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Procedures for Protest to New York State and City Tribunals

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This new feature of the New York Law Journal will highlight cases involving New York State and City tax controversies decided by the New York State Tax Appeals Tribunal (State Tribunal) and the New York City Tax Appeals Tribunal (City Tribunal). In order to understand the cases and their significance, however, it may be helpful to describe the procedural process involved in contesting New York State and City taxes, as well as a bit of the history of how the current structure evolved. Therefore, this first article in the series will address:

- The history of the Tribunals
- The tax controversy process
- How the Tribunals operate

History

New York State and New York City each have their own Tax Appeals Tribunals. Although referred to as Tribunals, they are comprised of two distinct divisions, one composed of Administrative Law Judges (ALJs) who function as hearing officers, and the other comprising three Commissioners, who function as an appellate board that rules upon appeals taken from determinations of the ALJs. The Tax Tribunals hear and determine all controversies involving New York State and New York City income and excise taxes, that is, all taxes other than real property taxes.

The Tribunals were created to provide a forum for adjudicating tax controversies independent of the tax agency asserting the tax liability. For decades, protests of tax liabilities were handled through an administrative process that culminated with a determination by the State Tax Commission or the New York City Commissioner of Finance. Although these determinations were subject to CPLR Article 78 review by the courts, this process was perceived to be inherently unfair to taxpayers because a taxpayer could not receive a hearing by someone unconnected with the taxing authority until a petition for Article 78 review was filed and, in most instances, a bond posted for costs and to secure the collection of any tax deficiency.

In 1986, as a result of the joint efforts of tax practitioners and the New York State Department of Taxation and Finance, the New York State Tax Appeals Tribunal was created with jurisdiction over all taxes administered by that Department (e.g. personal income taxes, corporate taxes and sales and use taxes). Ch.282 of the Laws of 1986. In 1989, the New York City Charter established the New

York City Tax Appeals Tribunal with jurisdiction over a limited number of City taxes; the City Tribunal's jurisdiction was expanded in 1992 to include all nonproperty taxes administered by the New York City Department of Finance. Ch. 808 of the Laws of 1992.

The Controversy Process

The State and City procedures for asserting a tax deficiency and the adjudication of a protest of that deficiency are significantly different from the Federal procedures. Under IRS procedures, the taxpayer receives a Revenue Agent's Report (RAR), that explains in some detail the nature of the audit adjustments, and gives the taxpayer 30 days to respond to the proposed adjustments. The taxpayer may then protest the issues raised by seeking a conference with the Appeals Office which, although within the IRS, is independent of the Examinations Division.

In contrast, a Notice of Deficiency from the State or Notice of Determination issued by the City merely sets forth the amount of tax, interest and any penalty due. Although a taxpayer is entitled to an exit conference at the conclusion of a field audit, at which he may discuss the issues raised, those assertions are not set forth in any formal document issued to the taxpayer. As a result, petitions protesting a New York State or City tax determination may be very simple and need only contain enough information to identify the notice protested, state the tax being disputed and be properly executed. Generally, the taxpayer has ninety days to protest a determination or two years to protest a denial of a refund claim, but each statute must be checked carefully for the time period within which to file a protest.

Once a statutory notice is issued, a taxpayer has the option of requesting a conference before a "conciliator" who works for the tax department in either the State's Bureau of Conciliation and Mediation Services or the City's Conciliation Bureau. If the case is not resolved in the conciliation process (each tax departments' statistics show that over 80% of cases are resolved at conciliation) the taxpayer has 90 days from the date of the issuance of the conciliation order (or the taxpayer's withdrawal from conciliation) to file a petition with the Tribunal.

Petitions must be filed directly with each Tribunal at its statutory office. The petitions are directed to the Administrative Law Judge (ALJ) parts of each Tribunal. Each Tribunal has its own extensive mailing rules which should be thoroughly reviewed by anyone practicing before it. Regs. Search7RH3000.22; Rule Search7RH1-17.

Here it should be noted that the State Tax Tribunal's office is located in Troy, New York. All petitions must be sent to that office. For several years, up until April, 1997, all hearings before an Administrative Law Judge in the State Tax Tribunal were held in Troy. Now, upon request of the taxpayer, and subject to scheduling problems, State ALJ hearings may also be held in Manhattan. There are ongoing discussions about providing hearings in other parts of the State as well.

All City Tribunal petitions must be sent to its office in the Municipal Building in lower Manhattan, and all hearings are held at that location.

Both Tribunals have a small claims procedure. Tax Law Search7RH 2012; N.Y.C. Charter Search7RH169(e). The City Tribunal's small claims procedure is limited to controversies where the disputed tax is \$10,000 or less, exclusive of interest and penalties. State Tribunal small claims are limited to matters involving \$20,000 for any 12-month period (exclusive of interest and penalties) or \$40,000 of tax for a 12-month period if the case involves the sales and compensating use tax. Reg. Search7RH3000.13(b).

The small claims procedure is intended to be an expedited proceeding and is available solely at the option of the taxpayer. Under the State process, until the recent reconvening of hearings in Manhattan, the small claims procedure was the only way to have a protest heard in a place other than Troy, N.Y. The trade-off for the expedited and informal small claims process is that the determination issued by the presiding officer (as differentiated from an Administrative Law Judge who hears a non-small claims matter) is *not* appealable by either party. Tax Law Search7RH2012; N.Y.C. Charter Search7RH169(e). Therefore, very careful consideration must be given before invoking the small claims procedure.

For cases which are not governed by the small claims process, each Tribunal's rules require the tax department's advocate to serve an answer to the taxpayer's petition; and each Tribunal permits limited discovery by the parties. Bills of Particular are frequently used to identify and clarify issues. Both Tribunals encourage the use of admissions and stipulations so that the hearing can focus on the real disputed issues. Experience has shown the State attorneys to be more receptive to stipulations than the City attorneys. Ordinary civil discovery devices such as interrogatories or depositions generally are not permitted.

Pre-Hearing Talks

The City ALJs hold pre-hearing conferences in which the issues may be clarified, settlement discussions encouraged and means of expediting the hearing discussed. Often stipulations of facts are discussed and issues may be refined or settled at these pre-hearing conferences. While the City's ALJs will listen to the parties positions and frequently play the role of moderator between the adverse parties, they cannot force a settlement and do not participate in negotiations. The State Tribunal has announced that is about to institute a pilot program for a comparable procedure.

State regulations require the parties to submit a pre-hearing memorandum that identifies witnesses expected to be called and contains a brief description of the evidence to be relied upon. The purpose of the pre-hearing memorandum and the City's pre-hearing conference is to get the parties thinking about how they will present their cases and, it is hoped, expedite the actual hearing.

The hearing before the ALJ is where the record is made, documents are placed in evidence and testimony is taken. It is the *only* opportunity for the taxpayer to set forth the evidence upon which the ALJ and then the Tribunal will make their decisions. The Appellate Division, where appeals from Tribunal decisions are heard, will review the record made at the ALJ hearing to determine whether there is substantial evidence in the record to support the determination. Tax statutes generally place the burden of proof upon the taxpayer challenging the Department's assessment so the evidence in the record often will make or break the case. The ALJ hearings are therefore an exceedingly important part of

the tax controversy process, and taxpayers must take care to present the full factual basis for their positions at these hearings. Although the proceedings before the ALJ are formal, they still are administrative in nature, and therefore traditional rules of evidence are not strictly enforced.

Hearing Not Needed

Where the factual development of a case does not require a hearing the parties can agree to a determination upon submission without the need for appearances by counsel or witnesses. Reg. Search7RH 3000.12 ; Rule Search7RH 1-09(f). The matter may be determined on stipulated facts, or even the stipulation of an entire record if the parties can agree to do so. Post-hearing memoranda may be submitted and the ALJs will also consider proposed findings of fact to be included in their determinations.

Pursuant to statute, an ALJ determination is required to be issued within six months after the later of the conclusion of the hearing or the submission of all documents and briefs. Tax Law Search7RH2010.3.; N.Y. C. Charter Search7RH171.a(2). The statute establishing the State Tribunal provides that "[d]eterminations issued by administrative law judges shall not be cited, shall not be considered as precedent nor be given any force or effect in any other proceedings." Tax Law Search7RH2010.5. This leads to interesting situations since it may be to a party's advantage *not* to appeal an ALJ decision in order to avoid having a Tribunal decision that would stand as precedent on the issue. This also sometimes leaves tax advisors in the predicament of having an ALJ determination that is directly on point but which cannot be relied upon, or even cited, as precedent.

Either the taxpayer or the tax department may file an exception to the ALJ decision within thirty days after the determination is issued. Extensions of the thirty-day period may be obtained upon written request within the thirty-day period. Generally, the first request for an extension of time for a reasonable period is granted without the need for reciting extensive reasons. However, in all cases the request to extend the time for filing an exception must be made in writing and must be made before the expiration of the thirty-day period.

Briefs are to be filed with the exception or within a fixed period of time after the exception has been filed. After the opposing party files a reply brief, oral argument may be requested. The granting of that request is a matter within the discretion of the Tribunal. The practice has been that the City Tribunal almost always grants oral argument when asked, while the State Tribunal grants argument more sparingly. Oral argument is heard by the full panel of Tribunal Commissioners participating in the decision.

State Sets Precedent

As a result of the negotiations leading to the creation of the City Tribunal, the statute provides that the City Tribunal is bound to follow the precedent set by the State Tribunal. The effect of this language is currently the subject of much debate among tax practitioners and also is the subject of pending litigation involving U.S. Trust Corporation. In that case, the taxpayer was the subject of a bank tax audit performed by the State and City under a joint audit program.

Before the State Tribunal (*Matter of U.S. Trust Corporation*, DTA No. 810461, decided April 11, 1996) the taxpayer successfully defended against a claim that its Delaware subsidiary should be required to join in the filing of its combined bank tax return. A City ALJ determination (issued before the State Tribunal ruling) found in favor of the City and required the subsidiary to be included in the combined bank tax return. *Matter of U.S. Trust Corporation and Subsidiaries*, TAT(H)93-204(BT), TAT(H)93-205(BT), TAT(H)93-804(BT) decided December 14, 1995.

The appeal by the taxpayer is now pending at the City Tribunal level. The City attorneys have argued that the record made in the City proceedings is different from that made in the State matter and, therefore, the City case involves issues not considered at the State level. Along with its substantive position on the merits of combination, the taxpayer is arguing that the City Tribunal is statutorily bound to follow the State Tribunal result. Obviously, the City Tribunal's decision in this case will be very interesting, not simply for the substantive analysis, but also for its treatment of the issue of State/City conformity in Tribunal decisions.

Both Tribunal statutes require a decision to be issued within six months after the final submission of papers or the oral argument, whichever is later. Tax Law Search7RH2006.7; N.Y.C. Charter Search7RH171(a)(3). In August 1996, two Commissioners retired from the State Tribunal; leaving only a single Commissioner. Since the participation of two Commissioners is required to issue a decision, the entire State Tribunal process was halted from August, 1996 until the State Senate confirmed two new Commissioners in December, 1996.

Decisions in 42 cases that had been heard by the prior Commissioners were later issued by the newly reconstituted Tribunal after the expiration of the 6-month statutory period. Litigation is pending which raises the issue of the effect of this failure to issue timely decisions. Although a similar massive failure to comply is unlikely to occur with any frequency, this is another issue to watch.

Appeals from Tribunal decisions are available only to taxpayers; the tax departments have no right to appeal from Tribunal decisions. Tax Law Search7RH2016; N.Y.C. Charter Search7RH171(b). In a unique provision, under the additional New York City Mortgage Recording Tax, a tax administered by the State Department of Taxation and Finance for the benefit of the City of New York, the City is made a party to proceedings before the State Tribunal and may appeal decisions issued by the State Tribunal. Tax Law Search7RH251.

Action Against Tribunal

The Department of Taxation and Finance did manage to protest a Tribunal decision in one instance--by bringing an action against the State Tribunal itself! *Tax Dept. v. Appeals Tribunal*, 151 M2d.326 (Sup. Ct., Albany Co., 1991). That case started out as routine residency case. The taxpayer claimed that he did not live in New York and protested a personal income tax assessment to the Tribunal. At the ALJ level the taxpayer won, but the ALJ also noted that the notices of deficiency had not been placed in evidence by either party. Upon the Department's exception, the Tribunal decided that it did not have subject matter jurisdiction and vacated the tax assessment based upon the failure to have the notices in evidence.

The Department then filed a proceeding in Albany County Supreme Court alleging that the Tribunal had exceeded its authority and did not comply with its own rules by failing to give notice to the parties of its intent to dismiss the exception on jurisdictional grounds. Recognizing that the Department could not seek judicial review of the Tribunal decision on the merits, the court upheld the Department's right to seek a determination that the Tribunal had acted beyond its authority. This is, of course, different from a circumstance in which the Department's objection to the Tribunal's decision lies in its substance, and not in the Tribunal's statutory authority to render the decision.

A taxpayer's appeal of a Tribunal decision is taken directly to the Appellate Division, Third Department in the case of an appeal from the State Tax Tribunal, and to the First Department in the case of an appeal from the City Tax Tribunal.

The next in this series of articles on State and City tax controversies will focus on the standard of review applied by the Courts in Article 78 appeals from Tribunal decisions, the scope of the Tribunals' jurisdiction, and some of the major cases that have shaped the Tribunals' view of its role and function in adjudicating New York tax cases.

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