STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
RONALD AND CHRIS LABOW	:	DECISION DTA No. 812779
for Redetermination of a Deficiency or for Refund of New York State and New York City Personal Income Taxes under Article 22 of the Tax Law and the New York City Administrative Code for the Years 1986 and 1987.	:	

Petitioners Ronald and Chris Labow, 126 Hurst Lane, Bellevue, Idaho 83313, filed an exception to the determination of the Administrative Law Judge issued on November 22, 1995. Petitioners appeared by Bard & Glassman (Bart L. Fooden, CPA). The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Craig Gallagher, Esq., of counsel).

Petitioners filed a brief in support of their exception. The Division of Taxation filed a brief in opposition. Oral argument was not requested.

Commissioner Pinto delivered the decision of the Tax Appeals Tribunal. Commissioners DeWitt and Jenkins concur.

ISSUES

I. Whether the Division of Taxation properly determined that petitioners were taxable as residents of New York City during the years 1986 and 1987.

II. Whether the Division of Taxation properly disallowed claimed alimony payments by petitioner Ronald Labow in the amounts of $252,157.00 in 1986 and $730,451.00 in 1987.

III. Whether the Division of Taxation properly disallowed a claimed business loss by petitioners in the amount of $246,262.00 for 1986.

IV. Whether penalties imposed upon the deficiencies for the years at issue should be abated.

V. Whether the Division of Taxation properly increased petitioners' taxable income for the additional compensation in the amount of $246,262.00 for the year 1986.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

Pursuant to a field audit of Ronald and Chris Labow ("petitioners") which commenced in November 1989, the Division of Taxation ("Division"), on August 1, 1991, issued a Statement of Personal Income Tax Audit Changes to petitioners asserting additional New York State and City of New York personal income tax due in the amount of $248,836.00, plus penalties and interest, for a total amount due of $380,222.35 for the years 1986 and 1987. The Statement of Personal Income Tax Audit Changes advised petitioners that the deficiencies resulted from a determination by the Division that petitioners were residents of New York City for such years as well as disallowance of a loss of $246,262.00 for the year 1986 (thereby increasing petitioners' taxable income by that amount) and disallowance of an alimony deduction for each of the years at issue.

On September 25, 1991, the Division issued a Notice of Deficiency to petitioners asserting additional State and City personal income taxes due of $248,836.00, plus penalties and interest, for a total amount due of $432,348.55 for the years 1986 and 1987.

Previously, petitioners' representative executed two consents extending the period of limitation for assessment of personal income taxes relating to the 1986 tax year (***see***, Division's Exhibits "B" and "C"), the second of which agreed that taxes for 1986 could be determined at any time on or before October 2, 1991.

The Division's auditor, Luis E. Pulgarin, appeared at the hearing and testified that an initial appointment letter and request for records was mailed to petitioners (at 360 Pea Pond Road, Katonah, New York 10536) on December 4, 1989, setting up an appointment for examination of the records on December 21, 1989 (***see***, Division's Exhibit "M"). The letter was returned to the Division with the notation, made by the U.S. Postal Service, that the "forwarding time expired".

A second letter (***see***, Division's Exhibit "N") was sent to petitioners at 86 Stone Hill, Pound Ridge, New York 10576 setting the appointment date for February 6, 1990. The auditor stated that petitioners' representative postponed the appointment on a couple of occasions; the meeting eventually took place on June 6, 1990. Some records were provided to the auditor on that date, but the auditor made several additional written requests for documentation (***see***, Division's Exhibits "O", "P", "Q", "R" and "S").

On May 16, 1991, the auditor met with petitioner Ronald Labow and petitioner's representative, Bart L. Fooden, at the latter's office. The auditor testified that Mr. Labow alleged that he had already provided the documentation requested and, as a result, he prepared a list of documents (the list was dated February 6, 1990 because of a prior document request) which both he and the auditor signed. Pursuant to the list (***see***, Division's Exhibit "T"), documents provided to the auditor were: a power of attorney, Federal return and related schedules, bank statements for certain periods during the years at issue, driver's license and automobile registration and a letter from the school where petitioners' daughter was enrolled.

The auditor testified that, at the May 16, 1991 meeting, he obtained a letter to Ronald Labow from the District Counsel, Internal Revenue Service dated July 21, 1987 and a Form 1098, Mortgage Interest Statement for 1987 issued to petitioner Chris Labow. Both of the documents were addressed to the respective petitioners at 1725 York Avenue, New York, New York.

The auditor further testified that he spoke with Mr. Labow at the May 16, 1991 meeting and that Mr. Labow stated that:

(a) he worked five days per week for Neuberger & Berman, an investment banking firm, at its Fifth Avenue offices in New York City;

(b) he commuted to work each day by train or automobile;

(c) he had only one credit card in 1986 and 1987, i.e., an American Express card; and

(d) he maintained a bank account in the Mountain State Bank in Idaho and Mrs. Labow had an account at the Dollar Drydock Savings Bank in White Plains, New York.

The auditor stated that petitioners had filed as New York City residents for 1985. For each of 1986 and 1987, petitioners filed a joint New York State resident return (Form IT-201) and petitioner Ronald Labow filed a City of New York nonresident earnings tax return (Form NYC-203). On each of the City of New York nonresident returns, Mr. Labow answered "no" to the following questions:

(a) "Were you a City of New York resident for any part of the taxable year?"

(b) "Did you or your spouse maintain an apartment or other living quarters in the City of New York during any part of the year?"

Petitioners did not appear at the hearing nor did they submit affidavits. Their representative, Bart L. Fooden, stated that they resided in New York City at 1725 York Avenue from 1982 through November 1985 at which time they moved to Katonah (Westchester County), New York primarily because they wanted to enter their daughter in a private school in Caanan Ridge, Connecticut. Mr. Fooden stated that, in 1988, petitioners purchased and moved into a new home in Pound Ridge, New York (Westchester County). Mr. Fooden acknowledged that, by virtue of his having commuted to work in New York City during the years at issue, Mr. Labow was in New York City for more than 183 days in each of 1986 and 1987.

Mr. Fooden stated that the apartment at 1725 York Avenue was owned by petitioner Chris Labow, as evidenced by the shares of stock of 1725 York Owners Corp. (***see***, Petitioners' Exhibit "7"). Initially (after their move to Katonah), petitioners desired to retain the New York City apartment for use as Mrs. Labow's place of business (she was an interior decorator). Subsequently, because of its distance from Katonah, Mr. Fooden stated that petitioners decided to put the apartment up for sale but, due to market conditions, it was not sold until July 19, 1988 (***see***, Petitioners' Exhibit "7").

As previously indicated, petitioner Ronald Labow claimed an alimony deduction for each of the years at issue which deductions were disallowed by the Division. For 1986, as part of Federal adjustments to income (line 19 of State return), petitioner claimed alimony paid in the amount of $252,157.00; for 1987 (on line 17 of the return), petitioner claimed to have paid $730,451.00 in alimony.

Petitioners submitted the affidavit of James Kaufman, Esq. (***see***, Petitioners' Exhibit "1"), sworn to on January 30, 1995. The affidavit stated that Mr. Kaufman represented petitioner Ronald Labow in various court actions brought against him by his ex-wife, Myrna Labow. Mr. Kaufman's affidavit stated that he reviewed his records and court papers regarding the monies claimed to have been paid by Mr. Labow in 1986 and 1987. The $252,157.00 claimed to have been paid in 1986 consisted of two payments, $139,653.15 on February 21, 1986 and $112,504.86 on December 18, 1986. As to these payments, the affidavit stated as follows:

> "1. $139,653.15 for unallocated alimony and child support arrears for a time period prior to October, 1985.
>
> "2. $112,504.86 for unallocated alimony and child support arrears for the time period from November, 1985 to July, 1986, and court-imposed penalties (in the amount of $52,250). But when the Appellate Division, First Department, of the Supreme Court of the State of New York reversed the lower court and ordered such penalties to be eliminated, the court also ordered that Myrna Labow give Mr. Labow a credit in the amount of $52,250 towards unallocated alimony and child support then owing or to be owed."

As to the payment of $730,451.00 allegedly made in August 1987, the affidavit of James Kaufman states that this amount was allocated as follows:

> "3. $118,958.94 for unallocated alimony and child support arrears for the time period from August, 1979 to April, 1983.
>
> "4. $58,242.07 for unallocated alimony and child support arrears for the time period from March, 1985 to October, 1985.
>
> "5. $458,210.20 for alimony and child support arrears for the time period from October, 1985, to April, 1987, and real estate taxes (in the amount of $95,655, plus interest from December 28, 1984 to date of payment at 8% per annum).
>
> "6. $80,940 for alimony and child support arrears for the time period from April 13, 1987, to August 4, 1987.

"7. $14,100 for alimony and child support arrears for the time period from August 4, 1987, to August 24, 1987."

Copies of checks were furnished after the hearing (***see***, Petitioners' Exhibits "8" through "13"). All of the checks were drawn on the account of Neuberger & Berman.

The judgment of divorce of the Supreme Court, Fairfield County (Connecticut), dated August 28, 1978 (***see***, Petitioners' Exhibit "2"), provided, in part, that the defendant (petitioner Ronald Labow) was required to pay to the plaintiff (Myrna Labow) "the sum of $4,500.00 monthly for alimony and support of the three minor children issue of this marriage, said sum being unallocated as between alimony and support." The decree stated that the three minor children were as follows: Brenda Hope Labow, born June 30, 1961; Sabrina Labow, born November 7, 1967; and Steven Lance Labow, born April 9, 1970. Petitioner was also required to pay the sum of $566.85 per week to his ex-wife for real estate maintenance, rent, mortgage, taxes, insurance and any charges arising from cooperative apartment maintenance. The record does not disclose which of the parties owned the cooperative apartment or if it was jointly owned.

Attached to the affidavit of James Kaufman (***see***, Petitioners' Exhibit "1") were pages 4, 9, 30, 31 and 32 of the Memorandum of Decision of George A. Saden, State Trial Referee of the Superior Court at Bridgeport dated September 9, 1985, which, among other things, provided that the defendant, Ronald Labow, was to pay the sum of $4,500.00 per week to plaintiff, as alimony, and the sum of $200.00 per week for the support of each minor child until such child attained the age of 18.

Submitted as additional evidence subsequent to the hearing was a photocopy of a handwritten receipt allegedly signed by Myrna Labow on August 6, 1987 (***see***, Petitioners' Exhibit "14"). The receipt stated that she received four checks, drawn on the account of Neuberger & Berman, as follows:

Check No.	Amount
6701	$458,210.20
6702	80,940.00
6703	58,242.07
6704	118,958.94

The receipt described the allocation of the checks as follows:

(a) Check No. 6701 ($458,210.20) for order dated July 20, 1987;

(b) Check No. 6702 ($80,940.00) for alimony arrears and child support April 15, 1987 to August 8, 1987;

(c) Check No. 6703 ($58,242.07) for January 23, 1987 judgment; and

(d) Check No. 6704 ($118,958.94) for amounts before Referee Colgan, May 29, 1987 order.

The report of Florence Belsky, Special Referee, dated September 5, 1990 (***see***, Petitioners' Exhibit "15") set forth a list of court orders, judgments and decisions involving petitioner Ronald Labow and his ex-wife, Myrna Labow. This list indicated that, in 1986, Ronald Labow paid $139,633.15 on February 21, 1986 and paid $112,504.86 (including penalties of $52,250.00) on December 8, 1986. For 1987, the report stated that Ronald Labow made payments in the amount of $730,000.00 on August 5, 1987 and made a payment of $14,000.00 on August 27, 1987.

Petitioners' Exhibit "16", an order of the Supreme Court, New York County, reversed that portion of a November 6, 1986 order which directed Ronald Labow to pay Myrna Labow the sum of $52,250.00 in penalties for not having timely paid his support obligations. The covering letter submitted by petitioners' representative, accompanying Exhibits "8" through "16", states that the amount previously paid as penalty of $52,250.00 was applied to alimony arrears; however, there is no additional evidence to support that statement.

In support of petitioners' contention that they incurred a loss in the amount of $246,262.00 for 1986, they submitted Ronald Labow's brief in the court case (United States Court of Appeals for the Second Circuit) of ***Competex, S.A., plaintiff-appellee v. Ronald Labow, defendant-appellant***. From petitioners' brief in the present matter and in the brief filed in the

aforementioned case, the underlying circumstances surrounding this loss, according to petitioners, can be summarized as follows:

(a) As a result of commodity trading with an English broker on the London Metal Exchange, petitioner Ronald Labow suffered a loss, in 1978, of 39,852.92 pounds which was owed to the British brokerage firm, Competex, S.A. (this statement was derived solely from allegations contained in petitioners' brief). Labow disagreed that the amount was due so, in 1991, Competex sued Labow. Competex obtained a judgment of 187,929.82 pounds (which included interest and costs).

(b) In an attempt to enforce the judgment, Competex commenced an action in U.S. District Court to recover the amount due under the English judgment. A trial was held in October 1983 and the validity of the English judgment was upheld. The court also held that the judgment was to be converted to United States dollars at the prevailing exchange rate on March 16, 1981 (1 pound = $2.20), the date on which the English judgment was entered. Therefore, the corresponding United States dollar amount of the English judgment was $413,445.60. To that amount was added $103,406.70 (interest to February 4, 1984) and a U.S. fee award of $66,349.48, resulting in a total U.S. judgment of $583,201.78 which was entered on February 4, 1984.

(c) On December 10, 1984, Mr. Labow paid the entire English judgment, in pounds, and the entire U.S. fee award, in U.S. dollars, in both cases plus interest (Mr. Labow paid a total of 226,448.13 pounds and $71,408.68). Competex then attempted to recover the balance of the U.S. judgment. On May 24, 1985, it was held that Mr. Labow's obligation could be satisfied only in dollars. The U.S. District Court determined that, as of December 10, 1984, the U.S. judgment was equal to $627,780.77, against which a credit of $391,546.10 (for the December 10, 1984 payment) was allowed. A balance of $236,234.67 was, therefore, still due and owing. Mr. Labow appealed this ruling to the U.S. Court of Appeals which held that he was liable for the additional amount of the judgment in U.S. dollars.

(d) Petitioners submitted the affidavit of Vincent T. Cavallo, a general partner of Neuberger & Berman (***see***, Petitioners' Exhibit "5"), which stated that, on May 5, 1986, at the request of Ronald Labow, Mr. Cavallo caused Neuberger & Berman to issue a check in the amount of $246,261.54 to Orens, Elsen & Lupert, attorneys for Competex, S.A. (a copy of the check was attached to the affidavit). In addition, Mr. Cavallo stated that, on the same date (May 5, 1986), he required Ronald Labow to sign a promissory note in the amount of $246,261.54, plus interest at the rate of 10% per annum, in favor of Neuberger & Berman (a copy was attached to the affidavit). Finally, the affidavit stated that, on May 22, 1986 and May 29, 1986, Ronald Labow repaid the promissory note in full, with interest, by endorsing payroll checks (with taxes withheld) to Neuberger & Berman and by a personal check (in the amount of $41,000.00) from Arthur Labow, petitioner Ronald Labow's brother (***see***, Petitioners' Exhibit "6").

OPINION

The issues of domicile and residency were analyzed by the Administrative Law Judge and he determined that petitioners were domiciliaries and statutory residents of the City of New York. He found petitioners to be domiciliaries within the definition set forth in section 11-1705(b)(1) of the Administrative Code of the City of New York and the applicable section of the regulations at 20 NYCRR 105.20(d), made applicable to New York City domicile matters by 20 NYCRR 290.2. The Administrative Law Judge found that there was no evidence in the record of petitioners' intent to abandon their New York City domicile and acquire a new one in Westchester County. Further, the Administrative Law Judge said that petitioners did not appear or testify at hearing, furnish any affidavits supporting their claim, or produce adequate documentary evidence or testimony of anyone familiar with them.

The Administrative Law Judge also rejected petitioners' claim that they were not statutory residents. Petitioners conceded that they spent in excess of 183 days in the City of New York during the years in issue and owned an apartment in the City as well, even though they stated that they did not maintain living quarters in New York City on their tax returns for the years in issue.

The Administrative Law Judge determined that there was no evidence in the record to indicate that the apartment was anything other than a dwelling place suitable for full-time occupancy by petitioners and their family or any other persons. The Administrative Law Judge found that the fact that petitioners removed their furniture did not change its nature as a "permanent place of abode." Further, there was no evidence in the record which proved that petitioners did not or could not have lived in the apartment during the years 1986 and 1987.

Petitioners argue that the circumstances clearly indicate their intent to change their domicile. They point to Mr. Labow's answer to the question posed by the auditor as to their domicile that he intended to change their domicile, that they moved to enroll their daughter in a private school and that Mrs. Labow had abandoned her business operated out of the New York apartment to devote more time to the care of her children. Although they conceded not retaining all requested records, petitioners did produce some utility bills, bank statements, drivers' licenses, credit card receipts and a letter from the school.

As stated above, the Administrative Law Judge determined that petitioners' evidence did not prove that they intended to abandon their New York City domicile and acquire a new one in Westchester County. He found no evidence regarding the Katonah residence which demonstrated their actual dates of residence there.

We affirm the determination of the Administrative Law Judge on this issue. We find that the Administrative Law Judge correctly and fully addressed these issues and we affirm for the reasons stated in the determination.

In the alternative, the Administrative Law Judge found that petitioners were residents of New York City for the years in issue pursuant to Administrative Code of the City of New York § 11-1705(b)(1)(B). Since petitioner Ronald Labow concededly spent more than 183 days in the City of New York during each of the years in issue, the only issue was whether petitioners maintained a permanent place of abode in the City. The Administrative Law Judge relied on the regulation at 20 NYCRR former 102.2(e)(1), defining "permanent place of abode," in coming to his conclusion that petitioners' apartment at 1725 York Avenue was a dwelling place suitable for

full-time occupancy by petitioners, regardless of whether they removed most of their furniture. Without evidence that petitioners did not or could not have resided in the apartment during the years in issue, the apartment was properly determined to be a permanent place of abode within the meaning of the statute and regulations.

Petitioners argue that Mr. Labow did indeed spend more than 183 days in New York City during the years in issue, but they did not maintain a permanent place of abode in New York City. Petitioners cite ***Matter of Evans*** (Tax Appeals Tribunal, June 18, 1992, ***confirmed Matter of Evans v. Tax Appeals Tribunal***, 199 AD2d 840, 606 NYS2d 404) in support of their position. However, the Administrative Law Judge concluded that petitioners maintained a permanent place of abode in New York City by continuing their living arrangements in that particular dwelling place (***Matter of Evans***, ***supra***), a conclusion with which we are in agreement. The cooperative apartment in this matter was never abandoned by petitioners as their permanent place of abode and, as the Administrative Law Judge succinctly noted:

> "the apartment . . . was . . . a dwelling place suitable for full-time occupation by these . . . persons. The mere fact that petitioners may have chosen to remove most or all of their furniture from this apartment during 1986 and 1987 (and that fact has not been established) does not cause it to lose its status as a 'permanent place of abode.' Moreover, as was the case with the issue of domicile, this record does not contain any testimony or other evidence by which petitioners could sustain their burden of proving that they did not (or could not) reside in the apartment during 1986 and 1987" (Determination, conclusion of law "F").

We affirm the determination of the Administrative Law Judge and find that he correctly and fully addressed this alternative issue in the determination.

A critical factor in the determination of the issue of domicile and residency was petitioners' failure to provide adequate or credible substantiation of their change of domicile or residency. The record reveals numerous requests for documentation which were not answered by petitioners and, as the Administrative Law Judge accurately indicated, they neither submitted documentation nor provided testimony of their intent to change their domicile. Intent is a crucial element in domicile cases and petitioners did not sustain their burden of proving that they intended to abandon their New York City domicile and assume a new one in Westchester County (***Matter of***

Bourne's Estate, 181 Misc 238, 41 NYS2d 336, ***affd*** 267 App Div 876, 47 NYS2d 134, ***affd*** 293 NY 785; ***Matter of Bodfish v. Gallman***, 50 AD2d 457, 378 NYS2d 138).

Although petitioners argued that they filed nonresident income tax returns which, in their minds, affirmatively stated their intention to move permanently to another jurisdiction, it still remains that they offered no credible evidence which demonstrated an intent to permanently change their domicile to Katonah, New York. Many of the facts and characterizations on which petitioners rely were contained in unsworn statements of their representative in his brief and not in affidavits or sworn testimony. The Administrative Law Judge had very little evidence before him which supported petitioners' position on the issues of residency and domicile, and, accordingly, the Administrative Law Judge determined the issues consistent therewith. We disagree with petitioners' belief that their appearance at a hearing, where they could have testified under oath before the trier of fact, would not have served any useful purpose, especially in circumstances where the documentation was so sparse and incomplete. An Administrative Law Judge has great discretion in assigning weight and credibility to the evidence before him, including sworn testimony (***Matter of Shaw***, Tax Appeals Tribunal, November 12, 1992, ***confirmed Matter of Shaw v. State of New York Tax Appeals Tribunal***, 203 AD2d 720, 610 NYS2d 971, ***lv denied*** 84 NY2d 803, 617 NYS2d 137; ***Matter of Auriemma***, Tax Appeals Tribunal, September 17, 1992).

Next, the parties argued the propriety of the Administrative Law Judge's determination regarding the treatment of the alimony deduction taken by petitioners on their returns. The Administrative Law Judge discussed the provisions of Internal Revenue Code ("IRC") § 215(a), which allowed a deduction for alimony paid during the individual's taxable year, and the provisions of IRC § 71(b), which pertained to separation agreements executed prior to January 1, 1985 and provided that payments to support minor children were not deductible, as specified in the separation agreement. The judgment of divorce controlling this matter, dated August 28, 1978, made no specific provisions for the amount of alimony and child support to be paid, but was modified by an agreement dated September 9, 1985 which did allocate specific amounts to

alimony and child support. The Administrative Law Judge examined the ages of the children and the amount of support payable to them, the specific payments as set forth in the Report of the Special Referee, Florence Belsky, dated September 5, 1990, the payment record set forth in the affidavit of James Kaufman, Esq., and the record of payments acknowledged as received by Myrna Labow to arrive at a total amount of alimony paid by petitioner Ronald Labow in the years in issue. The Administrative Law Judge refused to allow a deduction for a penalty assessed by the Court in the sum of $52,654.86 because there was no evidence that Mr. Labow had been granted a credit towards alimony by the Court. Further, for the year 1987, the payment of real estate taxes and interest thereon was disallowed by the Administrative Law Judge because the record did not indicate who owned the property on which the tax was paid, and Temp Treas Reg § 1.71-1T (Q/A-6) required that the payments be for the maintenance (including real estate taxes) of property owned by the payor and used by the wife.

Petitioners argue that the Administrative Law Judge's refusal to allow the $52,250.00 in penalty as alimony was in error given the Kaufman affidavit, the Appellate Division decision (***Labow v. Labow***, 133 AD2d 564, 519 NYS2d 652) and the report by the Referee. This is the same argument made to the Administrative Law Judge and is not supported by the record. There remains no proof that the payment of penalty was credited to alimony in the tax year 1986. Further, petitioners argue that the payment of real estate taxes in the sum of $95,655.00, plus the interest allowed thereon, should have been allowed as a deduction pursuant to the terms of Temp Treas Reg § 1.71-1T (Q/A-6) because that regulation provides that a payment received "on behalf of a spouse" may qualify as alimony if the payment is pursuant to the terms of a divorce or separation agreement. Petitioners argue that the payment of taxes in the sum of $95,655.00 was for the Connecticut property not the New York property, but there is nothing in the record to document this assertion. It is curious that petitioners only provided five pages of the September 9, 1985 decision of the Connecticut Superior Court, which pages did not include the salient provisions regarding this substantial payment. Additionally, petitioners allege that Myrna Labow owned the property, but submitted no proof of this fact. The Court's order only refers to her

ownership of a one-half interest in the Weston and Fairfield properties without any further elaboration. Without more on these critical facts, petitioners cannot be said to have sustained their burden of proof. Since ownership of both the Connecticut and New York properties was not established in the record, the Administrative Law Judge was correct in his conclusion disallowing the real estate taxes paid.

The Division, which did not file an exception in this matter, raises for the first time in its brief in opposition that the Administrative Law Judge erroneously allowed any alimony deduction because part of the payment was interest. However, there is no basis in the record for such a conclusion. Although the Division points to Referee Belsky's reference to interest payments made by petitioner Ronald Labow, there is no specific reference to which payments contained such interest and there is no longer an opportunity for the Division or petitioners to submit copies of the judgment and orders which would have resolved this issue now raised by the Division (***Matter of Sandrich, Inc.***, Tax Appeals Tribunal, April 15, 1993). The issue raised by the Division is factual in nature and was not addressed at the hearing and cannot be raised here in a brief in opposition (***Matter of Ragozin***, Tax Appeals Tribunal, July 22, 1993; ***Matter of Clark***, Tax Appeals Tribunal, September 14, 1992). Therefore, the Division's argument is rejected.

Petitioners argue that the Administrative Law Judge erred in refusing to allow the foreign exchange loss on their 1986 tax return. The Administrative Law Judge found that, given the evidence presented, there was no way to determine whether petitioners incurred a loss in a trade or business, by theft or casualty or in a transaction entered into for profit, as required by IRC § 165. Additionally, the Administrative Law Judge found that there was no evidence that Mr. Labow was not reimbursed, by insurance or otherwise, for the amount paid.

In ***Competex, S.A. v. Labow*** (783 F2d 333), the United States Court of Appeals for the Second Circuit set forth the background of the transaction leading to the currency exchange loss. It stated that Mr. Labow had lost a substantial sum of money through speculation in copper on the London Metals Exchange. His broker, Competex, a Swiss corporation, satisfied these debts and then sued Mr. Labow for breach of contract in an English court and obtained a default

judgment for a sum certain in pounds sterling. The central issue in the Court of Appeals case was the date on which to convert a foreign currency debt into dollars. For the purposes of this decision, the issue is whether the loss incurred by Mr. Labow on the currency exchange was deductible. It is found that it was not deductible.

Petitioners argue that the loss incurred on the initial transaction in the London Metals Exchange and the loss incurred on the currency exchange were two separate taxable events (***National-Standard Co. v. Commissioner***, 80 TC 551, ***affd*** 749 F2d 369, 84-2 USTC ¶ 10,001). The Court in ***National-Standard*** held that the loss incurred by the company was ordinary loss because it was incurred on the discharge of indebtedness which did not constitute a sale or exchange under IRC § 1222, distinguishing it from a capital loss. In addition, it has been held that transactions in a foreign currency which fluctuates in value with respect to the dollar, have long been held to result in taxable gains and deductible losses (***National-Standard Co. v. Commissioner***, ***supra***), and that where the United States dollar value of foreign currency borrowed by a taxpayer fluctuates between the time of borrowing and the time of repayment, a profit or loss may be realized by the taxpayer (***Gillin v. United States***, 191 Ct Cl 172, 423 F2d 309). From the facts established in the ***Competex*** case, it is clear that Mr. Labow incurred an ordinary loss in 1986 on the currency exchange.

However, in order for Mr. Labow to claim the ordinary loss, he must still satisfy the requirements of IRC § 165, which require that the loss be incurred by an individual if it is not compensated by insurance or otherwise and only if it can be categorized as (a) a business loss, (b) a profit transaction loss or (c) a casualty or theft loss. The evidence in the record does not establish whether the loss was a business loss or a casualty or theft loss, even though Mr. Labow characterized the loss on his 1986 Federal and New York State income tax returns as commissions or expenses paid in connection with taxpayer's trade or business. No connection was made or evidence submitted to substantiate a link between Mr. Labow's business or occupation and the speculation on the London Metals Exchange or the loss incurred on the currency exchange. The only remaining question is whether it was a profit transaction loss.

Notwithstanding the discussion above with respect to the distinction between the loss incurred on the foreign currency exchange and the loss incurred on the London Metals Exchange, the courts in those cases were interested in whether the loss incurred was on the sale or exchange of a capital asset or an ordinary loss, finding that the latter resulted from the currency exchanges.

In the case of profit transaction losses, the profit motive must be the primary motive and the taxpayer must show a real intent to enter into a transaction for profit to qualify for a loss deduction. If a transaction has no economic substance but is entered into to achieve tax benefits only, a loss deduction is not allowed (***James v. Commissioner***, 899 F2d 905, 90-1 USTC ¶ 50,185). The paucity of evidence offered with respect to the transactions of Mr. Labow on the London Metals Exchange makes it impossible to determine if there was a profit motive, let alone if it was the primary motive. Petitioners' reliance on the dictionary definition of "speculation" for support of a profit motive is not dispositive. In fact, losses generated by trading in options on the London Metals Exchange have been found to be not deductible by taxpayers (***see***, ***Yosha v. Commissioner***, 861 F2d 494, 88-2 USTC ¶ 9589, ***affg Glass v. Commissioner***, 87 TC 1087; ***Keats v. United States***, 695 F Supp 353, 87-2 USTC ¶ 9654, ***affd*** 865 F2d 86, 89-1 USTC ¶ 9135). Without proof of the precise nature of these transactions, not apparent from the background provided in the ***Competex*** case in the Court of Appeals or in the briefs submitted herein, it is impossible to determine whether the loss meets the requirements of IRC § 165 for this individual taxpayer. Further, although petitioners' representative argues in his brief that Mr. Labow received no compensation for his loss, there is absolutely no proof in the record to support this assertion. Petitioners' brief raises the specter of hedging, but offers no evidence that Mr. Labow did not hedge or otherwise insure his currency transaction. It is held that the Administrative Law Judge properly denied the deduction taken therefor.

The Administrative Law Judge did not dispose of the issue of whether the loan by Neuberger & Berman to Mr. Labow was properly deemed additional compensation by the Division. Since the record contains the requisite facts for resolution of this issue and it was briefed by both parties, we will decide the issue herein.

Petitioners submitted documentation at hearing in support of their position that the entire amount of an advance to Mr. Labow by Neuberger & Berman was repaid. Petitioners submitted the affidavit of Vince Cavallo, managing partner of the firm, who stated that, on May 5, 1986, he caused the firm to issue a check to the attorneys for Competex in the amount of $246,261.54 and then required Mr. Labow to sign a promissory note on May 5, 1986 in the same amount, plus ten percent interest per annum, in favor of Neuberger & Berman. Mr. Cavallo stated that Mr. Labow repaid the note in full by May 29, 1986 by endorsing payroll checks to the firm (with taxes withheld) and by personal check. Mr. Cavallo submitted copies of the check issued by the firm, the promissory note, a letter from the firm to Ronald Labow confirming his request for the advance and the terms of the agreement for the promissory note and the payroll record and ledger. Mr. Labow also submitted a copy of a check from his brother, Arthur Labow, payable to the firm in the sum of $41,000.00, received by the firm on May 29, 1986 and applied towards the repayment of the note. Mr. Labow has demonstrated that the amount of money paid by Neuberger & Berman to Orans, Elsen & Lupert, attorneys for Competex, was a documented loan which was repaid, with interest, by him and should not be considered additional income.

Given this documentation, it is determined that the Division improperly categorized the payment made on behalf of Mr. Labow as additional compensation and that portion of the assessment should be modified to delete the addition of $246,262.00 to income for the tax year 1986.

With respect to the penalties imposed by the Division, it should be noted at the outset that the Division has conceded to the cancellation of those penalties assessed pursuant to Tax Law § 685(i) and the Notice of Deficiency should be modified accordingly.

With regard to the penalties assessed pursuant to Tax Law § 685(b)(1) and (p), we find that the Administrative Law Judge adequately and completely addressed the issue when raised below. No new or additional arguments have been raised on appeal and we agree that petitioners have not established reasonable cause for the abatement of these penalties. The penalty for substantial

understatement of liability assessed pursuant to Tax Law § 685(p) will only be applicable to the extent warranted after the modifications directed by this decision.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Ronald and Chris Labow is granted to the extent that the Notice of Deficiency, dated September 25, 1991, should be modified to delete from income additional compensation of $246,262.00 for the year 1986, that penalties assessed pursuant to Tax Law § 685(i) are cancelled and penalties assessed under Tax Law § 685(p) are to be modified consistent with the modifications made herein, but in all other respects is denied;

2. The determination of the Administrative Law Judge is affirmed, except as modified in accordance with paragraph "1" above;

3. The petition of Ronald and Chris Labow is granted to the extent set forth herein, but in all other respects is denied; and

4. The Notice of Deficiency, dated September 25, 1991, as modified in accordance with paragraph "1" above, is in all other respects sustained.

DATED: Troy, New York
March 20, 1997

/s/Donald C. DeWitt
Donald C. DeWitt
President

/s/Carroll R. Jenkins
Carroll R. Jenkins
Commissioner

/s/Joseph W. Pinto, Jr.
Joseph W. Pinto, Jr.
Commissioner