Highlights and Lowlights From the Empire State

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As is my typical role, I'll tackle the highlights and lowlights in the New York tax world. On the "flop" side of things, the ongoing saga involving New York's "convenience of the employer rule" takes the cake. Over the past 12 months, there have been a string of cases (albeit non-precedential ones) out of New York's Division of Tax Appeals in what I'll call "office closure" cases: situations in which taxpayers who had no place to work in New York during the COVID-19 pandemic yet still got tagged with New York taxes under the auspices of the convenience rule.[61] I've covered the basics of the rule several times in my column,[62] but the overall idea is that if a nonresident taxpayer works remotely for their New York employer for their own convenience — as opposed to employer necessity — they are still subject to New York tax on their compensation. During 2020 and 2021, of course, most nonresident employees of New York companies worked many days at home. But was that for their own convenience? In almost all cases, they had nowhere else to go; their employer — or the government itself — mandated remote work!

But in three decisions issued over the past 12 months, ALJs in New York's Division of Tax Appeals have taken a different view. In *Zelinsky*, the ALJ determined that although the taxpayer's office was closed, that alone wasn't sufficient to constitute employer necessity. In *Struckle*, the ALJ upheld the application of the convenience rule because "the employees' ability to work remotely was permitted, but not obligatory" — an odd conclusion, given that the employer gave the employee no place else to work! And most recently in *Bryant*, the ALJ again upheld the application of the convenience rule in an office-closure situation, though at least there it turned on a burden-of-proof issue, and the ALJ may have ruled in the taxpayers' favor had they presented more evidence to show that their office was closed.

Thankfully, none of these cases are precedential, so we'll await the final word from the Tribunal on appeal. In fact, just a few weeks ago, the Tribunal held oral argument in the Zelinsky matter, and to say the bench was "hot" would be an understatement. The Tribunal commissioners clearly understood the importance and gravity of the case and seemed to grasp the critical issues. We are also handling several audits and some litigation involving similar questions. So, I'm hopeful that common sense prevails and this becomes one of the highlights in next year's year-end edition of Board Briefs!

But enough bad news! On the positive side, a couple months ago an ALJ in the New York City Division of Tax Appeals issued a decision in a UBT case that could bode well for future New York City litigants. The first piece of good news here, frankly, is just that there was a decision in the first place! Because of staffing shortages in New York City, there have been very few decisions out of the Tribunal in the past few years. Indeed, we have several cases that have been going on for five, six, or seven years. When the wheels of justice turn so slowly, sometimes there is no justice to be had — it's heartening to see some action.

As to the merits, the specific issue in *A&E Television Networks* — whether the taxpayer could deduct interest expenses from taxable income — seems narrow.[63] But the ALJ's exceptional and precise analysis gets to the core of how the UBT is supposed to work and, if upheld, should strike a significant blow to positions that the DOF is taking in lots of other UBT audits.

The issue was whether a deduction claimed by A&E for an interest expense was allowable for UBT purposes. Under federal law, this interest

[61] *Matter of Bryant*, DTA No. 830818 (N.Y. Div. Tax App. Sept. 12, 2024); *Matter of Struckle*, DTA No. 830731 (N.Y. Div. Tax App. Aug. 8, 2024); *Matter of Zelinsky*, DTA Nos. 830517, 830681 (N.Y. Div. Tax App. Nov. 30, 2023).

[62] Timothy P. Noonan and Emma M. Savino, "The Convenience Rule: Another Bite at the Big Apple," *Tax Notes State*, June 26, 2023, p. 1083.

[63] *Matter of A&E Television Networks LLC*, (TAT (H) 20-32 (UB)).

expense deduction was allowed, and indeed the IRS audited A&E and itself allowed the deduction. On audit, though, the DOF asserted that A&E could not claim this deduction because it was not "directly connected with or incurred in the conduct of the business" within the meaning of N.Y.C. Admin. Code section 11-507, the UBT statutory provision outlining available deductions. That provision begins with a preamble providing a deduction for "items of loss and deduction directly connected with or incurred in the conduct of the business, which are allowable for federal income tax purposes for the taxable year," unless a specific modification or addback applies. The statute then lists more than 20 specific modifications or addbacks — situations in which an allowable federal tax deduction is not allowed for New York City purposes.

But this litigation did not involve one of these modifications; the litigation instead was focused on the preamble in section 11-507. Under the DOF's view, this preamble imposes a discrete requirement that the claimed deduction must be directly connected with the taxpayer's trade or business to be allowed, irrespective of federal law, and separate from the other 20 or so addback modifications contained in the statute.

The ALJ, however, categorically rejected this interpretation and held that there was no discrete requirement that a deduction must be connected with the taxpayer's trade or business. Instead, the ALJ found that the "only reasonable construction" of section 11-507 is that the next phrase in the preamble — that the deduction is "allowable for federal income tax purposes" — illustrates only that "a determination of whether a particular item is 'directly connected with or incurred in the conduct of the business' must be made under the applicable federal standard." In other words, payments that are deductible for federal income tax purposes are, *by definition*, deductible for city UBT purposes, provided they do not fall within any of the enumerated modifications. And to reach this conclusion, the ALJ very carefully walked through the legislative history underlying the former state UBT statute and the current city law, as well as state and city precedent in which similar arguments had been rejected.

More broadly, in our practice we have seen the DOF take similar positions, attempting to add new discrete requirements in the statutory or regulatory framework of the UBT to support aggressive audit positions. The ALJ's decision here provides a clear step-by-step takedown of the city's position that can be a blueprint for taxpayers in other cases.