STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition :

of :

PATRICK MURPHY :

for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law and the New York City Administrative Code for the Year 2006. :

DECISION
DTA NO. 825277

In the Matter of the Petition :

of :

KATHLEEN MURPHY :

for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law and the New York City Administrative Code for the Year 2006. :

Petitioners, Patrick and Kathleen Murphy, filed an exception to an order of the Administrative Law Judge issued on April 18, 2014. The order denied two motions to withdraw subpoenas issued by the Administrative Law Judge and served by the Division of Taxation upon petitioners and certain other non-parties. The motions were brought by petitioners and such other non-parties, respectively, pursuant to 20 NYCRR 3000.5 and 20 NYCRR 3000.7 (c).

Petitioners appeared on exception by Hodgson Russ LLP (Timothy P. Noonan, Esq. and Joseph N. Endres, Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (Marvis Warren, Esq., of counsel).

Petitioners filed a brief in support of their exception. The Division of Taxation filed a brief in opposition. Petitioners filed a brief in reply. Oral argument was heard in New York, New York on January 8, 2015, which date began the six-month period for the issuance of this decision.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUE

Whether subpoenas duces tecum, served upon petitioners and non-parties JJF Realty Management, Inc., JJF Associates LLC, and JJF Realty ESOP Trust, seeking the production of various documents concerning the ownership and operation of those various non-parties during 2006, should be withdrawn.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge, except for findings of fact 2, 4, 5, 6, 7 and 9, which we have modified to more accurately reflect the record. The Administrative Law Judge's findings of fact and the modified findings of fact are set forth below.

1. The Division of Taxation (Division) issued a notice of deficiency, number L-035037360-3, dated November 22, 2010 to petitioners, Patrick and Kathleen Murphy, asserting personal income tax due under Article 22 of the Tax Law and the New York City Administrative Code for the year 2006.

2. This matter involves the central issue of whether petitioners failed to properly report on their New York State personal income tax return and pay tax on the Internal Revenue Code § 1231 gain from the 2006 sale of real property in Manhattan owned by JJF Associates LLC (JJF

Associates). JJF Associates was owned by two members: JJF Realty ESOP Trust (ESOP), which owned 99%, and Triune Foundation, Inc. (Triune), which owned 1%. Petitioners were the sole participants of ESOP. Petitioner Patrick Murphy was the principal person responsible for the operation of JJF Associates and was president of Triune. JJF Associates reported the gain from the sale of the property on its 2006 New York State partnership return, which was signed by petitioner Patrick Murphy in his aforementioned capacity.

3. Petitioners assert that ESOP and Triune are tax exempt entities. Additionally, petitioners maintain that ESOP was a pension trust established for the benefit of the employees of JJF Realty Management, Inc. (JJF Realty). Petitioners take the position that they were employees of JJF Realty during the applicable period.

4. Records of the New York State Department of State indicate that JJF Realty was incorporated in 1999; was dissolved by proclamation of the Secretary of State on June 25, 2003; and that, as of December 5, 2013, such dissolution has not been annulled.

5. After an audit, the Division has taken the position that petitioners failed to demonstrate that ESOP had tax exempt status or that JJF Realty actually had employees in 2006. The Division further maintains that ESOP was a "sham entity with no economic substance" and that petitioners were the sole participants in ESOP. Hence, according to the Division, the gain from the sale of the Manhattan property should flow through to petitioners as ESOP's only participants. The Division's theory of petitioners' liability for the subject deficiency has changed during the course of the audit and the pendency of this matter.

6. The ownership structure, compliance with formalities, and day-to-day operations of JJF Associates, ESOP, and JJF Realty may be relevant to the determination in this matter. The role

of petitioners in each of the companies may also be relevant.

7. The Division has sought, through subpoenas duces tecum issued by the Administrative Law Judge, to access information and materials germane to the structure and operation of JJF Associates, ESOP, and JJF Realty in 2006. In particular, the Division subpoenaed documents from petitioners demonstrating their ownership of and contributions, distributions, and forfeitures to and from ESOP during the year at issue. Additionally, the Division subpoenaed documents from the three related entities concerning 1) the operation of JJF Realty; 2) total contributions to and from ESOP; 3) securities that were allocated, either directly or indirectly, to ESOP for the benefit of petitioners; 4) federal forms claiming exemption filed by ESOP; 5) any lists of plan participants and vesting schedules for ESOP; and 6) the determination of the basis of the Manhattan property that serves as the genesis of the gain in question.

8. Many of the documents sought were previously requested by the Division during its related audits of JJF Associates and ESOP, but have not been provided by petitioners.

9. Following the issuance of the subpoenas duces tecum by the Administrative Law Judge on March 6, 2014 and their service by the Division on March 13, 2014, petitioners and the non-parties, JJF Realty, JJF Associates and ESOP, brought motions to withdraw on March 14, 2014.

THE ORDER OF THE ADMINISTRATIVE LAW JUDGE

Pursuant to the well-established standard on a motion to withdraw a subpoena, the Administrative Law Judge found that the subpoenaed documents were not "utterly irrelevant" to the matter in dispute. He therefore denied the motion. In reaching this conclusion, the Administrative Law Judge noted that the subpoenaed documents are relevant to the primary issue

in this case, which he defined as "the legitimacy of the ESOP and related companies and whether petitioners treated them and the 2006 gain properly." In response to petitioners' and the non-parties' arguments that the subpoenas are preempted by section 514 (a) of the Employment Retirement Income Security Act of 1974 (ERISA) (29 USC § 1144 [a]), the Administrative Law Judge indicated that petitioners needed to first substantiate "the existence of a legitimate pension plan" and "to demonstrate that ESOP qualifies for ERISA treatment." If petitioners meet their burden on this issue, the Administrative Law Judge indicated that their preemption argument "may be appropriate." The Administrative Law Judge noted that the assertion of ERISA preemption, "without more," was insufficient to require withdrawal of the subpoenas.

The Administrative Law Judge also rejected alternative grounds for the withdrawal of the subpoenas asserted by petitioners and the non-parties. Specifically, he rejected claims that the request was vague and overly broad and that the request was made in bad faith.

The Administrative Law Judge also noted that his denial of the motion to withdraw was not a ruling on the admissibility of the documents produced in response to the subpoenas. The order indicates that such a ruling would be made at the hearing after any objections are heard.

ARGUMENTS ON EXCEPTION

Petitioners assert that the Administrative Law Judge improperly rejected their contention that the subpoenas are preempted under ERISA. In contrast to their argument made before the Administrative Law Judge, however, petitioners' argument on exception specifically asserts that ERISA preemption doctrine precludes state authorities, such as the Division of Taxation and the Division of Tax Appeals, from determining whether an ERISA plan exists. Petitioners note that the Administrative Law Judge's order expressly finds that petitioners must prove that ESOP is a

legitimate pension plan before an ERISA preemption argument may be considered. Petitioners contend that this finding is in error and contrary to ERISA preemption doctrine. Petitioners thus contend that ERISA preemption renders the subpoenaed documents irrelevant and requires withdrawal of the subpoenas.

Petitioners also argue that, in any event, the record contains ample evidence to substantiate ESOP's existence.

Petitioners further contend on exception that the Division had ample opportunity to request the subpoenaed documents during the audit and should be precluded from doing so now, more than three years after issuing the notice of deficiency. Petitioners also assert that the Division has changed its theory of petitioners' liability several times during the pendency of this matter. Petitioners take the position that such an unceasing and ad hoc approach to audits must not be permitted and that, accordingly, the subpoenas should be withdrawn.

The Division argues that the subpoenaed documents are relevant to the issue of whether ESOP does, in fact, qualify as an ERISA plan or whether ESOP is a sham entity lacking in economic substance and therefore properly disregarded. The Division thus implicitly contends that ERISA preemption does not preclude the Division of Tax Appeals from ruling on the issue of ESOP's existence in this proceeding.

Regarding the timing of the subpoenas, the Division contends that, so long as petitioners have an opportunity to present a defense to the Division's positions, the service of subpoenas after the issuance of the notice of deficiency is not a basis to require their withdrawal.

The Division also asserts that, even if ESOP was, in fact, a qualified ERISA plan, the Tax Law is one of general application; is not directly related to ERISA; and is, therefore, not

preempted in the present matter. Petitioners take the contrary position to this argument, contending that the Tax Law is preempted by ERISA.

OPINION

The Tax Appeals Tribunal's Rules of Practice and Procedure (Rules) provide that, upon the request of any party, a subpoena may be issued by an administrative law judge to require the attendance of a witness or the production of documentary evidence at a hearing (20 NYCRR 3000.7 [a]). Any subpoena issued by an administrative law judge is regulated by the civil practice law and rules (CPLR) (***see*** Tax Law § 2006 [10]).

The Rules permit "any person to whom [such] a subpoena is directed" to request, by motion to an administrative law judge, that the subpoena be modified or withdrawn (20 NYCRR 3000.7 [c]). Petitioners and the non-parties, JJF Realty, JJF Associates and ESOP, thus properly filed motions pursuant to this provision seeking orders withdrawing the subpoenas.

A motion to withdraw a subpoena is equivalent to a motion to quash under CPLR 2304 (***see Matter of Winners Garage, Inc***., Tax Appeals Tribunal, October 8, 2009; ***see also Ayubo v Eastman Kodak Co.***, 158 AD2d 641 [2d Dept 1990]).

As the Administrative Law Judge correctly noted, the standard to be applied on a motion to withdraw (or quash) a subpoena duces tecum is whether "the futility of the process to uncover anything legitimate is inevitable or obvious" or whether the requested information is "utterly irrelevant to any proper inquiry" (***People v Laughing***, 113 AD3d 956, 958, [3d Dept 2014] citing ***Anheuser-Busch, Inc. v Abrams***, 71 NY2d 327, 331-332 [1988] [internal quotation marks, brackets and citations omitted]). The party challenging the subpoena has the burden to demonstrate "a lack of authority, relevancy or factual basis for its issuance" (***id.***, citing ***Hogan v***

Cuomo, 67 AD3d 1144, 1145 [3d Dept 2009]).

As noted, petitioners' primary argument on exception invokes ERISA preemption doctrine as a basis for withdrawing the subpoena. ERISA subjects employee benefit plans to comprehensive federal regulation (***see*** 29 USC § 1001 *et seq.*). ERISA's scope is such that it preempts state law in certain circumstances. Specifically, ERISA's provisions "supercede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan" (29 USC § 1144 [a]).

The Supreme Court and other courts have examined the scope of ERISA preemption on numerous occasions. In their argument on exception, petitioners rely, in significant part, on ***Ingersoll-Rand v McClendon*** (498 US 133 [1990]) in support of their position that the subpoenas at issue "relate to" ESOP, petitioners' purported ERISA-regulated plan, within the meaning of the preemption clause. In ***Ingersoll-Rand***, a fired worker filed a wrongful discharge action in a Texas state court alleging that the principal reason for his firing was his employer's desire to avoid contributing to his pension fund. The Supreme Court held that, because the worker must prove that an ERISA plan existed in order to prevail, the cause of action "relates to" an ERISA-covered plan within the meaning of 29 USC § 1144 (a) and is therefore preempted.

Petitioners assert that the rationale underlying the Administrative Law Judge's order, that is, that before invoking the preemption doctrine, petitioners must prove the existence of a qualified ERISA plan, runs contrary to the holding of ***Ingersoll-Rand***. Petitioners thus contend that, pursuant to ***Ingersoll-Rand***, the Division of Tax Appeals may not determine whether an ERISA plan exists. Therefore, according to petitioners, a subpoena seeking documents related to that purpose must be withdrawn.

Petitioners did not raise the issue of whether ERISA preemption precludes the Division of Tax Appeals from making a determination as to the existence of an ERISA plan and did not cite ***Ingersoll-Rand*** in their argument to the Administrative Law Judge. Accordingly, and considering also that there has been no evidentiary hearing in this matter, we conclude that this issue is insufficiently developed to be addressed in this decision. Rather, we find that the question of whether petitioners must prove ESOP's existence or legitimacy as an ERISA plan, or whether ERISA preempts the Division of Tax Appeals from addressing this issue, is a matter to be resolved through the hearing process. We have modified the facts herein to reflect this conclusion (***see*** Finding of Fact 6). We thus conclude that, at this point in the proceeding, the subpoenaed documents are not "utterly irrelevant to any proper inquiry" (***People v Laughing***). Accordingly, we affirm the Administrative Law Judge's order denying the motions to withdraw.

We note that our decision to affirm the Administrative Law Judge's order has the same effect as a ruling by an administrative law judge at a hearing that admits evidence pending a finding as to the weight to be accorded such evidence, a common occurrence at Division of Tax Appeals hearings. In this case, if preemption applies as petitioners assert, then the subpoenaed documents, along with documentation of ESOP's existence that is already in the record, likely will be accorded little or no weight. We further observe that petitioners do not claim on exception, as they did below, that the subpoenas are vague or overly broad and thus make no claim suggesting any difficulty in compliance.

We also reject petitioners' other arguments for withdrawal. Petitioners point to no authority that would preclude the Division from subpoenaing documents for a Division of Tax Appeals hearing that could have been requested or subpoenaed during an audit. Similarly,

petitioners point to no authority indicating that the Division's changing theory of liability provides a basis for withdrawing the subpoenas.

We do not address petitioners' argument that the record contains ample evidence to substantiate ESOP's existence or the parties' alternative arguments regarding whether the Tax Law is preempted by ERISA, as it is unnecessary to do so at this point in the proceeding.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Patrick and Kathleen Murphy is denied;

2. The order of the Administrative Law Judge is affirmed; and

3. This matter is remanded to the Administrative Law Judge for further proceedings consistent herewith.

DATED: Albany, New York
July 2, 2015

/s/ Roberta Moseley Nero
Roberta Moseley Nero
President

/s/ Charles H. Nesbitt
Charles H. Nesbitt
Commissioner

/s/ James H. Tully, Jr.
James H. Tully, Jr.
Commissioner