STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
RONALD K. AND MAXINE H. LINDE	:	DECISION DTA NO. 823300
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Year 2005.	:	

Petitioners, Ronald K. and Maxine H. Linde, filed an exception to the determination of the Administrative Law Judge issued on July 21, 2011. Petitioners appeared *pro se*. The Division of Taxation appeared by Mark Volk, Esq. (Christopher O'Brien, Esq., of counsel).

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

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

ISSUE

Whether income realized as a result of the sale by a nonresident partnership of real property located in New York is properly allocated solely to New York State.

FINDINGS OF FACT

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

During the year 2005, petitioners, Ronald K. and Maxine H. Linde, were residents of the state of Arizona. For the tax year 2005, petitioners filed a joint New York State Nonresident and Part-Year Resident Income Tax Return. During the year at issue, petitioners were partners in Strategic Hotel Capital, LLC (Strategic), which was headquartered in and managed from Chicago, Illinois. Included in petitioners' income for the year 2005 were partnership distributions received from Strategic.

The business of Strategic was the purchase, renovation and management of hotel properties with the ultimate objective of selling the properties at a gain. Strategic owned hotels in several states, including New York. When Strategic acquired a hotel, it usually renovated the hotel and furnishings to enhance the quality of the hotel, thereby increasing its usage, rates and value.

Strategic purchased the Marriott East Side Hotel on March 4, 1998 and the Essex House Hotel on March 12, 1999, both located in New York City. Each hotel was subsequently renovated. Strategic included the costs of maintaining the hotels plus the associated depreciation deductions in the calculation of its operating income from the operations of the hotels. Strategic allocated the operating income from all of its hotels to New York by using the three-factor business allocation percentage.

Over the years, most of Strategic's income had been the result of gains from the sale of real property. During 2005, Strategic sold the Marriott East Side and Essex House hotels, as well as hotels located in other states. At the time, Strategic had a business plan to divest itself of all remaining hotel properties, and it was completely liquidated in 2009. On its 2005 New York State partnership return, Form IT-204, Strategic apportioned the gains using a business allocation percentage of 16.29. On their return, petitioners allocated the same portion of the gain derived from the sale of the two hotels to New York.

Following an audit, the Division of Taxation (Division) determined that Strategic did not properly allocate New York source income to its partners. The income at issue was the sale of the two hotel properties located in New York City. It was the position of the Division that the entire gains should have been allocated to New York, as the situs of the hotel properties was in New York.

On September 21, 2009, the Division issued to petitioners a Notice of Deficiency (assessment number L-032511120-6) for personal income tax due of $51,169.00, plus interest.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge determined that for an individual partner of a partnership who is nonresident of New York State, where the partnership does business both within and outside of the State, the New York portion of partnership income is generally determined by the partnership's business in New York that is based upon a business allocation percentage determined by the business activity of the partnership both within and without of New York. The Administrative Law Judge also found that the Tax Law includes an exception to that general rule in that, pursuant to 20 NYCRR 132.16, gains and losses from the sale of real property are not subject to application of the partnership's business allocation percentage, but instead are allocated entirely to the state where the sold real property is located.

The Administrative Law Judge found that the Division's interpretation of the law that the entire gain from the sale of real property located within New York State should be allocated entirely to New York was neither irrational nor unreasonable and is wholly consistent with the Tax Law.

Furthermore, the Administrative Law Judge distinguished the various cases cited by petitioners from the present matter and noted that none of the cited cases involve the allocation of

the proceeds of the sale of real property located in New York State but instead dealt with issues that were not analogous to this controversy.

The Administrative Law Judge found that petitioners' position that they are entitled to the waiver of all interest is without merit and that petitioners had presented no evidence to support an abatement of interest.

As a result of his findings, the Administrative Law Judge denied the petition and sustained the relevant Notice of Deficiency.

ARGUMENTS ON EXCEPTION

In their exception, petitioners make the same arguments as made before the Administrative Law Judge. Petitioners refer the Tribunal to their brief that was submitted to the Administrative Law Judge for support of their exception. Before the Administrative Law Judge, petitioners submitted into evidence a number of letters authored by Gregory Bergmann of Deloitte Tax, LLP, addressed to either the petitioners or the Division; most of petitioners' analysis and arguments before the Administrative Law Judge, and this Tribunal, were performed in the Deloitte Tax, LLP letters.

On exception, petitioners contend that 20 NYCRR 132.16, when read together with 20 NYCRR 132.15, is limited to gains derived from the sale of rental property, which the subject hotels were not. Petitioners argue that according to 20 NYCRR 132.15 (a), if a nonresident individual, or a partnership of which a nonresident individual is a member, carries on a business both within and without of New York State, unless the subject property is rental property, the gain attributable to the sale of real property must be apportioned and allocated to New York State on a proportional basis utilizing petitioners' business allocation percentage. Furthermore, petitioners argue that the Division's application of the relevant Tax Law and regulations violates

the Privileges and Immunities Clause and the Commerce Clause of the United States Constitution.

In response, the Division requests that the Tribunal uphold the Administrative Law Judge's determination; the Division also offered certain limited analysis of the constitutional claims.

OPINION

New York State imposes personal income tax on the income of nonresident individuals to the extent that their income is derived from or connected to New York sources (Tax Law § 601 [e]). Included in such income is that which is attributable to a business, trade, profession or occupation carried on in New York State (Tax Law § 631 [b] [1] [B]). As the Court of Appeals stated:

> "Although a state may tax all the income of its residents, even income earned outside the taxing jurisdiction, it may constitutionally tax nonresidents only on their income derived from sources within the state (see Shaffer v. Carter, 252 U.S. 37, 57 [1920]). In New York, the income of nonresidents is thus taxed by the State if it is 'derived from or connected with New York sources' (see Tax Law §§ 601 [e] [1]; 631 [a] [1]).[footnote omitted] New York source income includes income attributable to a business, trade, profession or occupation carried on in this State (see Tax Law § 631 [b] [1] [B])" (***Matter of Zelinsky v Tax Appeals Trib. of State of N.Y.***, 1 NY3d 85, 89-90 [2003], ***cert denied*** 541 US 1009 [2004]).

If a taxpayer's business, trade, profession or occupation is carried on partly within and partly without this State, the items of income, gain, loss and deduction derived from or connected with New York sources shall be determined by apportionment and allocation under such regulations (***Matter of Schibuk v New York State Tax Appeals Trib.***, 289 AD2d 718 [2001], ***lv dismissed*** 98 NY2d 720 [2002], ***rearg denied*** 99 NY2d 554 [2002]).

The New York source income of a nonresident individual includes the sum of the net amount of items of income, gain, loss and deduction entering into the individual's federal

adjusted gross income "derived from or connected with New York sources, including: (A) his distributive share of partnership income, gain, loss and deduction, determined under [Tax Law] section six hundred thirty-two . . ." (Tax Law § 631 [a] [1]). The New York source income of a nonresident partner includes his distributive share of all items of partnership income, gain, loss and deduction entering into his federal adjusted gross income to the extent such items are derived from or connected with New York sources (Tax Law § 632 [a] [1]).

The New York source of partnership income is determined by the partnership's business in New York, with the allocation percentage determined by the business activity of the partnership within and outside of New York, calculated by the partnership's business allocation percentage (or as calculated by an alternative method authorized by the Division).

The business allocation percentage results from the three percentages of partnership property, partnership payroll and partnership gross income (20 NYCRR 132.15 [d], [e], [f]). However, pursuant to 20 NYCRR 132.16, income and deductions connected with the rental of real property and gain and loss from the sale or exchange of real property are not subject to allocation, but are considered as entirely derived from the situs of the real property.

Petitioners argue that, in conjunction with discussing the recognition of income and losses, Tax Law § 632 (a) (1) includes the limiting words "only the portion," and 20 NYCRR 132.15 (a) includes the limiting words "apportioned and allocated to New York" along with the reference to "items of income, gain, loss and deduction attributable to such business." Petitioners assert that when 20 NYCRR 132.16 is read in conjunction with both Tax Law § 632 (a) (1) and 20 NYCRR 132.15, the sourcing of income, deductions, gains and losses referred to

in 20 NYCRR 132.16 must be limited to only those derived from rental property.[1] We find that petitioners are attempting to read language that does not exist into 20 NYCRR 132.16. Furthermore, we find that the language of 20 NYCRR 132.16 is clear as written and that the vague language found in Tax Law § 632 (a) (1) and 20 NYCRR 132.15 does not prohibit the approach that is advanced by the Division and is in fact prescribed by 20 NYCRR 132.16. Accordingly, we hold that the Division correctly interpreted 20 NYCRR 132.16 as requiring that the gains from the sale or exchange of real property are to be considered as entirely derived from the situs of the real property.

Petitioners cite to certain cases to support their position that the sourcing of gains from the sale of real property is not determined solely by the location of the property. Specifically, petitioners cite ***Matter of Ausbrooks v Chu*** (66 NY2d 281 [1985]); ***Matter of Vogt v. Tully*** (53 NY2d 580[1981]); ***Matter of Domber v Tax Appeals Trib. of State of N.Y.*** (210 AD2d 529 [1994], ***lv denied***, 85 NY2d 810 [1995]) and ***Matter of Domber v Tax Appeals Trib.*** (263 AD2d 277 [2000], ***lv denied*** 95 NY2d 760 [2000]). The Administrative Law Judge accurately pointed out the differences between the cases cited by petitioners and the case at hand, and thus those cases have little bearing on this case.[2]

Petitioners also argue that the current application of 20 NYCRR 132.16 is unconstitutional under both the Commerce Clause and the Privileges and Immunities Clause of the United States Constitution in that 20 NYCRR 132.16 allegedly discriminates against: (i)

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[1] Neither party in this case claims that the Strategic properties in question are rental properties.

[2] Interestingly, in ***Domber v Tax Appeals Trib. of State of N.Y.*** (210 AD2d 529 [1994], ***lv denied***, 85 NY2d 810 [1995]) the court indicated that in fact, for purposes of the application of 20 NYCRR 132.16, there is a distinction between income generated by (i) the rental of real property and (ii) real estate sales gains. This recognized distinction further supports the Division's position in this matter.

nonresident New York individual partners as opposed to resident New York individual partners, and (ii) all individual partners as opposed to corporate partners.

As the Court of Appeals noted:

> "Although the dormant Commerce Clause limits the power of states to erect barriers against interstate trade, a challenged tax will generally satisfy constitutional requirements if it 'is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State' (Complete Auto Tr., Inc. v. Brady, 430 U.S. 274, 279 [1977])" (***Matter of Zelinsky v Tax Appeals Trib. of State of N.Y.***, 1 NY3d 85, 90 [2003], ***cert denied*** 541 US 1009 [2004]).

Here, petitioners challenge only the third prong of this four-part Commerce Clause test, and assert that the combined effects of 20 NYCRR 132.15 and 20 NYCRR 132.16 discriminate against interstate commerce. The remaining three criteria are not disputed by petitioners.[3]

Pursuant to 20 NYCRR 132.16, parties are taxed on the full amount of the gain realized on the sale of real property located within New York State, regardless of whether they are resident or nonresident individual partners. The Division's application of 20 NYCRR 132.16 is exactly the same as to resident and nonresident individual partners; that is, the tax regulation at issue is an "evenhanded" regulation (***see Oregon Waste Systems, Inc.* v *Department of Environmental Quality of Ore.***, 511 US 93 [1994]) and is completely tax neutral on its face. Furthermore, 20 NYCRR 132.16 addresses a certain very specific type of gain, that is, the gain derived from the sale of real property.[4] In contrast, 20 NYCRR 132.15 addresses the accounting

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[3] Although petitioners desire to have 20 NYCRR 132.16 applied in such a way as to require the apportionment of gains from the sale of real property between within and without of the State, petitioners do not assert that the allocation of all of the gains from the sale of real property located within New York to the State is independently a violation of the fair apportionment, or any other, requirement of the Commerce Clause.

[4] As noted, 20 NYCRR 132.16 also addresses the sourcing of income and losses attributed to rental property operations but such is not germane to this analysis.

for income, gains and losses from other business operations. On its face, 20 NYCRR 132.16 does not discriminate between resident and nonresident individual partners. Petitioners claim that nonresident individual partners are treated differently from their resident counterparts, in that the nonresidents are not able to fully utilize the depreciation deductions from business operations because such are allocated as between New York and non-New York sources pursuant to 20 NYCRR 132.15.[5] Petitioners assert that this creates a potential detriment to nonresident individuals because in the nonresidents' respective gain calculation under 20 NYCRR 132.16, nonresidents take into account all of the accumulated depreciation, but these nonresident individuals received a deduction only for an allocated portion of such depreciation.[6, 7] Petitioners assert that although resident individual partners have the same gain calculation, such partners were able to fully utilize the depreciation deductions that make up the accumulated depreciation component of the gain calculation.

We hold that any differences in depreciation utilization, which are not incorporated into the calculation of the basis for the real property sold, shall be properly remedied by an adjustment by the Division to petitioners' basis, such that the basis calculation takes into account only the depreciation for which the nonresident individual partners previously received a benefit. Upon adjustment to petitioners' and other nonresident individual partners' basis, 20 NYCRR 132.16 treats resident and nonresident individual partners alike in all respects and does not discriminate between such parties.

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[5] Petitioners do not challenge the constitutionality of the allocation of income and expenses required pursuant to 20 NYCRR 132.15.

[6] Nonresident individual partners may also be able to benefit substantially from a tax perspective from the allocation of operating business income as compared to resident individual partners, where no allocation of such income is performed.

[7] In its brief, the Division does not address the petitioners' depreciation argument in any detail.

> "Like the Commerce Clause, the Privileges and Immunities Clause derives from the fourth article of the Articles of Confederation and was promulgated to create a national economic union, with one citizenry, by placing the citizens of each State on equal footing with citizens of other States, as far as the advantages resulting from citizenship in those States are concerned (see, Supreme Court of New Hampshire v. Piper, 470 U.S. 274, 279-280). The goal was to insure that the union of States would provide an economic system that would work to benefit all citizens of the union (see, The Federalist No. 7, at 61 [Alexander Hamilton] [Clinton Rossiter ed. 1961]). . .
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> The Privileges and Immunities Clause is not absolute (Toomer v. Witsell, 334 U.S. 385, 396), and affords no assurance of precise equality in taxation between residents and nonresidents of a particular State (Lunding et ux. v. New York State Tax Appeals Tribunal, et al., 522 U.S. 287, 297). Instead, the Clause requires a standard of 'substantial equality of treatment' for the citizens of the taxing State and nonresident taxpayers (Austin v. New Hampshire, 420 U.S. 656, 665)"(***City of New York v State of New York***, 94 NY2d 577, 592-593 [2000]).

As analyzed above, the regulation in question does not discriminate against nonresident individual partners, and thus does not violate the Privileges and Immunities Clause of the United States Constitution as claimed by petitioners.

Petitioners' second constitutional claim is that the Division's application of the regulation in question discriminates unconstitutionally against all individual partners as opposed to corporate partners. Such a claim challenges the constitutionality of the law on its face. We reject this claim and note that the Division of Tax Appeals lacks jurisdiction over constitutional challenges to statutes, which are presumed to be constitutional on their face (***see Matter of Eisenstein***, Tax Appeals Tribunal, March 27, 2003; ***see also Matter of Geneva Pennysaver***, Tax Appeals Tribunal, September 11, 1989; ***Matter of Fourth Day Enters.***, Tax Appeals Tribunal, October 27, 1988).[8] Accordingly, while we have jurisdiction to consider constitutional

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[8] We do note that the United States Supreme Court articulated that:
"As a general rule, 'legislatures are presumed to have acted within their constitutional power despite the fact that, in practice, their laws result in some inequality.' *McGowan v. Maryland*, 366 U.S. 420, 425-426 (1961). Accordingly, this Court's cases are clear that, unless a classification warrants some form of heightened review because it jeopardizes exercise of a fundamental right or

challenges ("as applied") to the actions of the Division of Taxation, we do not have jurisdiction to consider this particular argument advanced by petitioners. Petitioners will not be denied a resolution of this constitutional claim if they bring an Article 78 proceeding to review this decision before the Appellate Division, Third Department.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Ronald K. and Maxine H. Linde is denied;

2. The determination of the Administrative Law Judge is affirmed as adjusted herein;

3. The petitions of Ronald K. and Maxine H. Linde are denied; and

4. After accounting for the adjustment to the petitioners' basis as noted herein, the Notice of Deficiency dated September 21, 2009 is sustained.

DATED: Albany, New York
May 24, 2012

/s/ James H. Tully, Jr.
James H. Tully, Jr.
President

/s/ Charles H. Nesbitt
Charles H. Nesbitt
Commissioner

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categorizes on the basis of an inherently suspect characteristic, the Equal Protection Clause requires only that the classification rationally further a legitimate state interest. See, *e. g., Cleburne v. Cleburne Living Center, Inc.*, 473 U.S. 432, 439-441 (1985); *New Orleans v. Dukes*, 427 U.S. 297, 303 (1976)." (***Nordlinger v Hahn***, 505 US 1, 10 [1992]).