NEW YORK CITY TAX APPEALS TRIBUNAL
ADMINISTRATIVE LAW JUDGE DIVISION

In the Matter of the Petition	:	**DETERMINATION**
Of	:	**TAT(H) 13-12(CR)**
CAFÉ NACIONAL LLC	:	

Gallancy-Wininger, A.L.J.:

Petitioner, Café Nacional LLC, at 60 Thompson Street, New York, New York 10012, filed a Petition for Hearing (Petition) with the New York City (City) Tax Appeals Tribunal (Tribunal) seeking a redetermination of a deficiency of City Commercial Rent Tax (CRT), pursuant to Chapter 7 of Title 11 of the City Administrative Code (Administrative Code). The deficiency was asserted by the City Department of Finance (Respondent) in a Notice of Determination dated June 26, 2012 (NOD) for the CRT tax year June 1, 2004 to May 31, 2005 (CRT Tax Year) and for each CRT Tax Year through and including the CRT Tax Year June 1, 2010 to May 31, 2011. The NOD asserted a CRT deficiency in the amount of $344,946.88 consisting of CRT due of $191,953.93, interest of $79,678.52 calculated to July 12, 2012, and penalties pursuant to Administrative Code § 11-715, in the amount of $73,314.43, for late filing, substantial understatement of tax liability and underpayment of interest pursuant to Administrative Code § 11-715 for each CRT Tax Year. Petitioner requested a Conciliation Conference before Respondent's Conciliation Bureau. A Conciliation Decision was issued on March 22, 2013 (Conciliation Decision). Petitioner protests the Conciliation Decision.

Petitioner appeared by Michael Buxbaum, CPA, of Buxbaum Sales Tax Consulting, LLC. The Commissioner of Finance (Respondent) was represented by Amy H. Bassett, Esq., Assistant Corporation Counsel. Frances J. Henn, Senior Counsel, joined Ms. Bassett on Respondent's brief.

Respondent submitted a Consent to Proceed on a Stipulated Record dated July 10, 2014 pursuant to § 1-09 (f) of the Rules of Practice and Procedure of the Tribunal (Tribunal Rules) together with a Stipulation as to certain facts and documents signed by Petitioner and Respondent (Stipulation). Petitioner submitted a letter dated January 22, 2015 confirming its consent to proceed on the Stipulated Record. Exhibits consisting of a copy of each of: the NOD; the Conciliation Decision; the Petition; Respondent's Answer; Respondent's Workpapers File; Respondent's Audit File; and Respondent's Tax Return File, were referenced in, and appended to the Stipulation (Stipulation Exhibits). Petitioner submitted a letter brief dated August 18, 2014. Respondent submitted a Brief dated November 3, 2014 together with the Affidavit of Saul Khutaina, a City Tax Auditor II. Petitioner submitted a letter dated November 17, 2014 and Respondent submitted a Reply Brief dated November 26, 2014.

ISSUES

Whether Respondent properly computed the CRT due from Petitioner by calculating for each CRT Tax Year, the rent expenses deducted by Petitioner and Tongkin Restaurant LLC (Tongkin) on their respective U.S. Return of Partnership Income (Internal Revenue Service [IRS] Form 1065 or Federal Partnership Tax Return), and combining the rent expense deducted by Petitioner with the rent expense deducted by Tongkin pertaining to such CRT Tax Year.

Whether Respondent properly imposed penalties in this matter.

FINDINGS OF FACT

Petitioner and Tongkin are related limited liability companies, and Petitioner is the sole member of Tongkin.

During the CRT Tax Years, Petitioner operated a restaurant at Thompson Hotel (Hotel), at 60 Thompson Street, New York, New York and Tongkin operated the bar at the Hotel.

Mr. Khutaina was assigned by Respondent to conduct an audit of Tongkin relative to City Unincorporated Business Tax (UBT). As a result of his UBT audit of Tongkin, Mr. Khutaina commenced the CRT audit of Petitioner in 2011, which is the subject of this proceeding.

During the course of the Tongkin UBT audit, Mr. Khutaina ascertained from information supplied by Petitioner's accountant, Alan Gross, that when its business began in 2004, Petitioner intended to open a restaurant and bar at the Hotel. However, because the Hotel offered room service, Petitioner needed to establish separate entities to operate the restaurant and the bar/lounge service. Petitioner operated the restaurant and Tongkin operated the bar/lounge service.

Mr. Khutaina affirms in his affidavit:

> Café Nacional's accountant [Mr. Gross] . . . explained that Café Nacional had an agreement with the Thompson Hotel that their rent would be based on 8.5% of gross sales. He stated

> that Café Nacional was the only entity paying rent to the Thompson Hotel, but added that in Café Nacional's books, there was a separate rent entry for Café Nacional and Tongkin. According to Petitioner's accountant, Tongkin never paid rent to Café Nacional nor did Café Nacional ever present a rent invoice requesting a rent payment.[1]

Mr. Khutaina states in his affidavit, that he requested a copy of both the agreement between Petitioner and the Hotel, and the bookkeeping records described above. However, Petitioner did not provide these materials.[2] Mr. Khutaina also states in his affidavit,that Mr. Gross advised him that "there was no separate rent agreement between the . . . Hotel and Tongkin" and "no rent payments were made directly from Tongkin to the Hotel."[3]

Petitioner did not file CRT Returns for the CRT Tax Years and did not pay CRT for the CRT Tax Years.[4]

Petitioner deducted rent as an expense for each of its Federal Partnership Tax Returns for calendar year 2004 and for each subsequent calendar year through and including calendar year 2010 (each calendar year, is the IRS Report Period). Tongkin also deducted rent as an expense on its Federal Partnership Tax Returns for each IRS Report Period from 2004 through and including 2010.

Mr. Khutaina based the amounts of "base rent" for CRT purposes on the amounts deducted by both Petitioner and Tongkin on their respective Federal Partnership Tax Returns for the IRS Report

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[1]Khutaina aff at 2.

[2]Khutaina aff at 2.

[3]Khutaina aff at 2.

[4]Khutaina aff at 3.

Periods from 2004 through 2010.

Petitioner and Tongkin filed their respective Federal Partnership Tax Returns on a calendar year basis. However, Administrative Code § 11-705 (a) requires the filing of a final CRT return based a CRT Tax Year ending on May 31st. In order to compute the CRT for each CRT Tax Year from 2004 to 2010, the annual rent amounts reported on Petitioner's annual Federal Partnership Tax Returns were divided by 12 to achieve monthly amounts for Petitioner and, the annual rent amounts reported on Tongkin's annual Federal Partnership Tax Returns were divided by 12 to achieve monthly amounts for Tongkin. The rents for each CRT Tax Year were computed by using Petitioner's monthly rent plus Tongkin's monthly rent for the 7 month period from June 1 to December 31 and Petitioner's monthly rent plus Tongkin's monthly rent for the 5 month period from January 1 to May 31 (Base Rent). Mr. Khutaina estimated Petitioner's Base Rent for the 2011 CRT Tax Year at $609,498, which was equal to the amounts calculated by Mr. Khutaina for the 2010 CRT Tax Year. According to Mr. Khutaina's affidavit, the rent paid by Petitioner and Tongkin for the 2011 CRT Tax Year was an aggregate of $625,053. However, the lower amount of $609,498 was used to calculate the amount of CRT asserted in the NOD for the 2011 CRT Tax Year. A 35% statutory reduction pursuant to Administrative Code § 11-704 (h) (2), was applied to the Base Rent for each CRT Tax Year. The CRT was computed at 6%[5] of 65% (*i.e.*, after giving effect to Administrative Code § 11-704 (h)(2) 35% reduction) of the Base Rent for each CRT Tax Year.[6]

Mr. Khutaina states in his affidavit, that a proposed

[5]*See*, Administrative Code § 11-702 (a) (1) (2).

[6]Khutaina aff at 4-7.

resolution whereby Respondent would waive all penalties except those penalties pertaining to failure to file, was discussed with Mr. Gross but, no agreement to this effect was reached.

Petitioner requested a Conciliation Conference with Respondent's Conciliation Bureau. Petitioner did not appear at four separately scheduled Conciliation Conferences and thereafter, a Conciliation Decision was issued on March 22, 2013.[7]

Petitioner timely filed the Petition with the Tribunal on April 30, 2013, protesting the Conciliation Decision.

Petitioner did not submit any materials in support of its position other than the Stipulation Exhibits, the letter brief dated August 18, 2014 and the letter dated November 17, 2014.

STATEMENT OF POSITIONS

Petitioner does not contest whether CRT is due. Rather, Petitioner disputes the computation of the amount of CRT due. Petitioner asserts that it and Tongkin are each separate legal entities that cannot be disregarded for CRT purposes. Petitioner asserts that it loaned money ("via [j]ournal entry") to Tongkin, to pay rent to the Hotel. (Letter brief for Petitioner at 2.) Petitioner asserts that Respondent improperly calculated the amount of CRT due by arbitrarily and capriciously combining rents paid by Petitioner with rents paid by Tongkin rather than issuing separate assessments against Petitioner and Tongkin.

[7]Although the Petition asserts that the Conciliation Decision was incorrectly issued because Petitioner had requested an adjournment of the conciliation proceedings due to Winter Storm Ukko, Petitioner did not provide documentary evidence that it requested such adjournment due to Winter Storm Ukko and, Petitioner does not pursue this point in its letter brief.

Petitioner asserts that Administrative Code § 11-703 (b) establishes a conclusive presumption that "rent ascribable to so much of such premises as is used as taxable premises shall be the amount which such tenant deducts as rent for such premises in determining the tenant's federal income tax." It is Petitioner's position that Administrative Code § 11-703 (b) precludes the combination of Petitioner's rents with Tongkin's rents for CRT purposes.

Petitioner also asserts, in reliance on *Matter of Harry's Exxon* (NY St Tax Appeals Tribunal, December 6, 1988 [No. 801193]), that Respondent is collaterally estopped from proceeding with penalties in this matter because of the purported "agreement" to waive penalties.

Respondent asserts that Petitioner is responsible for the CRT applicable to the rents paid by both entities irrespective of how the rents were reported by both Petitioner and Tongkin on their Federal Partnership Tax Returns.

Respondent further asserts that the imposition of penalties was appropriate in this matter and the concept of collateral estoppel is inapplicable.

CONCLUSIONS OF LAW

Administrative Code § 11-702 imposes CRT on "base rent" paid by a tenant. "Base rent" is defined under Administrative Code § 11-701 (7) as:

The rent paid for each taxable premises by a

> tenant to his or her landlord less the amounts received by or due such tenant for the same period from any tenant of any part of such premises.

The term "Rent" is defined under Administrative Code § 11-701 (6) as:

> The consideration paid or required to be paid by a tenant for the use or occupancy of premises, valued in money, whether received in money or otherwise, including all credits and property or services of any kind . . . .

The term "Tenant" is defined under Administrative Code § 11-701 (3) as:

> A person paying or required to pay rent for premises as a lessee, sublessee, licensee or concessionaire.

Section 11-703 (a) of the Administrative Code establishes 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, and the burden of proving that such presumptive base rent or any portion thereof is not included in the measure of the tax . . . shall be on the tenant.

Petitioner asserts that both Petitioner and Respondent are separate entities which each paid rent to the Hotel, and therefore, the two entities have separate, independent obligations for CRT which may not be joined.

Mr. Gross, Petitioner's accountant, stated to Mr. Khutaina that only Petitioner actually made rent payments to the Hotel.

Petitioner's assertion that Tongkin paid rent is based on an allegation that Petitioner lent the funds to Tongkin as a journal entry. Petitioner has not provided any evidence (*e.g.*, copies of the journal entries or canceled checks) to support its claim that Tongkin paid rent. In view of Mr. Gross' statement, the deductions taken by Tongkin on its Federal Partnership Tax Returns for rent expense cannot, without further explanation, be credited as evidence that those amounts, are rents paid by Tongkin for CRT purposes.[8]

In *Matter of Square Plus Operating Corp.*, (City Tax Appeals Tribunal TAT No. 90-1221, 5 (CRT) [City Tax Appeals Tribunal, October 29, 1992], *affd*, 212 AD2d 448 [1st Dept 1995], *lv denied*, 87 NY2d 804 [1995]), the Tribunal addressed whether rent obligations contained in a lease made by one entity and a guaranty of certain payments made by a second entity could properly be combined for CRT purposes. In finding that such combination was appropriate, the Tribunal stated:

> [W]e cannot help but note that these affiliated corporations paid the CRT only through the single corporate purse of Square Plus and that their filings routinely ignored corporate lines. It thus particularly ill-behooves Petitioner to claim, for the occasion of this litigation, an opacity to the corporate veil so great as to shield the subsidiary from its identification with its parent in connection with a transaction in which the two have essentially acted as one.

Petitioner provided no evidence that Tongkin paid rent to the

[8]In his affidavit, Mr. Khutaina stated that Tongkin's rent deductions aggregate $2,129,591 for the CRT Tax Years. (Khutaina aff at 3.) The affidavit does not reflect a separate pro-ration of Tongkin's rent for each of the CRT Tax Year.

Hotel, and the reasoning in *Matter of Square Plus* is persuasive.

Petitioner relies on the presumption regarding rent ascribable to taxable premises contained in Administrative Code § 11-703 (b), which provides:

> Where a tenant uses premises both for residential purposes and as taxable premises and the tenant pays an undivided rent for the premises so used, it shall be conclusively presumed against such tenant that the rent ascribable to so much of the premises as is used as taxable premises shall be the amount which such tenant deducts as rent for the premises in determining the tenant's federal income tax. . . . (Emphasis supplied.)

In order for the Administrative Code § 11-703 (b) presumption to apply, the premises must be used both for residential purposes and as taxable purposes. The premises in this matter were used as a restaurant and bar, not as residential premises and the presumption set forth in Administrative Code § 11-703 (b) does not apply.

CRT Rules of the City of New York (19 RCNY) § 7-11 provides:

> Every landlord of taxable premises and every tenant of taxable premises shall keep records identifying each tenant, the rent required to be paid, the rent paid and received, the location of each premises, and the periods of commencement and termination of every occupancy. In addition, such persons are required to keep all leases or agreements which fix the rents or rights of tenants of taxable premises, and such other records, receipts and other papers relevant to the ascertainment of tax due under the law.

Despite the requirements of 19 RCNY 7-11, the record is devoid of any affidavits, copies of checks, leases, rental

agreements, concession agreements, journal entries, documents evidencing loans between the entities or other relevant materials that would support Petitioner's position. The only year for which Petitioner's IRS Form 1065 contains a balance sheet is 2010. However, that balance sheet does not contain any information evidencing a loan from Petitioner to Tongkin.

Petitioner failed to provide any credible evidence to support its position. Petitioner did not sustain its burden of proof that Petitioner and Tongkin each paid rent separately to the Hotel.

Administrative Code § 11-715 (j) provides for penalties in the case of substantial understatement of tax liability. There is a substantial understatement of tax liability for a tax year "if the amount of the understatement for the tax year exceeds the greater of ten percent of the tax required to be shown on the tax return or five thousand dollars." (Administrative Code § 11-715 [j].) Administrative Code § 11-715 (j) contains exceptions in the case of an understatement for which there is either (i) substantial authority for the treatment accorded by the taxpayer or (ii) an item for which the tax treatment is adequately disclosed on the return or an attachment to the return. Petitioner satisfies neither of these exceptions. Petitioner never filed CRT returns and does not cite substantial authority for its failure to do so.

Petitioner asserts that Respondent is collaterally estopped from asserting penalties because Petitioner relied on an unaccepted "offer" that was not finalized. The general rule is that collateral estoppel is not available against a governmental agency in the exercise of its governmental functions (*Matter of Daleview Nursing Home v Axelrod*, 62 NY2d 30 [1984]; *Matter of Frye v Comm'r of Finance*, 62 NY2d 841 [1984]). The Court of Appeals explained in

Daleview, (in which a health care facility operator sought to estop the Commissioner of Health from recouping an erroneous Medicaid payment), that "the severely limited recognition of estoppel. . ." stems "from considerations of sovereign immunity, protection of the public fisc, and separation of powers." (*Daleview* at 34.)

Petitioner's reliance on *Matter of Harry's Exxon* to support its position that Respondent is collaterally estopped from seeking penalties, is misplaced. The taxpayer in that case received a letter from the Chief, Sales Tax Audit Section of the Buffalo District Office of the State Department of Taxation and Finance advising the taxpayer that a State sales tax audit had been concluded and no additional sales or use taxes were due. That taxpayer forwarded the letter to his accountant, following which the accountant destroyed certain records that might have been helpful to the taxpayer at a hearing. Approximately a year later, the taxpayer received a notice of a pre-hearing conference. The State Tax Appeals Tribunal stated that the elements of estoppel which apply in that matter are whether (i) the taxpayer is entitled to rely on the letter, and (ii) such reliance was to the taxpayer's detriment. The findings of facts by the State Tax Appeals Tribunal in *Harry's Exxon* are distinguishable from the facts in this matter. No settlement of this matter was finalized, and Petitioner cannot establish that it that it satisfies the two elements of estoppel set forth in *Harry's Exxon*. Petitioner failed to establish any basis upon which Respondent is collaterally estopped from asserting penalties.

ACCORDINGLY, IT IS CONCLUDED THAT Petitioner, Café Nacional, LLC is liable for the CRT, interest and penalties as asserted by Respondent. The Petition of Café Nacional LLC is denied and the Conciliation Decision dated March 22, 2013, and Notice of Determination dated June 26, 2012 are sustained.

DATED: March 9, 2015
New York, New York

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Jean Gallancy-Wininger
Administrative Law Judge