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# NY Tax Talk: Trump Tax Returns, Revenue Rebound, Reform

By **Craig Reilly** (October 16, 2020, 5:54 PM EDT)

After a brief hiatus, NY Tax Minutes is back this month under the new moniker, NY Tax Talk. New name. Same approach. To give readers a one stop shop for recent New York state and city tax news.


Craig Reilly

This month, we offer a glimmer of hope in the state's post-COVID-19 revenue decline; we check in on President Donald Trump's ongoing battle with the New York County district attorney's office over disclosure of the president's tax returns; and we highlight the new and noteworthy cases and other administrative guidance issued by the New York State Department of Taxation and Finance and the New York City Department of Finance.

**The Headlines**

***State tax revenues rebound but continue to lag.***

It seems as though it's no longer a headline to point out that state tax revenues are lagging in the wake of the ongoing COVID-19 pandemic. According to the New York State Comptroller's office,[1] state tax receipts declined by more than $3 billion through the end of August as compared to last year. But there may be some good, or at least less bad, news on the horizon.

Beginning with July, the rate of decline appears to have plateaued for the time being. The New York State Comptroller's office, for example, reports[2] that, after falling by approximately 25% year over year in April, May and June, sales tax revenue in July fell 8.2% compared to the same period last year, while collections fell by less than 8% in August.

That's hardly cause for celebration, and there are still major holes in the state's revenue pipeline. State Comptroller Thomas DiNapoli has noted that "[t]ax revenues continue to fall short of levels needed to fund education, health care and other vital services" and has warned, "The revenue hole the pandemic created is getting deeper."

And New York City Comptroller Scott Stringer recently released the city's quarterly cash report[3] for the fourth quarter of fiscal 2020, noting that total tax receipts have dropped by almost $4 billion, a decrease of 22.6% from this time last year.

But some recent indicators have come in above projections. Personal income tax collections, for example, totaled $2.7 billion in August, $157 million higher than anticipated, but still $185.5 million, or 6.4%, lower than last year.

On the sales tax side, it appears that state tax reductions may have at least partially been offset by other recent positive impacts on local sales tax revenue, including the 2018 U.S. Supreme Court ruling in South Dakota v. Wayfair Inc., which allowed states to require online retailers to collect and remit sales tax regardless of whether they have a physical presence in the state, along with the provisions in New York state's fiscal year 2019-2020 budget that requires online marketplaces, such as eBay Inc. and Etsy Inc., to collect and remit sales tax to New York on behalf of third-party sellers.

The news is still grim, but positive trends have to start somewhere, and the revenue shifts from June to July are a step in the right direction.

***The fight continues over Trump tax returns.***

To those keeping score, the U.S. Supreme Court issued two opinions in July. First, in Trump v. Vance,[4] the court held that presidential immunity didn't apply to a criminal investigation by the New York County district attorney's office, in which the DA's office issued a subpoena to Mazars USA LLP, Trump's longtime personal accountants, seeking Trump's tax returns and related schedules.

According to the court, a heightened showing of need is not required for state grand jury subpoenas issued to sitting presidents, and the court remanded the case to the lower courts to reconsider Trump's remaining arguments against the subpoena.

Manhattan District Attorney Cyrus Vance Jr. began the investigation in order to determine whether hush money payments to Stephanie Clifford and Karen McDougal by then-candidate Trump were falsely recorded as legal expenses. But recent court filings suggest that other forms of tax fraud may be part of the investigation, as well as bank and insurance fraud.

Second, in Trump v. Mazars USA LLP,[5] the Supreme Court held that the lower courts failed to adequately consider the separation of powers issues presented by congressional subpoenas issued to Trump's longtime accountants for his financial records and to two banks for his, his family's and his entities' financial information.

The court's decision vacated the U.S. Courts of Appeals for the D.C. Circuit and Second Circuit decisions that upheld the subpoenas and remanded the issue back to the circuit courts to more fully consider the separation of powers issues involved.

The Vance case now appears headed back to the Supreme Court. On Oct. 7, the Second Circuit dismissed claims by the president's attorneys that the subpoena was overbroad and politically motivated, instead affirming a lower court decision preventing Trump from blocking the subpoena.

The president then filed an Oct. 13 emergency application in the Supreme Court to stay the proceedings. Trump asked for a stay in the district court's order and judgment until his attorneys are able to file a petition for a writ of certiorari, which would request another round of formal review by the court. Stay tuned.

**The Cases**

In each issue of NY Tax Talk, 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 state or city taxes. In this issue, we cover The Walt Disney Co.'s attempts to exclude royalty payments from foreign affiliates when computing its corporation franchise tax, along with a New York City Tax Appeals Tribunal ruling on the taxability of the sale of a partnership interest.

***No New York exclusion of foreign royalty payments for Disney.***

On Aug. 6, the New York Tax Appeals Tribunal held in Matter of The Walt Disney Co.[6] that Disney and its consolidated subsidiaries may not exclude royalty payments to foreign affiliates when computing New York state corporation franchise tax.

During the audit years, Disney licensed intellectual property to foreign affiliates in return for payments ranging between $1.6 billion and $2.2 billion annually. Disney then deducted the payments from its entire net income under former New York Tax Law Section 208.9(o)(3). Section 208.9(o)(3) allowed taxpayers to exclude certain royalty income received from a related member from their entire net income.

Taxpayers had to include the income, however, if the royalty payments would not be required to be added back by the royalty payer. The exclusion was eliminated for tax years beginning on or after Jan. 1, 2013.

In the case below, Disney argued that it was entitled to exclude the royalties that it received from its foreign affiliates because those foreign affiliates would have been required to add back the royalty payment deductions if they had been New York taxpayers. But according to the tribunal, that was too big of an "if," and the tribunal disagreed with Disney's justification.

According to the tribunal, "related member royalty payments ... plainly would not be required to be added back if the related member-royalty payer is not a New York taxpayer." The tribunal therefore affirmed the lower administrative law judge determination, which found that the addback and exclusion provisions in the former law "work in tandem to ensure that royalty transactions between related members are taxed only once, not escape taxation altogether."

The tribunal also rejected Disney's argument that the audit division's interpretation of the statute violates the dormant commerce clause, finding that "case law defines dormant commerce clause discrimination in terms of economic interests, as opposed to the interests of taxable entities."

The tribunal concluded that similarly situated related members with a royalty payer that is a taxpayer would pay tax on the royalty payments because the royalty payer would include the royalties in its income while, in this case, Disney pays the tax directly.

We think this is a close question, and, with respect, we would have fallen on the other side. To us, the use of the phrase "would not be" instead of "are not" in former New York Tax Law Section 208.9(o)(3) indicates that the Legislature contemplated that nontaxpayer royalty payers would not preclude a royalty recipient from claiming the special exclusion.

We agree with the tribunal that the royalty payment add-back and exclusion was intended to combat the use of intercompany royalties to shift earnings out of high-tax states and into low- or no-tax jurisdictions.

But fairness dictates symmetry in tax provisions like this. So for every deduction denial, there ought to be a corresponding exclusion. Certainly, the tax department would not have permitted a New York royalty payer to avoid the deduction add-back requirement if the royalty recipient were not a New York taxpayer, since this is exactly the situation the law was intended to address.

But there is no symmetry unless the law is properly construed to permit an exclusion for a New York royalty recipient when the payer is a nontaxpayer. Otherwise, New York has a "heads I win, tails you lose" situation.

***New York City administrative law judge holds gain from partnership sale taxable.***

The New York City Tax Appeals Tribunal, Administrative Law Judge Division, held in the Matter of the Petition of Mars Holdings Inc.,[7] that the gain from the sale of interest in a limited partnership with property in New York City by a joint venture is subject to the city's general corporation tax.

The ALJ rejected the taxpayer's argument that the federal treatment of the sale of a partnership interest applies to the general corporation tax. The ALJ also rejected the taxpayer's argument that the federal treatment of the sale of a partner entire net income calculation.

The background of the sale involved the predecessor corporation to Mars Holding's joining with a construction company to form a joint venture that acted as a construction contractor doing business primarily in and around New York City. The joint venture then acquired minority interests in three limited partnerships that were engaged solely in the holding, leasing and managing of their respective real estate properties, which were located in New York City.

In 2012, Mars, through its interest in the joint venture, sold its interest in one of the limited partnerships to an unrelated third party. By this time, Mars maintained its only office in New Jersey and had no other place of business in New York City.

Mars reported the capital gain on its federal corporation income tax return and also reported the gain on its city general corporation tax return[8] but excluded the gain from its entire net income as a deduction from federal taxable income. The basis for the deduction was "gain on the sale of partnership interest — not used in trade or business in NY."

After the Department of Finance audited Mars's general corporation tax return, the department found that the gain should be included in Mars's entire net income because Mars did business within the city because of its ownership of the limited partnerships, which owned, leased and managed New York City property. The Department of Finance therefore exercised its discretion under Section 11-604.8 of the city's administrative code in order to include the capital gain in Mars's taxable entire net income.

On appeal, Mars argued that the city's proposed adjustment ran afoul of the federal conformity doctrine. Specifically, Mars argued that "as federal income is the starting point for ENI (Admin. Code § 11-602.1), federal conformity requires treating the Capital Gain as it would be under IRC § 741." Section 741 provides that "[i]n the case of a sale or exchange of an interest in a partnership, gain or loss shall be recognized to the transferor partner. Such gain or loss shall be considered as gain or loss from the sale or exchange of a capital asset."

Mars then argued that prior to the 2017 Tax Cuts and Jobs Act, the entity approach could apply to the disposition of a partnership interest. Under this approach, it noted, the partner is treated as though it owns a partnership interest, an intangible asset, as opposed to a proportionate share of the partnership's assets.

And according to Mars, when the gain from the sale of the partnership interest, an intangible, is not used in a trade or business, the gain should be sourced to partner's domicile, and, in this case, excluded from entire net income. Mars argued that in order for the city to tax the transaction under the aggregate theory, "federal conformity requires that a legislative act be taken in order to use the aggregate approach."

The tribunal disagreed, however. According to the tribunal, the underlying limited partnership conducted business within the city because it leased, held and managed real property in the city. Interpreting "doing business," the tribunal noted that the term included "ownership in a limited partnership that does business in the City."

Therefore, the capital gain, which flowed from the joint venture's sale of its interest in the limited partnership was properly included in the petitioner's entire net income for the tax year ending Dec. 31, 2012. Nothing in the federal conformity doctrine compel a different result.

**Other Guidance**

***New York continues updates to draft corporate tax reform regulations.***

Since at least early 2016, the New York State Department of Taxation and Finance has regularly provided draft updates and amendments to the state's Article 9-A Business Corporation Franchise Tax Regulations.[9]

The updates are meant to incorporate the changes made by New York's corporate tax reform legislation, which was contained in the 2014-2015 and 2015-2016 enacted New York state budgets. Because these are draft regulations, New York rightfully instructs taxpayers that the "draft regulatory amendments are not final and should not be relied upon."

In practice, however, taxpayers should review the draft regulations in search of any helpful guidance. If the information is helpful, there's no need to look a gift horse in the mouth!

The latest updates include draft regulations regarding the taxation of qualified New York manufacturers[10] and updated rules for imposing the metropolitan transportation business tax surcharge.[11]

With regard to qualified New York manufacturers, who, since 2015 have been eligible for a business income tax rate of 0%, the draft regulations appear to attempt to narrow the definition of at least two key terms — "manufacturing" and "goods" — related to who qualifies as a eligible manufacturer.

Taxpayers eligible for the preferred 0% rate are those "principally engaged in the production of goods by manufacturing, processing, assembling, refining, mining, extracting, farming, agriculture, horticulture, floriculture, viticulture or commercial fishing."[12]

The draft regulations first provide insight into the department's understanding of what qualifies as "manufacturing" by referencing activities that the department does not consider as qualifying manufacturing activities. This includes:

> (1) A process that makes an item more attractive for sale without substantially altering the item; (2) Market research, research and development, and design and creation of a prototype; (3) The manipulation of information; (4) The transmission of information; (5) The performance of a service; (6) The generation and distribution of electricity, the distribution of natural gas, and the production of steam, ice, or any other good associated with the generation of electricity; (7) The creation of a digital product; and (8) Heating, cooling, regulating, cleaning, purifying, blending and distributing activities.[13]

Similarly, the draft regulations attempt to define a qualified New York manufacturer not in relation to the production of the broader category of all "goods," which is what the statute appears to say, but, instead, by the production of only a narrower category of "tangible goods."[14]

These proposed amendments are not particularly taxpayer friendly. But, for the time being, remember what the tax department said, taxpayers are not required to rely on draft regulatory amendments. Especially if they conflict with the language of the underlying statute.

The tax department also updated its draft regulations regarding the metropolitan transportation business tax surcharge, both adding to the list of activities that are specifically deemed insufficient to subject a corporation to the tax surcharge and reflecting the fact that corporations previously subject to tax under New York Tax Law Article 32 (Franchise Tax on Banking Corporations) are now subject to tax under article 9-A (Franchise Tax on General Business Corporations).

The activities expressly deemed insufficient to subject corporations to the tax surcharge include:

> (a) the maintenance of cash balances with banks or trust companies in the MCTD; (b) the ownership of shares of stock or securities that are kept in the MCTD if: (1) kept in a safe deposit box, safe, vault or other receptacle rented for such purpose; (2) pledged as collateral security; or (3) deposited into safekeeping or custody accounts with one or more banks, trust companies or brokers who are members of a recognized security exchange; [and] (c) the taking of any action by a bank, trust company or broker in the MCTD incidental to the rendering of safekeeping or custodian service to the corporation as described in subdivision (b)(3) of this section.[15]

***New York Tax Department issues opinion on brownfield redevelopment tax credit.***

New York state's brownfield redevelopment tax credits are comprised of several different credits under New York Tax Law Section  21. At issue in a recent advisory opinion[16] issued by the tax department was the tangible property credit component of Tax Law Section 21(a)(3).

Specifically, whether the tangible property credit component limitation or cap should be: (1) $35 million or three times the sum of the costs included in the calculation of the site preparation credit component and the on-site groundwater remediation credit component, whichever is less; or (2) $45 million or six times the sum of the costs included in the calculation of the site preparation credit component and the on-site groundwater remediation credit component, whichever is less.

Under the statute, the higher cap is available for any "qualified site to be used primarily for manufacturing activities." Although the phrase "used primarily for manufacturing activities" is not defined in Tax Law Section 21, the phrase is defined in other tax department regulations as 50% or more.[17]

Applying the usual connotation of the word "primarily" to the facts presented in the advisory opinion, and using other sections of the tax law and regulations as guidance, the tax department concluded that if 50,000 square feet of a property owner and business START-UP NY incubator's 80,000 square foot mixed use building is used for manufacturing activities, the building would be used primarily for manufacturing activities.

Accordingly, the higher tangible property credit limitation for manufacturing sites — i.e., the lesser of $45 million and six times the sum of the costs included in the calculation of the site preparation credit component and the on-site groundwater remediation credit — would apply.

***New York City issues unincorporated business tax letter ruling.***

The New York City Department of Finance has issued a letter ruling[18] on the application of the city's unincorporated business tax to the sale of a membership interest in a limited liability company that is taxed as a partnership.

The underlying facts described in the ruling are that in 2015, a developer entered into negotiations with a potential tenant to construct and lease to the tenant a commercial facility on property located in Queens, New York.

The developer formed a new investment limited liability company to purchase the land and then entered into a contract with the investment LLC to "initiate, coordinate and administer all planning, design and construction activities for all improvements related to the completion of the commercial facility."

Construction was completed in 2017, and the lease agreement between the tenant and the investment LLC commenced.

The issues presented were (1) whether the investment LLC would recognize gain on the sale of the membership interests by its members, and (2) whether a management LLC that owned the investment LLC would be subject to the unincorporated business tax on the gain realized from the sale of their membership interest in the investment entity.

The ruling concluded that (1) the investment LLC will not recognize gain on the sale of its members' ownership interests, and (2) the management LLC is not subject to the unincorporated business tax.

With regard to the gain from the sale of the members' ownership interest in the investment LLC, the ruling noted that the unincorporated gross income of an unincorporated business, is defined in pertinent part as:

> the sum of the items of income and gain of the business, of whatever kind and in whatever form paid, includible in gross income for the taxable year for federal purposes, including income and gain from any property employed in the business, or from the liquidation of the business.[19]

For federal purposes, under Internal Revenue Code Section 741, which was also analyzed by the New York City Tax Appeals Tribunal in Mars Holdings, the gain or loss from the sale or exchange of an interest in a partnership is recognized not by the partnership, but, instead, by the transferor partner.

Accordingly, any gain or loss on the sale or transfer of a partnership interest in the investment LLC would not be attributable to the investment LLC itself and would therefore not be includable in its unincorporated business taxable income.

Although Section 741 of the Internal Revenue Code also requires that, as a transferor partner, the management LLC recognize the gain or loss from the sale of its partnership interest in the investment LLC, whether that gain is subject to unincorporated business tax depends on whether the management LLC is considered to be carrying on a taxable unincorporated trade or business within the city.

And according the city's letter ruling, the management LLC was not conducting a trader or business in the city. "In general," the ruling held:

> the trades, businesses, professions or occupations which constitute an unincorporated business when conducted, engaged in or being liquidated by an individual or an unincorporated entity include, without limitation, ... any other activity which involves the leasing of or trading or dealing in real or personal property.[20]

But an individual or other unincorporated entity, except a dealer, is not deemed engaged in an unincorporated business solely by reason of the acquisition, holding or disposition, other than in the ordinary course of business of an interest in unincorporated entities engaged solely in the purchase, holding and sale of property for their own accounts.[21]

This exclusion is otherwise referred to as the "full self trading exemption." Based on these rules, the letter ruling concluded that the investment LLC was "solely engaged in activity not constituting an unincorporated business subject to the tax." Therefore, under New York City Administrative Code Section 11-502(c)(2)(B), the management LLC was also not deemed to be engaged in an unincorporated business, solely by the holding and disposition of an interest in the investment LLC.

***New York governor reminds New Yorkers of ban on "pink tax."***

We end this month with a "good on, yah!" As part of New York's fiscal 2021 budget, the state banned businesses from charging what is known as a so-called pink tax — the practice of charging different prices for "substantially similar" goods or services marketed to different genders. In a Sept. 30 press release,[22] Gov. Andrew Cuomo reminded businesses of the new measures, which are now in effect.

According to the release, the new law mandates that retailers, suppliers, manufacturers, distributors and other businesses are prohibited from charging a different price for two substantially similar goods or services based only on the gender for whom the goods or services are marketed.

For example, the governor notes that violations would include selling "the same children's swimming pool product … in pink at $89.99 and blue at $69.99." Or "dry cleaning a woman's suit jacket for $12 and a man's suit jacket for $8."

Businesses that violate the law will now be subject to civil penalties, including a court ordered enjoinment of the sales, restitution to consumers, up to a $250 fine for the first violation, and up to a $500 fine for any subsequent violations.

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[1] https://www.osc.state.ny.us/press/releases/2020/09/dinapoli-states-financial-hole-deepens-tax-revenues-trail-32-billion-2020.

[2] https://www.osc.state.ny.us/press/releases/2020/09/dinapoli-local-sales-tax-collections-down-78-percent-august.

[3] https://comptroller.nyc.gov/reports/new-york-city-quarterly-cash-report.

[4] No. 19-635 (S. Ct. 2020).

[5] No. 19-715; No. 19-760 (S. Ct. 2020).

[6] Matter of The Walt Disney Co. and Consolidated Subsidiaries, DTA No. 828304, https://www.dta.ny.gov/pdf/decisions/828304.dec.pdf.

[7] Matter of the Petition of Mars Holdings Inc., https://www1.nyc.gov/assets/taxappeals/downloads/pdf/1614DET0620.pdf.

[8] Form NYC-3L, line 17(b)).

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

[10] https://www.tax.ny.gov/pdf/bus/ct/special-entities-may-2020-draft2.pdf.

[11] https://www.tax.ny.gov/pdf/bus/ct/mta-revisions-draft-9-10-20.pdf.

[12] N.Y. Tax Law section 210(1)(a)(vi).

[13] Draft section 10-1.2(b).

[14] Draft section 10-1.2(a).

[15] Draft section 9-1.3.

[16] https://www.tax.ny.gov/pdf/advisory_opinions/income/a20_4i.pdf.

[17] See, e.g., 20 NYCRR § 528.14(c).

[18] https://www1.nyc.gov/assets/finance/downloads/pdf/redacted-letter-rulings/ubt/redacted-20-5002-ubt.pdf.

[19] NYC Admin. Code 11-506(a).

[20] RCNY 28-02(a)(5).

[21] NYC Admin. Code 11-502(c)(2).

[22] https://www.governor.ny.gov/news/governor-cuomo-reminds-new-yorkers-pink-tax-ban-goes-effect-today.