NY Tax Minutes: December Review And 2019 Preview

By **Timothy Noonan and K. Craig Reilly** January 7, 2019, 3:44 PM EST

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It's a new year here at "NY Tax Minutes," but don't worry, we're still delivering all the month's New York City and state tax news in a way that's made for New Yorkers. Fast. But as we close the books on 2018 and look ahead to another year of tax updates, we're adding a new wrinkle to this month's column. We're pulling out our crystal balls and predicting whether the news that brought 2018 to a close will continue into the New Year or whether we can turn the clock on these issues.

So this month, as we cover New York state's largest ever whistleblower settlement; review Gov. Andrew Cuomo's declaration of independence from Washington, D.C., and analyze the important New York state and local tax decisions that closed out 2018, we also look ahead at what's likely to make the headlines in 2019.

The Headlines

New York State Announces Largest Ever Whistleblower Settlement with Sprint

If you thought New York's announcement of a $30 million settlement for tax abuses with a hedge fund manager was **news**, we've got a story for you. On Dec. 21, 2018, Attorney General Barbara D. Underwood and Acting Tax Commissioner Nonie Manion announced the "largest ever recovery in a single-state false claims act lawsuit," this time against Sprint Corp., the cell phone carrier, and some of its subsidiaries.

Under the settlement, Sprint has agreed to pay $330 million as part of a case involving claims that it knowingly failed to collect and remit more than $100 million in state and local taxes on wireless calling plans. Specifically, the state's original suit alleged that Sprint violated New York Tax Law Section 1105(b)(2), which imposes sales tax on all wireless voice services that are sold for a fixed charge, without differentiating between intrastate or interstate and international voice calls. The state alleges that despite knowing (and actually lobbying to prevent) the law, Sprint failed to collect and remit state and local sales tax on a portion of its flat-rate charges for wireless calling plans that Sprint deemed to be for interstate calls.

The Sprint case was the first suit to be brought under New York's False Claims Act, the only false claims law in the country that broadly covers all types of tax fraud. Over the course of the litigation, Sprint unsuccessfully moved to dismiss the state's complaint for failure to state a cause of action, but a 2015 New York Court of Appeals decision[1] upheld the suit.

The investigation leading to the settlement began with a 2011 whistleblower action, and as part of the final settlement, the whistleblower is now set to receive $62.7 million in exchange for bringing Sprint's business practices to light. New York's False Claims Act specifically entitles whistleblowers who report fraud against the government to share in the recovery.

What to Expect in 2019: Did you catch the part where we noted that the original whistleblower is set to receive $62.7 million? That's 62.7 million reasons why we fully expect the recent wave of tax-related False Claims Act complaints to continue in 2019.

Gov. Cuomo Declares Independence From Washington, D.C.

It seems like every month we have a new update on the ongoing saga over the New York (and other states) response to the federal Tax Cuts and Jobs Act's $10,000 state and local tax deduction cap. This month is no different. On Dec. 17, 2018, Gov. Andrew Cuomo announced his "2019 Justice Agenda," which outlines his legislative goals for the first 100 days of the next legislative session. And, not surprisingly, the fight to repeal the SALT cap is front and center in the governor's agenda.

With his announcement, Gov. Cuomo broke with tradition, laying out his legislative agenda in December, instead of waiting for the State of the State address. Before laying out his key points, however, many of which focus on maintaining and expanding the state's progressive tax system, the governor couldn't resist taking a shot at Washington, D.C.: "Let this agenda be New York's declaration of independence," the governor announced. "We declare independence from this federal government's policies. We disconnect from the nationalism, and the racism, and the chaos, and the xenophobia, and the misogyny, and the discrimination, and the dissembling of this Washington administration."

The governor’s 20-point agenda includes:

- *Ensuring a Progressive Tax System* — “While the federal government prioritizes tax cuts for corporations and the wealthy, Gov. Cuomo believes in a just, progressive tax system that taxes its citizens based on their ability to pay. The governor will maintain the state's progressive income tax with a millionaire's tax, while permanently capping regressive local property taxes at 2 percent.”

- *Cut Middle Class Taxes While Fighting to Repeal SALT* – “The federal government's cap on state and local tax deductions was a devastating and targeted assault on New York that has increased taxes on New Yorkers and reduced home values. Gov. Cuomo will continue to lead the fight to repeal the cap on SALT while in New York continuing tax cuts for middle class families.”

What to Expect in 2019: With the buildup to 2020 elections, we don’t expect Gov. Cuomo’s fierce words toward the federal government to stop any time soon (although we could probably do without the hyperbole of declaring independence from the Union). Add to that the fact that workarounds to the SALT deduction cap such as the charitable deduction play and entity-level taxes continue to pop up in states across the country, and the fight over the SALT deduction cap shows no signs of slowing down in the New Year. Oh, and not for nothing, the governor has officially announced the fight to repeal the SALT cap as part of his 2019 agenda.

New York City Council Questions Amazon HQ2 Deal

As we reported **last month**, Gov. Cuomo and New York City Mayor Bill de Blasio recently announced Amazon.com Inc.’s selection of Long Island City as one of its two new corporate ~~offices~~, sorry headquarters.

To entice Amazon to the Empire State, the state and city offered the company a package of performance-based incentives totaling approximately $3 billion. As we noted last month, we think it’s great that Amazon is coming to New York, but we questioned the need to offer up billions of dollars in incentives to convince a company to move to a city with one of the country’s most talented workforces, a top global reputation and other major industries already in place. And it now appears that members of the New York City Council's Economic Development Committee have similar questions.

During a Dec. 12, 2018, hearing, the committee grilled the head of the New York City Economic Development Corporation, James Patchett, along with two Amazon executives on the multibillion dollar incentive package.

Amazon is "worth $1 trillion," Council Speaker Corey Johnson said at the hearing. "Why do you need our $3 billion when we have crumbling subways, crumbling public housing, people without healthcare, [and] public schools that are overcrowding?" Amazon and the Economic Development Corporation touted the projected "9-to-1 return on investment" that the HQ2 site will hopefully bring to the state and city, but committee members didn't seem convinced.

Speaker Johnson said he felt "played" by Amazon's HQ2 selection process. "I don't look at it as a competition," he said. "I look at it as they were able to pit city after city against each other to see who would give them the best deal."

What to Expect in 2019: The Economic Development Committee hearing was the first of three on the Amazon project, with other meetings likely to take place in January and February 2019. There has also been a tremendous amount of public backlash to the Amazon bidding and incentive process, so the debate as to whether the Amazon deal is good for New York City and state seems set to continue well into 2019.

The Cases

Each month, we highlight noteworthy cases from New York State's Division of Tax Appeals and Tax Appeals Tribunal, along with any other cases involving New York taxes. This month, we highlight a New York Court of Appeals decision addressing whether certain telecommunications equipment qualifies as taxable real property and analyze a recent administrative law judge determination involving New York Empire Zone tax credits.

Court of Appeals Clarifies Whether Telecommunications Equipment Qualifies as Taxable Real Property

In Matter of T-Mobile Northeast, LLC v. DeBellis,[2] the New York Court of Appeals affirmed a lower court's ruling that certain large cellular data transmission equipment owned by T-

Mobile Northeast LLC and mounted to the exterior of buildings throughout Westchester County qualifies as taxable real property under the state's real property tax law.

In its ruling, New York's highest court provided a detailed summary of the evolution of the statutory scheme governing the taxation of telecommunications equipment in New York state. The changes culminated with new legislation enacted in 1987, which identified as taxable "lines, wires, poles, supports and inclosures for electrical conductors."[3] According to the court, the intent of the new legislation was "that equipment of a type that comported with traditional conceptions of real property be taxable, but not equipment that would be considered personality under the common law."

T-Mobile's equipment consisted of large cellular data transmission equipment that it installed on the exterior of buildings in Mount Vernon, New York. The installations, as described by the court, consist of "multiple pieces of interconnected equipment, including base transceiver stations (essentially cabinets housing wiring and providing battery power); antennas that transmit and receive the signals; and coaxial, T-1, and fiber optic cables running amongst the other components."

T-Mobile argued that its equipment did not constitute "lines, wires, poles, supports [or] inclosures for electrical conductors." But, instead, the company argued that the property fell within categories of property that were phased out from taxation as part of the 1987 legislation and that its installations qualified as "station connections," which are specifically exempt from taxation under Section 102(12)(i) of the property tax law.

According to the court, however, "it is clear from the plain language and legislative history of paragraph (i) that T-Mobile's arguments lack merit." Analyzing the language of Section 102(12)(i), the court held that T-Mobile's "base transceiver stations are essentially cabinets that house cables and other electrical components and provide battery power, so they qualify as 'inclosures for electrical conductors.'" Similarly, "[t]he large rectangular antennas are part of the base transceiver stations and, thus, also 'inclosures for electrical conductors.'" Finally, the court noted that "[t]he various cables in the installations are 'lines' and/or 'wires' under the plain text of the statute," and "[b]ecause the primary function of the equipment installations is to transmit cellular data, the components are 'used in connection with the transmission or switching of electromagnetic voice, video and data signals between different entities separated by air, street or other public domain,' as required by the statute." Thus, the court held that "although ambiguities in tax statutes are generally resolved in favor of the taxpayer ... that doctrine is not implicated here because the plain text of RPTL 102(12)(i) unambiguously indicates that T–Mobile's equipment installations are taxable real property."

The court also rejected that any of the 1987 phase outs from taxation, which the court held were intended to cover property located in the "central office" of a telephone company, applied to T-Mobile's property and dismissed T-Mobile's argument that its equipment fell under the Section 102(12)(i) exception for "station connections." According to the court, that exception "relates to wiring physically connecting customer telephones to telephone poles and does not encompass the equipment at issue here — large outdoor installations including fiber optic cables and antennas." Instead, the court noted that it appears "T–Mobile's equipment is precisely the type of property the Legislature intended to cover when it substantially revised the RPTL in 1987."

What to Expect in 2019: Unless T-Mobile plans to raise substantial federal or constitutional questions in a petition for certiorari with the U.S. Supreme Court, this is the end of the road for T-Mobile's appeal. But given the lengthy and complicated history of the evolution of the statutory scheme governing the taxation of telecommunications equipment in New York state, future challenges from other taxpayers appear likely.

Tax Department's Refusal to Adjust Empire Zone Real Property Tax Credits Deemed Arbitrary and Capricious

In Matter of Schahet,[4] Hodgson Russ successfully argued that the Division of Taxation and Finance's decision to deny retroactive adjustments to Empire Zone real property tax credits was arbitrary and capricious and an abuse of its discretion. Since our firm handled this case, we'll keep the commentary to a minimum.

The case involved the proper computation of Empire Zone real property tax credits. Under Section 15 of New York tax law, businesses that are certified as a Qualified Empire Zone Enterprise are able to claim credits against tax for eligible real property taxes paid or incurred by the QEZE. The issue in Schahet involved limitations on the credit when taxpayers make payment in lieu of tax, or PILOT, payments and the Tax Department's discretionary adjustments to those limitations.

The taxpayers were members of a hotel group that qualified as a QEZE in connection with the building of a hotel in Schenectady, New York. As part of the development, the group made PILOT payments to the Schenectady Metroplex Development Authority.

Where PILOT payments are involved, the real property tax credits that are available to QEZEs are subject to a limitation or cap, which is calculated by multiplying the federal tax basis in the eligible real property by the estimated effective full value tax rate within the county in which the property is located.

The group's investment in the hotel was about $10 million. But the group's federal tax basis in the hotel was reduced to account for the receipt of a grant from Empire State Development in 2007 and a $5 million allocation of the Federal Renewal Community benefit in 2007 (both reductions were required by the Internal Revenue Code).

The taxpayers originally filed personal income tax returns for each of the 2011 through 2013 tax years under audit and claimed the real property tax credits for the full amount of the group's PILOT payments. Following an audit, however, the taxpayers received notices of deficiency reducing the credits claimed by applying the statutory cap discussed above. In applying the statutory cap, the Tax Department computed the "effective full value tax rate" using a single average county-wide full value rate.

During the audit, and while the statute of limitations was still open for all of the audit years, the group requested that the Division of Taxation disregard the two basis adjustments mentioned above for purposes of calculating the QEZE credits. This would have permitted the taxpayers to receive most of the claimed credit. The division responded saying it would disregard the basis reductions for the tax returns that had not yet been filed (i.e., 2014 and subsequent years), but not for the 2011 through 2013 returns that had been filed and were under audit. The division stated that it viewed the taxpayers' request as similar to a discretionary adjustment to a business allocation percentage, which the division asserted was permitted only on a prospective basis. Accordingly, the division deemed the request untimely for the 2011-2013 years.

The taxpayers argued that the division's decision to grant the group's basis request for a discretionary adjustment in the federal tax basis in the hotel for 2014 and beyond, but to deny that same request for the 2011-2013 tax years was arbitrary and capricious. The taxpayers argued that whether tax returns have been filed or not is not relevant to the value of the hotel, or whether that value was properly reflected in its federal tax basis, which the taxpayers argued were the only relevant issues for accepting or denying the discretionary adjustment.

The administrative law judge agreed with the taxpayers that the division's decision to ignore the basis reductions for only the periods after the audit was arbitrary and capricious. As noted by the ALJ, even if the division viewed the taxpayers' request as similar to a discretionary adjustment to a business allocation percentage, the division had previously issued specific guidance in a technical memorandum indicating that requests for such an adjustment "may be submitted either before or after the filing" of a tax return. Accordingly, the judge allowed the basis adjustments for the 2011-2013 tax years.

The taxpayers also argued that the "estimated effective full value tax rate" used by the division to calculate the credit cap on the PILOT payments was computed incorrectly since the division used one county-wide rate and the language in the statute requires the division to calculate "rates" (plural) for each county. The ALJ, however, sided with the division on this issue, finding that the division's interpretation of the tax law (i.e. that only one rate per county needed to be calculated) was reasonable and that the taxpayers did not meet their burden of proof to show their interpretation was the only reasonable construction.

What to Expect in 2019: The state's Empire Zone program, which provides credits against taxes for qualifying businesses in certain geographically defined areas, is currently closed to new entrants, so you might expect us to predict that future QEZE disputes are unlikely. But with that said, these types of disputes remain frequent (which may be why the program is closed to new entrants!) and we actually fully expect to see more Empire Zone disputes in 2019.

Other Guidance

New York State Seeks Comments on Amended Corporate Franchise Tax Regulations

As part of New York state's sweeping corporate tax reforms ushered in with the legislation contained in the 2014–2015 and 2015–2016 New York state budgets, the Department of Taxation and Finance has been developing and drafting various amendments to the Article 9-A business corporation franchise tax regulations in order to incorporate the legislative changes. As the draft regulations are developed, the Tax Department has posted each change on its website, seeking public comment prior to the state administrative procedure process for formally adopting the regulations.

On Dec. 5, 2018, the Tax Department issued its most recent proposed regulations, which describe the computation of tax under the new law, define the various types of income and capital, and provide examples regarding the types of investment capital and the limitations on investment income. Under the state's current law, Article 9-A taxpayers are required to pay tax computed on the higher of the "business income base;" "the capital base;" and "the fixed dollar minimum tax."

The draft regulations describe each base in detail and address other computation issues such as correcting distortions of income or capital; defining "entire net income;" and expanded definitions of investment capital and investment income. Under the business income tax base, business income is defined as entire net income minus other exempt income and investment income, so the new definitions will assist taxpayers in the computing their income under the relevant tax bases. The draft regulations also provide helpful examples of what qualifies as both income and capital under the new law. Like past draft regulations issued by the state, these examples are some of the more helpful additions to the state's guidance.

Comments on the proposed amendments are due to the Tax Department by March 5, 2019.

What to Expect in 2019: Here, we have more of a wish than a prediction, as we hope this trend continues in 2019. While some of the standards announced in the Tax Department's current draft regulations remain vague, the department deserves full credit for working to get this information to taxpayers and seeking comment from interested parties. Our hope for 2019 is that we start to see some final regulations.

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[1] State v. Sprint Nextel Corp.; No. 127

[2] Matter of T-Mobile Northeast, LLC v. DeBellis, No. 140, 2018 WL 6533281 (N.Y. Dec. 13, 2018).

[3] RPTL Section 102(12)(i).

[4] Matter of Schahet, DTA Nos. 827351, 827352, 827353, and 827354, ALJ Determination (Nov. 29, 2018).