COURT OF APPEALS

STATE OF NEW YORK

BURTON, et al.,

Appellants,

-against-

No. 115

NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE,

Respondent.

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20 Eagle Street
Albany, New York 12207
June 4, 2015

Before:

CHIEF JUDGE JONATHAN LIPPMAN
ASSOCIATE JUDGE SUSAN PHILLIPS READ
ASSOCIATE JUDGE EUGENE F. PIGOTT, JR.
ASSOCIATE JUDGE JENNY RIVERA
ASSOCIATE JUDGE SHEILA ABDUS-SALAAM
ASSOCIATE JUDGE LESLIE E. STEIN
ASSOCIATE JUDGE EUGENE M. FAHEY

Appearances:

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CHIEF JUDGE LIPPMAN: We're going to start with number 115, Burton v. New York State Department of Taxation.

Counselor, do you want any rebuttal time?

MR. MOORE: Yes, Your Honor, I'd like to reserve three minutes.

CHIEF JUDGE LIPPMAN: Three minutes, go ahead. You're on, counselor.

MR. MOORE: Thank you. Good afternoon, Your Honors. My name is Kenneth Moore. I represent the appellants in this case of first impression before this court. The issue being, of course, whether or not the Constitution controls in this instance to make the - - -

CHIEF JUDGE LIPPMAN: Well, what does the Constitution say about this issue?

MR. MOORE: The Constitution - - - the first sentence of the Constitution says that money, credits, securities and other intangible personal property not employed in carrying on any business by the owner in the state, is deemed to be located, or sitused, in the domicile of the nonresident.

CHIEF JUDGE LIPPMAN: So what is inta - - - intangible personal property mean?

MR. MOORE: In this instance, stock of a

corporation - - -

CHIEF JUDGE LIPPMAN: So if you have stock in - - - in New York and you live out of New York State, it's not going to be taxed?

MR. MOORE: The stock itself - - - you can't have a property tax on - - - on stock.

CHIEF JUDGE LIPPMAN: But you could have a tax on the income from the stock?

MR. MOORE: You could have a tax on the income if the stock is being used by its owner, a nonresident, in a separate trade or business in New York.

CHIEF JUDGE LIPPMAN: Okay, so - - - so how does - - -

MR. MOORE: That gets to the situs of New York.

CHIEF JUDGE LIPPMAN: So how does this impact on the facts in our - - - our case?

MR. MOORE: Well, in our case you have Tennessee residents owning stock in a Tennessee corporation that sold it to another non-New York corporation. The corpora - - - the stock that - - - the corporation of the stock that was sold did a small part of its business in New York.

CHIEF JUDGE LIPPMAN: Right.

JUDGE ABDUS-SALAAM: So they're only looking to tax the portion of the business that was done in New York, not the entire proceeds, correct?

MR. MOORE: Yes, they can tax the portion of the corporation's business that was done in New York, but the stock does not belong to the corporation. The stock belongs to a nonresident individual who was not doing business in New York. And under the Constitution - - -

JUDGE ABDUS-SALAAM: So this - - - there is no pass-through from the corporation to - - -

MR. MOORE: There would be a pass-through - - -

JUDGE ABDUS-SALAAM: - - - these are S corporations, right?

MR. MOORE: Yes.

JUDGE ABDUS-SALAAM: Yes.

MR. MOORE: There would be a pass-through of income - - - the corporation's income. Any interest, dividends or - - - not dividends - - - interest that the corporation owns on carrying on business in New York and deductions all would pass through to the shareholder in computing his income.

JUDGE STEIN: But where - - - where does it say that - - - that it applies to gains from the sale of these assets?

MR. MOORE: I'm sorry?

JUDGE STEIN: Where - - - where does the Constitution - - - how does the Constitution apply to the gains from the sale of these assets, as opposed to the income that the assets generate just from being there?

MR. MOORE: The - - - the - - - it's the intan - - - the corpora - - - the Constitution talks about the intangible asset, not income. It doesn't talk about income, but if the asset can't be taxed in New York, income from that asset can't be taxed, because it's deemed to be located or sitused in this - - - the domicile of the nonresident. Now, the situs rule is state - - -

JUDGE READ: What's - - - what's your authority for that? That if the intangible asset can't be taxed, the income derived from it can't be taxed as well.

MR. MOORE: The - - - well, there's the old cases - - - there were Supreme Court cases going back into the 20s that said you can't do that. Eventually, the Supreme Court overruled those in 1942 in the Aldrich - - - Utah v. Aldrich case, but Justice Jackson stated that that rule is still good;

even if it's an old situs rule, it's still good in New York, because they incorporated it into its Constitution, and as the Constitution says, if the - - - if the property is sitused outside, New York has no jurisdiction to tax it.

JUDGE READ: Okay, so there's no New York case that says that?

MR. MOORE: No. There's - - - the only New York case close - - - and - - - and the State raises a number of cases, but those are excise tax cases. There's a - - - the commercial rent tax, I think, was the major case, Ampco Printing, but the - - - there the issue was whether the commercial rent tax - - - New York City's rent tax on the use of commercial premises was an ad valorem levy, which would be prohibited. And of - - - this court said, no, it's merely an excise tax for the use of property, and it doesn't come within the prohibition of the Constitution.

JUDGE STEIN: How - - - how was this - - - this sale reported on the federal income tax returns? Was it reported as a gain from sale of stock? Or was it reported as a sale of assets?

MR. MOORE: It's for federal income tax purposes - - -

JUDGE STEIN: Federal.

MR. MOORE: - - - the election is a federal election. And for federal income tax purposes, they reported it as a sale of property and of the assets. But it's a fiction. It didn't happen. There - - -

JUDGE STEIN: Well, it was a fiction for federal - - --

MR. MOORE: For federal purposes.

JUDGE STEIN: - - - income tax purposes as well, right?

MR. MOORE: Right.

JUDGE STEIN: Yes. And - - - and why wouldn't it - - -

MR. MOORE: And it doesn't - - -

JUDGE STEIN: - - - why wouldn't there be - - -

MR. MOORE: Conformity?

JUDGE STEIN: - - - the same - - - yeah, uniformity with the State?

MR. MOORE: Generally, there is conformity, but it's not absolute. The statute itself - - -

JUDGE STEIN: But why wouldn't it - - - why shouldn't it be absolute here?

MR. MOORE: Because the Constitution prohibits it.

JUDGE STEIN: Okay, so if we disagree with you about the Constitutional prohibition, then we have a different - - -

MR. MOORE: You have a different case.

JUDGE STEIN: - - - a different question, okay.

MR. MOORE: Because they changed the law. Without that law change, the State's own Tax Appeals Tribunal said you can't tax it.

JUDGE READ: Well, they changed the law, I guess, after the Tax Tribunal - - -

MR. MOORE: Yes.

JUDGE READ: - - - said that, right?

MR. MOORE: Exactly.

JUDGE FAHEY: And you didn't argue retroactivity? Or I'm - - -

MR. MOORE: I'm sorry.

JUDGE FAHEY: I'm sorry. You abandoned retroactivity in the lower court?

MR. MOORE: Yes, we did. We - - -

JUDGE FAHEY: That's what I thought.

MR. MOORE: - - - we knew that that issue was being raised and - - - which you'll address in the next case - - -

JUDGE READ: Why - - -

MR. MOORE: - - - and we wanted to focus on the substantive issue, because whether it's retroactive or prospective, we think that that law was unconstitutional in that it violated the Section 3 Article 16.

JUDGE ABDUS-SALAAM: So counsel, the - - - there was no explicit provision that says that the income or gains can - - - cannot be taxed. It's only that the asset is sited in some other state besides New York.

MR. MOORE: That's right.

JUDGE ABDUS-SALAAM: And so you infer from that that there can be no tax on the - - -

MR. MOORE: On the income.

JUDGE ABDUS-SALAAM: - - - sale or gain.

MR. MOORE: Yes.

JUDGE ABDUS-SALAAM: Okay.

JUDGE RIVERA: What about - - -

MR. MOORE: Now - - - now - - -

JUDGE RIVERA: What about the - - -

MR. MOORE: - - - that's not to say a transfer tax or these other excise taxes, because the Constitution - - -

JUDGE RIVERA: Well, those are specifically - - - the history of Section 3 makes clear that it's not the transfer taxes - - -

MR. MOORE: Right.

JUDGE RIVERA: - - - those kinds of taxes - - -

MR. MOORE: Stock transfer.

JUDGE RIVERA: - - - were not prescribed by Section 3.

MR. MOORE: Right.

JUDGE RIVERA: So but what about Tamagni? What about Tamagni?

MR. MOORE: The Tamagni is an interesting case, but there, this court didn't address the issue of the Constitution. It wasn't raised before this court. The Appellate Division said it doesn't apply because he's a resident, a statutory resident, and a resident - - -

JUDGE RIVERA: You're saying the question is open, but doesn't the Third Department case go directly against your position?

MR. MOORE: The Appellate Division said it - - - it doesn't apply to a statutory resident. We're not dealing here with a statutory resident. And that quest - - - that case actually has been called into question now by the U.S. Supreme Court decision on May 18th, just last month, which said that - - - giving rise to double taxation, not allowing a credit.

CHIEF JUDGE LIPPMAN: Why - - - why from a - - - from a more policy-related perspective, why is it - - - why - - - why shouldn't this be taxed? What's wrong with it? I understand your argument to the violate - - -

MR. MOORE: It may be that the situs rule is old-fashioned and out-of-date, as the State seeks to say, but until - - - as Judge - - - Justice Jackson said in the Aldrich case, unless the State changes its Constitution, it can't take advantage of the new rule - - -

CHIEF JUDGE LIPPMAN: Yeah, but - - - but who's being taken advantage of if they can't tax you? I mean, why - - - it's - - -

MR. MOORE: Well, it was the intention of the Constitution not to tax it. They want - - -

CHIEF JUDGE LIPPMAN: All right. So you're strictly arguing on the Constitution - - -

MR. MOORE: Yes.

CHIEF JUDGE LIPPMAN: - - - not necessarily on fairness or - - - to you or to the State?

MR. MOORE: There's nothing fair about taxes.

JUDGE READ: There's just - - - just inevitability, right?

CHIEF JUDGE LIPPMAN: I think that's a good point. Keep going.

JUDGE FAHEY: Not everybody out there is entitled to comments.

CHIEF JUDGE LIPPMAN: Anything else, counselor?

MR. MOORE: No, and just to get back to the conformity. New York State does not have absolute conformity with the federal law. Its own statute, Section 607, I believe, says that you only conform unless a different meaning is required.

JUDGE STEIN: I think we're just trying to figure out why - - - why a taxpayer would get the benefits of a capital gains treatment, but then not have to pay.

MR. MOORE: Well, it's a benefit - - - New York doesn't even recognize capital gain treatment. It's taxed as ordinary income, so you don't have that conformity there. But typically, the nonresident would pay a tax in his state of domicile.

JUDGE FAHEY: Yeah, but - - - but that's - - - the core of the argument is - - - is - - - to follow up on what Judge Stein just - - - just said is

- - - in each jurisdiction, why should you get the benefit of recharacterizing a particular asset in a different way solely to benefit you and to work against the taxing jurisdiction? Because - - -

MR. MOORE: What we're dealing with is the substantive - - - the substantive item was a sale of stock. If the feds - - -

JUDGE FAHEY: I - - - I just - - - I'm saying - - - as a - - -

MR. MOORE: - - - want to create a fiction, that's their business.

JUDGE FAHEY: As a policy matter.

MR. MOORE: As a policy matter.

JUDGE RIVERA: Okay. So - - - so are you saying that you'd be double taxed because you're clients paid - - -

MR. MOORE: Typically.

JUDGE RIVERA: - - - in Tennessee or wherever they paid - - - they paid a state tax on this somewhere, even if not in New York?

MR. MOORE: At - - - to be honest, Tennessee doesn't tax it, but I would think - - -

JUDGE RIVERA: How convenient.

MR. MOORE: - - - the forty-nine other states would have - - - would have taxed the nonresident on the sale of the stock. Tennessee has a strange rule, but - - - but - - -

JUDGE RIVERA: They may have more citizens after today.

MR. MOORE: Excuse me?

JUDGE RIVERA: They may have more citizens after today now that you've said that.

MR. MOORE: Yeah. But the state won't give a credit for - - - for taxes paid, even in a statutory resident situation. They will not give a credit if - - - if you have to pay a tax in another state because the property is sitused in that other state.

CHIEF JUDGE LIPPMAN: Okay, counsel, you'll have - - -

JUDGE RIVERA: So, I'm sorry. Could I just - - -

CHIEF JUDGE LIPPMAN: I'm sorry, Judge Rivera.

JUDGE RIVERA: - - - just to clarify this last point. So you're saying that they did not have to pay a sale - - - a state tax because Tennessee does not tax this particular gain - - -

MR. MOORE: That's right.

JUDGE RIVERA: - - - and if we ruled

against your client and they had to pay or they can't get the refund on the state taxes - - - they've already paid it; excuse me - - -

MR. MOORE: Right.

JUDGE RIVERA: - - - they can't get - - - they cannot then go back and get a credit - - -

MR. MOORE: No - - -

JUDGE RIVERA: - - - for having paid that somewhere in Tennessee.

MR. MOORE: Because they didn't pay it. If they were in any other state, they would - - -

JUDGE RIVERA: Isn't that a wash, because then the credit would have been zero? I mean, then you really wouldn't have paid.

MR. MOORE: Most states don't give credits against intangibles. That's a - - - that's a problem and - - -

JUDGE RIVERA: I understand, but then you pay - - -

MR. MOORE: - - - that's why the - - -

JUDGE RIVERA: You paid once, because Tennessee hasn't charged at all.

MR. MOORE: I'm sorry?

JUDGE RIVERA: But then it's a wash, isn't it, because you've paid once, because Tennessee hasn't - - - hasn't charged you at all - - -

MR. MOORE: Well - - -

JUDGE RIVERA: Why are you going to get credit? You didn't pay any - - - anything anyway?

MR. MOORE: Right, so New York is actually not collecting it from the taxpayer. It's collecting it from the other state is what you're saying - - - it's shifting the burden to the other state.

CHIEF JUDGE LIPPMAN: Okay, counsel, thanks. You'll have your rebuttal. Let's hear from your adversary.

MR. MOORE: Thank you.

CHIEF JUDGE LIPPMAN: Thank you.

MS. VALE: May it please the court, Judith Vale for DTF. This is not a case of first impression. This court and many other courts in New York have already ruled that Section 3 is about value- and location-based taxes. It's not about income- or use-based taxes. And that's clear from Section 3's plain wording, from the drafting history, and from the way it's been applied by the courts for nearly eighty years.

JUDGE STEIN: Well, it - - - the - - - the - - - there are a couple of sort of contrary pronouncements, I think, in the 1992 Technical

Services Bureau Memo and in 20 NYCRR 132.5(a), which seemed to indicate to the contrary. What - - - what do we make of that?

MS. VALE: Well, those - - - most of the Technical Memos are talking about the statutes. They're talking about the legislative policy that has been put in place - - -

JUDGE STEIN: Right.

MS. VALE: - - - to generally not tax income. There is one memo that mentions Section 3 as background, but then goes on to describe several different kinds of taxes, one of which is income tax, and - - - and others - - - taxes that actually turn on location.

And so I think the key here is that although Section 3 sets the physical location of the intangible as the domicile, that only matters if the tax at issue turns on location. And income tax in New York doesn't turn on location. It turns on the nexus, the connection of either the person, the income, the transaction to New York. It's been that way since the income tax was first put in place before Section 3.

JUDGE RIVERA: So what's the nexus here for this transaction?

MS. VALE: The nexus here is that it was a deemed sale of assets, corporate assets, that were used to do substantial business in New York to make profits from New York.

JUDGE RIVERA: The thirteen percent.

MS. VALE: Thirteen percent.

JUDGE RIVERA: You're going to tax them at that thirteen percent that they had - - - so how do you figure out the thirteen percent, by the way?

MS. VALE: There's a - - - well, there's a formula for getting to the thirteen percent. It's based on receipts from New York, payroll in New York, and, I think, property in New York. And that thirteen percent is applied to the corporation's pass-through income for all different kinds of income.

JUDGE RIVERA: So in the past, they had paid this thirteen percent?

MS. VALE: I don't know if it was thirteen percent in each year, but they had been paying whatever their business allocation was for that year - - -

JUDGE RIVERA: That New York source income.

MS. VALE: Correct, correct. And to be clear on New York source income, source doesn't mean physical location. Source is a statutory term of art and there are different ways that the legislature has decided that income from an intangible or other property has a connection in order to be a New York - - - New York source income.

And there are lots of examples when income from an intangible of a nondomiciliary has enough connection to New York to be taxed. That is the Tamagni case. That's exactly the ruling of the case. In that case, the plaintiffs made the exact same argument as the plaintiffs are making here. They said that the first sentence of Section 3 created an automatic bar on any income tax, because their intangibles were located outside of New York, because they were nondomiciliaries.

And the court re - - - resoundingly rejected that and correctly ruled that it just doesn't logically follow from a location principle about physical location that you could then not tax income tax, because income tax doesn't turn on location. And - - -

JUDGE RIVERA: Because the income is - - - is generated in New York? That thirteen percent you're talking about?

MS. VALE: Correct, it was - - -

JUDGE RIVERA: You didn't charge them on the other eighty-seven percent.

MS. VALE: Correct, you - - -

JUDGE RIVERA: That's derived from business or business associations, not - - - not New York-based.

MS. VALE: Correct, they're on - - - New York, it would only tax the thirteen percent. It's - - - it's sort of fairly allocated among the states.

JUDGE RIVERA: Okay, so just to get that. So that's that thirteen percent. So you're saying once they - - - once they then sell the asset, not the stock, you're only charging on that thirteen percent?

MS. VALE: Correct. It's only on that thirteen percent, and that thirteen percent is the pass-through gain - - - it's going to be on the pass-through gain from the deemed asset sale.

JUDGE RIVERA: If - - - if they had not done a deemed asset sale and sold it as stock?

MS. VALE: If it had been a pure stock sale - - -

JUDGE RIVERA: Yes.

MS. VALE: - - - New York wouldn't have taxed it, but that's because of the tax law. That's because of the statutory legislative policy decisions that the legislature has made. But the legislative policy - - -

JUDGE FAHEY: That's why a lot of times in these transactions, they're adjusted, to deal with the tax deficiency that might be created by whether or not you choose a deemed asset sale or a stock sale. Isn't that right?

MS. VALE: I think that's right.

JUDGE FAHEY: Yeah.

MS. VALE: And I think - - - and just - - -

JUDGE FAHEY: Well, it took my mind - - - it took me a while to get my mind around it too, so don't - - - don't worry. But that's my understanding of it, and - - - and that's - - - that's why the - - - the effect may be minimized.

MS. VALE: Right. And they're taxing here on the deemed assel sale - - - the deemed asset sale gain. There's actually a calculation that's done to figure out the corporation's gain on its assets. And that's the income that's passing through.

And so it's - - - it's just not really a stock sale anymore, and it's not - - - it's a tax fiction, but it has very real consequences both in the federal system and in the New York system. The purchasers get the asset sale benefits. They get to depreciate the asset sale - - - the assets that they have bought over time. And with that benefit for the transaction also comes the consequences.

JUDGE RIVERA: So other than the two cases that result in you going to the legislature and - - - and asking for the amendment to the statute in 2010, had you previously treated a deemed asset as taxable income of an S corporation shareholders?

MS. VALE: Yes, yes.

JUDGE RIVERA: Nonresident?

MS. VALE: Yes. I mean, and this goes a - - - a little bit to the issues in - - - in the next case, but there is a lot of evidence that's showing that New York was treating the deemed asset sale gain as New York source income that passed through, well before Baum and Mintz.

But there's also lots of other examples outside of the deemed asset sale context, where the legislature has taxed income from intangibles of nonresidents, because it's sufficiently connected to New York, so besides the Tamagni case, which is one example, there's also, if you sell - - - if you're a nonresident that sells your intangible share in a co-op, you technically have an intangible that's sitused outside of New York. But of course, that transaction has enough connection to New York that New York can tax the income from it.

JUDGE RIVERA: So if they literally had their stock in - - - in New York, but had not, in any way, derived income from it historically, zero percent, on the deemed asset sale, you would have nothing to tax, because there's nothing that's that New York business connection you're talking about?

MS. VALE: Well, I think you have to - - -

JUDGE RIVERA: Is that correct or is that impossible?

MS. VALE: I think that's not quite correct because you have to separate out the corporation's assets and the shareholder's stock. So if a shareholder just has their stock sitting in a vault in New York, Section 3 says that that value of that stock that's just sitting there won't be taxed, okay? But - - -

JUDGE RIVERA: Right, yeah. That's obvious.

MS. VALE: But what we're talking about here are the assets of the corporation, not really the shareholder's stock, and it's that deemed sale of the assets that were used to do business in New York that would pass through. If a corporation did no business in New York and didn't have any percentage allocated to New York in the normal course, then there would be no tax, but that's just because there wouldn't be any New York connection anymore.

If the court doesn't have any - - -

JUDGE RIVERA: Well, can I just ask how significant is this? What's the experience with this? How many corporate entities really do this?

MS. VALE: There is - - - it's - - -

JUDGE RIVERA: Or shareholders or - - -

MS. VALE: It's fair - - - I don't know the exact number. It's fairly significant in terms of - - - in magnitudes of millions of dollars that are at issue with just the 338 - - - the deemed asset sale.

But this issue is very significant for other laws. There are other examples, like I said, the - - - the whole nonresident statutory - - - the whole scheme for statutory residents would fall, if plaintiff's theory on Section 3 was correct, because then all statutory residents who have a domicile elsewhere would have intangibles that are technically located outside of New York and - - - and under plaintiff's theory, there's now an automatic bar on any income tax on all of those intangibles.

JUDGE RIVERA: So you're saying it goes - - -

MS. VALE: So it's very significant.

JUDGE RIVERA: So you're saying it goes against that history of Section 3 which is always to attract wealth to New York - - - retain wealth - - - even for nonresidents, but you don't want the residents also migrating out.

MS. VALE: Yes, it - - - it would - - - all of Section 3 was about this historical problem of trying to stop a wealth flight, and trying to stop the old system of location and - - - and value-based taxes, but it's clear from the convention history that the drafters wanted to open the door to the newer systems of taxation, including income tax - - -

JUDGE FAHEY: Well, in - - - in Tamagni, the - - - the resident, I - - - the resident was a statutory resident here - - - the taxpayer was a statutory resident.

MS. VALE: Correct.

JUDGE FAHEY: But here it's a nonresident.

MS. VALE: That's correct.

JUDGE FAHEY: Right.

MS. VALE: But the theory - - - plaintiff's theory would - - - would still destroy the statutory resident scheme, because that - - - the person in Tamagni was a Florida - - - I believe, Florida domicile.

JUDGE FAHEY: Right.

MS. VALE: And so what Section 3 says is that, technically, that person's intangibles are physically located at their domicile, irrespective of the statutory resident. And under plaintiff's theory, that location principle would somehow create a total bar on all income tax, no matter how connected the person, the transaction, is to New York. And that just doesn't make any sense. It's antithetical to the way that New York's income tax system works and it's antithetical to the history and the words of Section 3.

And I just want to stress again, that if you look at the wording of Section 3, it just doesn't say that there's any total bar on income tax. It doesn't say that. When - - -

JUDGE ABDUS-SALAAM: All it - - - all it says, I think, according to your position, would be that the property would be sited in another state, not that the tax - - - you couldn't tax that property - - -

MS. VALE: Right, it's - - -

JUDGE ABDUS-SALAAM: - - - in some form or another.

MS. VALE: Right. What it does is it - - - it tells you where the physical location of the intangible is, and if - - -

JUDGE FAHEY: Well, you can tax the income generated from the intangible. Is that - - - is that - - -

MS. VALE: Correct.

JUDGE FAHEY: - - - your argument?

MS. VALE: Under Section 3 - - - yes, under Section 3 you can. And the location of the intangible may still have relevance for taxes that turn on location.

So an example would be New York's estate tax, the death tax. When somebody dies, New York taxes - - - the property that's actually physically located in New York at the time of their death. So if you needed to figure out where somebody's intangibles were for that tax, you look - - - then you do look to the situs principle in Section 3. It still has relevance.

But - - - but it doesn't have any - - - that same - - - it doesn't have any relevance to income tax, because income tax has never turned solely on the actual physical location of the intangible itself.

JUDGE RIVERA: Well, the one - - - one thing that's - - - I don't think they're even disputing under Section 3 is, of course, the ad valorem provision, and the - - - the particular category of excise taxes, which otherwise excise taxes that are stock transfer taxes clearly can be imposed.

But even that first sentence, which is about adopting the rule of situs, excludes the exact thirteen percent you're talking about. Because that's not treated as having a domicile outside of New York.

MS. VALE: No, the first sentence - - -

JUDGE RIVERA: My - - - the - - - the part of the intangible property that's actually got the business connection to New York is not treated as having the domicile of the share - - - the nonresident, even under the first sentence of Section 3.

MS. VALE: That's right, but it's because your - - - the property that you're talking about here is the corporation's assets, so there's just - - - the shareholders - - - nobody's stop - - - nobody's taxing the shareholder's stock because it sits within a New York vault. That's the kind of tax that Section 3 was concerned of - - - concerned about. What we're talking about here is a sale of the corporate assets that were used to do business in New York.

And so - - - so even the first sentence of Section 3 just doesn't speak at all to what is going here. The transaction here is just - - - it has nothing to do with ad valorem tax. It has nothing to do with location.

JUDGE RIVERA: All right, then I - - - sorry. Then I do need you to clarify this. So it's - - - just the section that's relevant here. "Intangible personal property within the state, not employed in carrying on any business, shall be deemed to be located at the domicile of the owner". So that means - - - so the part that - - - the thirteen percent you're talking about is treated as domiciled in New York, correct?

MS. VALE: It - - - no, that's not correct - - -

JUDGE RIVERA: All right.

MS. VALE: - - - because the thirteen percent that we're talking about is flowing from the corporation's assets. The actual shares in - - -

JUDGE RIVERA: Yes.

MS. VALE: - - - JBS are domiciled - - - are located in Tennessee, but that's not really what's generating any of the income here.

JUDGE RIVERA: So what - - - what - - - what - - -

MS. VALE: It's the corporate assets.

JUDGE RIVERA: - - - so what does that mean? So I'm totally confused. Then what does intangible personal property mean? I mean, an asset is tangible, so that makes no sense. An asset's not covered by this.

MS. VALE: That's - - - that's correct, and that's why we think that Section 3 doesn't apply here at all.

JUDGE RIVERA: I understand that, but then - - - you know, I - - - I'm going back to first question about the stocks, because then I'm not understanding why it would say "Intangible personal property within the state, not employed in carrying on any business".

MS. VALE: Well, that - - - that is talking about the actual stock. So if we were talking about a stock sale - - - if we were talking about a true stock sale, then Section 3 would still say that it's physically located in Tennessee, except if that stock was used in a business in New York.

So an example of that would be if somebody is a - - - is a broker - - - is a stock broker, and they're using stock to - - - to earn their income, then that stock could - - - could create an actual physical location in New York. That's an example of when the location of the stock could actually change under Section 3.

But the - - - the substance of the transaction here isn't a stock sale. It's the sale of the assets of the corporation. And those are - - - don't - - - just don't have anything to do with Section 3. They were used to do business in New York, and they were used to do business in other states.

CHIEF JUDGE LIPPMAN: Okay, counsel.

MS. VALE: Thank you.

CHIEF JUDGE LIPPMAN: Thanks, counsel.

Counsel, rebuttal.

MR. MOORE: Yes, thank you. I - - - I believe counsel's confused about what is substance and what is form. The substance here, as in the transfer taxes which this court has upheld dealing with nonresidents owning stock in a co-op or owning stock in a corporation that owns real estate in New York, the substance of the transaction is the real estate. Whether they form a dummy corporation to transfer the stock, to get an effective control of the real estate, you said is meaningless; it's the substance of the transaction. They're buying real estate.

Here, what was sold and what was purchased was stock. The fiction - - - the form - - - may - - - for federal purposes was a sale of assets, and that has nothing to do with taxing the corporation on thirteen percent of its income. It was taxed on thirteen percent of its allocated income as stated, based on the formula dealing with property, payroll and receipts.

JUDGE READ: So you - - - you're saying what we should - - -

MR. MOORE: But business carried on in this state.

CHIEF JUDGE LIPPMAN: Counsel, Judge Read.

JUDGE READ: - - - you're - - - well, you're just saying we should - - - we should just ignore the whole - - - we should ignore the whole federal deemed asset. That's not relevant at all - -

-

MR. MOORE: Yes.

JUDGE READ: - - - of the consideration of - - -

MR. MOORE: In the State tax law, corporations, when filing the New York State corporation tax, have to file as if they were not S corporations. They have to file as if they were C corporations. That's in the statute - - -

JUDGE READ: So it's just irrelevant. It's just irrelevant that you decided - - -

MR. MOORE: - - - 208.9.

JUDGE READ: It's just irrelevant that you decided to make this a deemed asset sale - - -

MR. MOORE: Yes, because it's - - -

JUDGE READ: - - - for federal tax purposes.

MR. MOORE: If they're taxed as a C corporation, then there is no 338(h)(10). It doesn't exist. You're not qualified for it. Only S corporations and certain consolidated corporations can quality for S and get this fictional deemed asset sale and deemed liquidation.

JUDGE ABDUS-SALAAM: So is it - - - is your - - - is it your position - - -

MR. MOORE: So under New York State law, the corporation can't.

JUDGE ABDUS-SALAAM: Counsel, is it your position that no matter how this - - - this sale or transfer was characterized, it wouldn't be taxed at all?

MR. MOORE: It - - - under - - - because of the Constitution. That it's a sale of stock owned by a nonresident that is not being used by that nonresident in a trade or business. And therefore the in - - - the stock cannot be taxed ad valorem, nor can the income from that tax - - - be taxed to the nonresident.

CHIEF JUDGE LIPPMAN: Who makes the fiction that it's - - -

MR. MOORE: I'm sorry?

CHIEF JUDGE LIPPMAN: The fiction that you say that it's - - - it's not really a sale of assets. Whose decision is that?

MR. MOORE: That's in the Internal Revenue Code.

CHIEF JUDGE LIPPMAN: So - - - so it must be treated - - - you must have - - -

MR. MOORE: It says this will be treated as a deemed asset sale.

JUDGE READ: Well, isn't it your choice? You didn't have to do that, did - - -

MR. MOORE: Yes, you can make an election to do that. Right.

JUDGE READ: Yeah, it's your choice. It's the taxpayer's choice, right?

MR. MOORE: Yes.

JUDGE RIVERA: But your clients and Yahoo - - - both parties, though - - - the seller and the purchaser - - -

MR. MOORE: They both have to be.

JUDGE RIVERA: - - - you must agree to this - - -

MR. MOORE: Yes, they do.

JUDGE RIVERA: - - - because the purchaser gets a lot of benefits and - - -

MR. MOORE: The purchaser gets the benefits.

JUDGE RIVERA: - - - your side maybe doesn't. You got negotiate something to make sure that's not the case.

MR. MOORE: Perhaps.

JUDGE READ: Maybe the sale price is greater, right?

MR. MOORE: Could be. It may well be.

JUDGE FAHEY: Well - - -

JUDGE RIVERA: We won't ask you to - - -

JUDGE FAHEY: - - - it pretty much always is.

JUDGE RIVERA: Just the hypothetical of it, right?

MR. MOORE: Yes, it is hypothetical.

JUDGE RIVERA: One would enter this situation and say, it - - - if it is not of value to the seller - - - the seller of the stock or the asset in the deemed asset, why would they do this, right? If only the purchaser is getting some benefit off of making it a deemed asset, so obviously the other side has to see some kind of value to this.

MR. MOORE: Or maybe it's a distressed sale. Maybe he has to sell, and the only way - - -

JUDGE RIVERA: Well, it doesn't sound like it here.

MR. MOORE: - - - the purchaser will buy is if you do it - - -

JUDGE RIVERA: You've got over eighty-eight million.

MR. MOORE: Huh?

JUDGE RIVERA: You've got over eighty-eight million. You've got over eighty-eight million to

Yahoo.

MR. MOORE: Well, it may have been worth a hundred million; I don't - - -

CHIEF JUDGE LIPPMAN: Okay.

MR. MOORE: But - - -

CHIEF JUDGE LIPPMAN: Go ahead; finish your thought.

MR. MOORE: The point is that the substance of the transaction is the sale of stock and there are decisions in other states that say that you can't tax the sale of stock if you can't situs the stock.

CHIEF JUDGE LIPPMAN: But can it be - - - I think we get it as to what it really is, let's say - - -

MR. MOORE: Right.

CHIEF JUDGE LIPPMAN: - - - and what's a fiction, but can it be for one - - - in one case, it's for - - - it's denominated as - - - as one thing and in another case, the same transaction is viewed differently? Does - - -

MR. MOORE: The State does that. That State does that with the corporation. You can't tax - - - you can't report as if you were a C corporation - - - S corporation. You have to report as if you were a C corporation. And in one instance, the State actually went after the corporation to try to get them to pay the tax on the deemed asset sale and it - - - it was - - - the - - - the attempt was rejected in 2004. But as far - - -

JUDGE RIVERA: Did JBS - - -

MR. MOORE: Huh?

JUDGE RIVERA: - - - file? Did JBS file in New York as a C corporation or whatever?

MR. MOORE: They had to file New York State returns - - -

JUDGE RIVERA: They declared - - -

MR. MOORE: - - - and they reported it as - - -

JUDGE RIVERA: They declared the eighty-eight million - - - over eighty-eight million in gains, or not?

MR. MOORE: They reported it as federal income, and the federal return is attached as part of the state return.

JUDGE RIVERA: They didn't pay any taxes on it?

MR. MOORE: But they didn't - - - they didn't pay tax because - - -

JUDGE RIVERA: They did not.

MR. MOORE: - - - they didn't report it as

New York Source income.

JUDGE RIVERA: So the corporation didn't pay any State tax on it.

MR. MOORE: No, the corporation didn't - - -

JUDGE RIVERA: The shareholder is the same. They are not - - -

MR. MOORE: The corporation - - -

JUDGE RIVERA: - - - liable to pay taxes on it.

MR. MOORE: The corporation did not pay tax on the - - - on the eighty-eight million.

JUDGE RIVERA: That's what I'm saying.

MR. MOORE: It's not their - - -

JUDGE RIVERA: The corporation did not - - - yeah, because it flows through the income - - -

MR. MOORE: Right.

JUDGE RIVERA: - - - as flowing through - - - is distributed to the - - -

MR. MOORE: Just to distribute the share from the operations of the business.

JUDGE RIVERA: By the way, just for clarity on - - - on the - - - on the - - - are your clients in this all of the shareholders in that S - - -

MR. MOORE: There's one - - -

JUDGE RIVERA: - - - or were there others?

MR. MOORE: There's one that didn't want to join.

JUDGE RIVERA: That's not part of this. Okay, thank you.

CHIEF JUDGE LIPPMAN: Okay, thank you both.

MR. MOORE: Thank you.

CHIEF JUDGE LIPPMAN: Appreciate it.

MR. MOORE: Thank you, Your Honor.

(Court is adjourned)

C E R T I F I C A T I O N

I, Karen Schiffmiller, certify that the foregoing transcript of proceedings in the Court of Appeals Burton v. New York State Department of Taxation and Finance, No. 115 was prepared using the required transcription equipment and is a true and accurate record of the proceedings.

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