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Sales Tax Refund Cases Show No Sympathy for Sellers

By: Joseph Lipari

When I was growing up, way too many years ago, it was common for small convenience stores to have a sign hanging behind the counter that said, "We don't charge sales tax, we only collect it." Who is liable for tax is often irrelevant to buyers and sellers—until they want a refund. Two recent Division of Tax Appeals (DTA) administrative law judge (ALJ) determinations, *New Cingular Wireless PCS LLC*[1] and *Richard L. Feigen & Co., Inc.*[2]work through some of these issues. *Cingular* may have turned on the fact that the seller not yet refunded sales tax to its customers. On the other hand, in *Feigen*, the seller ended up bearing the tax although it had already refunded its customer.

The two cases generally deal with section 1139 of the New York Tax Law, which provides the rules for receiving a sales tax refund in cases where such tax was "erroneously, illegally or unconstitutionally collected or paid." Section 1139(a) requires the State to refund such sales tax if the tax was paid in the last three years and the collector of sales tax has already issued a refund to the customer. Under section 1139(c), in order to receive a refund, a collector or payer of sales tax must file a claim within the later of three years of the filing of a return or two years of paying the tax.

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In *Cingular*, petitioner (referred to as "ATTM" throughout the determination and in this article) was a provider of wireless Internet access to smartphones, laptops, and other devices. ATTM mistakenly collected and remitted sales tax from its customers in New York (and other states) on these services.[3] As part of a settlement of a Federal class-action lawsuit for ATTM's wrongful collection and remittance of sales tax in multiple states, ATTM agreed to file for a refund of sales tax from New York State (and other states) and to pay or direct the refund to certain settlement escrow accounts (which, in theory, would eventually be disbursed to customers–class action plaintiffs). Under the settlement agreement and a subsequent "clarifying" agreement, ATTM and the plaintiffs agreed that any payment that ATTM made into an escrow account would constitute a refund of sales tax to customers. ATTM assigned any of its rights to a refund to be paid directly to escrows (ATTM agreed it would fund the escrows if it received a sales tax credit). In the order approving the settlement, the Federal District Court was explicit that the settlement did not "dictate to any state the substance of its laws with regard to refunds or refund procedure."

The outcome of the case hinged on the distinction between a collector's ability to file a claim under section 1139(c), and the State's requirement to pay the refund under section 1139(a). Petitioner argued that the State wrongly denied its *claim* for refund on the grounds that petitioner had not yet repaid its customers. Section 1139(c) does not require repayment prior to *filing of the claim*. However, section 1139(a) requires repayment to customers prior to the State *issuing the refund*. While the ALJ agreed with petitioner that repayment to customers is not necessary for filing of a claim, he also found that the State had permitted ATTM to file a claim, as evidenced by the State's employees' consideration and subsequent audit of the claim. The ALJ also rejected on two grounds petitioner's secondary argument that the terms of the settlement agreement and ATTM's assignment of its refund claim to the escrows constituted repayment to its customers. First, the ALJ noted that the explicit language of the Federal District Court order stated that it did not govern state sales tax refund law. Second, the settlement agreement (and subsequent clarifying agreement) required ATTM to pay into the escrows to make a refund, an action which ATTM had not taken as of the time of the filing of the claim. The assignment of its rights was not sufficient. On the face of it, ATTM lost its case because it had not paid anything into the escrows before filing its claim.

In *Feigen*, in contrast, the petitioner refunded the sales tax to the customer, but lost anyway. Petitioner had sold a painting to the customer in 2004 (under the mistaken belief that it was authentic), but did not discover that the painting was

a fake until seven years later. Petitioner then refunded to the buyer of the fake painting the entire amount paid, including the sales tax forwarded on to the State. Petitioner put forth several arguments to circumvent the three-year statute of limitations on sales tax refunds in the cases were sales tax was "erroneously, illegally, or unconstitutionally collect or paid"; the ALJ rejected all of petitioner's arguments.

Petitioner's main argument was that the collection of sales tax was not erroneous, illegal, or unconstitutional, and therefore the three-year statute of limitations did not apply. The ALJ agreed that the collection of sales tax was not erroneous, illegal, or unconstitutional, finding that although the sale was made under "mutual mistake of fact," the sales tax was lawfully collected and remitted at the time of the sale. However, whereas petitioner argued that section 1132(e), which deals with refunds of sales tax in cases of a rescission of contract (as opposed to "illegal" sales), did not impose a three-year limitation on refunds, the ALJ found that regulations (explicitly permitted in the statute) impose a three-year limitation and incorporate the rules of section 1139 by reference on rescinded sales.[4] In addition to its main argument, petitioner threw out a series of arguments to get around the statute and regulations. Petitioner argued that under the Civil Practice Law and Rules (CPLR), the statute of limitations should have been tolled since the refund claim was an "an action based upon a fraud." he ALJ found Tax Law section 1139(c) (imposing the three-year limitation) was clear on the issue, and the relevant CPLR provision did not govern. The ALJ also rejected the argument that she had the power to decide the matter on grounds of equity. Petitioner additionally argued that the tax commissioner had general discretionary power under which he could issue a refund, and that certain personal income and corporate franchise tax provisions provide guidance demonstrating that the commissioner could issue a refund after the running of the statute of limitations. Petitioner further argued that the application of these rules to only personal income and corporate franchise—but not sales—tax was as violation of its equal protection and due process rights. The ALJ rejected all these arguments. She found that on the face of the statute and under relevant case law, the tax commissioner did not have discretion to issue such a *sales* tax refund, and that this did not violate petitioner's constitutional rights.

The two cases read together could stand for the proposition that refunding sales tax to the customer is a necessary-but-not-sufficient condition for a collector to get its refund. Toward the beginning of his legal analysis, the ALJ in *Cingular* gives his two cents on what the case is really about: ATTM wanted assurance of the amount of refund it would receive before funding any of the escrows, so that it would not have to pay out of pocket if the refunded amount fell short of the amount it had to pay into the escrow. The ALJ was not sympathetic to this, noting that "it is curious that [ATTM] at once claims that it has impeccable and accurate records . . . yet it will not rely on them to make payment to its customers." What the ALJ did not say is that he may also have had skepticism that the funds, once paid into escrows, would ever make it into the hands of ATTM's customers. The ALJ's repeated quotation of the Federal order stating that the settlement agreement did not "dictate to any state the substance of its laws" suggests that he may have made room to find for the State *even if* ATTM had paid into the escrows before filing a claim. ATTM's failure to pay in beforehand simply gave him an easier out.

Putting the cynic's reading aside, ATTM, unlike the *Feigen* petitioner, could have (at least facially) remedied its issue by paying. By comparison, there was no outside action that the *Feigen* petitioner could have taken to make its refund permissible. Although the *Feigen* petitioner had no real legal argument, the result still seems harsh. That petitioner was stuck with its facts and had to construct the best arguments it could to get around the limitations. The only action he could have taken to avoid bearing the cost of the sales tax was to not refund it to the customer in the first place. Perhaps the case serves as a good reminder to other taxpayers that no good deed goes unpunished.

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1 DTA No. 825318 (July 17, 2014).
2 DTA No. 824996 (July 10, 2014).
3 Internet access services are exempt from sales tax under N.Y. Tax Law § 1115(v).
4 *See* 20 N.Y.C.R.R. § 534.6(a)(2).