

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
JAMES AND JUDITH BOYLE	:	DECISION
for Redetermination of a Deficiency or for	:	DTA No. 813970
Refund of Personal Income Tax under Article 22	:	
of the Tax Law for the Year 1975.	:	

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on December 12, 1996 with respect to the petition of James and Judith Boyle, 15 Brayton Road, Scarsdale, New York 10583-1419. Petitioners appeared by Janow & Meyer, LLC (Hugh Janow, Esq., of counsel). The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Michael J. Glannon, Esq., of counsel).

The Division of Taxation filed a brief in support of its exception. Petitioners filed a brief in opposition and the Division of Taxation filed a brief in reply. The Division of Taxation's request for oral argument was withdrawn.

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

ISSUE

Whether the Administrative Law Judge properly applied the doctrine of equitable recoupment such that petitioners are able to offset a 1975 State tax deficiency by a 1976 overpayment of tax where both the deficiency and overpayment are based upon Federal changes to petitioners' reported taxes in 1975 and 1976 and where the statute of limitations expired with respect to the 1976 tax refund under Tax Law § 687(c).

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for finding of fact "4" which has been modified. The Administrative Law Judge's findings of fact and the modified finding of fact are set forth below.

Petitioners and the Division of Taxation ("Division") signed on April 26, 1996 and April 29, 1996, respectively, a Joint Stipulation as to the facts in this case. These facts have been incorporated into the following findings of fact. Petitioners have also submitted proposed findings of facts which have been incorporated into the following findings of fact unless otherwise indicated.

The Internal Revenue Service ("IRS") sent to petitioners a letter, dated August 31, 1983, informing them of adjustments to their 1975, 1976 and 1977 income tax returns with respect to their tax shelter activity. Attached to the letter was the IRS examination report (Forms 4549-A, 886-A, 1040, 4625, 3468, and 870) indicating a disallowance of an ordinary loss of \$135,170.00 in 1975 with respect to silver transactions (calls and futures) placed on the London Metal Exchange. In its explanation of the disallowance, the IRS stated the following in Form 886-A:

"Based on an examination of the 7512 and 7612 silver transactions (calls & futures) placed on the London Metal Exchanged [sic] - the ordinary loss generated has been disallowed per Rev. Ruling 80-324, and 77-185; and Reg. Sec. 1.165-1(b); and step-transaction theory; and substance over form principles, and economic reality principles."

The report also set forth an adjustment for 1976 of \$56,094.00 with respect to silver transactions of options and futures indicating that petitioners should not have reported this amount as income. The IRS explained this adjustment as follows:

"Based on the examination of all silver transactions for 7512 & 7612 of options and futures, which have been determined to lack economic reality, the 1976 silver transactions have been eliminated per Rev. Rulings 77-185, 80-324; Reg. Sec 1.165-1(b)."

On August 10, 1984, petitioners signed a settlement agreement (Form 906) with the Internal Revenue Service resolving all Federal income tax liabilities of petitioners for the years 1975 and 1976 with respect to the "gains and losses from the purchase and sale of commodity options and futures contracts through Merrill Lynch" The settlement agreement was

signed by an authorized representative of the Commissioner of Internal Revenue on September 25, 1984.

We modify finding of fact "4" of the Administrative Law Judge's determination to read as follows:

In the settlement agreement, it was stated that petitioners reported in their 1975 Federal tax return a \$135,170.00 ordinary loss and reported in their 1976 Federal tax return a \$591,097.00 long-term gain and \$478,909.00 short-term loss with respect to the purchase and sale of commodity options and futures contracts completed through Merrill Lynch. The agreement recognized that an issue existed between petitioners and the IRS concerning whether or not the gain and losses from the above-described transactions may be recognized for Federal income tax purposes and that petitioners agreed to a proposed tax deficiency for 1975 and an overassessment of tax for 1976. Based on these gains and losses, petitioners agreed to a proposed tax deficiency for 1975 and an overassessment of tax for 1976. According to the agreement, petitioners agreed "that the overassessment for 1976 contained in Form 870 . . . will be an offset to any amounts payable as an overassessment for the year 1975 which results from a claim for refund or credit filed for the year 1976 attributable to the aforementioned commodity transaction." Attached to the Joint Stipulation by the parties was Form 870-AD which indicated that the amount of the 1975 Federal income tax deficiency was \$68,923.00 and the amount of the 1976 and 1977 Federal income tax overassessment was \$10,458.00 and \$57.00, respectively.¹

Petitioners did not timely file within 90 days reports of the Federal audit changes (Form IT-115) that resulted from the settlement agreement. Tax Law § 659 requires the taxpayer to report any changes or corrections by the United States Internal Revenue Service to the taxpayer's Federal income tax within 90 days of the final determination of such change or correction.

The Division issued to petitioners a Notice of Additional Tax Due (assessment number L-005332770), dated March 2, 1992, stating that based on the Federal audit changes, petitioners owed for the 1975 tax year an additional \$20,083.71, plus interest in the amount of \$51,061.65,

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We modified this finding of fact by deleting the first sentence which erroneously stated that the intent of the settlement was to resolve a dispute as to whether the gains and losses from the purchase and sale of commodity options and futures contracts reported by petitioners on their Federal tax returns may be recognized for Federal income tax purposes. The settlement agreement recognized the issue in this case involved the reported gains and losses by petitioners on their Federal tax returns, however, the settlement did not address the merits of that issue, but rather, the parties agreed to settle the case rather than litigate the issue. We added the second sentence of this fact to clarify the language of the settlement agreement.

for the total amount of \$71,145.36. The Division calculated the 1975 deficiency without providing offsets, as was permitted in the settlement agreement, for the 1976 overassessment agreed to between petitioners and the IRS in the settlement agreement.

The Division issued to petitioners a Notice of Assessment Resolution, dated May 23, 1994, with respect to assessment number L-005332770. In that notice, the Division stated that the balance of \$12,623.61 must be paid in full after which time petitioners could file a claim for refund. In calculating the balance of \$12,623.61, the Division noted it applied payments and credits in the amount of \$62,012.65 to the amount due of \$20,083.71, plus \$54,251.32 in interest and \$301.23 in penalty.

Petitioners filed a Report of Federal Changes (IT-115), dated April 15, 1994, for the tax year 1976 indicating a refund due of \$3,387.00. Petitioners also filed a Report of Federal Changes (IT-115), dated June 15, 1994, for the tax year 1975 requesting a refund of \$13,156.00. They calculated the refund by taking into account their payments of \$62,013.00 and \$12,623.00 on July 2, 1992 and June 15, 1994, respectively, and a "discounted 1976 refund" of \$3,122.00. They subtracted the total amount of the payments plus the discounted 1976 refund from the sum of \$20,066.00 (the additional tax due plus interest) and interest in the amount of \$44,536.00 to arrive at the \$13,156.00 refund.

The Division issued a Notice of Disallowance, dated July 26, 1994, denying the refund claim for \$13,156.00 on the ground that the claim was not filed within two years and 90 days of the final Federal determination. The Division noted that the refund claim was received on July 15, 1994 and the final Federal determination was dated September 25, 1984. On the top of the notice the tax year listed was 1976.

After a conciliation conference on March 10, 1995, the conciliation conferee issued to petitioner James Boyle an order, dated April 28, 1995, sustaining the statutory notice. In the caption of the order, the year specified was 1975 and there was the notation "Notice of Disallowance Dated July 26, 1994".

Petitioners filed a petition, dated June 12, 1995, with respect to the tax year 1975 challenging notice/assessment number L-005332770 and stating that the amount contested was \$13,156.00. In the petition, petitioners alleged that on June 10, 1994, petitioners paid the disputed amount and then filed a claim for refund which was disallowed by notice dated July 26, 1994. They also alleged that they requested a Conciliation Conference protesting the Notice of Disallowance and that by Conciliation Order, dated April 28, 1995, the conferee sustained the Notice of Disallowance. Petitioners argued that the Division failed to compute the 1975 State tax deficiency in a manner consistent with the computation of the 1975 deficiency as set forth in the Federal Closing Agreement; that the Division had not audited petitioners' returns and instead based the deficiency on the Federal audit; and that the Division's refusal to follow the terms of the Closing Agreement, which reduced the 1975 deficiency by the 1976 overassessment, constituted an attempt to collect the same tax twice.

The Division filed an answer, dated August 21, 1995, admitting that petitioners paid the 1975 deficiency on June 10, 1994 and then filed a claim for refund which was disallowed by the July 26, 1994 Notice of Disallowance. The Division also admitted that the Conciliation Order, dated April 28, 1995, sustained the Notice of Disallowance. In the answer, the Division further stated that it correctly and properly concluded that petitioners had additional taxable income for 1975 based on Federal audit changes to petitioners' 1975 income tax return which were not timely reported to New York State.

In a letter dated February 13, 1996, the Administrative Law Judge ("ALJ") informed the parties of the due dates for the submission of all briefs and evidentiary documents in the case. The ALJ noted that the record would be closed as of April 25, 1996 and no further evidence would be admitted after that date.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

Initially, the Administrative Law Judge granted the Division's request to exclude from the record four documents which petitioners submitted with their brief after the close of the hearing based upon the Tax Appeals Tribunal's long-standing policy of not allowing the

submission of evidence after the close of the record (*see, Matter of Schoonover*, Tax Appeals Tribunal, August 15, 1991).

Turning to the merits of the case, the Administrative Law Judge noted that Tax Law § 659 requires a taxpayer to report any changes or corrections made by the IRS in Federal taxable income to the Division within 90 days after the final determination of such change or correction. The Administrative Law Judge observed that there is no dispute that petitioners failed to file a report of the Federal changes with the Division within 90 days and did not file a claim for a credit or refund with respect to the Federal changes within the 2 years and 90 days required under Tax Law § 687(c). However, the Administrative Law Judge determined that the doctrine of equitable recoupment applied to the facts presented by petitioners and, thus, petitioners were able to offset the 1975 deficiency by the amount of the 1976 overpayment which results from incorporating the findings of the IRS audit of petitioners' 1976 Federal return as finally set forth in the settlement agreement.

ARGUMENTS ON EXCEPTION

The Division argues that petitioners' claim for refund or credit for an overpayment for 1976 is barred by the statute of limitations contained in Tax Law § 687(c). Also, the Division states that the doctrine of equitable recoupment does not apply in this case since the 1976 overpayment year is different than the deficiency year which is 1975. Furthermore, the Division asserts that there is no double taxation of the same income. Lastly, the Division argues that petitioners have not proven that they are entitled to the refund claimed.

In opposition, petitioners argue that the Supreme Court in *Bull v. United States* (295 US 247) established the proposition that the same transaction may not twice be subject to taxation using inconsistent legal theories. Petitioners assert that the Administrative Law Judge properly applied this principle in reaching her determination that petitioner could offset deficiencies from the loss side of a straddle transaction with overpayments attributable to gains from the same straddle transaction.

OPINION

We reverse the determination of the Administrative Law Judge on the issue of equitable recoupment.

As stated by the Administrative Law Judge, in *Matter of Turbodyne Corp.* (Tax Appeals Tribunal, July 3, 1996, *confirmed Matter of Turbodyne Corp. v. Tax Appeals Tribunal*, ___ AD2d ___ [Dec. 31, 1997]), we stated that:

"[t]he doctrine of equitable recoupment allows a taxpayer against whom a deficiency is asserted to offset against that deficiency overpayments which are time barred for claiming a refund and (1) involve the same type of tax as the deficiency; (2) were paid during the period that comprises the deficiency; and (3) involve the same transaction as is the subject of the deficiency (*National Cash Register Co. v. Joseph*, 299 NY 200)."

In her determination, the Administrative Law Judge found that the facts of this case satisfied all three criteria as stated in *Turbodyne*. We disagree.

The Administrative Law Judge determined that petitioners established that the deficiency and offset involved the same straddle transaction. As set forth by the Administrative Law Judge, we discussed the concept of straddle transactions in our decision in *Matter of Hemmers* (Tax Appeals Tribunal, March 1, 1990). We stated, in pertinent part, that:

"[a] 'straddle' is a combination of a sale contract and a purchase contract undertaken at the same time [T]he sale and purchase would differ in their delivery dates so that a straddle would typically result in a present agreement to purchase (or sell) a commodity at a future date and to sell (or purchase) the same commodity at a later date. As the prices of the commodity and of the contracts change, they will, of course, cause a gain and loss in any contract position . . . [and] any gain or loss in one of the positions will be offset by an opposite change, hopefully equal, in the other position."

Furthermore, prior to 1981, the IRS had claimed that the sale of one leg of a straddle was not a completed transaction and a taxpayer was prohibited from deducting any losses resulting from such a sale until he disposed of the other leg of the straddle as well (*Deweese v. Commissioner*, 870 F2d 21, 28). Thus, if the deficiency and offset at issue were, in fact, the result of a straddle, such deficiency and offset would be considered to emanate from the same transaction.

The basis for the Administrative Law Judge concluding that the deficiency and offset involved the same straddle transaction was a comparison of the terms of the settlement agreement and the IRS examination report accompanying the August 31, 1983 letter to petitioners informing them of their adjustments to their 1975, 1976 and 1977 income tax returns. She found that these two documents indicated that the 1975 deficiency and the 1976 offset involved the same straddle transaction with respect to silver options and futures. We find that the Administrative Law Judge improperly relied on the IRS examination report. Petitioners did not agree with the IRS examination report and, therefore, did not sign it. Instead, petitioners sought to pursue the issue further, relying on their income tax returns as originally filed for the years in issue. Subsequently, both petitioners and the IRS entered into a settlement agreement which was not the IRS examination report. It is unknown from the terms of the settlement agreement whether the numbers agreed to by the parties resulted from a straddle transaction since the settlement agreement was silent as to the basis for the calculations other than to state that the amounts reflected a \$135,170.00 ordinary loss reported on their 1975 Federal tax return and a \$591,097.00 long-term gain and a \$478,909.00 short-term loss on their 1976 Federal tax return with respect to the purchase and sale of commodity options and futures contracts completed through Merrill Lynch. From the language contained in the settlement agreement, it appears that the numbers agreed to by the parties resulted from separate transactions that occurred during two separate tax years.

Contrary to the argument of petitioners, the facts contained in the record support the conclusion that the IRS made separate determinations of a tax deficiency for 1975 and of an overassessment of tax for 1976. While the net effect of these two determinations was an overall deficiency for 1975, there can be no confusion that these determinations related to separate tax years. In *National Cash Register Co. v. Joseph (supra)*, the Court of Appeals held that equitable recoupment does not allow one transaction to be set off against the other. Rather, it permits a transaction which is made the subject of the plaintiff's action "to be examined in all its aspects, and judgment to be rendered that does justice in view of the one transaction as a

whole"(*National Cash Register Co. v. Joseph, supra*, at 203). Thus, the Federal tax overpaid as the result of transactions occurring during 1976 was paid during a period different from that comprising the 1975 deficiency. The result is that petitioners are not entitled to equitable recoupment of their 1976 overpayment against their 1975 tax deficiency.

As set forth in the findings of fact, and as conceded by the parties, petitioners failed to timely file within 90 days their settlement agreement reached with the IRS for the years 1975 and 1976 with the Division as required by Tax Law § 659. Tax Law former § 687(c) stated, in pertinent part, that:

"[a] claim for refund of any overpayment of tax attributable to a federal change or correction required to be reported pursuant to section six hundred fifty-nine shall be filed by the taxpayer within two years from the time the notice of such change or correction or such amended return was required to be filed with the tax commission."

Since petitioners failed to file a claim for refund within two years and 90 days, they are barred from any refund of tax for the 1976 tax year.

Petitioners' assertion that they are being taxed twice is without merit. The Division assessed tax for the year 1975 based upon the figures contained in the settlement agreement for the year 1975. Petitioners' failure to timely report to the Division the Federal changes to their income for the years 1975 and 1976 resulted in the forfeiture of their right to claim a refund for 1976.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is granted;
2. The determination of the Administrative Law Judge is reversed with respect to the issue of equitable recoupment, but is otherwise sustained;
3. The petition of James and Judith Boyle is denied; and

4. The Notice of Disallowance dated July 26, 1994 is sustained.

DATED: Troy, New York
February 26, 1998

Donald C. DeWitt
President

Carroll R. Jenkins
Commissioner

Joseph W. Pinto, Jr.
Commissioner