NY Tax Minutes: Trump Tax Updates, End To SALT Cap Suit

By **Timothy Noonan and Craig Reilly** (November 6, 2019, 1:46 PM EST)

Timothy Noonan

Craig Reilly

It seems that President Donald J. Trump often finds himself at the center of New York state tax news, and therefore at the center of our monthly "NY Tax Minutes" column. This month is no different. First, the president continues two separate lawsuits seeking to prevent disclosures of his personal income tax returns, and second, Trump, whose name has graced New York buildings and tabloid headlines for decades, recently declared that he plans to abandon his New York tax residency for the warm weather (and low taxes) of Florida.

But Trump is not the only story making news this month. We also cover a federal court's recent dismissal of New York's challenge to the state and local tax, or SALT, deduction cap, along with a review of the new and noteworthy cases from the New York Division of Tax Appeals. Lastly, we outline some helpful recent guidance from the state and city tax departments, including the city's treatment of global intangible low-taxed income, or GILTI, and the state tax department's updated guidance for both marketplace providers and vapor products dealers.

The Headlines

Trump Files Florida Declaration of Domicile

New York state personal income tax residency audits have always been a major component of the state's tax enforcement efforts. Year-over-year, for example, personal income taxes make up the bulk of the state's tax collections, with over $48 billion collected in the state's most recent 2018-2019 fiscal year.[1] The likelihood of a New York residency audit is so high that we generally peg the odds of an audit for most of our high net worth clients at roughly 100%. How do you like those odds?

So, what are the chances that the state decides to audit one of its most famous residents, who currently occupies the White House and remains in a near constant back-and-forth with the state's governor and other taxing authorities? Well, we're about to find out.

As first reported by the New York Times, and as confirmed on the president's Twitter feed, Trump will soon be making Palm Beach, Florida, his permanent tax residence. According to the president's tweets: He will always "cherish" the people of New York, but "unfortunately," the President claims, "despite the fact that I pay millions of dollars in city, state and local taxes each year, I have been treated very badly by the political leaders of both the city and state." The president therefore concludes that it is "best for all concerned" for him to leave New York and make Florida his new home.

There's only one problem with the president's claim. If a tweet were enough to convince the New York State Tax Department that an individual has legally abandoned his New York tax residency, we'd be out a job. Instead, we could a write a book on the difficulties of trying to leave New York (in fact, we have).[2] And the president faces a number of obstacles ~~if~~ when the state decides to audit his change of residency.

A New York state residency audit is difficult, intrusive and document-intensive, and the New York Tax Department has one of the most sophisticated and aggressive residency-audit programs in the country. The state's audits focus on not just one, but three, general areas. First, the auditors will focus on the first residency test, called the domicile test. Second, the auditors will look to the alternative residency test, called statutory residency or the 183-day test. And finally, even if you are able to establish nonresidency, the audit will also examine whether you properly allocated your sourced income to New York on your tax return.

The president is likely to face pushback on all three fronts.

First, as the party asserting a change of domicile, the president will have the burden to prove, by clear and convincing evidence, that he has both abandoned his historic New York domicile and moved to Florida with the intent to remain there indefinitely. In other words, a tie (or a close case) goes to the Tax Department, and the department will analyze various factors of the president's life including his professional and family connections; his homes; the location of his near-and-dear personal items; and the amount of time the president spends in each location.

Second, with respect to statutory residency, so long as the president keeps his Trump Tower penthouse, the state would treat the president as a New York resident in any year that he spends more than 183 full or part days in New York, regardless of his domicile.

And, third, as a nonresident, the president would still be required to pay tax on income that is derived from New York sources, which includes items such as wage income associated with days worked in New York; director's fees; gains on the sale of property located in New York; commissions derived from New York customers; and income from partnerships or other flow through entities.

The only factor that may weigh against a high likelihood of an audit here is the lingering accusation that the president generally avoids recognizing any taxable income in the first place. Gov. Andrew Cuomo, for example, responded warmly to the news of Trump's new home via Twitter, announcing, "Good riddance. It's not like @realDonaldTrump paid taxes here anyway … He's all yours Florida." But somehow, we don't see the state letting go so easily.

Lawsuits Continue Over Trump's Tax Returns

The amount at stake in a potential Trump residency audit remains one of the great unknowns of the president's first term, as the fights over disclosing Trump's tax returns continued on two fronts this past month.

First, the president sought to prevent his accounting firm, Mazars USA LLP, from turning over his tax records to the New York County District Attorney's Office in connection with an ongoing criminal investigation. In a complaint originally filed with the U.S. District Court for the Southern District of New York,[3] the president argued that he cannot be subject to any criminal process while in office. Specifically, the president argued that a grand jury subpoena that attempts to criminally investigate a sitting president is unconstitutional, and he therefore asked the court to enjoin enforcement of the district attorney's subpoena until after he leaves office.

U.S. District Judge Victor Marrero of the U.S. District Court for the Southern District of New

York originally ruled that Trump wasn't entitled to absolute immunity from criminal investigation.

And, on Nov. 4, less than two weeks after Trump's attorneys made the headline-grabbing claim at oral argument that local authorities would be barred from investigating the president even if he shot someone on Fifth Avenue, the U.S. Court of Appeals for the Second Circuit affirmed the district court judge's ruling,[4] finding that "presidential immunity does not bar the enforcement of a state grand jury subpoena directing a third party to produce nonprivileged material, even when the subject matter under investigation pertains to the President."

The case is now likely heading to the U.S. Supreme Court, which, if it takes up the argument, will have the final word on whether anyone actually gets to see the president's elusive tax returns.

And this isn't the only legal action involving the president's tax returns. As we **reported** in June, Cuomo recently signed legislation authorizing the state to provide the president's state tax return information to Congress. In July, 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 and Finance seeking to prohibit Congress from obtaining his state tax information.[5]

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 New York state defendants have since filed a motion to dismiss the president's suit, arguing that the U.S. District Court for the District of Columbia lacks personal jurisdiction over them and that the district is an improper venue for Trump's legal challenge.

Judge Dismisses States' Challenge to SALT Deduction Cap

A federal judge has dismissed the lawsuit filed by Connecticut, Maryland, New York and New Jersey, challenging the constitutionality of the state and local tax deduction cap. As we **reported** last November, the states' lawsuit alleged that the SALT cap overturned more than 150 years of precedent, dating back to the first federal income tax enacted in 1861. And the states claimed the law was unconstitutional, violating the 10th Amendment, the 16th Amendment, and Article 1, Section 8, of the U.S. Constitution.

On Nov. 2, 2018, the federal government filed a motion to dismiss the complaint. And in September, U.S. District Judge J. Paul Oetken of the Southern District of New York granted the government's motion to dismiss.[6] The court ruled that the Tax Cuts and Jobs Act's $10,000 SALT deduction cap was not unconstitutionally coercive and found that the states had not plausibly alleged that the cap meaningfully constrains the states' decision-making processes.

Though Judge Oetken said that the SALT deduction cap "makes certain state and local policies more attractive than others," he declined to speculate on Congress' motives in passing the legislation. He added that even if Congress intended to prompt states to lower their taxes (one of the states' allegations), the ultimate decision to do so remained with the individual states.

Cuomo clearly disagreed with the court's ruling, announcing in a Sept. 30 statement, "There is no doubt in my mind that President Trump's unfair tax policy targets New York and other blue states by funding tax cuts for corporations and the rich on the backs of New Yorkers."[7] The governor adds that the federal government's tax policy is "unprecedented, unlawful, punitive and politically motivated — and it must be stopped."

At this point, it appears as though the states could be picking a fight they can't win — at least one they probably can't win in the federal courts. But given the other workarounds to the SALT deduction cap, such as charitable deductions and entity-level taxes that continue to pop up around the country, along with Cuomo's vow to fight on, we don't expect state politicians to back down from their challenges any time soon.

The Cases

Each month, we highlight new and noteworthy cases from the New York Division of Tax Appeals and Tax Appeals Tribunal, along with any other cases involving New York taxes. This month, we cover the latest round in Moody's long-running battle over the proper allocation of its credit rating receipts. We also cover the Tax Appeals Tribunal's review of sales tax penalties assessed against the owner of several parking garages, where the underlying liabilities resulted from the misdeeds of the garages' chief financial officer.

Moody's Granted Alternative Apportionment for Credit Rating Receipts

In Matter of Moody's Corp. & Subsidiaries,[8] we saw the latest round in Moody's long-running battle over the proper allocation of its credit rating receipts for purposes of New York state's pre-2015 cost-of-performance based sourcing rules.

We **covered** the last round of the Moody's dispute in our June article, but for those new to "NY Tax Minutes," Moody's is involved in several lines of business, with its major source of revenue coming from analyzing the creditworthiness of debt issued by various securities issuers (corporate and governmental). Once the debt is rated by Moody's, it is typically posted, so that the investing public becomes aware of the rating.

Because Moody's is a New York City-centric business, any cost-of-performance based sourcing methodology would have resulted in a significant New York state tax bill. So Moody's started asked for alternative apportionment beginning in 2008. And it asked a lot of times. Here is a fairly damning phrase from the most recent determination, "The Division did not formally respond[.]" This phrase is repeated no less than four times in the judge's findings of fact involving Moody's requests for alternative apportionment.

In 2014, Moody's again requested alternative apportionment, and this time it was finally granted, allowing Moody's to source receipts based on the location of the issuer of the debt being rated. But throughout all of this back-and-forth, Moody's got wind of a rumor that its biggest competitor, S&P, had already struck a prior deal with the Tax Department that allowed it to source its receipts on a destination basis.

Moody's 2011 to 2014 corporate franchise tax returns were then selected for audit, and it was uncovered that Moody's had sourced its credit rating receipts to New York based on the ratio of New York population to U.S. population, which resulted in a single-digit apportionment percentage. On audit, the Tax Department made multiple assertions, including that because credit rating receipts are service receipts, the receipts must be sourced based on the location of performance.

In reviewing the Tax Department's audit findings, the administrative law judge reached several different conclusions. In a nutshell, however, the ALJ found that although credit rating receipts are receipts for services, and thus should generally be sourced based on location of performance, the Tax Department arbitrarily and improperly denied Moody's requests for alternative apportionment methods for the 2011 through 2013 tax years. Accordingly, the ALJ permitted Moody's to use location-of-issuer sourcing (this differed from Moody's population-based sourcing) for all of the years. The Tax Department's argument that Moody's had not made requests for alternative apportionment for the 2011 through 2013 tax years was dismissed, since the facts found showed that Moody's had requested alternative apportionment methods on a fairly regular basis since at least 2008.

The ALJ also ruled, however, that the Tax Commissioner was permitted to differentiate between the treatment of S&P and Moody's, as S&P's separate treatment was based on the state's desire to avoid a significant loss of 3,000 jobs to New Jersey, and any discrimination was therefore incidental and not purposeful.

This is a meaty determination (nearly 80 pages) with lots of money involved and several close call issues. We therefore expect to see the case work its way up to the full Tax Appeals Tribunal.

Tax Appeals Tribunal Rules Theft Does Not Support Penalty Abatement

In Matter of Reuben,[9] the petitioner Gregg Reuben was the founder of Alliance Parking Services LLC, which was the sole member of 12 LLCs that operated various parking lots and garages around New York City.

Because of Alliance's growth, Reuben hired a chief financial officer and comptroller to run the business's finances. The CFO, Kwesi Bovell, was in charge of paying vendors, managing payroll and filing the companies' sales tax returns, in addition to paying the tax due. At some point, however, Reuben started receiving calls that payments weren't being made, and Bovell's reasons as to why this was happening seemed suspicious, so Reuben fired him. Reuben then did some research into the financial state of the company and realized that Bovell had failed to file and pay certain sales tax that was due, which resulted in the Tax Department issuing 44 notices of determination for unpaid sales and use tax.

Reuben was then assessed individually as an officer or responsible person of the LLCs. Reuben challenged his status as a responsible person, but the Tax Appeals Tribunal held that under Tax Law Section 1131, Reuben was per se liable for the sales and use tax due because he was a member of Alliance, which was the sole member of the 12 individual LLCs that received the assessments. This piece of the tribunal's ruling wasn't overly surprising, but to add insult to injury, the tribunal also refused to abate any of the penalties assessed against Reuben.

The tribunal affirmed the imposition of penalties because it was, according to the tribunal, Reuben who hired Bovell, and he chose to not oversee Bovell's actions and gave him near-total control over financial matters. According to the tribunal, Reuben "made the choice to focus his attention on other aspects of the business, thereby leaving Bovell unsupervised and allowing him to perpetuate his seemingly criminal scheme." That's the part that gets us.

As explained in the tribunal's decision, Reuben filed a separate civil complaint against Bovell alleging that he diverted money from Alliance to himself. And although the complaint had not been answered by the date of the hearing, it appears that the underlying liabilities were directly caused by the fraudulent (if not criminal) acts of someone other than the responsible person facing an individual tax assessment. It seems to us that if liabilities are caused by another's criminal actions, it's hard to accuse anyone other than the bad actor of "willful neglect," which is the general standard for imposing penalties in New York.

Other Guidance

NYC Breaks From State With New GILTI Guidance

New York City issued two recent finance memoranda regarding its treatment of global intangible low-taxed income and other income earned overseas. The memoranda are intended to explain the city's response to the federal Tax Cuts and Jobs Act, or TCJA, which created new provisions in the Internal Revenue Code regarding income earned from overseas operations.

Under the TCJA, for federal tax purposes, a U.S. shareholder of a controlled foreign corporation, or CFC, is now required to include in gross income its GILTI, which is the excess of a U.S. shareholder's net CFC-tested income for the tax year over the U.S. shareholder's net deemed tangible income return for the tax year. To help mitigate the effect of GILTI inclusions, however, the TCJA also added Code Section 250, which provides U.S. corporate owners of CFCs with a 50% deduction to potentially offset GILTI.

In Finance Memorandum 18-9,[10] the city broke with New York state and announced that it requires business corporation tax taxpayers to include net GILTI income in entire net income, which is the taxpayer's GILTI recognized under Section 951A less the allowable Section 250(a)(1)(B)(i) deduction. This guidance differs from New York state's **recently enacted law**, which exempts 95% of GILTI from the state corporate franchise tax base without allowing for the 50% deduction. New York City therefore decoupled from the state's decision to exempt 95% of GILTI from the state corporate franchise tax base, choosing instead to conform to the federal 50% deduction.

The city continued its GILTI guidance in Finance Memorandum 18-10,[11] providing detailed instructions for federal S corporations and partnerships subject to the city's general corporation tax, or GCT, and unincorporated business tax. The guidance notes that "under the City's GCT ... entire net income is the same as the entire taxable income which a taxpayer would have been required to report to the United States Treasury Department if it had not made an election under Subchapter S." Therefore, "taxpayers subject to the GCT ... will be required to compute their GILTI inclusion and deduction amounts as they would if they were C corporations." This means that although the federal GILTI deduction does not apply to S corporations or their shareholders, taxpayers subject to the GCT are permitted to calculate entire net income by taking the GILTI deduction into account. This should come as welcome news to S corporation taxpayers subject to the city's GCT.

The memorandum goes on to provide that GILTI earned by New York City companies must also be included in taxpayers' business allocation percentages when derived from stock considered to be business capital. Specifically, the net GILTI income must be incorporated in the business allocation percentage's denominator, but not the numerator, according to the memorandum.

New York State Tax Department Issues Vapor Products Dealer Registration and Filing Requirements

The New York State Tax Department has advised dealers of vapor products in a new technical memorandum[12] that beginning Dec. 1, a 20% supplemental sales tax will be imposed on all retail sales of vapor products and that all vapor products dealers are required to register with the Tax Department for each location where such products are sold. Given the recent national focus on vapor products, we expect the Tax Department to actively enforce its new laws.

The memorandum defines the terms “vapor product” and “vapor product dealer” and provides detailed instructions for new vapor product dealer registrations. The memorandum also notes that if a person sells cigarettes and tobacco products, they must still register as a vapor products dealer even if they already possess a cigarette and tobacco license. The Tax Department has posted a new vapor products summary on its website.[13]

New York State Updates Sales Tax Guidance for Marketplace Providers

The New York State Department of Taxation and Finance also updated its guidance on the sales tax collection requirements for marketplace providers.[14] The updated guidance reflects legislation enacted June 24, which increased the sales threshold for marketplace providers from $300,000 in annual sales of tangible personal property to $500,000 in annual sales, retroactive to June 1.

Marketplace providers — which are defined as those who (1) provide a sales forum, and (2) collect sales receipts — who meet the new sales thresholds are required to register for and collect and remit sales tax on their marketplace sellers’ sales to New York customers.

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] https://www.tax.ny.gov/research/collections/fy_collections_stat_report/2018_2019_annual_statistical_report_of_ny_state_tax_collections.htm.

[2] https://www.hodgsonruss.com/assets/htmldocuments/2019%20What%20to%20Expect%20in%20a%20Residency%20Audit.pdf.

[3] https://s3.amazonaws.com/pdfs.taxnotes.com/2019/2019-36128_TNTCourts_TRUMP-complaint.pdf.

[4] https://s3.amazonaws.com/pdfs.taxnotes.com/2019/2019-41918_TNTCourts_TRUMP-VANCE-opinion.pdf.

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

[6] https://s3.amazonaws.com/pdfs.taxnotes.com/2019/2019-37319_STTDocs_NYdistct_093019NewYorkVsMnuchinOpinion.pdf.

[7] https://www.governor.ny.gov/news/statement-governor-cuomo-district-courts-dismissal-lawsuit-new-york-new-jersey-maryland-and.

[8] Matter of Moody’s Corporation & Subsidiaries,[8] DTA Nos. 828094 and 828203, https://www.dta.ny.gov/pdf/determinations/828094.det.pdf.

[9] Matter of Reuben, DTA No. 827340, https://www.dta.ny.gov/pdf/decisions/827340.dec.pdf.

[10] https://www1.nyc.gov/assets/finance/downloads/pdf/fm/2018/fm-18-9.pdf.

[11] https://www1.nyc.gov/assets/finance/downloads/pdf/fm/2018/fm-18-10.pdf.

[12] https://www.tax.ny.gov/pdf/memos/sales/m19-3s.pdf.

[13] https://www.tax.ny.gov/bus/vpt/default.htm.

[14] https://www.tax.ny.gov/pdf/memos/sales/m19-2-1s.pdf.