the instance of this nurse and her agreement with this geriatric center, employee status was found, and her UBT was refunded.

One main contention put forward by the City and rejected by the Tribunal was that the presence of a deduction for a Keogh plan precluded finding employee status, since the taxpayer ought to be bound by the position taken on her Federal income tax return and the tax benefit derived therefrom. The Tribunal stated that it had previously decided to review all factors in *Matter of Baxter* (decided October 17, 1996), and the taking of a Keogh deduction was not determinative of the issue. In the meantime, difficult issues remain, with inconsistent rules for federal income tax, withholding, self-employment, unemployment, disability coverage, and City UBT purposes. An individual could be deemed an employee by some agencies administering the programs and an independent contractor by others.

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[1] Please note that the author participated in writing an Amicus Curiae Brief submitted in Bray Terminals. A motion for leave to appeal to the Court of Appeals is pending.
[2] 82 N.Y.2d 183 (1993).
[3] 489 U.S. 803 (1989).
[4] 174 A.D.2d 253 (3rd Dept. 1992), appeal dismd. 79 NY2d 976 (1992).

[5] Pursuant to a stipulation, 120 similarly situated taxpayers and the Division of Taxation agreed to be bound by the outcome of *Byrne*.

[6] 83 App. Div. 487 (3rd Dept. 1954).

[7] 126 A.D.2d 497 (1st Dept. 1987). The author was among those representing New York City in *Matter of Goldman*.