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THE BR STATE + LOCAL TAX SPOTLIGHT

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Note from the Editor

By Eugene J. Gibilaro

Welcome to the September 2022 edition of *The BR State + Local Tax Spotlight.* We understand the unique demands of staying on top of important State + Local Tax developments, which happen frequently and across numerous jurisdictions. Staying updated on significant legislative developments and judicial decisions helps tax departments function more efficiently and improves strategy and planning. That is where *The BR State + Local Tax Spotlight* can help. In each edition, we will highlight for you important State + Local Tax developments that could impact your business. In this issue, we will be covering:

- Plain Meaning of Statute Wins in Maryland
- Federal Judge Approves Tax Settlement between Taxpayer and New York State over Objections of *Qui Tam* Plaintiff
- New York State Tax Appeals Tribunal Reverses ALJ and Holds That Taxpayer Was Not a Statutory Resident

We invite you to share *The BR State + Local Tax Spotlight* with your colleagues and visit Blank Rome's State + Local Tax webpage for more information about our team. Click here to add State + Local Tax to your subscription preferences.

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MITCHELL A. NEWMARK
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Plain Meaning of Statute Wins in Maryland

By Mitchell A. Newmark

Too often we hear states assert that the company's view cannot be correct because if it was correct the company would owe less or no tax. Maryland's intermediate appellate court told the Comptroller in an unreported decision that such an argument is not how laws are interpreted. *Comptroller v. Leadville Insurance Co.,* No. C-02-CV-17-001285 (Md. Ct. Spec. App. Aug. 29, 2022). When determining the meaning of a statute we first look at the plain meaning of the statute itself and if there is no ambiguity we must follow the words of the statute (when a statute's plain meaning is ambiguous other aids of statutory construction can be considered). Having to pay less or no tax does not make the statute ambiguous, the Maryland court understood that, so the company won.

The Facts: The Comptroller audited Macy's, Inc. One of its subsidiaries (Macy's Retail Holding, Inc.) paid amounts to Leadville Insurance Company ("Leadville"). Leadville was established under the laws of Vermont to provide insurance to Macy's subsidiaries for excess earthquake risks if the subsidiaries were unable to obtain market coverage for such risks. Leadville qualified as a captive insurance company under Vermont law and insured risks, some of which were held by Macy's department stores in Maryland.

Leadville wrote its policies in Vermont, not in Maryland, and paid premiums tax in Vermont, not in Maryland. Leadville was not located in Maryland. In most of the years audited, Leadville did not pay premiums tax in Maryland and, for all the years audited, it did not pay corporate income tax in Maryland.

Macy's Retail Holding, Inc. ("MRHI") deducted premium and interest expense that it paid to Leadville for 1996 to 2003. For 1997 to 2003, Leadville earned no Maryland premiums. The Comptroller denied the deductions to MRHI (it added them back to MRHI's income) and asserted that the denied deductions could be attributed to, and tax, interest, and penalty assessed against, Leadville in June of 2010. (This backwards assessment is really an end run around the statute of limitations on assessment that was condoned in a much earlier case for another company regarding payment of royalties to a related party and the Comptroller's loophole for such actions needs to be closed.)

As a Vermont insurer that writes its policies in Vermont, Leadville did not hold a certificate of authority from the Maryland Insurance Commissioner making it an "unauthorized insurance company." When an unauthorized insurance company effects, continues, or renews insurance on a property in Maryland it "shall pay" a premium receipts tax of three percent of the gross premiums charged. The same statute provides that: "The premium receipts tax under this section is instead of all other State taxes." Md. Code Ann., Ins. Sec 4-209(b)(1); (c).

> **The court agreed with Leadville that the statute is clear that the premiums tax "is instead of *all* other State taxes."**

The Decision: Leadville said that being subject to the premiums tax meant that it was not subject to corporate income tax under the plain meaning of the specific words used by the legislature in the statute. The Comptroller asserted that if Leadville is correct and if the statute is given its plain meaning, the statute would create a "tax shelter for unauthorized insurance companies operating in Maryland that do not generate income from premiums." The Comptroller continued reasoning that the statute is an exemption from the corporate tax, exemptions should be construed against the company, and because the premiums tax statute's words are ambiguous, the construction should go in favor of the Comptroller to assert corporate income tax. The court agreed with Leadville that the statute is clear that the premiums tax "is instead of *all* other State taxes."

The takeaway is that just because the company would owe more tax if the State ignores the plain meaning of a statute, it does not make the statute ambiguous. Don't back down when the State says it is because we say it is! □

IRWIN M. SLOMKA
SENIOR COUNSEL

Federal Judge Approves Tax Settlement between Taxpayer and New York State over Objections of *Qui Tam* Plaintiff

By: Irwin M. Slomka

A recent United States District Court decision under the New York False Claims Act offers good news to New York taxpayers that may be facing *qui tam* actions from private party litigants making questionable and frequently onerous tax claims. A federal judge granted New York State's motion for court approval of a corporate tax settlement between the State and a New York corporate taxpayer for $100,000, over the objections of a *qui tam* plaintiff that claimed millions of dollars of taxes were allegedly owed by the corporation. *State v. Egon Zehnder Int'l, Inc.,* No. 212-cv-6833 (LJL), (S.D.N.Y., Aug. 31, 2022). The decision demonstrates the potential benefits of working with the State Tax Department to resolve *qui tam* claims, even where the *qui tam* plaintiff objects to the settlement, as courts tend not to second guess the State's settlement judgment.

> **The decision demonstrates the potential benefits of working with the State Tax Department to resolve *qui tam* claims, even where the *qui tam* plaintiff objects to the settlement.**

Background: Under the New York False Claims Act (N.Y. Fin. Law § 189(1)), a defendant can be subject to treble-damages liability owed to New York State or a locality if the defendant "knowingly makes, uses, or causes to be made or used, a false record or statement material to an obligation to pay or transmit money or property to the state or a local government." This law extends to New York tax liabilities. It allows a *qui tam* action to be brought by "any person" (a "relator") for violation of the law and, if successful, entitles the relator to 25 to 30 percent of the amounts recovered.

The Facts: The taxpayer is the U.S. subsidiary of a Swiss corporation that, through affiliates, operates a worldwide executive search business. The relator, an alter-ego entity for a "whistleblower" who was formerly the taxpayer's controller, brought a False Claims Act claim against the taxpayer in the New York courts alleging that the taxpayer's failure to include in its New York taxable income fees that it sourced to its non-U.S. affiliates constituted the making and using of "false statements" in the taxpayer's State and City tax returns, and the underreporting of "tens of millions of dollars" of taxable income.

New York State—the Attorney General and the Tax Department—conducted a lengthy investigation into the relator's allegations and ultimately decided not to intervene. The State learned that the relator had previously made a whistleblower claim with the Internal Revenue Service ("IRS") concerning the same alleged underreporting and the IRS had concluded that no adjustments were warranted.

Thereafter, the taxpayer successfully removed the *qui tam* action from state court to federal court, over the relator's objections, persuading the court that the dispute largely depended on a federal tax question (*i.e.,* the computation of the taxpayer's federal taxable income). The State and the taxpayer then reached a settlement agreement in principle for a payment of $100,000, $30,000 of which would be held for payment to the relator or its lawyer. The relator filed an opposition to the settlement.

The Decision: The court held that the State made a reasonable judgment that a $100,000 settlement was "fair, adequate and reasonable" to all parties—as the law requires—and approved the settlement. The court found there was considerable risk to the relator that there was no "obligation"—a critical element of a *qui tam* action—to pay New York tax on amounts the IRS had determined, after an audit, were not includable in federal taxable income. The court also found that a decision on the merits could have a detrimental effect on "unsettled questions" regarding the interplay between federal and state tax reporting. The court noted that a decision for the relator could lead to the enactment of similar statutes nationwide, resulting in investigations "instigated by private persons intrigued by the prospect of personal recovery." □

KARA M. KRAMAN
OF COUNSEL

New York State Tax Appeals Tribunal Reverses ALJ and Holds That Taxpayer Was Not a Statutory Resident

By Kara M. Kraman

The New York State Tax Appeals Tribunal reversed a determination of an Administrative Law Judge ("ALJ") and determined that a teacher who rented an apartment in New York City during the tax year at issue was not a statutory resident of New York during that year. *In re Joseph Pilaro and Joseph Gorrie,* DTA No. 829204 (N.Y. Tax App. Trib., Aug. 18, 2022).

The Facts: Mr. Pilaro shared a house in California with his husband Joseph Gorrie in 2014, but from January 1, 2014, through November 1, 2014, while he was teaching at a New York college, he rented an apartment in New York City. Mr. Pilaro and his husband subsequently bought an apartment in New York City on December 3, 2014. For the period between the expiration of his lease on November 1, 2014, and before the purchase of his apartment on December 3, 2014, Mr. Pilaro stayed with friends in New York.

In the proceeding before the ALJ, Mr. Pilaro's attorney conceded that Mr. Pilaro became domiciled in New York once he purchased the apartment in New York City on December 3, 2014. However, at oral argument, Mr. Pilaro stated that his former attorney misrepresented his residency status, and that he was not domiciled in New York State at any time during 2014 as he did not move into his New York City apartment until January 2015.

To be a statutory resident, a taxpayer must (1) maintain a permanent place of abode in the state or city; and (2) be physically present in the state or city on more than 183 days in a taxable year. See Tax Law § 605(b)(1)(B). Further, a statutory resident must maintain his or her permanent place of abode for "substantially all of the taxable year," which the Division's Audit Guidelines interpret to mean a period *in excess* of eleven months. 20 NYCRR 105.20(a)(2).

The Decision: The Tribunal reversed the ALJ and determined that Mr. Pilaro was neither a domiciliary nor a statutory resident in 2014. Regarding domicile, the Tribunal noted that the burden of proof is on the party asserting a change in domicile to show such a change, and that Mr. Pilaro's hearing testimony, as well as his statement at oral argument, both established that he did not move into the New York City apartment he purchased and become domiciled in New York until January 2015.

The Tribunal also found that since Mr. Pilaro did not occupy the New York City apartment he purchased in December 2014 until January 2015, it did not qualify as a "permanent place of abode" for statutory residency purposes. Further, and unlike the ALJ, the Tribunal concluded that Mr. Pilaro did not maintain a place of permanent abode during the period that he stayed with friends, finding that the facts in the record weighed in Mr. Pilaro's favor, including the brief and temporary nature of the living arrangements and the fact that the Division itself did not argue that the arrangement constituted the maintenance of a "permanent place of abode."

A statutory resident must maintain his or her permanent place of abode for "substantially all of the taxable year," which the Division's Audit Guidelines interpret to mean a period *in excess* of eleven months.

Accordingly, the Tribunal determined that Mr. Pilaro maintained a permanent place of abode in New York for the period January 1 through November 1, 2014, only, and that such 10-month period was insufficient to establish statutory residency.

While it would likely not have changed the outcome of this case, it is worth noting that for tax years beginning in 2022, the Division changed its Audit Guidelines to provide that "substantially all of the year" generally means a period exceeding 10 (rather than 11) months for tax years in which a taxpayer either acquires or disposes of a residence. □

What's Shaking: Blank Rome's State + Local Tax Roundup

Blank Rome's nationally prominent State + Local Tax attorneys are thought leaders in the community as frequent guest speakers at various local and national conferences throughout the year. Our State + Local Tax attorneys believe it is necessary to educate and inform their clients and contacts about topics that will impact their businesses. We invite you to attend, listen, and learn as our State + Local Tax attorneys interpret and discuss key legal issues companies are facing and how you can put together a plan of action to mitigate risk and advance your business in accordance with state and local tax laws.

Tax Executives Institute ("TEI") 77th Annual Conference

- Craig B. Fields will be a panelist at the Tax Executives Institute ("TEI") 77th Annual Conference, being held October 23 through 26, 2022, in Scottsdale, Arizona. Craig will speak on "NOLs—The Most Valuable State Tax Assets You Only Think You Have" on Tuesday, October 25 from 11:00 a.m. to 12:00 p.m. as part of the State & Local Tax ("SALT") educational track. To learn more, please click here. □

29th Annual Paul J. Hartman State and Local Tax Forum

- Craig B. Fields and Nicole L. Johnson will speak at Vanderbilt University Law School's 29th Annual Paul J. Hartman State and Local Tax Forum, being held October 19 through 21, 2022, in Nashville, Tennessee. There will also be a virtual option available for all program sessions. Craig will speak on the "Leading Practices in Audits, Assessments, and Alternative Dispute Resolutions" panel, taking place Wednesday, October 19. Nicole's session, "Allocable Income," will take place the next day, Thursday October 20. To learn more, please click here. □

New Jersey State and Local Tax Day

- Eugene J. Gibilaro and Mitchell A. Newmark will speak at the New Jersey State Bar Association's New Jersey State and Local Tax Day being held September 15, 2022, via webinar. Mitchell and Eugene's topic is "State of the States Litigation." To learn more, please click here. □

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