

10 Considerations For Litigating A New York Tax Case

By **Cyavash Ahmadi and Jeffrey Friedman** (January 2, 2024, 3:28 PM EST)

On Dec. 27, 2023, the New York Department of Taxation and Finance formally adopted long-awaited regulations implementing state corporate tax reforms that were enacted nearly a decade ago.

Although the department solicited feedback from the public throughout the process that culminated in the rules' formal adoption, there remain several rules that we are certain will cause irreconcilable disputes.

In addition to the reasonable disagreements taxpayers and the department will have over these regulations, the state's legislative response to the Tax Cuts and Jobs Act is all but certain to lead to litigation. For example, New York state's and New York City's treatment of global intangible low-taxed income is, in our view, unconstitutional in a number of fact patterns.

It seems like it is only a matter of time before these issues come to a head.

Litigation at the state and city level generally follows the same process. A tax case begins in the New York state or New York City Tax Appeals Tribunal by filing a petition protesting an assessment or denial of a refund claim.[1] Upon filing, cases are assigned to and heard by an administrative law judge.[2]

Both the government and the taxpayer can file an exception — i.e., an appeal — to an ALJ's determination.[3] Exceptions are heard by the commissioners of the tribunal, who are generally appointed by the governor or mayor.[4]

If taxpayers or, in certain state-level cases, the government, are aggrieved by the commissioners' decision, they may file an appeal by commencing an Article 78 special proceeding — a challenge to an administrative determination — in the Appellate Division of New York's Supreme Court — which is not the state's highest court.[5]

With this process in mind, it is worth asking yourself — do you feel lucky? What should one consider before venturing into the New York litigation process? What follows are some questions worth thinking through before committing to New York tax litigation.

1. Can you commit for the long haul?



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Litigating a case to finality can take years. But this should not dissuade taxpayers from litigating the right case. And certain decisions, like whether to engage with the state's Bureau of Conciliation and Mediation Services, can lead to more efficient timelines.

Moreover, where there are constitutional issues in play, taxpayers may not need to exhaust their administrative remedies at all — New York has a fairly broad exception to the administrative exhaustion requirement applicable to constitutional challenges, which, when appropriately deployed, may avoid the tax tribunal process altogether.[6]

2. Is the dispute legal or factual?

Because tax appeals are brought as Article 78 proceedings, New York law provides deference to the factual determinations made by the New York State Department of Taxation and Finance or the New York City Department of Finance.[7] The departments' legal interpretations, on the other hand, receive much less, if any deference. These interpretations are reviewable de novo.[8]

It is not always obvious, however, whether an issue is based on an interpretation of the relevant statute or on factual determinations made by the department. Careful consideration should be given to whether and how strong a case can be made that the issue is one of competing legal interpretations instead of factual determinations.

A competing consideration worth mentioning is the value of advocating a legal position in the context of a taxpayer's facts. There are instances in which it is more effective to present a case as arising in the context of a pure legal question.

3. If factual, how much discovery is necessary?

Taxpayers should consider whether they have what they need from the department. Because tax appeals are not formal actions in New York state court, the tax appeals tribunals have different rules concerning disclosure.

Discovery is highly circumscribed at the New York state and New York City tax appeals tribunals. Although obtaining authorization to depose auditors can be challenging, there are alternative methods available to develop the record — for example, through public records requests and the creative use of procedural devices like a demand for a bill of particulars.[9]

4. Are the relevant records and witnesses available?

Related to the factual development of a case are the challenges associated with mustering the evidence necessary to carry the taxpayer's burden to prove its case. Executives change jobs or retire, and institutional documents may dwindle over time. As litigation is often protracted, it is important to keep contemporaneous records of support for disputed tax positions.

The departure of a potential witness can pose challenges if their background is necessary to prove an important element of a case. But these departures are not insurmountable obstacles to success — retired colleagues often turn out to be terrific witnesses because they may have availability to participate in trial preparations. Expert witnesses may also be used to strategically provide additional context.

Lastly, it goes without saying that taxpayers should regularly document tax positions and be deliberate in negotiating the terms of tax cooperation agreements in mergers and spinoffs.

5. Is settlement an option?

We recognize that most cases should settle during an audit — but sometimes the terms dictated by the audit division are a nonstarter. Filing a petition with the New York State Division of Tax Appeals or New York City Tax Appeals Tribunal results in a review by some other players who may have a different perspective than the auditor who contributed to the controversy.

If you have a good legal argument to which the auditor may not be receptive, the state's or city's lawyer may provide an opportunity to revisit resolution. State and city lawyers appreciate the hazards of litigation and may help reason with the agency to produce a reasonable settlement.

6. Can the issue be resolved in conciliation?

New York state and New York City provide taxpayers with the option of conciliation before filing a petition with the tax appeals tribunal.[10] Conciliation is a mediation between the auditor and the taxpayer facilitated by the department's conciliation bureau. Conciliation can save time and expense, depending on the issues in the case.

There are a number of factors to consider when deciding whether to opt for conciliation, including the potential for irritating information requests by the conciliator, and the additional time and expense associated with the effort.

7. Is privacy a concern?

New York state and New York City have enacted tax privacy laws, similar to those in many states, that prohibit auditors and other tax department officials from publicizing information reported on a tax return or learned during the course of a tax audit.[11] However, litigation may lead to public disclosure of your dispute.

This usually means that the amount of income reported by a company or individual may enter the public domain, which may be less of an issue for publicly traded companies. But other details of a tax dispute may not be public — including a company's tax structure and transactions. Fortunately, protective orders and similar devices may be available to limit the disclosure of private affairs.[12]

8. Is the issue likely to arise in the future or in other states?

Are there enough dollars at stake to justify the time and expense of litigation? A recurring issue is potentially a more worthy candidate for litigating than a one-off dispute. Relatedly, if the tax dispute arises in multiple states, it may be worthwhile to litigate in New York given the stature of its legal system.

9. Is it possible to recover legal fees?

New York has a special rule for recovering attorney fees in tax disputes. If the commissioner's position is not "substantially justified" as defined in Tax Law Section 3030, then taxpayers may be entitled to an

award of attorney fees.[13]

The law provides a rebuttable presumption that the commissioner's position is not substantially justified if the department did not follow "applicable published guidance," including technical services bureau memoranda.[14] Advisory bulletins issued to the taxpayer also qualify as applicable published guidance.[15] By statute, attorney fees are capped at \$75 an hour, but a court may decide to increase that amount if it finds that a special factor justifies a higher rate.[16]

10. Has tax been paid?

New York taxpayers are not required to pay to play — i.e., satisfy deficiencies before exhausting their administrative remedies. However, taxpayers are generally required to pay or deposit the amount of any assessment with the commissioner in order to appeal beyond the tax appeals tribunal.[17]

While paying the deficiency will stop interest from accruing, there are risks associated with doing so. For example, some taxpayers resist paying a tax they believe is not due because, in part, payment can signal low confidence in a case.

Another consideration is the difference between interest on overpayments and underpayments: Interest rates are adjusted quarterly, and interest rates on overpayments are uniformly set at lower amounts than interest on underpayments.[18]

The decision to move forward with litigation is never an easy one, often rife with competing concerns: The necessary subjective decision-making that is required to determine whether one feels lucky is premised on these and other factors.

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[1] NY Tax Law §§ 1089(a), 2008(1); NYC Administrative Code § 11-680(1).

[2] See 20 NYCRR § 3000.15(a); 20 RCNY § 1-12(a).

[3] See 20 NYCRR § 3000.17(a); 20 RCNY § 1-13(a).

[4] See 20 NYCRR § 3000.17(a); 20 RCNY § 1-13(a).

[5] NY Tax Law §§ 1090(a), 2016(3); NYC Administrative Code § 11-681(1).

[6] See e.g. *Matter of First Natl. City Bank v. City of N.Y. Fin. Admin.*, 36 N.Y.2d 87, 92 (N.Y. 1975) ("When a tax statute ... is alleged to be unconstitutional, by its terms or application, or where the statute is attacked as wholly inapplicable, it may be challenged in judicial proceedings other than those prescribed by the statute as 'exclusive.'").

[7] See *Matter of Wegmans Food Markets, Inc. v. Tax Appeals Trib. of N.Y.*, 33 N.Y.3d 587 (N.Y. 2019)

("We reiterate the long-standing rule that, in CPLR article 78 proceedings, courts have no right to review the facts generally as to weight of evidence, beyond seeing to it that there is substantial evidence.")

[8] *Walsh v. N.Y. Comptroller*, 34 N.Y.3d 520 (N.Y. 2019) ("In CPLR article 78 proceedings to review determinations of administrative tribunals, this Court's typical standard of review is whether there was substantial evidence to support the hearing officer's decision. Here, however, because an issue of statutory interpretation underlies this question, we engage in de novo review of the statutory interpretation."); see also *Debevois & Plimpton v. N.Y. State Dept. of Tax'n & Fin.*, 80 N.Y.2d 657 (N.Y. 1993).

[9] See N.Y. Pub. Off. L. § 84 et seq. (providing for public records requests); 20 NYCRR § 3000.6 (providing for bill of particulars in State Tax Appeals Tribunal proceedings); 20 RCNY § 1-06 (providing for bill of particulars in City Tax Appeals Tribunal proceedings).

[10] *Id.* § 170(3-a); N.Y.C Admin. Code § 11-124.

[11] E.g., N.Y. Tax Law § 211(8)(a); N.Y.C. Admin. Code § 11-688(1) (New York City business taxes).

[12] See N.Y. CPLR § 3103.

[13] See N.Y. Tax Law § 3030(a), (c)(5)(B).

[14] *Id.* § 3030(c)(5)(B)(iv).

[15] *Id.*

[16] *Id.* § 3030(c).

[17] N.Y. Tax Law §§ 1090(c), 1138(a)(4).

[18] See New York State Department of Taxation and Finance, Interest Rates, <https://www.tax.ny.gov/pay/interest/> (last visited Dec. 5, 2023).