STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
JOHN W. AND DORIS N. RIEHM	:	DETERMINATION
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Years 1982 and 1983.	:	

Petitioners, John W. and Doris N. Riehm, 1321 South College, Tyler, Texas 75701, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the years 1982 and 1983 (File No. 803437).

A hearing was held before Nigel G. Wright, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on October 17, 1988 at 1:15 P.M. Petitioners appeared pro se. The Division of Taxation appeared by William F. Collins, Esq. (Herbert Kamrass, Esq., of counsel).

ISSUES

I. Whether a Notice of Deficiency which was not mailed to petitioners' last known address as required by Tax Law § 681(a) is sufficient under Tax Law § 683(e) to suspend the three-year limitation period on assessments provided by Tax Law § 683(a).

II. Whether the income of petitioners, residents of New York, should include capital gains realized by a trust located in Texas, the income of which is taxable to petitioners for Federal purposes under Internal Revenue Code § 671. III. Whether a negligence penalty under Tax Law § 685(b) was properly imposed.

FINDINGS OF FACT

1. In 1982 and 1983, the years here in question, petitioners resided in Bronxville, New York. They also resided there in 1984 and 1985. They at sometime in 1985 or 1986 moved to Tyler, Texas.

2. (a) A Notice of Deficiency was issued on April 10, 1986 to John and Doris Riehm for 1982 and 1983 personal income taxes in the amount of $52,342.23, a penalty for negligence under Tax Law § 685(b) of $2,617.11 and interest of $12,272.77, for a total of $67,232.11.

(b) The notice was sent to petitioners at 238 Pondfield Road, Bronxville, New York 10708. This notice was not received by petitioners until after April 15, 1986. The Division of Taxation has agreed that the Bronxville address was not the last known address.

(c) Petitioners had informed the White Plains District Office of the Department of Taxation by letter dated March 17, 1986 of their change of address to Tyler, Texas. This had been in response to the receipt from that office of a Statement of Audit Changes. That office acknowledged receipt of the letter stating that their file had been sent "to Albany" and that petitioners "will receive" from Albany a deficiency notice.

3. (a) The asserted deficiency is due to a number of items: an increase in capital gains; disallowance of an investment credit in 1982; disallowance of a resident credit for failure of proof; addback of depletion in 1982; decrease in a partnership loss in 1983; and increase in capital gains.

(b) Many of these items have been agreed to by the parties. The sole remaining item of deficiency involves capital gains from sales of securities in 1982 and 1983 by the John W. Riehm Revocable Trust. The increase in gains (after capital gains deduction) is $986.64 for 1982 and $179,333.20 for 1983.

4. (a) Mr. John Riehm created a revocable trust in 1982. This was created in Texas with a Texas bank as trustee.

(b) The trust instrument provided that:

> "if any part of the corpus...is sold the proceeds shall be immediately reinvested as corpus and no portion thereof shall be considered to be distributable net income of the Trust as that term is defined in the Internal Revenue Code."

(c) In 1982 and 1983 the Texas trustee sold some of the assets of the trust.

(d) The trust included the capital gain in its Federal tax forms 1041 for 1982 and 1983. The trust paid no tax. This same income, however, was included in the Federal tax returns of petitioners for 1982 and 1983.

CONCLUSIONS OF LAW

A. The Notice of Deficiency must be considered insufficient to suspend under Tax Law § 683(e) the limitation period for 1982 with the result that any assessment for that year is now time-barred. It can be immediately noted that the issue is not whether the Notice of Deficiency is sufficient to commence the 90 day period under Tax Law § 689(b) for filing a petition to contest the deficiency. That may be another matter but here both parties agree that the petition for a hearing was timely filed. The limitation period for an assessment is governed by Tax Law § 683(a). That provides that an assessment cannot be made after three years from the date a

return is filed (Tax Law § 683[a]). Furthermore, an assessment cannot be made until a Notice of Deficiency has been issued (Tax Law § 681[c]). That time, where the addressee of the notice is within the United States, is 90 days (Tax Law § 689[b]). Since the 90-day period suspends the three-year time period for making an assessment, it follows that that time period is met when the deficiency notice itself, if properly mailed, is issued. To be proper, however, the Notice of Deficiency must meet the terms of the statute. Section 681(a) of the Tax Law authorizes such a notice and then requires that such notice "shall be mailed...to the taxpayer at his last known address...." This is clearly a requirement of the notice, as admitted by the Department's memorandum. (It can be noted that the Tax Law language so providing is in sharp contrast to the comparable language of the Internal Revenue Code which states merely that a correct notice "is sufficient"). This requirement was not met in this case with the result that the limitation period in this case has continued to run and any assessment now would be time-barred. The argument to the contrary made by the Department relies entirely on cases where the taxpayer was trying to get a hearing and his petition to get the hearing was delayed beyond 90 days from receipt of the Notice of Deficiency because of a delay in receiving the Notice of Deficiency itself (see___ Matter of Agosto v. Tax Commission, 68 NY2d 891; Matter of the Petition of Panza, State Tax Commission, June 17, 1986, TSB-H-86-[108]I). For this purpose the effective date of the Notice of Deficiency has been held to be the time of mailing only when the statutory provision for mailing is precisely followed and to be the date of physical delivery to the taxpayer in other cases, such as where a bad address was used and the taxpayer was prejudiced. The mistake of the Department in using a wrong address is remedied by, in effect, granting the taxpayer more time to file his petition. These cases, of course, are consistent with the policy of the statute to grant taxpayers a hearing. Where, as in this case, the limitation period on assessments is involved, the mistake of the Department should not be used to harm the taxpayer. A statute of limitations is a statute of repose and should be read so as to give the greatest meaning to the apparently clear cut time period provided by the Legislature and not to create imprecision in the computation of that

period. A definite time period will avoid litigation on the issue of the limitation period itself and so provide the greatest degree of security from State claims.

B. The capital gains of the Riehm trust are properly taxed to petitioners. For resident individuals New York adjusted gross income means Federal adjusted gross income with modifications not pertinent here (Tax Law § 612[a]). The resident receives as New York itemized deductions the amount of his Federal deductions from Federal adjusted gross income with modifications not pertinent here (Tax Law § 615[a]). These references to the Federal adjusted gross income and Federal deductions are to those terms as defined in the laws of the United States and must necessarily refer to all sections of the laws of the United States and not, as petitioner appears to contend, to only those sections cited explicitly in the New York law. For Federal purposes where the grantor is treated as the owner of a trust, the items of income and deduction of the trust are included in the taxable income of the grantor (IRC § 671). This income is reportable to the grantor as if received by him directly (U.S. Treas. Reg. 1.671-3). Thus, because the gains are in petitioners' Federal taxable income, they must be in their New York taxable income.

The petitioners' arguments based on section 618 of the New York Tax Law must be rejected. That section deals with the taxation of trusts. It does, as petitioner points out, allude to gains which are "excluded from Federal distributable net income of the trust". This, of course, is important for the taxation of "simple" and "complex" trusts under subparts B and C of part 1 of subchapter J of the Internal Revenue Code. This allusion, however, does not imply that the further provisions of subpart E of part 1 of subchapter J dealing with "grantor" trusts are not to be taken into account. In fact, as stated above, Regulation 1.671-3 requires that the income of such trusts be reportable directly by the grantor. Such income will not, for either New York or Federal purposes, be taxable to the trust. The first sentence of section 618 defines New York taxable income of a trust by reference to the Federal taxable income of the trust. Under section 671 of the Internal Revenue Code none of the items of income of this trust, as a grantor trust, will be

taxable to the trust (U.S. Treas. Reg. 1.671-4). It is further immaterial that the capital gains of this trust are to be immediately added back to corpus. The Federal regulations explicitly state with respect to a grantor trust that "it is ordinarily immaterial whether the income involved constitutes income or corpus for trust accounting purposes" (U.S. Treas. Reg. 1.671-2[b]).

C. The negligence penalty should not be imposed here. The petitioner's position has not been previously litigated. It has been maintained in a candid and courteous manner as one of several issues, the others of which have been resolved by mutual concessions. Additionally, I note that I have no way of knowing that it was a nonreporting of the capital gain item that caused the imposition of the penalty, and without a specification of the reason for the penalty, I cannot uphold it (Kilborn v. Comm'r., 29 TC 102, 111-112 [1958], acq 1951-1 CB 5, rev'd on other issues 58-2 USTC 9847 [5th Cir 1958], rev'd per curiam sub nom U.S. v. Hine Pontiac et al., 360 US 715 31 ed 2d 1539 [1959]).

D. The petition of John W. and Doris N. Riehm is granted and the deficiency for 1982 is cancelled. The deficiency for 1983 is found correct.

DATED: Albany, New York

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ADMINISTRATIVE LAW JUDGE