

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

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In the Matter of the Petition	:	
of	:	
<b>EDISON AND SALVADORA BLANCO</b>	:	DECISION
	:	DTA NO. 815813
for Redetermination of a Deficiency or for Refund of	:	
New York City Personal Income Tax and City of Yonkers	:	
Income Tax Surcharge under the New York City	:	
Administrative Code and Article 30-A of the Tax Law	:	
for the Years 1993, 1994, and 1995.	:	

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Petitioners Edison and Salvadora Blanco, 128 Parkway N., Yonkers, New York 10704-3915, filed an exception to the determination of the Administrative Law Judge issued on April 8, 1999. Petitioners appeared by Lore & Levy (Norman Levy, Esq., of counsel). The Division of Taxation appeared by Barbara G. Billet, Esq. (Justine Clarke Caplan, Esq., of counsel).

Petitioners filed a brief in support of their exception. The Division of Taxation filed a brief in opposition and petitioners filed a reply brief. Oral argument, at petitioners' request, was heard on October 12, 1999, in New York, New York.

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

***ISSUE***

How much of a New York State Lotto prize, payable in annual installments, remains taxable by the City of New York for the years subsequent to petitioners' change of status in 1992 from residents of the City of New York to nonresidents of the City of New York.

***FINDINGS OF FACT***

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

*General*

Petitioners are husband and wife, and report their income on the cash basis.

Petitioners were residents of the City of New York on March 28, 1992.

Edison Blanco owned a ticket with all the numbers drawn March 28, 1992 on the Lotto game run by the Division of the Lottery (“the Lottery”), an independent unit of the Department of Taxation and Finance.

On April 16, 1992, Mr. Blanco was certified by an authorized signatory on behalf of the Lottery to be entitled to 1 initial payment on April 15, 1992 in the amount of \$476,100.00 and 20 subsequent annual payments in the amount of \$476,195.00 on March 15 of each year beginning on March 15, 1993.

At the time Mr. Blanco won the Lotto game for March 28, 1992, he was required to accept his Lotto prize as 1 initial payment and 20 subsequent annual payments.

On or about April 15, 1992, Mr. Blanco received the initial payment of \$476,100.00.

On or about March 15, 1993, 1994 and 1995 Mr. Blanco received annual payments of \$476,195.00.

Petitioners remained residents of New York City until July 24, 1992 when they moved to the City of Yonkers where they have resided ever since.

On July 24, 1992 petitioners' status with respect to the New York City resident income tax changed from resident to nonresident, and their status with respect to the City of Yonkers income tax surcharge changed from nonresident to resident.

*Returns, Withholding and Claims*

Petitioners filed a 1992 New York State income tax return reporting, among other things, the receipt of the initial Lotto prize installment of \$476,100.00, and petitioners paid New York State and New York City resident income taxes thereon.

Petitioners filed a 1993 New York State income tax return reporting, among other things, the receipt of the 1993 initial annual Lotto prize installment of \$476,195.00, and petitioners paid New York State income tax and City of Yonkers income tax surcharge thereon. Petitioners did not, however, pay City of New York resident income taxes on the 1993 Lotto prize installment of \$476,195.00 with the New York State income tax return as filed.

The Division subsequently assessed New York City resident income tax on the full \$476,195.00 1993 Lotto prize installment, and petitioners paid the amount assessed, less a small sum which sum is now in issue.

Petitioners filed a 1994 New York State income tax return reporting, among other things, the receipt of the 1994<sup>1</sup> annual Lotto prize installment of \$476,195.00, and petitioners paid New York State income tax, City of Yonkers income tax surcharge and New York City resident income tax thereon.

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<sup>1</sup>The word "initial" has been removed from the wording as set forth in the stipulation. The 1992 payment was the initial installment, the 1993 payment was the initial annual installment, and therefore, the use of the word initial regarding the 1994 payment appears to be a typographical error.

Petitioners filed a 1995 New York State income tax return reporting, among other things, the receipt of the 1995<sup>2</sup> annual Lotto prize installment of \$476,195.00, and petitioners paid New York State income tax, City of Yonkers income tax surcharge and New York City resident income tax thereon.

With respect to the<sup>3</sup> Lotto prize installments, petitioners on their returns for 1992 (and for 1993, 1994 and 1995) did not report any special accrual upon a change in residence, but elected to have New York State and New York City income taxes withheld by the Lottery from each of the annual payments.

Petitioners timely filed their claims for refund with respect to the City of New York resident income tax and City of Yonkers income tax surcharge for the years 1993, 1994 and 1995.

The Division never granted or denied any of the refunds so claimed.

More than six months elapsed between the time petitioners filed their claims for refund with respect to the City of New York resident income tax and City of Yonkers income tax surcharge for the years 1993, 1994 and 1995 and the time they filed their petition in this proceeding.

#### *The Lottery - General*

Lotto is a lottery game run by the Lottery.

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<sup>2</sup>The word "initial" has been removed from the wording as set forth in the stipulation. The 1992 payment was the initial installment, the 1993 payment was the initial annual installment, and therefore, the use of the word initial regarding the 1995 payment appears to be a typographical error.

<sup>3</sup>The word "annual" has been removed from the wording as set forth in the stipulation since this paragraph refers to both the initial 1992 payment and the annual 1993, 1994 and 1995 payments.

The Lotto game allows a player to select 6 of 54 numbers. Prizes are awarded to the player if the set of six numbers he has picked contains four or more of the numbers that are drawn. The largest prize (“jackpot”) is awarded if the player has selected all six. If more than one player has selected the set of six numbers which are drawn for any particular jackpot, then they divide the prize equally.

The odds of any particular set of 6 numbers being the same as the 6 numbers drawn is about 1 in 25,827,165. A player gets two chances for each dollar wagered.

The Lottery is not required to pay as Lotto prizes any minimum amount or percentage of the total amount for which tickets have been sold.

Tax Law § 1612 limits Lotto prizes the Lottery may award to 40% of the total amount for which tickets have been sold, plus the interest earned thereon. However, the Lottery more commonly applies only about 38% of the total amount for which tickets have been sold, plus the interest earned thereon. The other 2% is reserved to cover eventualities, such as inclement weather or other causes, resulting in insufficient sales to cover the jackpot previously announced. In addition to the two percent reserve fund, the Lottery is authorized to use interest earned on prize funds (Tax Law § 1612) and unclaimed prize funds (Tax Law § 1614) to supplement the moneys available from ticket sales for the payment of Lotto prizes.

Lottery sales agents retain another 6% as commissions and the Lottery applies about 5% to cover its costs and expenses. The remainder, approximately 49%, is paid over to the Comptroller of the State of New York for disposition in accordance with the law.

When the Lotto game was first introduced, jackpots were paid out only in substantially equal installments, one initially and the balance in 20 subsequent annual installments on a certain date each year.

Under the Separate Trading of Registered Interest and Principal of Securities (“STRIPS”) program, selected Treasury securities with 10 or more years of original maturity may be maintained in the book-entry system operated by the Federal Reserve Banks in a manner that permits separate trading and ownership of the principal and interest components (marketable as zero coupon instruments in the secondary market).

As soon after a drawing as the Lottery has determined whether or not there has been at least one jackpot winner, it prices STRIPS which upon maturity pay approximately the amount of the annual prize installments due.

Prior to 1996 the Lottery purchased STRIPS at that time, that is, as soon as it determined that there had been a ticket sold which would qualify for a jackpot prize.

Since 1996 the Lottery has offered players the option to receive the jackpot prize either as a cash lump sum option or in escalating installments, 1 initially in the amount of 2.5% of the stated prize and the balance annually over the next 25 years in amounts increasing from 2.7% to 5.1%.

Since 1996, as soon as the Lottery has determined the mix between valid tickets sold for cash lump sum payments or annual installments, it purchases the STRIPS necessary to cover the installment payout obligation, and a jackpot winner who elected a lump sum payment receives an amount equal to the sum of the cost of the STRIPS plus the initial installment for a winner who had elected the installment payout.

In all events, the purchase of the STRIPS always occurs within a few days of the draw.

STRIPS are issued in multiples of \$1,000.00 payable at maturity.

STRIPS maturing on March 15 are not available, but STRIPS maturing February 15 are.

All STRIPS purchased by the Lottery are backed by the full faith and credit of the United States or an instrumentality thereof.

The STRIPS purchased by the Lottery to fund a particular jackpot maturing in different years over the payout period commonly have rates of return that vary significantly.

The average effective rate of return on all STRIPS acquired to pay a particular jackpot prize in installments usually approximates the Federal long term rate at the time of purchase, plus or minus about 0.1%.

STRIPS acquired to fund Lotto jackpot prize installments are registered in the name of the Lottery.

A Lotto jackpot winner has no equitable interest in the STRIPS acquired by the Lottery to pay those annual installments as they mature.

A Lotto jackpot winner being paid in annual installments has no right to convert the right to the installments into either cash or the STRIPS the Lottery has acquired to pay those annual installments as they mature.

The Lottery's policy, as set forth in 21 NYCRR 2803.9, is not to accelerate its obligation to pay annual installments, and it has never done so.

The payment of the installments of a jackpot prize is not guaranteed by the United States or any instrumentality thereof.

Tax Law § 1613 provides in pertinent part that

Payment of prizes shall be made by the Division [of the Lottery] to holders of the tickets to which prizes are awarded, except that payment of any prize drawn may be paid to the estate of a deceased prize winner, and except that any person pursuant to an appropriate judicial order may be paid the prize to which the winner is entitled. The Division [of the Lottery] shall be discharged of all further liability upon payment of a prize pursuant to this subdivision.

For compliance with Tax Law § 1612, the Lottery calculates the cost of a jackpot prize as the sum of the installment initially paid plus, if the jackpot winner elected a payout in annual installments, the cost of the STRIPS purchased to fund the payment of the annual installments to him.

Income statements on Federal Forms W-2G are provided in the case of a winner of a game operated by the Lottery who is a resident at the time of the selection of a prize-winning lottery ticket where the prize exceeds \$5,000.00.

*Mr. Blanco's Lotto Prize*

On or about March 30, 1992 the Lottery paid approximately \$4,724,421.26 for STRIPS to fund the 20 annual installments due Mr. Blanco commencing on March 15, 1993.

The face amount of the STRIPS to fund the installments due Mr. Blanco commencing March 15, 1993 was \$9,530,000.00, \$6,100.00 more than the sum of the \$9,523,900.00 payments due Mr. Blanco. This \$6,100.00 difference was attributable to the rounding up of the installments due to the nearest \$1,000.00.

\$4,721,397.23 was the cost to the Lottery of the portion of the STRIPS necessary to fund its liability to pay jackpot installments totaling \$9,523,900.00 to Mr. Blanco, and the balance was attributable to the \$6,100.00 referred to in the preceding paragraph.



The STRIPS purchased to fund the 20 annual installments due Mr. Blanco commencing March 15, 1993 mature on February 15, beginning in 1993 and continuing through 2012.

The difference between the amount received each year by the Lottery upon maturity of the STRIPS to fund the then current installment and the amount of the installment certified to be due Mr. Blanco is retained by the Lottery in the prize account to be paid to other winners.

The amount realized each year as income by the Lottery upon the proceeds of the STRIPS between February 15 and the payment of the installment to Mr. Blanco on March 15 is retained by the Lottery in the prize account to be paid to other winners.

Between the April 6, 1992 settlement date on the Lottery's purchase of STRIPS to fund the installments due Mr. Blanco and July 24, 1992, the Lottery earned \$101,183.28 on those STRIPS.

#### *Valuation*

The value of property as of March 30, 1992 of a stream of 20 annual payments of \$476,195.00 commencing March 15, 1993 using 7.61%, the Applicable Federal Rate, Long Term Compounded Annually ("AFR"), for March 1992 is calculated to be \$4,828,955.00. The value as property as of March 30, 1992 of a stream of 20 annual payments of \$476,195.00 commencing March 15, 1993 using 7.83%, the AFR, for April 1992 is calculated to be \$4,749,993.00. The Division does not dispute either of these calculations but denies their relevance in this matter.

\$4,828,955.00 appreciating at 7.61% compounded annually would have grown between March 30, 1992 and July 24, 1992 by \$116,789.00 to \$4,945,744.00.

As of March 30, 1992, Mr. Blanco's right to 20 annual payments by the Lottery of \$476,195.00 commencing March 15, 1993 had no attributes making the value of that right as

property at that time greater than the fair market value of the STRIPS purchased by the Lottery to fund those annual payments. The Division does not dispute this statement, but denies its relevance in this matter.

As of March 30, 1992, Mr. Blanco's right to 20 annual payments by the Lottery of \$476,195.00 commencing March 15, 1993 had attributes making the then value of that right as property less than the fair market value of the STRIPS purchased by the Lottery to fund those annual payments, to wit: (a) Mr. Blanco's right is not freely transferable; (b) Mr. Blanco's right is not Federally insured; and, (c) Mr. Blanco's right did not allow for the earning of additional income between February 15 and March 15 each year upon \$476,195.00. The Division does not dispute this statement but denies its relevance in this matter.

The value of the property as of March 30, 1992 of a stream of 20 annual payments of \$476,195.00 commencing on March 15, 1993 was less than the value as property as of March 30, 1992 of a stream of 20 annual payments of \$476,195.00 commencing February 15, 1993. The Division does not dispute this statement but denies its relevance in this matter.

The value of the property as of March 30, 1992 of Mr. Blanco's right to the stream of 20 annual payments of \$476,195.00 each commencing March 15, 1993 was no more than the \$4,721,397.23 the Lottery paid for the STRIPS purchased to fund those annual payments. The Division does not dispute this statement but denies its relevance in this matter.

#### *Miscellaneous*

If the Division is correct that the amount that specially accrued on July 24, 1992 with respect to the 20 Lottery prize installments due Mr. Blanco was the sum of the face amounts of

each installment, then the entire annual installments received in 1993, 1994 and 1995 accrued on July 24, 1992. Otherwise:

a. If the amount that specially accrued on July 24, 1992 equals the \$4,721,397.00 cost of the STRIPS to the Lottery, then the portions of the annual payments received in 1993, 1994 and 1995 which accrued on July 24, 1992 were \$118,818.00, \$112,080.00 and \$120,947.00, respectively, and the remainder of each \$476,195.00 payment accrued after July 24, 1992; and

b. If the amount that specially accrued on July 24, 1992 was the \$4,828,955.00 discounted value of the installments using the March 1992 AFR, then the portions of the annual payments received in 1993, 1994 and 1995 which accrued on July 24, 1992 were \$124,567.00, \$118,191.00 and \$127,185.00, respectively and the remainder of each \$476,195.00 payment accrued after July 24, 1992; and

c. If the amount that specially accrued on July 24, 1992 was the \$4,749,993.00 discounted value of the installments using the April 1992 AFR, then the portions of the annual payments received in 1993, 1994 and 1995 which accrued on July 24, 1992 were \$120,334.00, \$113,693.00 and \$122,595.00 respectively, and the remainder of each \$476,195.00 payment accrued after July 24, 1992.

If the amount that specially accrued on July 24, 1992 was other than \$9,523,900.00 (face of the 20 installments), \$4,721,397.00 (cost of the STRIPS), \$4,828,955.00 (March 1992 AFR discounted value) or \$4,749,993.00 (April 1992 AFR discounted value) then the portions of annual payments received in 1993, 1994 and 1995 representing the amount accrued on July 24, 1992 is to be calculated using the following steps:

- a. Start with the closing balance for one year/opening balance for next year, the amount that accrued on July 24, 1992 being used to start in 1993, then
- b. Calculate the current interest by multiplying the opening balance by the “interest factor.” The interest factor for the payment of March 15, 1993 is not the calculated rate but rather the amount calculated — as 1 plus the calculated rate raised to the 23/24 power, less 1 — to account for the short compounding period between March 30, 1992 and March 15, 1993. Using 23/24 of the calculated rate gives a close but not completely accurate result. In any event, in all subsequent years, the interest factor is the calculated rate unadjusted because the lapse of time is exactly one compounding period, a year.
- c. Subtract the current interest so calculated from the \$476,195.00 annual payment to calculate the amount of the current year’s \$476,195.00 payment applied to pay down the outstanding principal balance, and finally
- d. Subtract the amount applied to pay down the outstanding principal balance from the opening balance for the year to determine the closing balance for that year/opening balance for the next.

If the amount that specially accrued on July 24, 1992 was other than \$9,523,900.00 (face of the 20 installments), \$4,721,397.00 (cost of the STRIPS), \$4,828,955.00 (March 1992 AFR discounted value) or \$4,749,993.00 (April 1992 AFR discounted value) but the applicable interest rate is unknown, then before applying the steps set forth in the preceding paragraph the interest rate is to be calculated by using the following formula for each payment

Value of each payment = \$476,195.00 (payment amount) \* $((1 + \text{rate})$  to negative power of lapsed time for the particular payment),

where the sum of the values of each payment is equal to the amount that specially accrued on July 24, 1992.

*City of Yonkers Income Tax Surcharge*

The Division and petitioners agree that the City of Yonkers income tax surcharge does not apply to any amount of the Lottery prize received by Mr. Blanco in 1993, 1994 and 1995 which is subject to the New York City resident income tax.

*Additional Findings of Fact*

The only income at issue in these proceedings is the payments Mr. Blanco received from the Lottery (\$476,100.00 in 1992 and \$476,195.00 in 1993, 1994 and 1995). For each of these years petitioners filed returns and paid New York State personal income tax, which is not at issue in this matter. For 1992, the year that Mr. Blanco won the Lotto prize and petitioners changed their residency from New York City to Yonkers, petitioners also paid New York City resident personal income tax. Therefore, 1992 is also not at issue in these proceedings. What is at issue is petitioners' New York City resident personal income tax liability and City of Yonkers personal income tax surcharge liability for 1993 through 1995 for the Lottery prize payments as follows:

a). For 1993, petitioners paid City of Yonkers personal income tax surcharge. The Division issued a notice of deficiency asserting New York City resident personal income tax on the amount of the Lottery payment. Petitioners paid the amount due set forth in the notice of deficiency "less a small sum which sum is now in issue." Petitioners then filed a claim for a refund for both the New York City resident personal income tax and City of Yonkers personal income tax surcharge. At issue in these proceedings is the validity of the notice of deficiency and petitioners' refund claim for 1993.

b). For 1994 and 1995 petitioners paid both New York City resident personal income tax and City of Yonkers personal income tax surcharge. Petitioners then filed a claim for refund for both taxes. These claims for refund are also at issue in these proceedings.

Petitioners filed a request for conciliation conference with regard to the notice of deficiency for 1993. By letter dated January 27, 1997 the conciliation conferee explained that upon review of the evidence the notice of deficiency would be sustained. The letter explained that with regard to the New York City resident personal income tax the notice would be sustained pursuant to Tax Law §§ 638(c) and 1307(b) — the accrual provisions. Furthermore the letter explained that:

With respect to the Yonkers surcharge, requesters appropriately remitted the tax to Yonkers since their move to that jurisdiction. The tax is an income tax surcharge on residents of that City based on the net state tax as defined in Section 1323 of the Tax Law. Section 1327 of the Tax Law relies on section 638 for any accrual provisions. In the instant matter, no change of state residency took place; therefore, the Yonkers surcharge is due as well on all payments.

On February 28, 1997 a conciliation order was issued sustaining the notice of deficiency.

A petition was filed with the Division of Tax Appeals on May 5, 1997. Submitted with the petition were photocopies of petitioners' refund claims and a covering letter indicating that the claims for refund were submitted on June 30, 1995 to BCMS during the course of the conciliation process. However, both the January 27, 1997 letter from the conciliation conferee and the conciliation order relate solely to the notice of deficiency and do not mention the claims for refund. The petition filed with the Division of Tax Appeals on May 5, 1997 does reference both the conciliation order sustaining the notice of deficiency and the claims for refund. There is

no jurisdictional issue because the parties have stipulated that petitioners timely filed their claims for refund and that by the time the petition was filed more than six months had passed since the filing of the claims and the Division had neither granted or denied the claims.

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

This matter was submitted to the Administrative Law Judge as a motion for summary determination by each party. In her determination, the Administrative Law Judge first reviewed the guidelines for determining a motion for summary determination. She concluded that since neither party had raised a question of fact, and there being no material and triable facts at issue, the matter was properly the subject of a motion for summary determination.

The Administrative Law Judge noted that when a taxpayer changes his status from a New York City resident to a New York City nonresident, the taxpayer's final resident City income tax return is subject to the special accrual provisions of section 11-1754 of the Administrative Code of the City of New York ("Administrative Code"). Pursuant to subsection (c)(1) thereof, a taxpayer is required to accrue to the portion of the taxable year prior to his or her change in status any items of income accruing prior to the change in status, regardless of the taxpayer's method of accounting. However, subsection (c)(4) thereof provides that such accruals shall not be required if the taxpayer files a bond or other acceptable security conditioned on the inclusion of amounts accruable in the taxpayer's New York City adjusted gross income for subsequent years as if such taxpayer had not changed his or her resident status. Pursuant to Administrative Code § 11-1771(b)(3)(B), a lottery winner is allowed to substitute withholdings from his or her winnings as an acceptable security. The Administrative Law Judge noted that petitioners herein had elected to avail themselves of the option provided by sections 11-1754(c)(4) and 11-1771(b)(3)(B).

The Administrative Law Judge concluded that whether only the present value of the lottery prize or the actual amount to be received in cash over the course of time is subject to the accrual provisions of Administrative Code § 11-1754 was a question of statutory construction. She concluded that the intent of the statutory scheme was clear from the language of the relevant provisions, i.e., petitioners did not accrue the income from the Lotto prize to New York City at the time of their change of residence and they agreed to file their returns as if they were residents of New York City regarding this income in future years. Thus, such income was subject to the City of New York resident personal income tax for the years in question. The Administrative Law Judge held that because petitioners never accrued the income in question in the first place, the issues presented by the parties as to the valuation of the accrued income were rendered moot.

The Administrative Law Judge considered the fact that petitioners also paid the City of Yonkers income tax surcharge on the Lotto prize income for the years 1993, 1994 and 1995. The parties stipulated that to the extent the Lotto prize income was taxable by New York City for the years 1993, 1994 and 1995, it was not taxable by the City of Yonkers. Therefore, the Administrative Law Judge held that the Lotto prize income for the years 1993, 1994 and 1995 was not subject to the City of Yonkers personal income tax surcharge. In accordance with her conclusions, the Administrative Law Judge granted partial summary determination to each party.

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

On exception, petitioners offer the same arguments as were presented to the Administrative Law Judge. Their position, however, is that the Administrative Law Judge failed to determine the main issue underlying this controversy, i.e., the amount that must be “accrued” pursuant to section 11-1754(c)(1) of the Administrative Code by a taxpayer changing his or her



status from a resident to a nonresident of the City of New York. Petitioners continue to maintain that when they became nonresidents of the City of New York, they were only required to “accrue” the present value of the right to receive annual lottery payments, rather than the face value of the payments to be made to them over time. Petitioners assert that despite their election to continue the withholding of New York City personal income tax from their annual lottery payments, it is only this “present value” amount, a portion of which continues to be received on an annual basis, that remains subject to the New York City personal income tax. The remainder of the annual awards is subject to the City of Yonkers personal income tax surcharge, or to tax by any other jurisdiction in which petitioners might reside in the future, but is not subject to tax by the City of New York since it is not New York City source income. Petitioners then supply alternate arguments concerning how the present value of the award might be calculated, using a variety of methods arising from federal tax law.

The Division, in opposition, argues that the Administrative Law Judge correctly determined the issues in this matter. Since petitioners elected not to accrue their income in the year they changed their resident status but to defer recognition pursuant to the provisions of section 11-1754(c)(4) of the Administrative Code, the Division argues that petitioners’ theories concerning special accruals are irrelevant.

### ***OPINION***

Petitioners have identified the key issue in this proceeding, which is the amount which must be accrued pursuant to section 11-1754(c)(1) of the Administrative Code by a taxpayer who changes his or her status from a resident to a nonresident of the City of New York. We disagree,

however, with petitioners' fundamental position that the amount they were required to accrue on becoming nonresidents was an amount less than the face value of their unpaid lottery award.

On their motion for summary determination, petitioners analogized their situation to that of the holder of a debt instrument on which there is original issue discount. Essentially, original issue discount is the excess of the stated redemption price at maturity of a debt instrument over the issue price of such an instrument (Internal Revenue Code ["IRC"] § 1273). Pursuant to IRC § 1272, taxpayers holding debt instruments with original issue discount must make a daily accrual of such discount over the life of the instrument and include the annual amount of such accruals as income in the holder's personal income tax return.

First and foremost, petitioners are not the holders of a debt instrument on which there is original issue discount. Rather, they are the recipients of a lottery prize. Here, there is no statutory provision requiring the daily accrual of income just as there is no redemption of a debt instrument at the end of the stream of lottery prize payments.

Section 1307 of the Tax Law provides, in applicable part, that:

(a) General. If an individual changes his status during his taxable year from city resident to city nonresident, or from city nonresident to city resident, he shall file one return as a city resident for the portion of the year during which he is a city resident, and a return under a local law authorized by article two-E of the general city law for the portion of the year during which he is a city nonresident, subject to such exceptions as the state tax commission [commissioner of taxation and finance] may prescribe by regulation. Such return shall be due at the same time as the return for the portion of the year during which such individual is a city resident.

(b) The city taxable income for the portion of the year during which an individual described in subsection (a) is a city resident individual shall be determined under the rules provided in section

six hundred fifty-four of this chapter, as if he were computing his New York taxable income and his taxable year for New York state personal income tax purposes were limited to the period of his city resident status.

When an individual changes his status from city resident to city nonresident, or from city nonresident to city resident, he shall, regardless of his method of accounting, accrue for the portion of the taxable year prior to such change of status any items of income, gain, loss or deduction accruing prior to the change of status. Such accruals shall be made as provided in subsection (c) of section six hundred fifty-four of this chapter.

\* \* \*

(f) For purposes of this section, references to "section six hundred fifty-four of this chapter" shall mean section six hundred fifty-four of this chapter as such section was in effect for taxable years beginning before nineteen hundred eighty-eight.

Section 11-1754(c) of the Administrative Code of the City of New York provides:

(c) Special accruals. (1) If an individual changes his or her status from city resident to city nonresident, he or she *shall*, regardless of his or her method of accounting, *accrue* for the portion of the taxable year prior to such change of status *any items of income*, gain, loss or deduction *accruing prior to the change of status* . . . . The amounts of such accrued items shall be determined with the applicable modifications described in sections 11-1712 and 11-1715 *as if such accrued items were includable or allowable for federal income tax purposes* (emphasis added).

Pursuant to IRC Reg. § 1.446-1(c)(1)(ii)(A) "Generally, under an accrual method, income is to be included for the taxable year when all the events have occurred that fix the right to receive the income and the amount of the income can be determined with reasonable accuracy."

The item of income at issue herein is the right to receive \$9,523,900.00 from the New York State Division of the Lottery as a prize. Petitioners' right to receive the income was fixed in 1992 at the time they won the lottery drawing and were still residents of the City of New York. The

amount of the income to which petitioners were entitled was also fixed at that time. The means used by the Lottery to fund the payment of petitioners' award is not relevant to the amount which petitioners "accrued" per section 11-1754(c).

Petitioners argue that the City of New York seeks to apply its resident income tax without regard to whether or not petitioners are residents of the City when the income being taxed is realized. In support of this argument, petitioners rely on *Matter of Michaelsen v. New York State Tax Commn.* (67 NY2d 579, 505 NYS2d 585). We do not believe that this case is on point, since it concerns realization of investment income by a nonresident rather than accrual of income by a resident on changing his status to a nonresident. Thus, the distinctions made by the Court of Appeals in that case are not determinative in the present situation.

The issue herein is not, as petitioners argue, what amount was realized by petitioners in the year they won the lottery and became nonresidents. Had petitioners not elected to continue to have New York City tax withheld from their payments, the face value of their lottery prize would have been both realized and recognized in the portion of the taxable year prior to their change of residence, since it accrued as income to petitioners as a matter of law pursuant to section 11-1754(c). Had petitioners included this prize in their New York City resident income tax return for the portion of the taxable year prior to their change of residence, the subsequent receipt of annual award payments would not be a tax recognition event for New York City tax purposes (Administrative Code § 11-1754[c]).

Petitioners, however, elected to continue to have taxes withheld from their annual payments, thus avoiding the accrual in the year their resident status changed. We think that the statutory scheme is plain that in return for allowing them to defer recognition of the lottery prize

in the portion of the taxable year prior to their change of residence, the statute required petitioners to include “*amounts accruable under this subdivision*” in their New York City adjusted gross income in the subsequent taxable years of payment “*as if the individual had not changed his or her resident status*” (Administrative Code § 11-1754[c][4]).

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Edison and Salvadora Blanco is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petition of Edison and Salvadora Blanco is granted to the extent set forth in conclusion of law “F” of the Administrative Law Judge’s determination, but in all other respects is denied;
4. The Notice of Deficiency, dated April 24, 1995, is sustained; and

5. Petitioners' claims for refund for the years 1993, 1994 and 1995 are upheld to the extent indicated in conclusion of law "F" of the Administrative Law Judge's determination, but in all other respects are denied.

DATED: Troy, New York  
April 6, 2000

/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