

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

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In the Matter of the Petition	:	
of	:	
<b>MATTHEW J. AND RACHEL A. DOMBER</b>	:	DECISION
	:	DTA NO. 813972
for Redetermination of a Deficiency or for Refund of	:	
New York State and New York City Income Taxes under	:	
Article 22 of the Tax Law and the New York City	:	
Administrative Code for the Years 1989 and 1990.	:	

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The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on March 13, 1997 with respect to the petition of Matthew J. and Rachel A. Domber, P. O. Box 58028, Tierra Verde, Florida 33714. Petitioner appeared by Maurice A. Reichman, Esq. 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 and a reply brief. Petitioner filed a brief in opposition. Oral argument, at the Division of Taxation's request, was heard on February 11, 1998 in New York, New York.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision. Commissioner Pinto took no part in the consideration of this decision.

***ISSUE***

Whether petitioners met their burden of proof to show that their allocation of net long-term capital gain and Internal Revenue Code § 1231 gain from the law partnership of Domber and Ward was properly considered non-New York source income for 1989.

***FINDINGS OF FACT***

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

On November 15, 1993, the Division of Taxation ("Division") issued to petitioners, Matthew J. Domber and Rachel A. Domber, husband and wife, a Notice of Deficiency asserting additional personal income tax due for the years 1989 and 1990 in the aggregate amount of \$26,175.88, plus penalty and interest. The computation section of the notice specifies the amount of tax at issue to consist of \$23,827.65 (State) and \$479.14 (City) for 1989, and \$1,714.39 (State) and \$154.70 (City) for 1990.<sup>1</sup>

A Statement of Personal Income Tax Audit Changes, previously issued to petitioners on September 28, 1993, details the basis for the above-asserted liabilities for each of the subject years. Specifically, this statement provides that "[p]artnership income has been found to be improperly allocated to New York. Audit adjustments are being proposed to pick up the proper allocation of partnership income to New York." The statement reveals that the audit adjustments increased petitioners' New York income by reallocating to New York (as New York source income) the aggregate amounts of \$329,055.00 for 1989 and \$24,828.00 for 1990, as follows:

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<sup>1</sup>Petitioners executed a validated consent extending the period of limitation on assessment such that the Division was entitled to determine petitioners' personal income tax liability for the years 1989 and 1990 at any time on or before April 15, 1994.

1989

Ordinary income allocated to New York.....	\$73,690.00
Rental, interest and dividend income.....	24,322.00
Net long-term capital gain.....	172,666.00
Section 1231 gain.....	58,377.00

1990

Ordinary income allocated to New York.....	\$22,730.00
Interest income allocated to New York.....	1,983.00
Dividend income allocated to New York.....	115.00

For each of the years at issue, petitioners jointly filed New York State (and City) nonresident and part-year resident income tax returns (Forms IT-203). In August 1992, the Division commenced an audit of petitioners' returns for the years 1989 through 1991. The initial focus of the audit was petitioners' claimed status as nonresidents of New York. After reviewing information submitted, the Division accepted that petitioners were domiciliaries of Florida and were not taxable as residents of New York. However, the Division determined that, consistent with the results of a prior audit, petitioner Matthew J. Domber improperly allocated out of New York a portion of his distributive share of items of income and gain from the law partnership of Domber and Ward ("the Firm"). The auditor concluded that petitioner Matthew J. Domber was a general partner in the Firm; that the Firm maintained only one office, which was in New York; that the business of the Firm was centered around housing projects and real estate developments located outside of New York; and that, while all distributions from such real estate partnerships were accounted for as distributions to the Firm, petitioner Matthew J. Domber nonetheless allocated to New York as New York source income (on petitioners' nonresident returns) his distributive share of the Firm's income relating only to legal services performed by the Firm.

Since the Firm did not maintain an office outside of New York and commingled all funds received in one account, the auditor denied petitioners' claimed allocation and instead reallocated to New York all of the distributive items from the Firm received by petitioner Matthew J. Domber.

The additional income set forth above as reallocated to New York (see above) represents the difference between petitioner Matthew J. Domber's distributive share of items from the Firm as set forth on Schedule K-1 ("Partner's Share of Income, Credits, Deductions, Etc.") and the amounts claimed to be allocable to New York on petitioners' New York income tax returns for each of the years at issue as follows:

1989

a) The additional ordinary income amount (\$73,690.00) represents Mr. Domber's distributive share of the Firm's ordinary income from trade or business activities per Schedule K-1 at line 1 (\$109,406.00) less his New York allocated amount of partnership income per Form IT-203 at line 12 (\$35,716.00).

b) The additional rental, interest and dividend income amount (\$24,322.00) represents the total of Mr. Domber's distributive share of the Firm's net income from rental real estate activities (\$19,164.00), portfolio interest (\$12,522.00) and portfolio dividends (\$42.00) per Schedule K-1 at lines 2, 4a and 4b, respectively, less his New York allocated amount of taxable interest income per Form IT-203 at line 2 (\$7,436.00).

c) The additional income described as net long-term capital gain (\$172,666.00) and section 1231 gain (\$58,377.00) represents items reported as such from the Firm per Schedule K-1 at lines 4e and 6, respectively, with no part of such amounts reported as allocable to New York per Form IT-203.

1990

a) The additional ordinary income amount (\$22,730.00) represents Mr. Domber's distributive share of the Firm's ordinary income from trade or business activities per Schedule K-1 at line 1 (\$50,261.00) less his New York allocated amount of partnership income per Form IT-203 at line 12 (\$27,531.00).

b) The additional interest income allocated to New York (\$1,983.00) represents the Firm's portfolio interest per Schedule K-1 at line 4a (\$4,066.00) less his New York allocated amount of taxable interest income per Form IT-203 at line 2 (\$2,083.00).

c) The additional dividend income allocated to New York (\$115.00) represents the Firm's portfolio dividends per Schedule K-1 at line 4b (\$115.00) less his New York allocated dividend income per Form IT-203 at line 3 (\$0.00).

During the years at issue, the Firm maintained an office at 20 Vesey Street, New York, New York. It is conceded that the Firm did not maintain a law office in any other jurisdiction, and there is no claim that either of the two capital partners in the firm, Matthew J. Domber (petitioner herein) or Jacob B. Ward, were licensed to practice law in any jurisdiction other than New York.

The Firm's partnership agreement, dated August 15, 1972, includes the following relevant provisions:

#### Section 1.2 Purpose

The purpose of the firm shall be to engage in the practice of law in the State of New York in accordance with the Code of Professional Responsibility as adopted by the American Bar Association and in accordance with all rules of practice and other regulations adopted by any courts and administrative bodies before which the partners or associates of the firm shall be admitted to practice. The firm may also engage in the acquisition, ownership, development, management and disposition of real estate projects, provided, however, that any partnership interest in such real estate projects shall, if held in the name of a capital partner, be deemed to be held as a nominee for this partnership.

#### Section 1.3 Location

The offices of the firm shall be at 258 Broadway, New York, New York or at such other or additional locations as may be agreed upon by the capital partners.

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### Section 3.2 Drawings

The drawings of the capital partners shall be in such amounts as Domber and Ward shall determine from time to time.

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### Section 4.1 Profits or Losses

The capital partners shall share equally all partnership profits and losses.

Petitioner Matthew J. Domber and his law partner Jacob B. Ward have been involved since the 1970s in developing low and moderate income apartment housing projects. Such projects, as relevant to this proceeding, are all United States Department of Housing and Urban Development ("HUD") assisted developments, and all are located in the states of Pennsylvania and West Virginia.<sup>2</sup> As discussed more fully below, the record does not include documents showing petitioner Matthew J. Domber individually owning an interest in any of the partnerships. However, the record includes Schedules K-1 prepared by a certified public accountant in Pennsylvania and issued on behalf of each of the development project partnerships to Mr. Domber's law partner, Jacob B. Ward. On each of these Schedules K-1, Jacob B. Ward is listed as an individual partner. The names of the development partnerships relevant to this proceeding, and Jacob B. Ward's ownership percentage in each, are as follows:<sup>3</sup>

<u>PARTNERSHIP NAME</u>	<u>OWNERSHIP PERCENTAGE</u>
Evergreen Arbors Associates	2.000%
Fairmont Arbors Associates	1.000%

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<sup>2</sup>Tenant apartment rental payments at each development are augmented with supplemental rent payments from HUD to enable the tenants to pay the market rental for the apartments they occupy.

<sup>3</sup>The development partnerships may, hereinafter, be referred to collectively as the "Arbors" partnerships.

Butler Arbors Associates	5.000%
Franklin Arbors Associates	2.500%
Charleston Arbors Associates	2.000%
Bedford Crawford Associates	1.333%
Jacob Arbors Associates	2.000%
Carmichaels Arbors Associates	2.000%
Weston Arbors Associates	2.000%
Washington Arbors Associates	2.000%
Hulton Arbors Associates	1.333%
Penn Arbors Associates	0.275%
Sykesville Associates	29.70%

In or about 1982, Matthew J. Domber and Jacob B. Ward formed Arbors Management, Inc. ("Arbors Management"), a Pennsylvania corporation, to centrally manage the above-described properties. One-third of the stock of Arbors Management was owned by one Edward J. Quinlan, who described himself as an officer, director and "head of the office" of Arbors Management. The remaining two-thirds of the stock was owned, in equal one-sixth amounts, by George W. McAnallan, Robert McAnallan (both of whom were described as Pennsylvania residents), Matthew J. Domber and Jacob B. Ward. Documents in the record bear out that the McAnallans and Messrs. Domber and Ward have, over the years, participated in joint ventures in the development, construction, ownership and operation of various low and moderate income housing projects located in West Virginia and Pennsylvania.

During the years in issue, the various Arbors partnerships made partnership distributions to Jacob B. Ward which were, in turn, deposited into the operating account of the law firm of Domber and Ward in New York City. It is alleged by petitioners that the Arbors partnership distributions represent the amounts due to both Mr. Domber and Mr. Ward, and that Mr. Ward was receiving such distributions for himself and as trustee for Mr. Domber. Such receipt, allegedly as trustee, was necessary because petitioner Rachel A. Domber was an employee of

HUD which, coupled with her marriage to Mr. Domber, presented conflict of interest circumstances preventing Mr. Domber from holding direct ownership interests in any HUD affiliated projects.

Copies of Arbors partnership agreements, regulatory agreements and power of attorney forms were included in the record as part of the Division's post-hearing submission of documents. These documents bear out that petitioner was an authorized agent (per power of attorney) with full authority to act for and on behalf of the partners with respect to all matters of Arbors partnership business. However, the documents show that only Jacob B. Ward, not petitioner, held an ownership interest (i.e., partner status) in the Arbors partnerships. The record contains no documents substantiating the alleged trust agreement between Mr. Ward and Mr. Domber.

During the years in question, the Firm received fees for services rendered. Such payments included not only legal fees for services rendered for private clients, but also legal fees paid by Arbors Management for services rendered to the various Arbors partnerships. Bills for such services were issued by the Firm to Arbors Management, and checks in payment thereof were drawn on the account of Arbors Management. Such checks were made payable to the law firm of Domber and Ward, as distinguished from Arbors partnership distribution checks which were payable to Jacob B. Ward.

All of the receipts described above, including Arbors distributions, legal fees from Arbors Management, fees from other clients, etc., were deposited into the Firm's one operating account. According to an affidavit of Jacob B. Ward, all fees were deposited in one account for

convenience, primarily because the Firm account was the only account held in common by Messrs. Domber and Ward.

Petitioners maintain that the business of the Arbors projects was conducted outside of New York State by Arbors Management. Petitioners assert that the Firm had no involvement in the management of the Arbors partnerships and that Messrs. Domber and Ward owned their interests in such partnerships in their own right and not through the Firm. In addition, petitioners note that for previous years, the Division conducted an audit of the Firm and of petitioners' personal returns, and concluded that, because the Firm did not maintain an office out of state, the Arbors income distributions received by the Firm represented Firm income from New York activities which was not subject to allocation out of state. In contrast, petitioners argued then, and argue now, that the distributions represent income and gain items generated directly from the real estate activities of the Arbors partnerships. Petitioners assert that in the prior proceedings the auditor excluded direct real estate items (i.e., capital gains, rental income, etc.) from his adjustments, and only included fees (i.e., management fees, legal fees, etc.) received from the out-of-state partnerships as nonallocable New York source law firm income. However, petitioners argue that in the present matter the auditor did not conduct an audit of the law firm but rather simply disallowed the allocation of any items of distribution to Mr. Domber per the Schedule K-1 issued to him by the Firm.

In support of their argument, petitioners submitted Schedules K-1 issued to Jacob B. Ward for the year 1989 by each of the Arbors partnerships, together with a summary sheet listing the various items of distribution on an individual and a total basis (from such Schedules K-1) for each of the partnerships. Comparing this summary sheet to the Schedule K-1 issued to petitioner

Matthew J. Domber by the Firm reveals that exactly one-half of the total Arbors distributions of net long-term capital gain and section 1231 gain is reflected on Mr. Domber's Schedule K-1 from the Firm. In turn, such one-half amount is carried through to the "Federal Amount" column but not to the "New York Amount" column on petitioners' Form IT-203 for 1989. Stated differently, petitioners show an inflow of capital gain and section 1231 gain from Arbors through the Firm and on to Mr. Domber, with such gains treated as not allocable to or taxable by New York (as non-New York source income). The record, however, is not so clear with regard to tracing the other amounts (specifically the items of adjustment for ordinary income and rental, interest and dividend income) from the Arbors Schedules K-1 and summary sheet, to the Domber and Ward Schedule K-1, and on to petitioners' Form IT-203. Such items for 1989 may be presented, for purposes of comparison, as follows:

AS REFLECTED PER ARBORS' K-1's AND SUMMARY SCHEDULE

<u>ITEM</u>	<u>AMOUNT</u>
Ordinary income rental activity	\$ 37,732.00
Portfolio interest	<u>\$ 6,517.00</u>
Ordinary income to be reported	\$ 44,249.00
 Net long-term capital gain	 \$345,333.00
Section 1231 gain	\$116,755.00
Development/management fees	\$ 26,875.00

AS REFLECTED PER DOMBER AND WARD K-1 ISSUED TO MR. DOMBER

<u>ITEM</u>	<u>AMOUNT</u>
Ordinary trade or business income	\$109,406.00
Net income from rental activities	\$ 19,164.00
Portfolio income:	
Interest	\$ 12,522.00
Dividends	\$ 42.00

Net long term capital gain	\$172,666.00
Section 1231 gain	\$ 58,377.00

AS REFLECTED PER PETITIONER'S FORM IT-203

<u>ITEM</u>	<u>AMOUNT</u>
Partnership income alloc. to New York	\$ 35,716.00 <sup>4</sup>
Interest income alloc to New York	\$ 7,436.00

Included with petitioners' post-hearing submission of documents was an affidavit of their accountant (who also testified at hearing), an index listing documents examined on audit, and a one-page printout entitled "Domber and Ward 1989 Income." According to the affidavit, this printout was included as a representative page of Domber and Ward's cash receipts. The printout shows, in columns, receipts for the period January 4, 1989 through June 2, 1989, including, inter alia, management fees/legal fees in the "income" column and Arbors distributions in the "project income" column.<sup>5</sup>

In sum, the main thrust of petitioners' argument is that the returns, as filed, correctly reflect that a portion of the income "run through" the Firm's operating account and reflected as items of distribution to Mr. Domber, was income derived from non-New York sources, specifically from real estate located outside of New York. Petitioners argue that such income

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<sup>4</sup>Income from the Domber and Ward law partnership per Schedule 6 to Form IT-203.

<sup>5</sup>The Division's representative objected to paragraphs "2" through "5" of the affidavit as "incorrect, contradicted by documents in the record, or lacking supporting source documents", and to the affidavit itself since the affiant had testified at hearing. Such objections are overruled and the affidavit is included as part of the record. The posthearing submission of affidavits and documents was anticipated in this matter. Further, with respect to the objections to the specific paragraphs, it is noted that paragraph "2" may contain accurate statements, yet the same are of little value in verifying petitioners' claims since only a partial cash receipts sheet is included. Paragraph "3" merely repeats an allegation made at hearing. Paragraph "4" essentially points toward a conclusion supported independently by other evidence. Paragraph "5" speaks of Federal tax law, a matter of which notice may be taken independently.

was not income from the Firm's business activities and that the Firm itself had no ownership interest in the Arbors partnerships. Petitioners maintain that Messrs. Domber and Ward were, individually, the owners of the out-of-state real estate interests, and that the Firm was simply a convenient conduit by which to receive, distribute and account for distributions from the Arbors partnerships. Thus petitioners argue that the income was correctly allocated out of state because the same represented non-New York source income earned by a nonresident partner from real estate located out of state.

***THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE***

The Administrative Law Judge noted that the issue of the proper allocation of certain distributions from the Arbors partnerships which petitioners received through the Firm had been addressed for prior years in ***Matter of Domber*** (Tax Appeals Tribunal, April 1, 1993, ***confirmed*** ***Matter of Domber v. Tax Appeals Tribunal***, 210 AD2d 529, 619 NYS2d 829, ***lv denied*** 85 NY2d 810, 629 NYS2d 724). In that proceeding, the Appellate Division confirmed the Tribunal's decision that the Arbors partnership interests were owned by the Firm and not directly by petitioners. Further, the Court concluded that petitioners had failed to prove that the distributions at issue therein from Arbors to Jacob B. Ward were anything other than fees. Although derived from out-of-state real estate ventures, such fees were held to constitute business income generated by the Firm's activities in New York and, thus, were properly sourced to New York. The Court also recognized, however, that if the distributive items were rental income and/or sales gains from the out-of-state real estate ventures, as opposed to fees therefrom, such items would be sourced according to the situs of the real property pursuant to 20 NYCRR former 131.16.

In the present proceeding, the Administrative Law Judge concluded that petitioner Matthew Domber acquired his interest in the Arbors partnerships as a partner in the Firm, just as in the prior case. The Administrative Law Judge concluded that this did not necessarily mean that the Arbors distributions lost their initial character and became New York-sourced business income of the Firm. Rather, the Administrative Law Judge noted that the present case turned on whether petitioners have established their claim that some or all of the income was real estate sales gains and/or net rental income or gross rents, as opposed to business income/fees received as the result of the Firm's (and its partners') active involvement in conducting the affairs of the out-of-state real estate ventures.

The Administrative Law Judge concluded that the long-term capital gain and Internal Revenue Code (IRC) § 1231 gain were not fees generated by the Firm's activities. The Administrative Law Judge traced the dollar amounts of these items from the individual Schedules K-1 for each of the Arbors partnerships to the Schedule K-1 issued to petitioner Matthew J. Domber from the Firm and petitioners' 1989 nonresident return. The Administrative Law Judge concluded that such non-fee direct distributions from the Arbors partnerships were properly sourced out-of-state according to the situs of the real property. Accordingly, petitioners, as nonresidents, were entitled to treat such items as not subject to New York tax.

As to remaining items reallocated by the auditor for 1989, the Administrative Law Judge concluded that petitioners failed to prove that these items represented properly allocated items of rental income or gross rents from the out-of-state partnerships as opposed to fees properly treated as New York source business income of the Firm. Further, petitioners offered no specific evidence with regard to the amounts in question for 1990. Thus, petitioners did not establish the

propriety of sourcing the balance of items at issue out of New York. The Administrative Law Judge also sustained the imposition of penalty because there were no reasons provided to explain why penalty abatement would be warranted.

### ***ARGUMENTS ON EXCEPTION***

The Division agrees with the facts as found by the Administrative Law Judge but has taken exception to that portion of the Administrative Law Judge's determination which held that petitioners properly allocated their net long-term capital gains and IRC § 1231 gains as non-New York source income for 1989. The Division argues that the Administrative Law Judge improperly relied on 20 NYCRR former 131.16 in sourcing such items outside of New York because petitioners failed to meet their burden of proof to demonstrate that such items were generated by either rental income from real property or gain from the sale of such real property as required by that regulation.

The Division notes that petitioners' witness testified that he did not prepare the Arbors partnerships K-1 forms. Rather, he used the information contained on the Arbors K-1 forms to complete the Firm K-1, treating the net long-term capital gains on the Arbors K-1s as gain from the sale of a partnership interest. The Division argues that the sale of a partnership interest in an Arbors partnership would have generated New York source income since the proceeds were deposited in the Firm account. The Division argues that the Arbors K-1 forms do not support a finding that the net long-term capital gains consist of rental income or income from the sale of real property. Further, the Division argues that there was no evidence in the record to demonstrate that the IRC § 1231 gain accrued from the sale of real estate rather than other business assets. Rather, argues the Division, the record supports the conclusion that the net long-

term capital gain and IRC § 1231 gain constitute intangible assets which flowed into the Firm and became New York source income. Since the Firm only had a New York office, the Division argues that all distributions received by petitioners from the Firm were New York source income pursuant to Tax Law § 632(b)(2) and 20 NYCRR former 134.2(b).

Petitioners, in opposition, argue that the Administrative Law Judge correctly traced the income items at issue to distributions from out-of-state realty partnerships attributable to rental income or sales of realty. Petitioners argue that the Administrative Law Judge correctly concluded that these were non-fee direct distributions from the Arbors partnerships properly sourced according to the situs of the real estate pursuant to 20 NYCRR former 131.16. In the alternative, petitioners argue that if the income represents gain from the sale of partnership interests, then such items are excluded from income pursuant to Tax Law § 631(b)(2) as income from intangible personal property which is not employed in a business, trade, profession or occupation carried on within New York State.

### **OPINION**

Pursuant to Tax Law former § 601(f), persons carrying on business as partners are liable for New York State income tax only in their separate or individual capacities. Nonresidents of New York are subject to taxation by New York State only on their New York source income. In the case of nonresident partners, Tax Law former § 632(a)(1) provided that:

In determining New York source income of a nonresident partner of any partnership, there shall be included only the portion derived from or connected with New York sources of such partner's distributive share of items of partnership income, gain, loss and deduction entering into his federal adjusted gross income, as such portion shall be determined under regulations of the tax

commission consistent with the applicable rules of section six hundred thirty-one.

Tax Law former § 631(b), describing income and deductions from New York sources, provided:

(1) Items of income, gain, loss and deduction derived from or connected with New York sources shall be those items attributable to:

(A) the ownership of any interest in real or tangible personal property in this state; or

(B) a business, trade, profession or occupation carried on in this state . . .

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(2) Income from intangible personal property, including . . . gains from the disposition of intangible personal property, shall constitute income derived from New York sources only to the extent that such income is from property employed in a business, trade, profession, or occupation carried on in this state.

A business, trade, profession or occupation is carried on within New York State by a nonresident when:

such nonresident occupies, has, maintains or operates desk space, an office, a shop, a store, a warehouse, a factory, an agency or other place where such nonresident's affairs are systematically and regularly carried on, notwithstanding the occasional consummation of isolated transactions without New York State. This definition is not exclusive. Business is carried on within New York State if activities within New York State in connection with the business are conducted in New York State with a fair measure of permanency and continuity (20 NYCRR former 132.4[a][2]).

Income from, and deductions connected with, the rental of real property, and gain and loss from the sale, exchange or other disposition of real property, however, are not subject to

allocation but "are considered as entirely derived from or connected with the situs of such real property" (20 NYCRR former 131.16).

In his determination, the Administrative Law Judge concluded that the net long-term capital gains and the IRC § 1231 gains allocated by petitioners as non-New York source income were "non-fee direct distributions from the Arbors partnerships properly sourced according to the situs of the real property" (Determination, conclusion of law "L"). We do not agree with this conclusion. Rather, we conclude that petitioners have failed to demonstrate that they were entitled to exclude these items from their New York source income.

Initially, we agree with the Division that the record contains no evidence that these items of income were derived from the rental of real property or were gains from the sale, exchange or other disposition of real property in order to entitle them to be sourced outside New York pursuant to 20 NYCRR former 131.16. A distribution of money by a partnership to a partner in an amount which exceeds the partner's adjusted basis in his partnership interest requires the recognition of gain (IRC § 731[a]). This gain is treated as arising from the sale or exchange of an interest in the partnership which, pursuant to IRC § 741, is considered to be a capital asset. Thus, the net long-term capital gain distributed to Jacob Ward, as evidenced by the Arbors K-1 forms, represented a sale or exchange of Ward's interest in the partnership to the extent that the amount of the monetary distribution exceeded his basis in the partnership. There is no evidence in the record to support the conclusion that this distribution consisted of real property rental income or gain from the sale, exchange or other disposition of real property.

IRC § 1231 gain arises from the sale or exchange of property used in a trade or business. Generally, "property used in a trade or business" is that which is held for more than one year and

subject to an allowance for depreciation, or real property held for more than one year, and which is not included in inventory or held for sale to customers in the ordinary course of business (IRC § 1231[b]). Further, a net IRC § 1231 gain only arises if gains from the sale or exchange of all § 1231 assets exceeds losses from the sale or exchange of all § 1231 assets for the taxable year. Thus, the IRC § 1231 gains generated by the Arbors partnerships for 1989 did not necessarily arise from the sale or exchange of real property and the record in this proceeding does not indicate their source. Therefore, these gains cannot be considered non-New York source income pursuant to 20 NYCRR former 131.16.

In the prior decision of this Tribunal concerning petitioners' out-of-state allocation of partnership distributions arising from the Arbors partnerships (*Matter of Domber, supra*), we concluded that: "[t]he inquiry does not end simply because the source of the income or loss is related to out-of-state real property; rather, the factors listed in *Ausbrooks* [*Matter of Ausbrooks v. Chu*, 66 NY2d 281, 496 NYS2d 969] must be considered." In *Ausbrooks*, the Court of Appeals considered whether certain New York limited partnerships, whose function was to become limited partners in several non-New York realty partnerships, were carrying on a business in New York. By looking at the activities of the New York limited partnerships, the Court concluded that they were not carrying on a business in New York. Specifically, the Court found that the New York limited partnerships had no right to manage the property or affairs of the second-tier limited partnerships and the commercial activity of the New York partnerships was sited outside of the State of New York. The Court concluded that the relationship between the New York limited partnerships and the second-tier partnerships "constituted a series of isolated investments, whereby the Copem [New York limited] partnerships derived no direct

ownership interest in second-tier partnership assets" (*Matter of Ausbrooks v. Chu, supra*, 496 NYS2d, at 973). Therefore, the income from the second-tier non-New York limited partnerships was not properly sourced to New York.

The issue to be determined in the present case is not, as petitioners argue, whether or not the Arbors partnerships owned real property in New York State or carried on a business, trade, profession or occupation in New York State. Rather, the threshold issue is whether or not Domber and Ward (and hence, petitioner Matthew Domber, as a partner therein) was doing business in New York State. The Administrative Law Judge found that Domber and Ward was a viable law firm with a New York office, two general partners and income derived from rendering legal services as well as income from its real estate activities. Therefore, we conclude that Domber and Ward was conducting business in New York State (*see, Weil v. Chu*, 120 AD2d 781, 501 NYS2d 515; *Matter of Hickey*, Tax Appeals Tribunal, April 23, 1992, *confirmed Matter of Hickey v. Tax Appeals Tribunal*, 208 AD2d 1125, 617 NYS2d 961, *appeal dismissed* 85 NY2d 923, 627 NYS2d 324). Pursuant to 20 NYCRR former 132.4(a)(2), we also conclude that petitioner Matthew Domber was conducting business in New York State as a partner in Domber and Ward.

The evidence in the present matter discloses that Jacob Ward was a general partner in 12 of the 13 Arbors partnerships. (The partnership of which he was a limited partner did not generate any of the gains at issue in this proceeding.) As the Administrative Law Judge concluded, Jacob Ward held an interest in the Arbors partnerships in his individual capacity. Matthew Domber had no direct interest in such partnerships and no direct right to share in their income, gain, deductions or losses. The Domber and Ward partnership agreement provided that

any partnership interest in real estate projects held in the name of a capital partner was deemed to be held as a nominee for this partnership. Thus, petitioner Matthew Domber's only interest in the Arbors partnerships was as a member of the law firm of Domber and Ward, and only due to the interests held by Jacob Ward, as nominee for the partnership. As a nominee for Domber and Ward pursuant to the Firm's partnership agreement, Ward's status of general partner accrued to the Domber and Ward partnership as well.

As a general partner, Ward (i.e., Domber and Ward) had an opportunity to undertake an active role in the control and operation of each of these partnerships. Pursuant to the Domber and Ward partnership agreement, it was contemplated that the Firm might "engage in the acquisition, ownership, development, management and disposition of real estate projects" (CITE). As the Administrative Law Judge concluded, based on copies of Arbors partnership agreements, regulatory agreements and power of attorney forms introduced by the Division, petitioner was an authorized agent of the Arbors partnerships with full authority to act for and on behalf of the Arbors partners with respect to all matters of Arbors partnership business. Thus, the income from the Arbors partnerships accrued to petitioner Matthew Domber as part of his distributive share of the partnership of Domber and Ward. Petitioner has failed to show that the Arbors partnership interests, although intangible personal property, were not employed by Domber and Ward in a "business, trade, profession or occupation carried on in this state."

In *Matter of Horowitz* (Tax Appeals Tribunal, July 17, 1997), we dealt with a situation similar to the one at issue herein. There, a nonresident partner in a New York law firm, with no offices outside of the City and State of New York, was one of 17 partners in the law firm that invested in certain tax shelter partnerships. However, the investments were made in the name of

the law firm. Similar to petitioners, the taxpayer in *Horowitz* argued that the investments were made in the law firm's name for convenience purposes only and were, in reality, investments made by a group of individuals. We affirmed the determination of the Administrative Law Judge which concluded that petitioner had failed to show that the income at issue was anything other than a distributive share of partnership income from the law firm in which he was a partner.

The taxpayer in *Horowitz* also argued that the income from the tax shelter partnerships was not New York source income. We agreed with and recited the Administrative Law Judge's conclusion that:

the law firm did make such investments and did derive income therefrom. All of the income of the law firm was New York source income since it had no offices outside of New York. Accordingly, despite the fact that three of the four tax shelter partnerships were located in other states, the income from the investments in these partnerships by the law firm is New York source income and petitioner's share of this partnership income was properly subjected to State and City tax by the Division (*Matter of Horowitz, supra*).

As a result, we conclude that the Division properly determined that the net long-term capital gains and the IRC § 1231 gains at issue herein were New York source income of petitioners.

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 that portion of the determination which concluded that the net long-term capital gains and the IRC § 1231 gains for 1989 were non-New York source items, but in all other respects is affirmed;
3. The petition of Matthew J. and Rachel A. Domber is denied; and

4. The Notice of Deficiency dated November 15, 1993 is sustained as issued.

DATED: Troy, New York  
August 11, 1998

/s/Donald C. DeWitt

Donald C. DeWitt  
President

/s/Carroll R. Jenkins

Carroll R. Jenkins  
Commissioner