NEW YORK CITY TAX APPEALS TRIBUNAL
ADMINISTRATIVE LAW JUDGE DIVISION

In the Matter of the Petition	:	**DETERMINATION**
of	:	**TAT(H)09-18(CR)**
SPIRIT CRUISES, INC.	:	

Schwartz, A.L.J.:

Spirit Cruises, Inc., 401 East Illinois Street, Suite 310, Chicago, IL 60611 ("Petitioner") filed a Petition for Hearing with the New York City ("City") Tax Appeals Tribunal ("Tribunal") seeking the redetermination of deficiencies of City Commercial Rent Tax under Chapter 7 of Title 11 of the City Administrative Code ("Code") for the four tax years beginning June 1, 2002 and ending May 31, 2006 ("Tax Years").

The parties agreed, pursuant to Rule §1-09(f) of the Tribunal's Rules of Practice and Procedure ("Rules") to have the controversy determined on submission without the need for appearance at a hearing. Petitioner was represented by Arthur C. E. Burkhard, Esq. of Grant Thornton, LLP. The Commissioner of Finance ("Respondent" or "Commissioner") was represented by Joshua Wolf, Esq., Assistant Corporation Counsel, of the City's Law Department.

All documents were submitted by October 6, 2010 and the record was closed on October 7, 2010. Included within the documents submitted by Petitioner was an affidavit of Lauren Baran ("Baran

Affidavit") and accompanying drawing ("Baran Drawing") the admissibility of which are objected to by Respondent and will be addressed below. Both parties filed briefs and reply briefs. All briefs were submitted by March 2, 2011.

By stipulation of the parties, the record was reopened on May 17, 2011 for the limited purpose of taking into the record the Second Supplemental Stipulation of Facts that contained a complete copy of the Interim Prime Lease that was missing certain pages in the original submission and to clarify that a document designated "Schedule C to the Sublease" is also referenced as "Exhibit A" in the Third Amendment to the Sublease. Thereafter, the record was immediately closed.

ISSUES

Whether Petitioner's payments of dock rent were to lease water areas, and, if so, whether such water areas are "premises," payments for which would be subject to the Commercial Rent Tax ("CRT").

Whether, if the CRT is properly imposed on dock rent, the Commissioner should be estopped from imposing it in this case because it is inconsistent with the results of a Department of Finance prior audit of Petitioner.

If the CRT is properly imposed on dock rent in this case, whether penalties should be imposed.

FINDINGS OF FACT

Petitioner owns and operates four boats (the "Boats") that offer dining, entertainment and sightseeing cruises in New York and New Jersey. The Boats cruise on the Hudson River through New York harbor and around the Statue of Liberty, spending time in both New York and New Jersey waters.

The premises known as Piers 59, 60, 61 and 62 are collectively known as "Chelsea Piers" and are located in the borough of Manhattan between (and directly abutting) both 11th Avenue and the Hudson River. Petitioner's cruises are available on the four Boats departing from piers located at Chelsea Piers and New Jersey. All four Boats primarily dock at Chelsea Piers during the summer. Petitioner also maintains a warehouse, storage area, ticket booth and certain office space at Chelsea Piers.

The State of New York (the "State") is the owner of Chelsea Piers and acts through the Commissioner of the State Department of Transportation ("DOT") with respect to the property. The State first leased Chelsea Piers to Petitioner's landlord, Chelsea Piers, L.P. ("Chelsea") on or about May 14, 1993 (the "Interim Prime Lease"). It was anticipated by the parties to the Interim Prime Lease that this document would be renegotiated to account for anticipated changes in the property's use. The State and Chelsea thereafter renegotiated and executed a new lease (the "Prime Lease") dated June 24, 1994, which superseded and replaced the Interim Prime Lease. The Prime Lease was then amended once further as of June 30, 1996 ("Prime Lease Amendment").

Effective on or about June 22, 1993, Petitioner entered into a sublease agreement ("Sublease") with Chelsea. The Sublease was

thereafter amended on or about May 9, 1994, August 9, 2002 and July 18, 2003. The Sublease, as amended, was in effect during the Tax Years.

Section 3 of the Sublease states that the Sublease shall be subject to and subordinate to the Interim Prime Lease and the Prime Lease. While the Prime Lease had not yet been executed at the time the Sublease was entered into, the Sublease contained a representation that the State and Chelsea "contemplate entering into a new lease which will supersede the Interim Prime Lease" and the Sublease included the draft of the Prime Lease as an exhibit and incorporated it by reference into the Sublease.[1] Accordingly, any rights Petitioner obtained under the Sublease or its amendments must be rights that Chelsea obtained from the State under the Interim Prime Lease and/or the Prime Lease.

Relevant Prime Lease Provisions

Under the Prime Lease, Chelsea leased from the State "the Premises, together with all easements, appurtenances and other rights and privileges now or hereafter belonging to or appertaining to the Premises . . .."[2]

"Premises" are defined as "the Land and Improvements."[3]

"Land" is defined as: "all that certain property situated, lying and being in the Borough of Manhattan, . . . more particularly

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[1] Ex. 1, p. 1, first and second Whereas clauses.

[2] Ex. 4, Section 2.1.

[3] Ex. 4, Section 1.

described in Exhibit A-1 . . .."[4] Exhibit A-1[5] to the Prime Lease consists of two pages. The first page, which is headed "Lease Limits Piers 59, 60, 61 & 62," states: "[a] certain tract or parcel of land including lands under water, together with the buildings and improvements thereon, being more particularly described as follows: [a metes and bounds description]." The second page of Exhibit A-1 is a drawing consisting of piers 59 through 62 and the space between them. The entire drawing is crosshatched and the heading states "[c]rosshatched areas indicate premises at ground level, second and third floors."

"Improvements" are defined as "the buildings, platforms, marinas, piers, wharfs, berths, slips, parks, stables, golf driving ranges, Equipments and other improvements and appurtenances of every kind and description . . . and the footings, foundations and other supports thereof beneath the Land . . .."[6]

The Prime Lease Amendment refers to the leased property as "DESCRIPTION OF LEASED PREMISES AND APPURTENANT EASEMENT OF ACCESS: Hudson River Piers 59 through 62 and related upland property, as more particularly described in Exhibit A attached hereto and made a part hereof." [Exhibit A includes the same drawing that was attached to the Prime Lease as Exhibit A-1.]

The Prime Lease enumerated many permitted uses for Chelsea Piers including a variety of sports and entertainment facilities such as a skating rink, film production facilities, a golf driving

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[4] *Id.*

[5] Located at Ex. 5 of the Stipulation.

[6] Ex. 4, Section 1.

range, restaurants, etc.[7] The Prime Lease also permitted the "management and operation of a marina, on any water portions of the Premises and contiguous apron areas."[8]

The Prime Lease places the responsibility for various repairs to Chelsea Piers on Chelsea.[9] The Prime Lease specifically requires Chelsea to:

> do such dredging from time to time . . . as shall be reasonably necessary to maintain a depth of water and slopes necessary for compliance with all Requirements, for [Chelsea's] business and operations and for underwater support of structures, comprising any part of the Premises.[10]

Chelsea is also responsible for removing any obstructions such as any waterborne craft that may have sunk within the bounds of the Premises.[11]

Relevant Sublease Provisions

The Sublease between Chelsea and Petitioner describes the Premises leased to Petitioner as "the Pier 61 perimeter space and the bulkhead areas between Piers 61 and 62 as more particularly described in Schedule C annexed hereto . . . and to provide use of the perimeter apron spaces . . .."[12]

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[7] Ex. 4, Section 21.1.

[8] Ex. 4, Section 21.1 (c).

[9] Ex. 4, Article 10.

[10] Ex. 4, Section 10.5.

[11] Ex. 4, Section 10.3.

[12] Ex.1, p. 1, fourth Whereas clause.

Because the proper interpretation of the drawing contained in Schedule C to the Sublease ("Drawing") is at issue in this case, the Drawing will be described in detail. The version of the Drawing included with the Sublease is a line drawing containing several areas, none of which is labeled.[13] The Drawing appears on an 8-1/2" x 11" piece of paper. It is not clear if it is drawn to scale and no scale is provided on the Drawing. However, distances are indicated in certain portions of the Drawing making it possible to approximate the distance in the rest of the Drawing, assuming the Drawing is roughly to scale. By stipulation, the Parties labeled those portions of the Drawing where they could agree on the meaning of the areas.[14]

The Drawing is a simple line drawing showing 11th Avenue on the right side (this would be on the East side of the Drawing running North-South) and the Hudson River on the left side of the Drawing. A long primarily rectangular shaped box runs parallel with and next to the 11th Avenue side of the Drawing. This box is labeled "Chelsea Piers - Main Building" and is approximately the length of the distance of the entire complex. To the left of this box are rectangular figures representing the four piers, Piers 59 through 62, each of which extends out at right angles to 11th Avenue. Assuming the Drawing is approximately to scale, each pier would be approximately 800 feet long by approximately 125 feet wide. The space between Pier 62 and Pier 61 would be approximately 225 feet. In the space between Pier 62 and Pier 61, parallel with 11th Avenue, and also along a portion of the north and south sides of Pier 61 there is a narrow cross-hatched line that is located next to the lines representing the structure of the Piers.

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[13] Ex. 2.

[14] Ex. F.

The cross-hatched line is not labeled and its meaning is in dispute in these proceedings. Respondent contends that the cross-hatched lines "are merely intended to indicate the portions of the perimeter pier space and wharfage that have been subleased by [sic] Petitioner"[15] However, Petitioner understands these cross-hatched lines differently.

Petitioner submitted an affidavit from Lauren Baran, who has been Petitioner's Chief Financial Officer ("CFO") since 2007. The Baran Affidavit discusses both Petitioner's CRT filing positions as well as Ms. Baran's understanding of the meaning of the cross-hatched lines in the Drawing. Attached to the Baran Affidavit is another version of the Drawing (the "Baran Drawing"). In this version, the cross-hatched lines are labeled "Pier 61 Perimeter Space on Water." The Baran Drawing reflects Ms. Baran's "general understanding of the Subleased Premises." Respondent objects to the admissibility of this affidavit. Its admissibility and the weight which is has been given in this proceeding will be addressed below.

The Sublease further provides that:

> [Petitioner's] right to utilize the western end of the north and south side of Pier 61 and the wharfage on the extreme west end of Pier 61 (as indicated in Schedule C) shall be subject to the reasonable requirements of (i) the community, with respect to the view corridor on the northside area; and (ii) [Chelsea], with respect to the southside and extreme westend area. [Petitioner] acknowledges and agrees that the Premises being sublet are perimeter wharfage . . .. [Chelsea] acknowledges that [Petitioner's] business operations will require appurtenant access to the Premises and use of the perimeter apron spaces adjacent to the Premises for passenger waiting areas, seating, queuing,

[15] Respondent's Brief at 12.

boarding gangplanks and ship support operations . . . .[16]

Paragraph 4 of the Sublease provides that certain specified provisions of the Interim Prime Lease and of the Prime Lease are incorporated by reference into the Sublease such that Petitioner takes on certain obligations with respect to the Premises being sublet and receives certain benefits that inured to Chelsea under the Prime Lease and the Interim Prime Lease. Under this provision, for example, Petitioner takes on the responsibility for dredging[17] but is not responsible for removing any watercraft that sink and obstruct the area.[18]

Allocation of Petitioner's Rent Payments

In addition to the dock space, Petitioner also has a ticket booth, storage space and office space in Chelsea Piers. Petitioner makes monthly payments to Chelsea for dock space, a ticket booth, office space and storage facilities, as well as common area maintenance, separately sub-metered electricity and various miscellaneous charges. Chelsea bills Petitioner monthly for the various payments due under the Sublease.[19] The bills separately list amounts for Dock Rent, Bateau Office Rent, Office Rent, Ticket Booth Rent, Storage Rent, Common Area Maintenance, Electric, Water [to be used on the Boats] and various miscellaneous items. The only item the taxability of which is in dispute in this proceeding is the Dock Rent and its related common area maintenance.

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[16] Ex. 1, Paragraph 1.

[17] *See*, text accompanying footnote 10.

[18] *See*, text accompanying footnote 11.

[19] *See*, Ex. 9.

Prior Audit

The City Department of Finance ("Department") conducted a CRT examination for the period June 1, 1992 through May 31, 1996 ("Prior Audit"). The Prior Audit was a desk audit that resulted in an assessment against Petitioner in the following amounts:

Tax year ended:	CRT Liability
5/31/94	$ 433.65
5/31/95	1,496.26
5/31/96	5,810.10

No further information about the Prior Audit was available from the Department.

The Sublease provided for "Base Rent" during each of the years included in the Prior Audit as follows:

Year	Base Rent
1994	$200,000
1995	300,000
1996	400,000

In addition, the Sublease provided for a percentage based on Petitioner's revenues and additional rent as a percentage of certain of Chelsea's expenses.[20]

For the first time, in his Reply Brief, Petitioner's Representative made reference to certain of Petitioner's internal records which he asserts contained additional information about the Prior Audit. However, those internal records were not provided to this forum or to Respondent although Petitioner's Representative had ample time to do so from when the Petition was filed on May 1, 2009

[20] Ex.1, paragraphs 5 and 14.

until the record in this proceeding was closed with the agreement of the parties on October 7, 2010. Accordingly, any reference to what those records may have indicated will be disregarded.

In the Baran Affidavit, Ms. Baran surmises, based on the Department's Audit Case Summary Report, that based on the amount of CRT that was assessed for those years and Petitioner's rent obligation for those years, the tax was imposed only on items other than dock rent. Ms. Baran also states that she obtained her understanding of the Prior Audit from discussions with current and former company personnel and her review of internal company documentation.

Second Filing Period

The Department did not conduct a CRT examination for the period June 1, 1996 through May 31, 2002. Petitioner filed returns for the period June 1, 1996 through May 31, 2001 ("Second Filing Period") and paid tax as follows:

Tax Year Ended	Tax Paid
5/31/97	$5,274.90
5/31/98	4,821.07
5/31/99	6,041.46
5/31/00	6,793.20
5/31/01	6,297.80

The Base Rent provided in the Sublease for each of the years covered by the Second Filing Period was as follows:

Year	Base Rent
1997	$ 500,000
1998	600,000
1999	750,000
2000	800,000
2001	1,000,000

The Tax Years

It is entirely credible that, as she states in her affidavit, Ms. Baran properly investigated Petitioner's CRT obligations and relied on information obtained from her colleagues regarding the outcome of the Prior Audit. Ms. Baran explained in her affidavit that Petitioner's personnel determined that charges for office rent, ticket booth, storage, HVAC, etc., were potentially taxable for CRT purposes. However, charges for Dock Rent and related items were not. Because Petitioner took the filing position that the portion of the total rent paid under the Sublease that was allocated to Dock Rent did not constitute rent for premises subject to the CRT, once the annual exemption provided by Code §11-704(b)2 exceeded the rent paid under the Sublease for items other than Dock Rent, Petitioner concluded that it no longer had a filing obligation under the CRT.[21] As a result, Petitioner did not file CRT returns or pay CRT for the Tax Years.

The Department conducted a CRT desk audit of Petitioner for the audit period covering the Tax Years. During the course of the audit, Petitioner provided the auditor with certain schedules related to the Sublease Premises, listing, by month, its allegedly taxable and allegedly nontaxable payments to Chelsea during the Tax Years. At the conclusion of the audit, the Department issued a Notice of Determination ("NOD") dated February 5, 2009, asserting

[21] Baran Affidavit.

proposed CRT deficiencies including interest[22] and penalties[23] aggregating $447,229.40 as follows:

Tax Periods	Principal	Interest	Penalty	Total
6/1/02-5/31/03	$ 54,564.65	$32,915.83	$ 38,283.78	$125,764.26
6/1/03-5/31/04	53,597.00	27,092.06	34,984.83	115,673.89
6/1/04-5/31/05	53,322.83	21,860.29	32,259.28	107,442.40
6/1/05-5/31/06	53,022.89	16,077.87	29,248.09	98,348.85
Total	$214,507.37	$97,946.05	$134,775.98	$447,229.40

Petitioner filed a petition (the "Petition") dated May 1, 2009 contesting the proposed deficiencies. Petitioner withdrew the argument cited in the Petition that Petitioner's use of the Subleased Premises is in interstate commerce, and therefore, not subject to the CRT.

POSITIONS OF PARTIES

Petitioner contends that the rent designated "dock rent" is for the use of water areas which are not taxable premises under the CRT. Respondent asserts that these payments are rent for land, improvements and an appurtenant right of access, which premises are taxable under the CRT and that even if the payments are for water areas, they would still be subject to the CRT.

Petitioner claims that the Department should be estopped from applying what Petitioner characterizes as a "new definition of taxable premises with respect to leased water areas." Petitioner contends that under the Prior Audit, the Department agreed with

[22] Computed to January 30, 2009.

[23] Penalties consisted of a 25% Late Filing Penalty, a 5% penalty for underpayment due to negligence, a 10% penalty for substantial understatement of liability and penalty of 50% of interest.

Petitioner's position regarding taxable and nontaxable premises. Petitioner claims that it detrimentally relied on the Department's Prior Audit findings by not filing returns for the Tax Years and now being exposed to taxes, penalties and legal expenses with respect to the years for which it did not file CRT returns. Respondent asserts that estoppel does not lie in this case.

Petitioner contends that no penalties should be imposed. It argues that it relied on the Department's prior audit position in determining whether it was obligated to file returns. As such, it acted as a person of ordinary prudence and intelligence would under the circumstances. Respondent contends that Petitioner has failed to meet its burden of proving that any of the penalties should be abated.

CONCLUSIONS OF LAW

Taxability of Dock Rent

Code §11-702 imposes the CRT on the "base rent" paid by a tenant to a landlord for "taxable premises." "Base rent" is "rent" paid for each "taxable premises" with certain adjustments. Code §11-701.7. "Rent" is the consideration paid or required to be paid by a tenant for the use or occupancy of premises . . .." Code §11-701.6. "Taxable premises" means "[a]ny premises in the city occupied, used or intended to be occupied or used for the purpose of carrying on or exercising any . . . commercial activity . . .." Code §11-701.5. "Premises" means "[a]ny real property or part thereof, and any structure thereon or space therein." Code §11-701.4. The applicable Rules merely restate the statutory language. 19 RCNY §7-01. Code §11-703.a contains the presumption that ". . . all premises are taxable premises and that all rent paid or required

to be paid by a tenant is base rent until the contrary is established. . .." The burden of proving that any presumptive base rent is not taxable is on the tenant. The key issue in this case is whether the "dock rent" Petitioner paid to Chelsea was rent for "[a]ny real property or part thereof, [or] any structure thereon or space therein." (Code §11-701.4.)

There is no doubt that the CRT applies to rent paid for the use of a pier. Code §11-704.c.3 provides a deduction for rent paid for the taxpayer's use of premises "[a]s piers insofar as such premises are used in interstate or foreign commerce." If the use of piers in commerce generally (that is to say maritime transportation) was not subject to the CRT, there would be no need for a deduction for certain uses of those piers. This deduction for use in interstate and foreign commerce should be contrasted with the deductions provided by Code §§11-704.c.1 and c.2 which provide blanket deductions for premises used for railroad transportation and air transportation with no requirement that the use be in interstate or foreign commerce. There would have been no need for the Legislature to provide the limited deduction provided by Code §11-704.c.3 for piers that applies only where the use is in interstate or foreign commerce unless the Legislature intended that rent paid for the use of a pier where the use was in intra-state commerce would be subject to the CRT. Otherwise, the Legislature would have provided a blanket deduction for piers used in commerce similar to the deductions for premises used in railroad and air transportation.

Petitioner contends that the vast majority of the payments to Chelsea represents fees for the use of dock space and related fees for the use of water areas where Petitioner's Boats are berthed. In this forum, the burden of proof is upon the Petitioner as to this factual issue. Rule §1-12(d)(4). Petitioner then asserts that the CRT does not apply to a sublease of water areas abutting a dock. It is not necessary to determine whether the lease of water areas would

be subject to the CRT because the record does not support Petitioner's factual premise.

Under the Prime Lease, the State leased to Chelsea certain land and improvements including land under water. It did not lease the water itself. The Prime Lease Amendment refers to the "Leased Premises and Appurtenant Easement of Access." An easement of access across water is appurtenant to the lease of a pier. Since all the rights that Chelsea had in the water was an appurtenant easement of access to the Piers it leased from the State, that was the most it could lease to its sublessee.

Under the Sublease, Petitioner leased from Chelsea "the Pier 61 perimeter space and the bulkhead areas between Piers 61 and 62 . . . and to provide use of the perimeter apron space." The Sublease further provides that "[Petitioner] acknowledges and agrees that the Premises being sublet are perimeter wharfage . . .." The terms "bulkhead areas," "apron" and "wharfage" are all terms of art in the maritime industry and all refer to the use of tangible structures affixed to land.

A "wharf" is defined as "any structure built or maintained for the purpose of providing a berthing place for vessels." N.Y. Nav. Law §2.20. "Wharfage" means the "[c]harge for use of wharf by way of rent or compensation." Black's Law Dictionary (Sixth Ed. at p. 1595). A "pier" is a "wharf or a portion of a wharf extending from the shoreline with water on both sides." N.Y. Nav. Law §2.22. A "bulkhead" is a "vertical partition . . . which separates different compartments or spaces from one another." International Maritime Dictionary (Second Ed. at p. 103) "Apron" refers to "the portion of a . . . pier . . . lying between the waterfront edge and the shed. The portion of a wharf carried on piles beyond the solid fill." *Id.* at 21.

Essentially, what Petitioner leased was the right to tie its Boats up to particular locations on the side of a physical structure affixed to land and the right to have its customers and agents walk on that physical structure to get access to the Boats and to load material such as food and beverages for Petitioner's dinner cruises onto the Boats. It is the physical structure that Petitioner is paying to use. This structure is essential to Petitioner's operation of its business of running dining, entertainment and sightseeing cruises. It provides the only way for its customers or agents to get to those Boats other than by swimming.

Petitioner, in asserting that the dock rent was a payment for the use of water in the Hudson River relies heavily on the Baran Affidavit and its attached Baran Drawing. Respondent objects to the admissibility of these documents.

Rule §1-12(d)(1) provides that:

> Affidavits as to relevant facts may be received, for whatever value they may have, in lieu of the oral testimony of the persons making such affidavits. Technical rules of evidence may be disregarded to the extent permitted by the decisions of the courts of this State, provided the evidence offered appears to be relevant and material to the issues.

Under the Rule, the Baran Affidavit and its attached Baran Drawing are admissible into the record. The Baran Affidavit deals, in part, with Ms. Baran's "understanding" of the meaning of the cross-hatched lines in the Drawing. Under the Rule, the amount of weight to be given to Ms. Baran's understanding must be determined.

Ms. Baran has been Petitioner's CFO since 2007. There is no indication that she was associated with Petitioner in any way at the time the Sublease was entered into in 1993. She has no first hand knowledge of any of the discussions or negotiations that led up to

Petitioner's entering into the Sublease. She states her "understanding" based on conversations with unidentified employees or former employees of Petitioner and no information is provided as to the basis for their "understanding." She makes no claim to be an expert in maritime law or maritime customs and usage or have any expertise in interpreting drawings related to maritime issues. She merely restates her employer's position with respect to how it would like to interpret the Sublease and the Drawing to support its legal position in this forum.

Petitioner was given the opportunity for a hearing at which Ms. Baran could have testified and been subject to cross examination. Petitioner also could have produced witnesses with expertise in maritime customs and usage. Petitioner elected not to do so. Under these circumstances, no weight is given to Ms. Baran's view of the meaning of the cross-hatched lines or to her version of the Drawing. Accordingly, since the dock rent is being paid for the use of the physical structure on real property, it is for the use of taxable premises and subject to the CRT.

Estoppel

Petitioner asserts that the Department should be estopped from applying a new definition of taxable premises with respect to leased water areas because of its prior audit position. Petitioner claims that it relied on the audit finding of the Prior Audit that did not impose a tax on dock rent. Petitioner claims that based on this audit finding, it ceased filing CRT returns once the portion of the rent it paid Chelsea that would be taxable under the finding of the Prior Audit did not meet the minimum threshold for taxability.

Petitioner relies on the Baran Affidavit for Ms. Baran's understanding of the Prior Audit which she states she obtained from discussions with current and former Company personnel and her review

of internal company documentation. Unlike the situation discussed above, where no weight was given to the portion of the Baran Affidavit containing Ms. Baran's interpretation of the Drawing, here, the statements in the Baran Affidavit regarding the Prior Audit and Petitioner's CRT filing positions are entitled to be given significant weight. As the CFO, Petitioner's tax obligations were well within Ms. Baran's scope of responsibility. It is entirely credible that she properly investigated Petitioner's CRT obligations and relied on information obtained from her colleagues regarding the outcome of the Prior Audit. It is unfortunate, that because of the passage of time the entire audit file is no longer available from the Department. However, the Department's records of the amount of tax liability assessed for the years covered by the Prior Audit is entirely consistent with Ms. Baran's understanding and provides support for the statements in her Affidavit.

Nevertheless, Petitioner's estoppel argument fails. Petitioner relies on *Montana v. US,* 440 US 147 (1979) and *ITT Corporation v. US*, 963 F2d 561(2nd Cir. 1992) for the proposition that collateral estoppel applies where first: the issues presented in the second litigation are in substance the same as those resolved in the first; second: where controlling facts or legal principals have not changed significantly since the first judgment; and finally, where no other special circumstances warrant an exception to the normal rules of preclusion.[24]

The difficulty with Petitioner's estoppel argument is that here there was no first litigation that resulted in a final judgment on the merits. There was merely a desk audit that covered the Prior Audit years. A desk auditor is charged with reviewing the documents submitted by a taxpayer and reaching some conclusion as to tax liability based on the Department's general guidelines to its

[24] Petitioner's Brief at 16-17.

auditors. This resolution can be by way of a settlement. It is in no way a final judgment in a court proceeding that would be binding on the Department in future years.

It is well settled that estoppel cannot be asserted against the State or its governmental units, particularly in tax matters. *See Frye v. Commissioner of Finance*, 62 NY2d 841, 843-44 (1984) ("estoppel is not available against a governmental agency in the exercise of its governmental functions."); *Daleview Nursing Home v. Axelrod*, 62 NY2d 30, 33 (1984) ("We have held many times that estoppel is not available against a governmental agency in the exercise of its governmental functions. And, as was made clear in *Moore*, such exception as has been made to that rule is of 'very limited application' and has been 'addressed to an unusual factual situation'") [internal citations omitted]; *see also Delafield 246 Corp. v. City of New York*, 11 AD3d 268, 272-73 (1st Dept. 2004); *Weil v. Chu*, 120 AD2d 781, 784 (3d Dept. 1986).

Accordingly, Petitioner's estoppel argument fails and it is liable for the CRT on the payments of dock rent and related charges.

Penalties

Petitioner contends that the penalties asserted by the Department should be abated because, based on the Prior Audit, it had reasonable cause to believe that the dock rent was not subject to the CRT. Respondent claims Petitioner has not met its burden of proof on this issue.

It is apparent that in recent years, the Department has begun to impose the CRT on berthing places for vessels. *See Circle Line Statue of Liberty Ferry, Inc.*, TAT(H) 08-82(CR) (City Tax Appeals Tribunal, ALJ Div., April 27, 2010.) The Department is not precluded from seeking every available source of tax revenue

permissible under the Code even if it may have refrained from doing so in a prior year. However, in a case such as this, where the Department published no notice advising an industry of what is, in practice, a change in its position, it is unreasonable to impose penalties on a taxpayer who relied on the Department's position on the same issue in a prior audit of that same taxpayer in determining its tax obligation. While the Prior Audit cannot provide the basis for a collateral estoppel claim, it certainly may provide the basis for the abatement of any penalties.

The Department asserted four penalties against Petitioner. Two of these, a twenty-five percent late-filing penalty (failure to file) under Code §11-715(c)(1)(A) and a ten percent penalty for understatement of liability under Code §11-715(j) shall be abated if the failure is due to reasonable cause and not due to willful neglect. The grounds for reasonable cause may include:

> [A]ny other cause for delinquency which appears to a person of ordinary prudence and intelligence as a reasonable cause for delay in filing a return and which clearly indicates an absence of gross negligence or willful intent to disobey the taxing statutes. Past performance should be taken into account. Ignorance of the law, however, will not be considered reasonable cause. [19 RCNY §7-17(b)(5)(iv).]

The two other penalties asserted by the Department were a five percent penalty for underpayment and a penalty of fifty percent of the interest. Code §§11-715(d)(1) and (2). Both of these penalties apply only where the underpayment was due to negligence or intentional disregard of the relevant Code provisions. A previous determination in this forum provides a clear standard for negligence or intentional disregard of the law:

> The Code does not define "negligence" or "intentional disregard." However, analogous federal tax authority provides guidance. The accuracy-related penalty of Internal Revenue Code ("IRC") §6662 is imposed where an underpayment is attributable to certain types of misconduct including "negligence or disregard of rules or regulations." Under IRC §6662(c) "[n]egligence consists of any failure to make a reasonable attempt to comply with the provisions of the [IRC] and disregard consists of any careless, reckless, or intentional disregard [and t]he courts have refined the [IRC] definition of negligence as a lack of due care or failure to do what a reasonable and prudent person would do under similar circumstances." *Henry v. Comm'r.*, T.C. Summary Opinion 2003-104 (Tax Ct. Summary 2003).

Air Pegasus Corporation, TAT(H) 00-23(CR), TAT(H) 00-24(CR) (City Tax Appeals Tribunal, ALJ Division, April 9, 2004) *aff'd* TAT(E)00-23(CR), TAT(E) 00-24(CR) (City Tax Appeals Tribunal, February 4, 2005).

For both the "reasonable cause" standard and the avoidance of "negligence or intentional disregard" it was entirely reasonable for Petitioner to rely on the Prior Audit in determining that the dock rent was not subject to the CRT. Accordingly, all penalties should be abated.

I have considered all other arguments and find them unpersuasive.

ACCORDINGLY, IT IS CONCLUDED THAT

A. Petitioner's payments of dock rent were not payment for water areas but were payments for land, improvements and an appurtenant right of access, which are taxable premises subject to the CRT.

B. The results of a prior audit alone do not form the basis for collateral estoppel against the taxing authority.

C. The 5% negligence penalty and the 50% negligence interest penalty are abated because Petitioner acted neither in a negligent manner nor with an intentional disregard of the law. The 5%/25% maximum late-filing penalty and the 10% understatement penalty are abated because Petitioner acted in good faith and with reasonable cause. Petitioner's reliance on the Prior Audit is sufficient under either standard.

Therefore, the Petition of Spirit Cruises, Inc. is denied and the Notice of Determination dated February 5, 2009 is sustained, except with respect to the assertion of the penalties, which are hereby abated.

DATED: June 2, 2011
New York, New York

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MARLENE F. SCHWARTZ
Administrative Law Judge