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TAX LITIGATION MEMORANDUM

TO: CPAs, Clients & Associates

FROM: David L. Silverman, Esq.
Shirlee Aminoff, Esq.

DATE: April 2, 2010

RE: Declaratory Relief Against NYS Department of Taxation & Finance

Tax disputes involving New York State are normally adjudicated in the New York State administrative tax tribunals. A “conciliation conference,” presided over by a “conferree” who is actually an employee of the Department of Taxation, usually commences the pas de deux. From there, the taxpayer may seek a hearing before an administrative law judge in the Division of Tax Appeals. An exception to an adverse decision by the ALJ may be taken to the Tax Appeals Tribunal. If the taxpayer loses, he may roll the dice again and appeal to the Appellate Division, Third Department, in Albany via an Article 78 proceeding. Leave to appeal to the Court of Appeals, rarely granted, may be sought if the taxpayer in the Appellate Division. In recent years, the U.S. Supreme Court has granted certiorari to relatively few petitioners involving substantive state tax issues.

Although the administrative dispute mechanism is fairly administered by competent judges,

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tax disputes often result in manifest unfairness to the taxpayer, since protest and filing deadlines are strictly enforced, notices are unclear, and unintended forfeiture of rights frequently occurs. Taxing statutes are narrowly construed and administrative tribunals have little or no equitable jurisdiction. Moreover, Article 78 proceedings are procedurally and substantively weighted against the taxpayer, the standard of review being the difficult to surmount “arbitrary and capricious” formulation. In the federal arena, suits against the IRS may proceed in federal courts only if the taxpayer has paid the tax and then sues for a refund; otherwise the taxpayer must litigate in Tax Court. The doctrine of sovereign immunity will, with few exceptions, pose an impenetrable bar resulting in dismissal of most actions brought by the taxpayer in federal court, except when expressly authorized by statute.

Yet, the doctrine of sovereign immunity exerts less pull in New York state courts. In fact, the Court of Appeals has expressly recognized that administrative remedies are not the sole method of contesting the validity of a taxation statute: “A tax assessment may be reviewed in a manner other than that provided by statute where the constitutionality of the statute is challenged or a claim is made that the statute by its own terms does not apply...” *Slater v. Gallman*, 377 N.Y.S.2d 448. Thus, even a taxpayer who has contested — and lost — in the administrative tribunals, may seek another “day in court” in state supreme court, a naturally more hospitable venue. Moreover, once in supreme court, the Department’s own counsel will mostly likely transfer the file to the Attorney General’s office to litigate the matter. Since the Attorney General may not have the same institutional loyalty to the Department, a satisfactory accord may be reached even where none was possible the Department’s counsel at the administrative tribunals stage.

Challenging the constitutionality of a taxing statute is difficult, as is succeeding in an argument that a taxing statute is unconstitutional or by its terms inapplicable. Nonetheless, the legislature is by no means incapable of enacting vague or unconstitutional statutes, and a serious challenge in supreme court may in the end vindicate the taxpayer’s interests. Thus, in *Tennessee Gas Pipeline Company v. Urbach*, 96 NY2d 124 (2001), a declaratory judgment action, the Court of Appeals reversed the Appellate Division and declared the gas import tax unconstitutional as violative of the Commerce Clause.

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In practice, a declaratory judgment action in state supreme court is commenced by filing a summons and complaint as in any other civil action. The usual rules of procedure as provided in the CPLR apply. Often, a complaint is brought on by an order to show cause (OSC) seeking injunctive relief and a stay of collection until a hearing has been held. The Department does not like to litigate outside of its administrative tribunal forum. Nevertheless, a taxpayer who seeks a declaratory judgment and alleges that a statute is unconstitutional or inapplicable is entitled to a judgment declaring the parties' rights. The appellate division has held that it is improper to "dismiss" a complaint seeking a declaratory judgment, since the proper action is to declare that the statute is — or is not — constitutional. If there is a real question as to whether the statute is unconstitutional or inapplicable, the Attorney General, on its client's — the Department's — instruction, may seek to resolve the dispute without forcing the court to render a decision on the merits, which could further impede the Department's efforts to collect tax against other similarly situated taxpayers if the Department were to lose and the statute were held to be inapplicable or unconstitutional.

Even if the taxpayer seeking a declaratory judgment appears unlikely to succeed on the merits, the mere presence of the taxpayer and his attorney in state supreme court with a Summons and an OSC against the Department and the Commissioner will more likely elicit the attention of an attorney or official with the power and inclination to settle the dispute than would the taxpayer on the receiving end of a telephone call from a collection agent. The declaratory judgment action can be an extremely useful device, especially where other viable options appear few.

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