

## Taxation Vexation

by Arthur R. Rosen



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In this article, Rosen interviews Art Rosen, whom he claims to "know quite well," about vexing state tax litigation. One instance that he found troubling came after he and two other taxpayer representatives presented their explanation of a case during a settlement

hearing, only to have a Department of Revenue representative respond that they weren't there to discuss the issues.

I recently had the opportunity to sit down with Art Rosen — whom I've gotten to know quite well over the years — to learn the reason for his apparent distress.

**ARR:** So tell me, my friend, what are you so upset about this time?<sup>1</sup>

**Art:** Well, although I hate to get up on my high horse or sound self-righteous, I do appreciate this chance to vent.

**ARR:** So what's the problem? Some of the horrible recent cases like *Equifax*, *Vodafone*, or the Texas comptroller's ruling regarding nexus with an out-of-state online provider of intellectual property?

**Art:** No, not those; I was not directly involved in those cases, so I acknowledge that I may not know the whole story. My concern is with my personal experiences in a few matters this past year. One would think that after all these years, I would be willing simply to accept these seemingly incredible situations, but I still find them quite vexing.

**ARR:** All right, what were those situations?

**Art:** The first situation arose in a case I have in court in a Southern state. I — along with local counsel and a senior executive from the taxpayer-corporation — went to that state's capital to meet with the assigned assistant attorney general handling the case, his supervisor, and various management personnel from the Department of Revenue to discuss settlement. We presented a comprehensive explana-

tion of why we think we have a strong case, using slides to demonstrate the unassailable facts and how the relevant law applies.

In response, the DOR representative said, "We are not here to discuss issues." Those on our side of the table were agog. I responded, "That is what one does at a settlement meeting: Each side explains its case so the other side can gauge how strong or weak its case is." The DOR representative refused to explain the state's argument. This was an extremely frustrating experience because it showed that the DOR either has no argument (and is thus holding up the taxpayer just to get some revenue) or is keeping its argument secret, both of which are a shameful way for a government agency to act.

**ARR:** I think I can feel your angst. Do you have another experience to share?

**Art:** Yes. The second situation arose in a mid-Atlantic state. There, the DOR had taken an extreme position, inconsistent not only with clear U.S. Supreme Court authority but also with clear authority from that state's courts. For the immediately preceding audit cycle, we had to start the judicial process to get the state virtually to concede; we paid less than 10 percent — as that would have been the legal fees to litigate.

Now, for the subsequent audit cycle, the DOR is taking an even more egregious position. Implicitly acknowledging that the state's position is wrong, a senior manager in the DOR told us that irrespective of how strong our case is, we would have to go to court because "we make all taxpayers go through the entire process and then into court before we will consider settling and we can't treat your client in a different manner."

**ARR:** So that old adage "we might be doing something wrong, but we do it to everybody so it's OK" is still alive?

**Art:** Unfortunately, yes. But I do have a recent example of a DOR ultimately doing the right thing. The DOR in a different mid-Atlantic state sent a statutory notice to our client saying that after reviewing our comprehensive submission covering the facts and the applicable law, the corporation must file returns.

When we asked for the basis of the notice, we were told that the company "is using intangible property in the state."

We responded by asking, "What intangible property?"

The DOR responded, "We can't tell you that. You have to request a formal ruling from our rulings unit, and they will let you know."

<sup>1</sup>For Billy Hamilton's interview of Rosen, see "What's Bugging Art Rosen Today?" *State Tax Notes*, Oct. 19, 2009, p. 199.

Although we were astounded, we proceeded as instructed and submitted our request a few months ago. Ultimately, we received a single-sentence letter saying that the notice had been canceled. Hooray, we have a right management decision being made!

**ARR:** Do you have any other stories you wish to share?

**Art:** We have a case in court in a state close to New York. It involves determining whether various minority investments made and maintained by a subsidiary of a major corporation are unitary so as to decide whether apportionment should take place at the partnership level or at the partner level (our client). Because these are very diverse businesses and are totally unrelated other than through our client's investment, which is far less than 10 percent in each partnership, there could never be a finding of unity.

"However," the DOR's attorney said in response, "there's a California case where unity was found between a lighting company and real estate businesses."

"Yes, but *Mole-Richardson* involved a very small family that controlled both businesses, and many essential activities were commingled," I responded.

"Oh, you got me," he said. That was a terrible experience, hearing a government official — and an attorney — trying to get away with something like that.

**ARR:** Boy, you really are sensitive, aren't you? One would think that by now you would be a little more mature and accepting of these occurrences. Well, in any event, I have time to hear one more.

**Art:** This story involves a DOR's satellite office where the office leader became involved in a question of whether our client and a subsidiary it had acquired were instantly unitary — the result our client was seeking. We provided a huge amount of material reflecting all the intercompany task forces that had been working for many months before the acquisition to make sure that the two businesses operated as one immediately on the acquisition. We also showed that this had, in fact, happened, with all the acquirer's policies going into effect at midnight of the acquisition date (the personnel of the acquirer had received extensive training

before this); that all contracts of the target had been replaced by the acquirer's similar contracts at midnight; that all signage — inside the retail establishments and outside — had been changed by midnight; that all employees of the target had become employees of the acquirer; and that what was to be offered for sale (this changes weekly) by the target after the acquisition was decided by the acquirer. The office leader had no choice but to accept the conclusion that there was indeed instant unity. But he insisted that the taxpayer pay something — about half of our projected litigation costs — because "one never knows what some judge might do."

**ARR:** That does sound distressing. Do you see such responses becoming more common?

**Art:** Not really. I remember, for example, an incident years ago when one audit supervisor said to me when I cited the U.S. Supreme Court's *Trinova* decision, "But that's not *our* supreme court." Incredible!

**ARR:** I notice that you've been very careful not to disclose the identities of the states you've discussed today. Why is that?

**Art:** I may not be very bright, but I'm not that dumb. I fully understand that adding fuel to a fire is advisable only if one is seeking a conflagration.

**ARR:** So is there anything that can be done to fix this problem?

**Art:** I think that senior DOR management must work hard to make sure that the audit staff really, thoroughly, completely internalizes that the job of auditors is not to look for ways to raise revenue, but rather to make sure that the law was followed correctly, and that a taxpayer's reasonable interpretation of any ambiguous statute should be given some weight. In other words, all DOR employees should be taught that their agency's responsibility is to execute or administer laws, and not to see how much money they can produce through "creative," tortuous interpretations of statutes or through torturing taxpayers.

**ARR:** Thanks for spending time with me today — I know how much you abhor doing that. And by the way, you're looking awfully good. ☆