STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
WILLIAM AND GLORIA KATZ	:	DETERMINATION DTA NO. 805768
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Year 1984.	:	

Petitioners, William and Gloria Katz, 217 Harborview North, Lawrence, New York 11559, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the year 1984.

On May 14, 1993 and May 24, 1993, respectively, petitioners, by their duly appointed representative, Blum, Gersen and Wood, Esqs. (Eugene B. Fischer, Esq., of counsel), and the Division of Taxation, by William F. Collins, Esq. (Andrew J. Zalewski, Esq., of counsel), waived a hearing and agreed to submit the matter for determination based on documents and briefs to be submitted by September 24, 1993. The Division of Taxation submitted its documents on July 1, 1993. Petitioners, in turn, submitted documents and a brief on July 27, 1993. The Division of Taxation submitted a responding brief on August 31, 1993. Petitioners' reply brief was submitted on September 24, 1993. After due consideration of the evidence andarguments, Dennis M. Galliher, Administrative Law Judge, renders the following determination.[1]

[1]A jurisdictional issue involving the timeliness of petitioners' protest herein was dealt with in a November 14, 1991 Tax Appeals Tribunal decision holding petitioners' protest to be timely and remanding the case for a determination on the merits (see, Matter of Katz, Tax Appeals Tribunal, November 14, 1991). Exhibits "A" through "J" and "1" and "2", submitted in connection with the prior proceedings, as well as the transcript of such proceedings, remain included as a part of the record herein.

ISSUE

Whether petitioners were entitled to claim a credit against their New York State personal income tax liability for 1984 based on income taxes they paid to another state on slot machine winnings from a casino located in such other state.

FINDINGS OF FACT

For the year 1984 petitioners, William and Gloria Katz, were residents of New York State and New York City. In 1984, petitioner William Katz hit a jackpot on a slot machine at Bally's Casino and Hotel in Atlantic City, New Jersey, winning $2,202,482.00.

Petitioners filed a New Jersey Non-Resident Gross Income Tax Return for 1984, reported the slot machine winnings thereon, and paid tax in the amount of $76,318.00 to New Jersey. Petitioners also filed a New York State Resident Income Tax Return for 1984, on which they claimed a credit against their New York State personal income tax liability (the "resident tax credit") in the amount of $76,318.00, i.e., the amount of tax paid by them to New Jersey.

The Division of Taxation ("Division") audited petitioners' 1984 New York return and thereafter issued a Statement of Audit Changes dated May 20, 1987 which disallowed petitioners' claimed resident tax credit. This statement explained that:

> "New York State does not allow a resident credit based on gambling winnings earned in another state as the income is not connected with personal service income or a trade or business carried on in the other jurisdiction."

The statement asserted additional income tax due in the amount of $58,372.00,[2] plus interest. Penalty was not asserted by the Division on such statement.

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[2]The dollar variance between the amount of resident tax credit claimed by petitioners ($76,318.00) versus the amount of the asserted deficiency following disallowance of such credit ($58,372.00) stems from other adjustments to petitioners' New York return (principally concerning refunds for other years based on application of a net operating loss carryback). This dollar variance is not in dispute and has no impact on resolving the resident tax credit issue presented herein.

The Division next issued to petitioners a Notice of Additional Tax, dated July 10, 1987, showing tax due of $58,372.00, plus interest. Again, penalty was not asserted on the document. This notice provided, in part, as follows:

> "If you do not agree with this adjustment, you may submit additional information pertinent to your case by writing to this office [Tax Compliance Division], referring to the above assessment number.
>
> "Your failure to respond to this letter within 15 days will result in the issuance of a statutory Notice of Deficiency for the amount of the additional tax plus accrued interest. The issuance of this Notice represents the Division's first formal step towards taking legal action to compel payment."

The Notice of Additional Tax described above was followed by the Division's issuance of a Notice of Deficiency, dated August 20, 1987,

asserting additional tax due in the amount of $58,372.00, plus interest. As before, no penalty was asserted by the Division.

On or about May 9, 1988, petitioners filed an Amended New Jersey Gross Income Tax Return for the year 1984, claiming that there was no provision in the New Jersey Income Tax Law under which a nonresident could be taxed on slot machine winnings. Petitioners thus claimed they owed no tax to New Jersey and requested a refund of the entire tax previously reported and paid to New Jersey, i.e., $76,318.00.

Petitioners' request for refund was denied by the New Jersey Division of Taxation ("N.J. Division"), as was a subsequent request for a conference regarding such denial.

On May 19, 1989, petitioners filed an action in the Tax Court of New Jersey requesting a refund of all taxes paid for the year 1984. Petitioners' position in this action was stated as follows:

> "The entire amount of income originally reported as from New Jersey sources was from winnings of a slot machine jackpot in Atlantic City. There is no provision in the New Jersey Income Tax Law under which a nonresident of New Jersey is taxable on such winnings. Section 54A:5-5 states that 'the income of a nonresident individual shall be that part of his income derived from sources within this State as defined in this act.' New Jersey source income for nonresidents is defined in N.J.S.A. 54A:5-8. The Division of Taxation has denied the refund claim citing Section 54A:5-8(3) which refers to income from 'work done' or 'business activities' conducted in New Jersey. It is the taxpayers' contention that the winning of money

> by the mere pulling of a slot machine handle on an infrequent visit to a casino in Atlantic City is not income from 'work done' or 'business activities' in New Jersey. Further, it is clear that it was not the Legislature's intent to subject non-residents to the New Jersey Gross Income Tax on such winnings as N.J.S.A. 54A-5-1(g) and (1) specifically include 'gambling' and 'amounts received as prizes and awards...' as income taxable to residents of New Jersey. No similar language is found in the definitions of income from New Jersey sources for a nonresident which is set forth in N.J.S.A. Section 54A:5-8. Further, New Jersey Gross Income Tax Regulations Section 18.35-1.20(b)(2) indicates that the Gross Income Tax will not be withheld from payments 'of winnings from a slot machine, or a keno or bingo game.' Therefore, even this Regulation which became effective September 6, 1988, well after the year at issue, recognizes the non-taxability of the taxpayer's winnings by New Jersey."

On September 12, 1990, a Stipulation of Dismissal of petitioners' action in the Tax Court of New Jersey was executed. Pursuant to this dismissal, the N.J. Division issued a refund in the amount of $76,318.00, plus interest at the rate of 6% from the date of the filing of the claim for refund to the date of its payment, in full payment of petitioners' claim for refund.

Petitioners' representative mailed a Notice of Withdrawal of Petition (the "Withdrawal"), dated January 14, 1991, to the Division of Tax Appeals, together with a covering letter which indicated that the Withdrawal should be considered as becoming effective only if the Division of Tax Appeals did not grant the relief (modification or waiver of interest per Tax Law § 2006.12) requested in the covering letter. A copy of this letter was sent to counsel for the Division. Thereafter, petitioners' representative sent another letter to the Division of Tax Appeals, dated January 18, 1991, in which he indicated that he was "withdrawing" the Withdrawal and requesting that the case proceed to determination. As before, a copy of this letter was sent to counsel for the Division.

On January 22, 1991, the Administrative Law Judge then assigned to this case sent a letter to petitioners' representative indicating: a) that he had received the January 18, 1991 letter (withdrawing the Withdrawal); b) that he had not received the January 14, 1991 letter containing the Withdrawal (as referenced in the January 18, 1991 letter); and c) that petitioners' representative should submit a copy of the January 14, 1991 letter. Thereafter, on January 29, 1991, the Administrative Law Judge sent another letter to petitioners' representative indicating that he had received the January 14, 1991 letter including the Withdrawal on January 29, 1991.

The Division submitted, as part of its documentary evidence, copies of petitioners' representative's January 14, 1991 and January 18, 1991 letters. The Division's copies of the January 14, 1991 and January 18, 1991 letters, as submitted herein, did not include the envelopes in which they were received by the Division. Each of such letters bears a Division of Taxation - Law Bureau indate stamp of January 24, 1991. By comparison, the Division of Tax Appeals' case file in this matter includes the originals of such letters together with the envelopes in which they were mailed. The envelope in which the original January 14, 1991 letter was mailed bears a machine-metered (Pitney-Bowes) postmark of January 17, 1991, no United States Postal Service ("USPS") postmark, and a Division of Tax Appeals indate stamp of January 29, 1991. In turn, the envelope in which the January 18, 1991 letter was mailed (withdrawing the Withdrawal) bears machine-metered (Pitney-Bowes) and USPS postmarks of January 18, 1991, while the letter itself bears a January 22, 1991 Division of Tax Appeals indate stamp.

On February 5, 1993, petitioners' representative was advised, by a letter from the Division's representative, that the Division's then-current records regarding this case indicated the amount at issue to consist of $58,372.00 in tax, $57,828.84 in interest and $14,593.00 in penalties.

SUMMARY OF PETITIONERS' POSITION

Petitioners, as New York residents, do not dispute that the slot machine winnings were properly subject to tax by New York under Tax Law Article 22, and in fact petitioners reported the same as income on their 1984 New York resident return (at line "17"). However, petitioners maintain in this proceeding that such income was derived from or connected to New Jersey sources, arguing that to win a slot machine jackpot one must be physically present at the site of the machine (in this case, New Jersey) in order to pull the machine's handle. Petitioners cite to New York tax regulations (20 NYCRR former 131.4[e]) in support of the argument that the slot machine winnings were New Jersey source income subject to New Jersey tax, upon payment of which petitioners became eligible for New York's resident tax credit.

Petitioners also claim that if no New York credit is allowed, they will have been subjected to double taxation, during the year in question, in light of the N.J. Division's original position that the winnings at issue constituted income subject to New Jersey's gross income tax. Finally, petitioners argue that New Jersey's repayment to petitioners pursuant to the Stipulation for Dismissal was not made with any express acknowledgement that the tax was not properly paid in the first instance, thereby leaving petitioners entitled to the New York credit. In this regard, petitioners argue that the Division may not "recapture" the New York credit claimed by petitioners based on New Jersey's repayment in 1990 absent any such express acknowledgement. In the alternative, petitioners maintain that if recapture is to be permitted based on the New Jersey repayment, the Division must first issue a "separate assessment" for recapture of the credit in 1990.

CONCLUSIONS OF LAW

A. A preliminary matter to be resolved is the Division's argument that petitioners submitted a Notice of Withdrawal of Petition (see Finding of Fact "10") which, according to the Division, became effective upon its filing with the Division of Tax Appeals and could only be withdrawn upon an order issued by the Division of Tax Appeals. The Division cites to Matter of D & C Glass Corp. (Tax Appeals Tribunal, June 11, 1992) in support of its claim that once a notice of withdrawal is filed, the only means of withdrawing the same is via a motion to reopen the case. However, unlike D & C Glass Corp.,[3] where the notice of cancellation was received by the Division of Tax Appeals prior to a telephone call indicating that the same had been mailed in error and was being retracted, the Withdrawal in this case was not received until after its cancellation in writing had been received by the Division of Tax Appeals. Thus, as petitioners point out, the Division of Tax Appeals could not have acted upon such Withdrawal since it had been withdrawn prior to its receipt. On this score, the Administrative Law Judge

[3]In D & C Glass Corp., the document involved was a "Notice of Cancellation of Deficiency/Determination and Discontinuance of Proceeding", submitted by the Division of Taxation to the Division of Tax Appeals.

then assigned to the case wrote to petitioners on January 22, 1991 indicating that he had not received the Withdrawal and was only aware of the same by virtue of the fact that he had received the cancellation thereof (see, Finding of Fact "11"). In addition, the evidence detailed in Finding of Fact "12" supports the conclusion that the Withdrawal was cancelled prior to its filing with the Division of Tax Appeals. More specifically, the Withdrawal envelope bears no USPS postmark and the letter bears a Division of Tax Appeals indate stamp of January 29, 1991, while the envelope for the cancellation letter reflects a January 18, 1991 USPS postmark and the letter bears a January 22, 1991 Division of Tax Appeals indate stamp. Hence, under well-established case law with regard to determining the date of filing of documents, the Withdrawal would be deemed filed on January 29, 1991 (as governed, in the absence of a USPS postmark,

by its delivery date), whereas its cancellation was filed earlier (as governed by its USPS postmark date) on January 18, 1991 (see, Matter of Stage Delicatessen East, Tax Appeals Tribunal, March 9, 1989; Matter of Harron's Electric Service, Tax Appeals Tribunal, February 19, 1988). Thus (although an anomaly) the Withdrawal was cancelled before it was filed.

Finally, the Administrative Law Judge obviously did not accept the Withdrawal, but rather considered the same to have been cancelled. This is evidenced by the fact that the Administrative Law Judge proceeded to issue a determination on the then-pending jurisdictional timeliness of the petition issue. Thereafter, an exception was taken to the Tax Appeals Tribunal, which in turn issued its decision reversing the Administrative Law Judge, holding petitioners' protest to be timely and remanding the case for a hearing on the merits (see, footnote "1"). In neither the Administrative Law Judge's determination nor the Tribunal's decision is the Withdrawal raised as an issue. Furthermore, there is no evidence that the Division, which was on notice of both the filing of the Withdrawal and the cancellation thereof, raised any objection or attempted to claim the Withdrawal to be effective and have these proceedings terminated at

any time prior to the filing of its brief herein. Accordingly, for all of the foregoing reasons, the Division's argument that petitioners had withdrawn their petition as to the merits of this case is rejected.

B. The substantive question presented here is whether petitioners, as residents of New York State for the year at issue, were entitled to a credit, pursuant to Tax Law § 620(a), against their New York personal income tax liability based on taxes they paid to the State of New Jersey.

C. Tax Law § 620(a) provides, in pertinent part, that:

> "A resident shall be allowed a credit against the tax otherwise due under this article for any income tax imposed for the taxable year by another state of the United States . . . upon income both derived therefrom and subject to tax under this article." (Emphasis added.)

D. In Matter of Mallinkrodt, decided November 12, 1992, the Tax Appeals Tribunal explained that in order to receive a credit for tax paid to another state, a taxpayer must prove three separate elements as follows:

(a) that another state of the United States imposed a tax on the subject income;

(b) that the income was derived from another state of the United States; and

(c) that the income was subject to tax under Article 22 of the Tax Law.

E. The third part of the three-part test described above, i.e., that the income was subject to tax under Article 22 of the Tax Law, has admittedly been met. However, petitioners have failed to establish that either the first or second parts of such test have been met.

As to the first part of the test, the New Jersey Tax Law, as in effect during the year in question, was not written in a manner such that a New Jersey nonresident individual was required to report and pay gross income tax on income resulting from gambling winnings (see, NJ Stat Ann former § 54A:5-8; compare NJ Stat Ann § 54A:5-1). The N.J. Division initially took a contrary position when faced with this specific argument in petitioners' refund claim and Tax Court action (see, Finding of Fact "8"). However, such position was apparently abandoned as evidenced by the fact that New Jersey thereafter agreed to refund to petitioners all of the tax paid based on such winnings. Furthermore, New Jersey has recently amended the nonresident

source income portion of section 54A so as to specifically include gambling winnings of a nonresident as income from sources within the state. In this regard, New Jersey Statutes Annotated, section 54A:5-8 was amended, approved and effective June 18, 1993 and applicable to tax years ending on or after such date, to provide that nonresidents are taxed on the income from any wagering transaction in New Jersey. In light of the Stipulation for Dismissal in petitioners' New Jersey Tax Court case, New Jersey's subsequent full refund of the tax paid by petitioners on the slot machine jackpot, and the described amendment to New Jersey's statute to specify that a nonresident's wagering transaction income is New Jersey source income subject to tax, it is concluded that in 1984 the applicable New Jersey law did not impose tax on such income.

F. In addition to the foregoing, the second part of the three-part test raises the question of whether the gambling winnings received by petitioners in 1984 were derived from New Jersey within the meaning of Tax Law § 620(a). On this score, 20 NYCRR former 121(4)(d) provided as follows:

> "'Income derived from sources within another state . . . (see, 20 NYCRR 120.1) is construed so as to accord with the definition of the term 'derived from or connected with New York State sources', as set forth in Part 131 of this Subchapter in relation to the adjusted gross income of a nonresident individual. Thus, the resident credit against ordinary tax is allowable for income tax imposed by another jurisdiction upon compensation for personal services performed in the other jurisdiction, income from a business, trade or profession carried on in the other jurisdiction, and income from real or tangible personal property situated in the other jurisdiction. On the other hand, the resident credit is not allowed for tax imposed by another jurisdiction upon income from intangibles, except where such income is from property employed in a business, trade or profession carried on in the other jurisdiction" (20 NYCRR 120.4[d]; emphasis added).

G. The Tax Appeals Tribunal has noted that the word "derived" in Tax Law § 620(a) requires a more substantial degree of contact with the taxing state than might be sufficient to grant that state the ability to constitutionally tax the income (Matter of Mallinkrodt, supra). Under the noted regulation, the degree of contact is sufficient where the income arises from either the taxpayer's commercial activities within the taxing state or from real or tangible property situated therein (id.). With regard to this test, it is clear that the slot machine income in question was not the result of commercial activities undertaken by petitioners within New

Jersey (there is no evidence that gambling was petitioners' business or profession), nor was such income derived from real or tangible property situated therein. There is no evidence that such winnings represented compensation for personal services performed in the other jurisdiction. Hence, the record does not establish that the income in question was derived from New Jersey pursuant to Tax Law § 620(a).

H. In light of the foregoing, the Division's disallowance of petitioners' claim for resident tax credit was proper and is sustained. As described, New Jersey has refunded the tax paid by petitioners. Hence, granting petitioners' claim for a New York resident tax credit would give petitioners a resultant windfall by which they would have paid no tax on the income in question to either jurisdiction (New York or New Jersey).

I. Finally, the balance of petitioners' arguments do not merit a great deal of discussion. It is sufficient to note that this case does not involve the Division's attempt to "recapture" a credit based on the New Jersey refund, but rather stems from the Division's consistent position that petitioners were not entitled to claim the credit in the first instance. That is, New Jersey's statute, as in existence during the year in question, did not impose a tax on gambling winnings by nonresidents. Since no tax was therefore due New Jersey (and since the income in question was not derived from New Jersey sources per Tax Law § 620[a] as described above), the Division properly disallowed petitioners' claim for resident tax credit.[4]

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[4]In one piece of correspondence, the Division indicated that a portion of the deficiency herein included penalty (see, Finding of Fact "13"). However, there is no evidence that penalty was asserted on any of the documents including, ultimately, the Notice of Deficiency. Furthermore, there is no evidence from which to conclude that the Division has, by such single piece of correspondence, asserted a greater deficiency based on the addition of penalty subsequent to the issuance of the Notice of Deficiency or, if so, that the Division has borne its resulting burden of proving the appropriateness of the assertion of a greater deficiency. It is also noted that the Division did not argue for the imposition of penalty at any point in its brief herein. Given these factors, it is concluded that penalty was not asserted, is not at issue, and that the Division's February 5, 1993 letter was issued in error in such regard.

J. The petition of William and Gloria Katz is hereby denied, the Division's denial of petitioners' claim for resident tax credit is sustained, and the resultant Notice of Deficiency, dated August 20, 1987, is sustained.

DATED: Troy, New York
March 24, 1994

/s/ Dennis M. Galliher
ADMINISTRATIVE LAW JUDGE