Noto v New York State Dept. of Taxation Fin.
2011 NY Slip Op 33718(U)
March 30, 2011
Sup Ct, Suffolk County
Docket Number: 35246/2010
Judge: William B. Rebolini
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Short Form Order

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SUPREME COURT - STATE OF NEW YORK

I.A.S. PART 7 SUFFOLK COUNTY

PRESENT:

WILLIAM B. REBOLINI
Justice

Lucio Noto and Joan Noto,

Plaintiff,

-against-

The New York State Department of Taxation Finance and Jamie Woodward, Acting Commissioner

Defendants.

Motion Sequence No.: 001; MOT.D
Motion Date: 12/15/11
Submitted: 12/15/11

Index No.: 35246/2010

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Clerk of the Court

Attorney for Defendants:

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Upon the following papers numbered 1 to 2 read on this motion to dismiss: Notice of Motion and supporting papers, 1 - 2; Other, defendant's Memorandum of Law; plaintiffs' Memorandum of Law; defendant's Reply Memorandum of Law.

This is an action for judgment, *inter alia*, declaring Tax Law §605, which defines residency for purposes of New York State personal income tax assessment, unconstitutional as applied to the plaintiffs.

According to the complaint, the plaintiffs reside in Greenwich, Connecticut. They also own a vacation home in East Hampton, New York and, for purposes of this action, acknowledge

that they were "statutory residents" of New York State within the meaning of Tax Law §605 during tax year 2006. On October 15, 2007, the plaintiffs filed a New York State income tax return for tax year 2006. Following an audit, the defendant informed the plaintiffs that their 2006 New York State income tax was being increased by $2,130,357 (consisting of $1,757,937 in taxes, $72,487 in interest, and $299,933 in penalties). The plaintiffs paid the asserted tax on May 20, 2008 and the asserted interest and penalties on August 29, 2008. On January 25, 2010, the plaintiffs filed a claim for a refund of the 2006 tax increase. By letter dated February 4, 2010, the defendant denied the plaintiffs' claim. This action followed.

The plaintiffs plead six causes of action for declaratory relief in their complaint. In their first, second, and third causes of action, the plaintiffs allege that Tax Law §605 is unconstitutional as applied to them, as statutory residents, because it permits New York to tax intangible income subject to tax in other states without allowing a credit or exemption for taxes paid in other states, thereby resulting in multiple taxation on income received by them during tax year 2006. In their fourth, fifth, and sixth causes of action, the plaintiffs allege that penalties were improperly imposed by the defendant under Tax Law §685 and should be abated.

The defendant now moves to dismiss the complaint for lack of subject matter jurisdiction, based on the plaintiffs' failure to exhaust the administrative remedies set forth in Tax Law article 40 and 20 NYCRR part 3000 before commencing this action, and for failure to state a cause of action.

To the extent the defendant seeks dismissal with respect to the first, second and third causes of action, the motion is denied. Notwithstanding the availability of administrative remedies, the plaintiffs are not restricted to those remedies under the circumstances presented. As a general rule, one who objects to the act of an administrative agency must exhaust administrative remedies before litigating in a court of law (*e.g.* Watergate II Apts. v. Buffalo Sewer Auth., 46 NY2d 52 [1978]). "[A] declaratory judgment action is an inappropriate vehicle for challenging a tax assessment determination where the plaintiff has failed to exhaust its administrative remedies" (Allstate Ins. Co. v. Tax Commn. of State of N.Y., 115 AD2d 831, 832 [3rd Dept., 1985], *affd* 67 NY2d 999 [1986]). However, so long as no issue of fact is involved, such an action "may be used to challenge the applicability or constitutionality of a taxing statute without exhausting the administrative remedies the taxing authority may provide" (National Merchandising Corp. v. New York State Dept. of Taxation & Fin., 63 AD2d 785, 786 [3rd Dept., 1978]; *accord* Matter of First Natl. City Bank v City of N.Y. Fin. Admin., 36 NY2d 87 [1975]). "[T]he invalidity or total inapplicability affects the entire statute, including the limitations and restrictions on the remedy provided in it" (id., at 92-93). Here, the plaintiffs effectively concede that if the statute is constitutional, they owe the amount (net of penalties) determined by the defendant. Consequently, it does not appear that there are any issues of fact, but only a question

of law. As for that branch of the motion which is for relief under CPLR §3211 (a) (7), it is "the rule in declaratory judgment actions that on a motion to dismiss the complaint for failure to state a cause of action, the only question is whether a proper case is presented for invoking the jurisdiction of the court to make a declaratory judgment, and not whether the plaintiff is entitled to a declaration favorable to him" (Law Research Serv. v. Honeywell, Inc., 31 AD2d 900, 901 [1st Dept., 1969]; *accord* Washington County Sewer Dist. No. 2 v. White, 177 AD2d 204 [3rd Dept., 1992]; Fillman v. Axel, 63 AD2d 876 [1st Dept., 1978]).

> [T]he test is not whether the complaint shows the plaintiff will succeed in getting a declaration of rights in accordance with his theory and contention, but whether he is *entitled to a declaration of rights at all.* If the complaint states the substance of a bona fide justiciable controversy which should be settled, a cause of action for a declaratory judgment is stated.

(Metropolitan Package Store Assn. v. Koch, 89 AD2d 317, 322 [3rd Dept 1982], *appeal dismissed* 58 NY2d 1112, *appeal dismissed* 464 US 802, *reh denied* 464 US 1003 [1983] [emphasis in original; internal quotation marks omitted]). Applying this liberal standard, and since a declaratory judgment action is a proper vehicle to attack the constitutionality of a tax statute, the Court finds the plaintiffs' first, second and third causes of action sufficient to withstand the defendant's motion to dismiss.

Dismissal is warranted, however, as to the plaintiffs' fourth, fifth and sixth causes of action. The plaintiffs allege that they are entitled to a refund of the penalties imposed because they adequately disclosed their position on their 2006 return, because they had a reasonable basis for the position taken on their 2006 return, and because they had reasonable cause for the position taken on their 2006 return. As those matters cannot be resolved as a pure matter of law and do not otherwise fall within any of the exceptions to the exhaustion rule (*see* Watergate II Apts. v. Buffalo Sewer Auth., 46 NY2d 52 [1978]),[1] the Court finds the plaintiffs' failure to exhaust their administrative remedies fatal to those causes of action (see, CPLR §3211 [a] [2]).

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[1] When a statute at issue in a dispute expressly delineates the exclusive steps which a party must undertake in order to seek judicial relief, the party cannot avail itself of certain exceptions to the exhaustion rule, namely, that exhaustion of administrative remedies would be futile or would cause irreparable harm (see, Bankers Trust Corp. v. New York City Dept. of Fin., 1 NY3d 315 [2003]). Because the Court has determined that the plaintiffs' allegations concerning the imposition of penalties do not fall within *any* exceptions to the rule, it need not decide whether Tax Law §690 (b) was intended to make an appeal to the tax appeals tribunal the exclusive remedy available to any taxpayer for the review of New York State personal income tax liability (*compare* Tax Law §§ 478, 1140, 1413).

Accordingly, it is

ORDERED that the motion by the defendant for an order dismissing the complaint pursuant to CPLR §3211 (a) (2) for lack of subject matter jurisdiction and pursuant to CPLR §3211 (a) (7) for failure to state a cause of action is granted to the extent of dismissing the plaintiffs' fourth, fifth, and sixth causes of action, and is otherwise denied; and it is further

ORDERED that the defendant shall serve its answer to the complaint within 10 days after service upon defendant's attorney of a copy of this order with notice of its entry (see, CPLR §3211 [f]).

Dated: March 30, 2011

HON. WILLIAM B. REBOLINI, J.S.C.

______ FINAL DISPOSITION __X__ NON-FINAL DISPOSITION