

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition :

of :

HENRY A. AND MARIANNE ITTLESON :

DECISION
DTA NO. 819283

for Redetermination of a Deficiency or for Refund of New :
York State and New York City Personal Income Tax under :
Article 22 of the Tax Law and the Administrative Code of :
the City of New York for the Year 1997.

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on July 1, 2004 with respect to the petition of Henry A. Ittleison and Marianne Ittleison, deceased, 1185 Poco Sabo Lane, Green Pond, South Carolina 29446. Petitioners appeared by Michael I. Saltzman, Esq. and Danielle Smith, Esq. (White & Case, LLP). The Division of Taxation appeared by Christopher C. O'Brien, Esq. (Kevin R. Law, Esq., of counsel).

The Division of Taxation filed a brief in support of its exception and petitioners filed a brief in opposition. The Division of Taxation filed a reply brief. Oral argument, at the Division of Taxation's request, was heard on March 16, 2005 in New York, New York.

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

ISSUE

Whether the Division of Taxation properly determined that the nonresident petitioners' gain from the sale of a painting was New York source income pursuant to Tax Law § 631(b)(1)(A) and, therefore, subject to New York personal income tax under Tax Law § 601(e).

FINDINGS OF FACT

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

Petitioner Henry A. Ittleson currently resides at 1185 Poco Sabo Lane, Green Pond, South Carolina (the "South Carolina residence").

Petitioner Marianne Ittleson is deceased.

Until April 14, 1997, petitioners held title to a cooperative unit at 812 Park Avenue, Apartment 11-D, New York, New York (the "New York apartment").

In no later than December 1996, petitioners became residents and domiciliaries of South Carolina. Prior to such time, they were residents and domiciliaries of New York City.

In January 1993, petitioners visited South Carolina and decided to make their home in South Carolina. They hired a real estate agent to begin a search for a satisfactory property in South Carolina.

In March 1994, petitioners identified the South Carolina residence as a potential new home. The acquisition of the South Carolina residence would involve their moving out of New York State and New York City.

On March 28, 1994, petitioners entered into a lease, with an option to purchase, the South Carolina residence. The option provided that petitioners could purchase the property no earlier than April 1, 1996 and no later than March 1, 1997.

From 1994 through 1996, petitioners caused substantial renovations to be made to the interior and exterior of the South Carolina residence.

In March 1996, renovations to the South Carolina residence were completed to petitioners' satisfaction.

Also in March 1996, petitioners moved most of their personal property to the South Carolina residence.

On May 8, 1996, petitioners offered the New York apartment for sale, having listed it with Sotheby's International Realty.

In December 1996, petitioners ceased using the New York apartment as their principal residence.

On December 23, 1996, petitioners received notification that their application for South Carolina voters registration had been processed.

Also in December 1996, petitioners received an offer for the purchase of the New York apartment.

On January 17, 1997, petitioners entered into a contract with a buyer for the sale of the New York apartment. The building in which the New York apartment was located was a cooperative, and the buyers could not actually purchase the apartment until such purchase was approved by the cooperative's board. Closing was therefore scheduled for April 14, 1997.

On March 1, 1997, petitioners obtained title to the South Carolina residence.

On March 14, 1997, petitioners closed on the purchase of the South Carolina residence after taking title. Petitioners closed after taking title on March 1, 1997, for the convenience of the seller.

On May 5, 1986, petitioners purchased a painting entitled “Jeanne Hebuterne Con Grande Cappello” (1918) by Amedeo Modigliani (1884-1920) (“the Painting”). The cost of the Painting was \$1,525,319.00.

When they were making renovations to the South Carolina residence during 1994 through 1996, petitioners made no suitable provision for hanging a valuable painting in the climate of the South Carolina residence. No space for hanging the Painting at the South Carolina residence was made. Also, at the time that petitioners’ personal property was moved from their New York apartment to the South Carolina residence, petitioners took no steps to move the Painting to the South Carolina residence.

In May 1996, when petitioners retained Sotheby’s to sell the New York apartment, petitioners also decided to sell the Painting through Sotheby’s.

Petitioners kept the New York apartment furnished while the apartment was being shown for sale. The Painting hung in the New York apartment until March 7, 1997.

On March 7, 1997, petitioners’ Painting was sent to Sotheby’s in advance of signing a consignment agreement.

On March 18, 1997, a consignment agreement was entered into between petitioners and Sotheby’s.

Sotheby’s exhibited the Painting from at least March through April 1997 in various cities outside New York and some cities outside the United States. The cities and dates the Painting

was exhibited were as follows: Tokyo, March 26-27, 1997; Los Angeles April 1-4, 1997; Paris, April 7-8, 1997; London, April 10-13, 1997; and Zurich, April 16-17, 1997.

From March 26, 1997 through April 17, 1997, the Painting was located outside New York.

After the exhibitions, Sotheby's prepared to auction the Painting and brought it back to New York City for auction to be held on or about May 13, 1997.

On May 13, 1997, the Painting was sold at auction for \$8,522,682.00 on behalf of petitioners at Sotheby's auction house in New York City.

The sale of the Painting at auction generated a gain to petitioners of \$6,997,363.00.

Petitioners also sold or caused to be sold several pieces of artwork and collectibles. The total gain realized by petitioners on all of the sales was approximately \$7,099,897.00, virtually all of which was attributable to the Painting.

On October 4, 2001, following an audit, the Division of Taxation ("Division") issued to petitioners a Notice of Deficiency which asserted \$494,432.83 in additional New York State and City income tax due for the year 1997, plus interest of \$138,973.96, for a total amount due of \$633,406.79. The deficiency resulted from the Division's determination on audit that petitioners' gain on the sales of the Painting, artwork and collectibles was subject to New York State and City income tax.¹

Petitioners filed a timely request for conciliation conference with the Division's Bureau of Conciliation and Mediation Services ("BCMS"). Following a conciliation conference on October 18, 2002, BCMS issued a conciliation order which modified the subject deficiency to \$483,871.49, plus interest.

¹ The parties apparently agree that the New York tax treatment of the gain on the sale of the collectibles should follow that of the Painting.

On audit the Division found petitioners to be domiciled in New York City and State through August 31, 1997. Subsequent to the conciliation conference and throughout this proceeding the Division has conceded that petitioners were domiciled in South Carolina as of January 1, 1997.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge issued a determination dated July 1, 2004 granting the petition and cancelling the Notice of Deficiency. The determination concluded that the Painting was in New York solely for sale and, accordingly, lacked a minimal connection to New York as required by the Due Process Clause of the Fourteenth Amendment in order to support taxation of petitioners' gain on its sale. A crucial premise for this conclusion is set forth in the following statement in the determination:

Obviously the Painting was located in New York for an extended period, i.e., from the time of its purchase by petitioners in 1986 until its removal by Sotheby's in March 1997. Critically, however, petitioners were New York residents until December 1996. At that point petitioners became nonresidents subject to tax only on their New York source income. The Painting was thus located in the apartment of a New York resident for an extended period, but was located in the apartment of a nonresident only temporarily. . . .

The location of the Painting during the time petitioners were New York residents is not relevant to a determination of whether, after petitioners became nonresidents, the gain from its sale is New York source income (Determination, conclusion of law "C").

Looking only to the period in which the Painting was held by the petitioners as nonresidents of New York – i.e., January 1, 1997 to May 13, 1997 – the determination held that the imposition of tax would fail to meet the two requirements of due process enunciated in *Quill Corp. v. North Dakota* (504 US 298, 119 L Ed 2d 91, at 102) namely, (i) that there is "some definite link, some

minimum connection, between a state and the person, property or transaction it seeks to tax” and (ii) that the income attributed to the state is “rationally related to ‘values connected with the taxing State.’ ” The first requirement is not met, according to the determination, because the Painting was in the state merely for temporary storage and sale. The Administrative Law Judge held that the second is not met because the New York location did not create any value for the Painting. Such value was instead created by “the international art market as shown by the international exhibition of the Painting prior to its sale” (Determination, conclusion of law “D”).

ARGUMENTS ON EXCEPTION

In support of its exception, the Division makes two arguments in its main brief. First, the Painting was always in New York from the time that the petitioners acquired it until it temporarily left New York for exhibition to facilitate the sale in New York. Accordingly, the Painting had a “physical situs” in New York and under the plain wording of the statute, the gain on sale was New York source income subject to tax. Second, under applicable decisions of the Supreme Court of the United States the imposition of tax on gain from tangible personal property is permitted under the Due Process Clause of the Fourteenth Amendment.

Petitioners’ brief asserts that the record shows that the situs of the Painting was changed to a situs outside New York before the sale and that its temporary presence in New York for purposes of sale did not satisfy the requirement that there be a “minimum connection” with the taxing state under applicable Supreme Court cases. Moreover, the gain from the sale of the Painting was not attributable to being property located in New York, but rather to the international art market in which it was sold.

In its reply brief, the Division rejects petitioners' argument that the Painting became disassociated from New York and asserts that petitioners "have not, and cannot, point to any locality other than New York as the painting's physical situs" (Reply brief, p. 2). It also asserts that the constitutional authority of the state to tax gain on tangible property located in the state is well supported by applicable Supreme Court cases.

OPINION

We reverse the determination of the Administrative Law Judge for the reasons set forth below.

The Painting was owned by petitioners for eleven years. The Painting hung on the wall of petitioners' New York City apartment throughout this period except for the final two months when it was in the hands of a New York auctioneer for purposes of sale. The only time that the Painting was absent from New York was during a three-week marketing tour conducted by the auctioneer.

Individual nonresidents of New York State are subject to personal income tax on their income derived from sources in New York including gains derived from tangible personal property located in New York. The statute reads, in pertinent part, as follows: "Items of income, gain, loss and deduction derived from or connected with New York sources shall be [*inter alia*] . . . those items attributable to the ownership of any interest in real or tangible personal property in this state . . ." (Tax Law § 631[b][1]). The generality of this language appears to impose tax in any case where tangible personal property is present in New York however briefly. The Audit Manual of the Division of Taxation stays the tax collector's hand, however, in certain circumstances. It reads as follows:

If tangible personal property is located in the state on a temporary basis and is not connected with a trade or business, the gain from the sale of that tangible property is exempt from New York income tax and is not included as New York source income. For example, if a nonresident consigns a piece of artwork to a New York auction house or gallery for sale, and the individual is not a dealer in artwork, the sale is not treated as New York source income. The sale of the same piece of artwork, if it were located in the nonresident's New York apartment for an extended period of time, would represent the sale of tangible personal property and the gain from the sale would properly be included as New York source income on a nonresident return (Audit Manual § 8.3.9.4.F.).

The focus of this provision is the location of the tangible personal property and indicates different results where the property is “located in the state on a temporary basis” and where the property is “located in [the state] for an extended period of time.” The determination of the Administrative Law Judge found that the Painting was located in the state for an extended period of time but concluded that the portion of this period during which petitioners were residents and domiciliaries of New York, May 5, 1986 to December 31, 1996, should not be considered for this purpose. Thus, the remaining period of weeks beginning on January 1, 1997, when their nonresident status began, and ending on May 13, 1997, when the Painting was sold, is the only relevant time to be tested. The determination concluded that this period was “temporary” with the result that the gain on the sale of the Painting is not New York source income. Moreover, the determination held that the application of tax in these circumstances would violate the Due Process Clause of the Fourteenth Amendment of the United States Constitution.

We are unable to find support in law or logic for excluding the period of residence as a step in the statutory or constitutional analysis. The quoted paragraph from the Audit Manual consists of three sentences. The first is a statement of the rule and the second and third are illustrative examples. As we read the paragraph, the sole issue presented is the duration of the

New York location of the tangible personal property. If “extended,” the gain is New York source; if “temporary,” it is not. New York is the art auction capital of the western hemisphere, at least, and the second sentence of the quoted paragraph seems intended to assure nonresident sellers who bring artwork to New York for sale that they will not be subject to income tax. The third quoted sentence makes clear that such assurance is not provided to nonresidents who have chosen a New York location for their artwork for an extended period. That sentence is on all fours with the facts of this case unless the sentence is read to imply that “located in the nonresident’s New York apartment” means “located in the nonresident’s New York apartment *during a period of nonresidence.*” We cannot discern such an implication. Moreover, such a reading would produce the odd result of taxing gain on a painting kept in a New York apartment if the taxpayers had been residents of New Jersey or Connecticut before moving to South Carolina but not if they had been residents of New York.

Accordingly, we agree with the determination of the Administrative Law Judge that “the Painting was located in New York for an extended period” but conclude that this entire eleven year period should be considered in deciding whether the gain on sale is from New York sources.

The Court of Appeals recently summarized the requirements of the Due Process Clause as applied to the personal income tax on nonresidents of New York as follows:

Due process . . . looks to the connection that must be present between the taxpayer and the taxing state before the state has the authority to impose its power to tax. [citations omitted] All that is required to satisfy due process is some “minimal connection” between the taxpayer and the state, and that the income the state seeks to tax be “rationally related to the values connected with” the state (*Huckaby v. New York State Tax Appeals Tribunal*, 4 NY3d 427, 796 NYS2d 312, at 319).

In the present case, the physical presence of the Painting in New York at the time of sale and for a substantial period of years before that clearly satisfies the requirement of a “minimal connection” with the state. In addition, the manifest benefits of the laws of New York attaching to petitioners’ ownership and sale of the Painting clearly are rationally related to the gain on the sale of the Painting which the state seeks to tax. This is no less true because high-end art auctions attract bidders from all parts of the world. There may well be cases in which the presence of tangible personal property in the state would be too ephemeral to satisfy the requirements of due process but this is not such a case.

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;
3. The petition of Henry A. and Marianne Ittleson is denied; and
4. The Notice of Deficiency dated October 4, 2001 is sustained.

DATED: Troy, New York
August 25, 2005

/s/Donald C. DeWitt

Donald C. DeWitt
President

/s/Carroll R. Jenkins

Carroll R. Jenkins
Commissioner

/s/Robert J. McDermott

Robert J. McDermott
Commissioner