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NEW YORK COURT OF APPEALS UPHOLDS "AMAZON" STATUTE

As this issue went to press, the Court of Appeals, New York's highest court, issued its decision holding that the State's "click-through nexus" statute does not violate the Commerce Clause or the Due Process Clause, and therefore an Internet vendor may be presumed to have nexus in New York State, and be required to collect sales tax from New York customers, when a link to the vendor's website appears on websites of New York residents who are compensated via a commission arrangement. *Overstock.com, Inc. & Amazon.com, LLC, et al.*, 2013 NY Slip Op. 02102 (N.Y. Mar. 28, 2013).

The New York law was amended in 2008 to provide a presumption that the definition of a "vendor," required to collect New York State sales tax on sales to New York customers, includes an entity that enters into an agreement with a New York resident under which the resident refers potential customers, including by a link on a website, "for a commission or other consideration." Tax Law § 1101(b)(8)(vi). Amazon and Overstock challenged the facial constitutionality of that presumption.

In brief, the Court of Appeals has now found that it was rational for the legislature to presume that New York residents who were compensated on a commission basis would seek to increase their business by soliciting New York customers, and that the ability to rebut the presumption through an annual certification "sensibly" placed the burden on the retailers to demonstrate the lack of solicitation activities.

One judge dissented, finding that the placing of links on a website was no more than advertising, and that the change in compensation method for such advertising–from a flat fee to a commission–does not change its essential nature.

GUILTY PLEA AND $5.5 MILLION SETTLEMENT RESOLVE FALSE CLAIMS CASE

By Hollis L. Hyans

A settlement, including a guilty plea to felony charges and payment of $5.5 million in tax, was reached to resolve civil claims concerning unpaid New York sales and income taxes that were due from a tailor, Mohanbhai "Mohan" Ramchandani, and his company, Mohan's Custom Tailors, Inc. According to the Attorney General's office, the claims had first been raised by a "whistleblower" under New York State's False Claims Act, which had been revised in 2010 to permit claims to be brought alleging violation of the tax laws.

On March 5, 2013, a civil complaint was filed, concluding an investigation that had begun when a former employee filed a claim against Mr. Mohan and his business under the False Claims Act. The complaint alleged that Mr. Mohan falsified his sales tax returns over a period of many years, going back to 2002. The investigation discovered that Mr. Mohan had been manipulating the numbers he used to report taxable sales to be consistent with his belief in numerology, ensuring that the digits added up to a multiple of ten. The result was reporting of alleged receipts with a level of consistency that was unlikely to have occurred by chance. By Mr. Mohan's own admission, he and the business failed to remit to the State at least $1.7 million in state and local sales taxes that had been collected from customers since 2002, and failed to pay at least $256,000 in state and local personal income taxes for 2007 through 2009.

Mr. Mohan was well known as a tailor to famous New Yorkers, including, according to press reports, Patrick Ewing, Wilt Chamberlain, Walt Frazier, and former mayors Rudolph Giuliani and the late Edward Koch, some of whom had appeared in promotions for the business.

Under the terms of the settlement, Mr. Mohan and Mohan's Custom Tailors, Inc. both pleaded guilty to filing false returns, and in addition the business pleaded guilty to falsifying business records. Mr. Mohan acknowledged that, between September 2002 and June 2012, his business made over $28 million in taxable retail sales, but reported only a little over $5.6 million.

In exchange for the guilty plea, Mr. Mohan will be sentenced to a prison term of one to three years, in addition to paying $5.5 million in damages and penalties. The former employee who blew the whistle will receive $1.1 million of that amount. Mr. Mohan is also expected to plead guilty to federal charges.

Additional Insights

According to the Attorney General's office, this is the first time that the new False Claims Act was used in resolving a tax case. As reported in the March 2011 issue of *New York Tax Insights*, the 2010 amendment to the statute for the first time permitted actions to be brought by private parties, called *qui tam* actions, alleging violations of state and local tax laws. The Attorney General may then take over those lawsuits and recover treble damages, plus penalties, attorneys' fees and costs, from anyone found to have submitted a "false claim" for money or property to the State government. In 2011, the Attorney General announced the formation of a Taxpayer Protection Unit to aggressively pursue violators of the tax laws. The statute offers large financial rewards to the *qui tam* plaintiff, who may, as in this case, receive a percentage of the amount for which a defendant is ultimately held liable, including a portion of the tax, treble damages, and penalties assessed.

CITY ALJ DISMISSES CASE SEEKING INTEREST ON $30 MILLION REFUND

By Amy F. Nogid

A New York City Administrative Law Judge dismissed a case brought by Deutsche Bank AG seeking interest on a misplaced $30 million refund check, finding that the New York City Tax Appeals Tribunal lacked jurisdiction to hear the matter. *Matter of Deutsche Bank AG*, TAT(H)10-7(BT) (N.Y.C. Tax App. Trib., Admin. Law Judge Div., Feb. 19, 2013).

Deutsche Bank filed its 2004 New York City bank tax return, claiming an overpayment of about $48 million, $18 million of which it directed to be applied to the following year's estimated tax payments, with the balance of $30 million to be refunded. The Department accepted the filing, applied the credit, and claimed to have mailed a refund check in June 2005. Almost four years later, Deutsche Bank realized that it had never received the refund, and contacted the Department, which issued a replacement check. No interest was included. Deutsche Bank filed a "refund claim" with the City's Department of Finance, seeking interest running from the due date of the return to the date of the replacement check. On February 20, 2009, the Department of Finance issued a Notice of Disallowance of the "refund claim," which stated that "there is '[n]o interest due on replacement refunds,'" and advised Deutsche Bank of its right to protest the denial within two years by requesting a Conciliation Conference or a hearing before the Tax Appeals Tribunal.

Initial Determination. On March 12, 2010, Deutsche Bank protested the Notice of Disallowance in the City's Tax Appeals Tribunal, challenging the denial of a "refund" of the interest that it computed to be $9 million. The Department of Finance sought dismissal of the case on the basis that Deutsche Bank had not timely requested the "refund." Matter of Deutsche Bank AG, TAT(H)10-7(BT) (N.Y.C. Tax App. Trib., Admin. Law Judge Div., Sept. 22, 2011) ("Deutsche Bank I"). The ALJ rejected the Department's argument, finding that the failure to

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pay interest did not place the taxpayer in a "refund" situation, and since the Administrative Code provided no statute of limitations for claiming overpayment interest on replacement checks, the action was governed by the general six-year statute of limitations in CPLR § 213.1 for claims "for which no limitation is specifically prescribed by law."

Deutsche Bank could not argue that the Department was estopped from denying it a remedy by the language in the Notice advising the Bank of its appeal rights, since estoppel cannot create rights that are not provided by statute.

However, in his Order in *Deutsche Bank I*, the ALJ had provided the Department of Finance with a roadmap to relief. In a footnote, the ALJ noted that the Department had taken no steps to withdraw the Notice of Disallowance, and never claimed that the denial constituted a final agency action subject to the CPLR's Article 78 four-month limitation period, which would have required Deutsche Bank to have filed an action in state court within four months of February 29, 2009, the date the Notice of Disallowance was issued, rather than the six-year period otherwise found applicable.

New Decision. It should have come as no surprise to Deutsche Bank, that after the Order in *Deutsche Bank I* was issued, the Department of Finance withdrew its Notice of Disallowance, stating that the Notice had been "issued in error" and was a "nullity." Also taking its cue from the ALJ, the Department filed a new motion urging dismissal on jurisdictional grounds, and this time it was successful, convincing the ALJ that no remedy existed in the Tax Appeals Tribunal.

The ALJ cited *ABC Radio Network v. State of New York Dept. of Taxation and Finance*, 294 A.D.2d 213 (1st Dept. 2002), a case involving the computation of interest on an overpayment discovered by the State's Department of Taxation and Finance on audit. In *ABC Radio Network*, shortly after the taxpayer was notified of the overpayment, it sent a letter to the State inquiring as to the computation of the interest, contending that interest should be computed from the date its returns were filed, under Tax Law § 1088(a)(2). The State treated ABC Radio Network's inquiry letter as the date of the refund claim and computed interest from that date. Ten months after the refund was issued (with interest only from the date of the inquiry letter), ABC Radio Network sued the State in New York Supreme Court (New York's trial court) for additional interest, running from the original due date of the return to the date of the inquiry letter. The trial court awarded the taxpayer the additional interest, and rejected the State's arguments that the case should have been dismissed, either on the basis that the taxpayer had failed to exhaust administrative remedies, or that it was barred by the four-month statute of limitations applicable to CPLR Article 78 proceedings. On appeal, the First Department reversed, and dismissed the case on the basis that the four-month statute of limitations did apply and had run. The First Department did not address the substantive issue.

In the instant case, the ALJ concluded that once the City withdrew its Notice there was "no petitionable notice and no claim that may be pursued administratively," since the Tax Appeals Tribunal could only hear appeals from specific notices as provided by statute. The ALJ also found that Deutsche Bank could not argue that the Department was estopped from denying it a remedy by the language in the Notice advising the Bank of its appeal rights, since estoppel cannot create rights that are not provided by statute, and also because any reliance by Deutsche Bank on the language in the Notice of Disallowance would not have been reasonable in light of A*BC Radio Network*. Relying on *ABC Radio Network*, the ALJ further held that an Article 78 proceeding was the only available option for Deutsche Bank, although the time to bring an Article 78 action had long since expired. The Department's motion to dismiss was granted.

Additional Insights

The case reminds taxpayers that failure to confirm timely receipt of tax refunds can have costly interest implications. If a refund is expected, prompt inquiries should be made if the check does not arrive. Effective September 19, 2001, New York State legislation was enacted requiring taxpayers to whom an overpayment has been disclosed by the Department of Taxation and Finance to file a refund claim within 120 days. Tax Law § 3004-a. The City's Administrative Code has no analogous provision.

The case also reminds taxpayers and their advisors that instructions regarding remedies set forth in notices sent by the taxing agency can turn out to be elusive or simply incorrect.

"GRANDFATHER" ELECTION AFTER GRAMM-LEACH-BLILEY CONTINUES DESPITE CORPORATE REORGANIZATION

By Irwin M. Slomka

The Department of Taxation and Finance has ruled that a bank holding company that previously qualified to be taxed under Article 9-A under the New York transitional provisions relating to the federal Gramm-Leach-Bliley Act may continue to be taxed under Article 9-A, even after it engages in a plan of reorganization that would otherwise result in the revocation of the "grandfather" election. *Advisory Opinion*, TSB-A-13(3)C (N.Y.S. Dep't of Taxation & Fin., Feb. 28, 2013).

Background on the "Grandfather" election. In 2000, as a result

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of the enactment of the federal Gramm-Leach-Bliley Act, Article 32 was amended to allow certain corporate affiliates of banks to remain taxable under Article 9-A during a transitional period (currently, through tax years beginning before January 1, 2013). Gramm-Leach-Bliley, among other things, removed certain limitations on affiliations between banks, securities firms and insurance companies. It also resulted in the creation of a new type of entity called a "financial holding company" ("FHC") that can own banks, securities firms and insurance companies.

In relevant part, the Tax Law was amended to allow a qualifying bank holding company to elect to file on a combined basis for a transitional period with any 65% or more owned or controlled "banking corporation" exercising its corporate franchise or doing business in the State, generally if the holding company elected to be an FHC for federal purposes. In addition, the statute prohibited the Department from requiring a bank holding company to file a combined Article 32 return during the transitional period with its 65% or more owned or controlled "banking corporation" that was newly-registered under the federal Bank Holding Company Act and that elected to be an FHC. Tax Law § 1462(f)(2)(iv)(B). This is an exception to the general rule that a bank holding company, even though classified as an Article 9-A taxpayer, could be included in an Article 32 combined return. Tax Law § 1452(d).

Prior Advisory Opinion. In 2004, the Department issued an Advisory Opinion to the same taxpayer as in the new opinion. That earlier opinion involved a banking corporation subsidiary of the Royal Bank of Canada that contributed all of its assets (including stock in subsidiaries subject to Article 32) to Newco in exchange for 100% of Newco's stock, in a transaction that qualified under IRC § 351. The Department ruled that Newco — a newly-formed entity that elected federal FHC status in 2003 — could elect to be subject to Article 9-A. It also ruled that Newco, as an electing FHC, although a "banking corporation" under Tax Law § 1452(a)(9), could not be required to file a combined Article 32 tax return with its Article 32 affiliates. *RBC Holdings USA, Inc.*, Advisory Opinion, TSB-A-04(1)C (N.Y.S. Dep't of Taxation & Fin., Feb. 26, 2004).

New Advisory Opinion. Newco (referred to in the new opinion as "Holdco") had continued to be subject to Article 9-A since its formation in 2003, and had not been included in a combined Article 32 return with its affiliates. Under a reorganization plan that was carried out in its tax year ended October 2011, Holdco acquired certain assets from its affiliates whereby, according to the opinion, its business operations "*may* be deemed to have changed" (emphasis added) from its operations before the reorganization. Subsequently, in March 2012, Holdco sold its stock in a banking subsidiary, after which it was no longer a bank holding company. The question presented was whether Holdco, although owned by a bank, could continue to be "grandfathered" under Article 9-A, both in the year of the reorganization and in the subsequent year.

Having been organized and registered as a bank holding company and as an FHC in 2003, Holdco had continued to be "grandfathered" under Article 9-A. However, Tax Law § 1452(n), enacted in 2007, sets forth certain circumstances that result in the revocation of the Article 9-A election (for example, where the corporation ceases to be a New York taxpayer, or where it engages in transactions which cause it to be principally engaged in a business different from the business it conducted immediately prior to the transactions).

In the Advisory Opinion, the Department declined to rule on whether Holdco's acquisition of assets would actually result in a revocation of the election, stating that it had insufficient facts to make that determination. Nonetheless, the Department concluded that, even if the election was revoked under § 1452(n), Holdco would continue to be subject to Article 9-A in the year of its reorganization because of its status as a bank holding company and as an FHC. As for the subsequent year when Holdco ceased being a bank holding company after it sold its banking subsidiary, the Department ruled that Holdco would continue to be taxable under Article 9-A. This was because, under the transitional provisions of Tax Law § 1452(m)(1), Holdco was properly subject to Article 9-A "in its last taxable year beginning before [January 1, 2011]," and therefore could continue to be taxed under that article.

Additional Insights

The Advisory Opinion reasonably addresses a potential concern regarding the impact of the deemed revocation conditions in the Tax Law applicable to "grandfathered" Article 9-A corporations. It should be noted that, as the Tax Law now stands, the generally pro-taxpayer transitional provisions discussed in the opinion expire for taxable years beginning after December 31, 2012, unless they are further extended by the Legislature.

NO EXEMPTION WHERE INDEPENDENT CONTRACTORS BOTH DELIVER PRODUCTS AND SOLICIT SALES

By Kara M. Kraman

A recent Advisory Opinion holds that an out-of-state company is not eligible for the Article 9-A fulfillment services exemption, or the protections afforded under Public Law 86-272, where its independent contractors both solicit sales and deliver products in New York State. *Advisory Opinion*, TSB-A-13(4)C, (N.Y.S. Dep't of Taxation & Fin., Mar. 4, 2013).

The company seeking the Advisory Opinion does not have any physical sales locations in New York, owns no property in New York, and does not pay any rent for the storage of goods in New York. Instead, the company ships inventory to a sales force of approximately 16 independent contractors located in

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New York, who store the inventory in their own facilities in the State at no charge. Once a sale is made by the independent contractor, the independent contractor delivers the consigned inventory to the customer, submits a sales slip to the out-of-State company, and the company then bills the customer. The company retains title to the inventory until it is sold.

Public Law 86-272 provides an exemption for state income tax where an out-of-state corporation's in-state activities are limited to the solicitation of sales of tangible personal property. Under the Article 9-A regulations, "a corporation will not be considered to have engaged in taxable activities in New York State . . . merely by reason of sales in New York State or the solicitation of orders for sales in New York State, of tangible personal property on behalf of the corporation by one or more independent contractors." 20 NYCRR 1-3.4(b)(9)(ii).

[B]ecause these independent contractors actually made sales, as opposed to just accepting and shipping orders, they exceeded the permissible activities under the fulfillment services exemption.

Under the "fulfillment services" exemption from Article 9-A, an out-of-state corporation will not be deemed to be doing business or owning or leasing property in New York merely because it uses the fulfillment services of an in-State nonaffiliated person, even if it has inventory stored at the fulfillment service provider's premises. Tax Law § 209(2)(f). "Fulfillment services" are defined as: (i) the acceptance of orders electronically or by mail, telephone, fax, or Internet; (ii) responding to customer inquiries electronically or by mail, telephone, fax, or Internet; (iii) billing and collection activities; or (iv) shipping orders from an inventory of products held in New York and offered for sale by the user of the fulfillment services. Tax Law § 208(19).

The Department addressed both exemptions to Article 9-A and concluded that neither applied. It determined that the fulfillment services exemption did not apply because the independent contractors did not just accept and ship orders in New York State; they also made sales to customers in the State. The Department also ruled that Public Law 86-272 did not apply because the independent contractors did more than solicit orders and make sales, and because the company retained title to the consigned goods located in New York.

Additional Insights

While the fulfillment services exemption provides protection from tax even where inventory is stored in, and shipped from, New York, because these independent contractors actually made sales, as opposed to just accepting and shipping orders, they exceeded the permissible activities under the fulfillment services exemption. If the independent contractors had not made sales in New York, the vendor may have qualified for the exemption. Similarly, an independent contractor that engages in any of the four activities defined as "fulfillment services" under New York law would almost certainly be deemed to be engaged in activities beyond the scope of activities protected by Public Law 86-272, and therefore subject the out-of-state seller to Article 9-A except for the fulfillment services exemption.

INSIGHTS IN BRIEF

Trapeze Artist Must Collect Sales Tax Only on Certain Performances

The Department of Taxation and Finance has determined that a professional trapeze artist must only collect sales tax on certain performances. *Advisory Opinion*, TSB-A-13(7)S (N.Y.S. Dep't of Taxation and Finance, Feb. 25, 2013). When she is hired as an independent contractor to provide instruction, to perform at functions by event planners or people hosting private parties, or by aerial groups who charge admission to the shows, she need not collect sales tax, because her services as an aerialist are not among the taxable services enumerated by Tax Law § 1105(c). However, when she performs directly for the public and charges an admission fee, tax must be collected under § 1105(f)(1), which imposes sales tax on admission charges exceeding ten cents. The Department relied on sales tax regulation § 527.10(d)(2) to conclude that the aerial performance is similar in nature to a circus and does not qualify for the "dramatic or musical arts admission charge" exclusion.

Lawsuit Filed Seeking to Prevent Sale of Tribal Cigarettes

On March 4, 2013, the New York State Attorney General filed suit in federal court against several Native American entities, seeking an injunction against the sale of untaxed cigarettes, and seeking penalties and damages under both state and federal law. *State of New York v. Grand River Enterprises Six Nations, Ltd., et al.*, No. 13-1112 (E.D.N.Y. Mar. 4, 2013), ECF No. 1. The complaint alleges that approximately 30 million packs of cigarettes were sold or shipped into New York between November 2011 and July 2012 without the proper tax stamps, in violation of the federal Contraband Cigarette Trafficking Act, the federal Prevent All Cigarette Trafficking Act, and New York State's tobacco tax statutes. According to the complaint, New York State had in the past followed a "long-standing policy of forbearance" allowing untaxed cigarettes to be sold by Native Americans, but that policy was revoked in 2010 and new legislation was enacted to ensure that tax was imposed on sales of cigarettes to non-members of the Native American nations. Lawsuits were filed challenging those statutes, resulting in the issuance of temporary injunctions while the merits of the actions were being considered, but all injunctions were lifted in June 2011.

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Receipts from Wellness Program Not Subject to Sales Tax

The Department of Taxation and Finance determined that a company providing an employee wellness program consisting of both an annual health assessment, and the provision of online and in-person information on maintaining good health, was not providing a service subject to sales tax. *Advisory Opinion*, TSB-A-13(6)S (N.Y.S. Dep't of Taxation & Fin., Feb. 11, 2013). The Department looked at the enumerated services subject to tax under Tax Law § 1105(c), and determined that the tax on services provided by a health salon was inapplicable because the company did not operate a physical establishment, and that the tax on information services was inapplicable because any instructional material provided with regard to healthcare was an "integral component of a broader service," and more in the nature of an educational service which is not subject to sales tax under New York law.

Business Networking Club Not a "Social Club" for Sales Tax Purposes

The Department of Taxation and Finance has ruled that a business development club's membership dues were not subject to sales tax because the club did not meet the definition of a "social club" for sales tax purposes. *Advisory Opinion*, TSB-A-13(8)S (N.Y.S. Dep't of Taxation & Fin., Feb. 28, 2013). The Department found it determinative that the club's main purpose was to promote the members' businesses by offering them a networking forum, while, in contrast, the main purpose of a social club (the dues for which would be taxable) is to provide an opportunity to congregate for social interrelationships.