STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
JOSEPH H. MEYER	:	DETERMINATION DTA NO. 808273
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Years 1981 through 1987.	:	

Petitioner, Joseph H. Meyer, 3901 S.E. St. Lucie Boulevard, Stuart, Florida 34997, 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 1981 through 1987.

A hearing was held before Jean Corigliano, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on June 20, 1991, at 1:15 P.M. The record was left open to August 15, 1991 to allow the parties an opportunity to file briefs. Neither party submitted a brief. Petitioner was represented by Robert W. Taylor, Esq. The Division of Taxation was represented by William F. Collins, Esq. (Michael J. Glannon, Esq., of counsel).

ISSUES

I. Whether petitioner, a nonresident partner of a New York partnership, is subject to New York tax on his distributive share of partnership income.

II. Whether the asserted tax deficiency should be adjusted by increasing the number of personal exemptions and the amount of the itemized deductions allowed petitioner.

III. Whether petitioner has established reasonable cause for failing to file New York State nonresident income tax returns for the years in issue, thus justifying cancellation of penalties and interest above the minimum.

IV. Whether there is any bar, at law or in equity, to the assessment of tax against petitioner after the passage of three years.

FINDINGS OF FACT

Petitioner, Joseph H. Meyer, is a resident of the State of Florida and has been since 1971. He did not file New York State personal income tax returns for any of the years in issue.

Petitioner was a limited partner in a New York partnership called 1400 Broadway Associates (the "Partnership") in the years 1981 through 1987. The Partnership leased a building located at 1400 Broadway in New York City which it operated as rental property. The Partnership's 1985 New York State partnership return indicates that its principal business activity was real estate rentals. It affirmatively responded to this question on the return: "Does the partnership have an interest in real property located in New York State?" The Partnership's 1987 Federal income tax return shows numerous expense deductions from rental income, including deductions for plumbing, electrical repairs, painting, and management fees.

Through an examination of the partnership income tax returns of the Partnership, the Division of Taxation ("Division") determined that petitioner received sufficient income from the Partnership to require him to file nonresident New York State personal income tax returns.

By letter dated September 16, 1987, the Division advised petitioner that a review of the Division's files showed that petitioner had filed no New York tax returns for the years 1982 through 1986. The Division's position with regard to the Partnership income was stated as follows:

> "Partnership distribution schedules of 1400 Broadway Associates indicates [sic] you received sufficient income to require filing New York returns. The New York Tax Law, Section 632 and 637 of Article 22 states that the New York adjusted gross income of your nonresident partner shall include his distributive share of all items of partnership income, gain, loss and deduction entering into Federal adjusted gross income to the extent such items are derived from or connected with New York sources."

Petitioner was asked to send copies of any returns he may have filed for the years indicated or to state his reason for failing to file and to file returns as soon as possible. He was also asked to submit copies of Federal income tax returns for 1982 through 1986.

Petitioner's representative, Robert W. Taylor, replied to the Division by letter dated October 14, 1987. As pertinent here, his letter states:

"We have reviewed the matter of the requirement for filing NYS Form IT-203, and was of the opinion, and still are, that no Tax Return or Tax was due, for the following reasons:

* * *

(2) 1400 Broadway Associates - is a Real Estate firm, collecting rents and making Investments. The Rental Income equals the Operating Expenses, so the remaining Income comes from Investments, and Interest is received. Again, a Non-resident is not subject to NYS tax, even if the Payor is a New York bases [sic] entity.

and our firm so advised Mr. Meyer, over the years."

The Division answered Mr. Taylor by letter dated November 6, 1987. This letter again put forward the Division's position, stating:

"Even though your client is a limited partner in 1400 Broadway Associates, the ordinary income derived from the partnership is from real property located in New York State and is considered income from New York sources and is taxable to a nonresident limited partner."

Petitioner was asked to file nonresident income tax returns for the years 1981 through 1986 and to provide copies of his Federal returns. No response was received, and a follow-up letter was sent to Mr. Taylor on or about March 11, 1988. By letter dated March 20, 1988, Mr. Taylor reiterated his opinion that petitioner was not subject to New York State tax, stating:

"Please be advised, I have expressed my opinion to Mr. Meyer, that he has no tax liability to the State of New York, for the period involved.

The issue is a legal matter, going to the nature of the distribution, which is Interest. It is surely fixed that Mr. Meyer is a Non-resident...and Interest, as well as other type [sic] of Income, is excluded from taxation in such instances, under the Tax Laws of the State of New York."

On or about September 30, 1988, the Division issued two statements of audit changes to petitioner which collectively covered the years 1981 through 1987. Based on the Federal partnership distribution schedules (Schedule K-1) filed by the Partnership, the Division determined petitioner's New York income for each of the years 1981 through 1987. Essentially, petitioner's New York income was determined to be his distributive share of the Partnership's ordinary income, modified by New York additions with respect to the Federal accelerated cost recovery system reduction and New York subtractions for allowable New York depreciation. The Division did not include petitioner's distributive share of interest income, dividends or

capital gains in its calculation of his New York income. Petitioner's income in each year was reduced by the standard deduction and one personal exemption to calculate his New York taxable income. The appropriate tax rate was applied to calculate a tax deficiency for each year as follows:

Year	Deficiency
1981	$ 682.00
1982	906.00
1983	1,619.00
1984	2,493.00
1985	2,694.00
1986	2,800.00
1987	2,573.00

Penalties were imposed pursuant to Tax Law § 685(a)(1) and (2) for failure to timely file returns and for failure to timely pay all tax required to be shown as due on those returns.

Petitioner made no reply to the statements of audit changes. Consequently, the Division issued to petitioner two notices of deficiency, each dated March 16, 1989. The first notice asserted a tax deficiency of $5,700.00 for the years 1981 through 1984 plus penalty and interest. The second notice asserted a tax deficiency of $8,067.00 for the years 1985 through 1987 plus penalty and interest.

Petitioner was not an employee of the Partnership, performed no services for the Partnership, and received no wage or salary income from the Partnership.

During the years in issue, petitioner claimed itemized deductions on his Federal income tax returns as follows: 1981 - $28,155.54; 1982 - $23,121.98; 1983 - $3,980.81; 1984 - $5,138.76; 1985 - $4,413.89; 1986 - $7,409.51. Petitioner claimed a standard deduction for dependents over 65 (himself and his wife) of $6,200.00 in 1987. Petitioner established these amounts by submission of schedules A for the years 1981 through 1986 and Form 1040 for 1987. Petitioner's reported Federal adjusted gross income for the year 1987 was $65,393.00. The Division determined that his New York source income for that year was $39,216.00.

Petitioner testified that he claimed three dependents on his Federal return in 1981 and 1982, himself, his wife and his youngest daughter, and two dependents in 1983, himself and his

wife. Petitioner also testified that he claimed three dependents in 1984. According to his testimony, he was allowed to claim himself as two dependents because he was over 65 and his wife as one dependent. From 1985 through 1987, petitioner testified, he claimed four dependents because both he and his wife were over 65.[1]

During the years in issue, petitioner's Federal income tax returns were prepared by his attorney, Mr. Taylor, who advised him that he was not required to file New York State personal income tax returns or to pay New York State personal income tax. When asked by the Division's attorney whether he personally had made any inquiries to the Division with regard to his tax liability, he responded: "No." He also stated: "I saw no reason to question Mr. Taylor. I saw no reason why I should have to pay tax." (Transcript at pp. 39 - 40).

SUMMARY OF PETITIONER'S POSITION

Petitioner claims that the partnership income he received was attributable to his ownership interest in intangible property, specifically his partnership interest in a lease owned by the Partnership. As petitioner sees it, a lease is intangible property and not an ownership interest in

real property. He equates the income he received from the Partnership to interest income and dividends from ownership of stock.

Petitioner alleges that it was an error for the Division to calculate his New York tax liability using a single personal exemption and a standard deduction for all years in issue. He claims that he is entitled to the same number of personal exemptions and the amount of the itemized deductions claimed on his Federal income tax returns for each year under discussion.

Because he was advised by his attorney that he was not required to file New York State tax returns or to pay New York taxes for the subject years, petition maintains that he acted with

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[1]Petitioner testified that he took four exemptions in 1987 since he and his wife were both over 65; however, according to the Federal return submitted in evidence, he actually claimed two exemptions and a separate standard deduction for persons over age 65.

reasonable cause and lack of willful neglect in all matters concerning his State tax liability.

Petitioner claims that by virtue of the Partnership's filing of returns the Division had actual knowledge of petitioner's failure to file returns throughout the period in issue and failed to act on this knowledge. It is petitioner's position that this constitutes negligence on the Division's part. He asserts both the three-year statute of limitations and laches as a bar to assessment of tax.

Petitioner stated in his petition that the regulation relied on by the Division, 20 NYCRR 134, did not become effective until January 23, 1983 "and therefore was not the law in 1981".

At hearing, petitioner requested that official notice be taken of a regulation of the Attorney General of New York issued under the authority of the New York Real Estate Syndicate Act (article 23-A of the General Business Law). The regulation requires, among other things, that partnerships required to file an offering statement under section 352-e of the General Business Law issue quarterly reports to New York residents, indicating the source of any distributions paid to the partners, e.g., whether the distributions were from loans, the sale of assets, funds generated from operations, etc. Petitioner submitted in evidence a "Source of Distribution Statement" issued by the Partnership for the period January 1, 1991 through March 31, 1991. A copy of the pertinent regulation appears on the reverse side of the form. In offering the form into evidence, petitioner's representative made the following statement:

> "the important thing it says here that the entity must transmit to the owners information concerning the distribution, and I want to quote from the fifth line down, 'who are residents of this state.' We ask that be taken under judicial notice in support of our position that there is no proof given of the need for Mr. Meyer to file a return. The regulations specify residents of the State of New York. That is all, your Honor."

In his petition, petitioner stated that the Partnership never forwarded copies of New York State partnership returns to him in Florida. Apparently, petitioner means to assert that the Partnership's failure to transmit information to him pursuant to the Attorney General's regulations or to transmit copies of New York State partnership returns to him is further evidence that petitioner was not a New York resident and not subject to New York tax.

CONCLUSIONS OF LAW

A. For the years 1981 through 1986, Tax Law former § 632(a)(1) provided, as material here, that the New York adjusted gross income of a nonresident individual shall be the sum of the net amounts of items of income, gain, loss and deduction entering into his federal adjusted gross income, as defined in the laws of the United States for the taxable year, derived from or connected with New York sources. (Section 77 of Laws of 1987 [ch 28] repealed former section 631 and renumbered former section 632 and the sections following it, effective January 1, 1988, applicable to tax years beginning after 1987. The legislation contained no substantive changes relevant to petitioner's tax liability for 1987. Citations in this determination are to the former provisions except where noted). The New York adjusted gross income of a nonresident individual included "his distributive share of partnership income, gain, loss and deduction determined under section six hundred thirty-seven" (Tax Law former § 632[a][1][A]).

The rules for determining whether or not a distributive share of an item of partnership income, gain, loss and deduction is connected with New York sources were the same as those applicable to other nonresident taxpayers (Tax Law former § 637[a][1]). As relevant to this determination, items derived from or connected with New York sources are those attributable to: "(A) the ownership of any interest in real or tangible personal property in this state; or (B) a business, trade, profession or occupation carried on in this state" (Tax Law former § 632[b][1][A], [B]).

"Income from intangible personal property, including annuities, dividends, interest and gains from the disposition of intangible personal property" did not constitute New York source income except "to the extent that such income is from property employed in a business, trade, profession or occupation carried on in this state" (Tax Law former § 632[b][2]). 20 NYCRR 131.3 provides:

> "The New York adjusted gross income of a nonresident individual includes items of income, gain, loss and deduction entering into his Federal adjusted gross income which are attributable to the ownership of any interest in real or tangible personal property in New York State. Thus, New York adjusted gross income includes rental income from real or tangible personal property in New York State or any interest therein after deducting ordinary and necessary expenses attributable to the ownership, operation or maintenance of such property." (Emphasis added.)

B. The income under discussion is unquestionably rental income from real property located in New York, and, therefore, would appear to be properly treated as New York source income under the applicable statutes and regulations.[2] Petitioner's claim that his distributive share of the Partnership's rental income is not attributable to an ownership interest in real property but instead flows from an investment in intangible personal property, namely the lease owned by the Partnership, is untenable. A lease may be defined as a "conveyance of interest in real or personal property for specified period or at will" (Black's Law Dictionary 800 [5th ed 1979]). Thus, the ownership of a lease is the ownership of an interest in real property. Accordingly, the Partnership's rental income was attributable to an ownership interest in real property in New York and constituted New York source income. Moreover, the record establishes that the Partnership was actively engaged in operating the real property as rental property and did not hold the lease as a mere passive investment.

C. The only information available to the Division with respect to petitioner's income for the subject years was contained in the Partnership's income tax returns and attached schedules. To determine petitioner's tax liability, the Division presumed that his Federal and New York State adjusted gross income were the same for each year (i.e., that petitioner's distributive share of partnership income was his only income). Petitioner was then allowed a New York personal exemption and standard deduction for

each year in the same amount as that which was allowed a New York resident. Petitioner argues that he should be allowed the same number of personal exemptions and the same amount of itemized deductions as claimed on his Federal return for each year.

During the years 1981 through 1987, a nonresident was allowed the same personal exemptions and itemized deductions as a New York resident (Tax Law former §§ 635[a];

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[2]The fact that the cited regulation was not filed until January 28, 1982 is immaterial since it essentially repeats the pertinent language of the statute. Whether or not a regulation was promulgated for the 1981 tax year does not affect petitioner's duties and obligations under the statute.

636[a]); however, if New York adjusted gross income reportable as a resident exceeded New York adjusted gross income reported as a nonresident by more than $100.00, the personal exemptions and deductions were allowed only in the proportion that New York adjusted gross income as a nonresident bore to adjusted gross income computed as if the taxpayer were a resident (Tax Law former §§ 635[c]; 636[a]). To accurately determine the exact amount to which petitioner is entitled for personal exemptions and itemized deductions, it first would be necessary to calculate petitioner's New York adjusted gross income reportable as a resident (essentially, his Federal adjusted gross income). Petitioner did not submit his Federal income tax returns for 1981 through 1986 or any other information which would establish the amount of his Federal adjusted gross income for those years. Therefore, he has not carried his burden of proof pursuant to Tax Law § 689(e) to show that he is entitled to any adjustment to the Division's calculations of his New York taxable income for those years.

Petitioner did submit a Federal income tax return for 1987 showing that he filed a joint return with his spouse where he claimed two personal exemptions, himself and his spouse, and a standard deduction for persons over age 65 in the amount of $6,200.00. An individual was allowed to claim itemized deductions on his New York return only if itemized deductions were also claimed on his Federal return (Tax Law former § 635[a]); therefore, petitioner was not allowed to claim itemized deductions on his New York return in 1987. The number of personal exemptions allowed for State purposes was the same as that for federal purposes (Tax Law former §§ 636[a]; 616[a]). Accordingly, petitioner was entitled to two personal exemptions; however, the deduction was limited to the relation that petitioner's New York adjusted gross income as a nonresident bore to the New York adjusted gross income that would be required to be reported if he were a resident. Petitioner's reported Federal adjusted gross income for 1987 (the amount he would have been required to report if he were a resident) was $65,393.00. The amount of the personal exemption was $900.00 for tax years beginning in 1987 (Tax Law former § 616[a]). The Division is directed to recalculate the amount of the personal exemption to which petitioner is entitled for 1987 in accordance with this Conclusion.

D. No grounds exist which would preclude the Division from assessing and collecting the tax owed by petitioner. The three-year statutory period of limitation for assessing a deficiency in income tax runs from the day the return was filed (Tax Law § 683[a]). Inasmuch as petitioner filed no returns, no statute of limitation exists (Tax Law § 683[c][1][A]). Petitioner puts forth a claim of laches as a defense against payment of the tax. Essentially, he claims that the Division had actual knowledge of the fact that petitioner was receiving income from a New York partnership and waited so long to put forth its claim that it should now be estopped from collecting the tax due. As a general rule, estoppel cannot be employed against the State absent exceptional facts which require its application to avoid a manifest injustice (Matter of Sheppard-Pollack v. Tully, 64 AD2d 296, 409 NYS2d 847). This general rule applies with special force where the petitioner seeks to estop the collection of taxes by the Division (see, Matter of Turner Construction Co. v. State Tax Commn., 57 AD2d 201, 394 NYS2d 78). The fact that the Division did not discover petitioner's failure to file returns and begin its inquiries until 1987 (some six years after the first tax year in issue here) is not ground enough to warrant an estoppel.

E. Petitioner claims that, if it is found that he was subject to New York tax from 1981 through 1987, the penalties imposed by Tax Law § 685(a)(1), for failure to file returns, and Tax Law § 685(a)(2), for failure to pay the tax required to be shown on those returns, should be abated on the ground that his failure to comply with the Tax Law was due to reasonable cause and not due to willful neglect. Specifically, petitioner maintains that his reliance on the advice of his attorney constitutes reasonable cause.

The record leaves no doubt that petitioner's attorney, who represented him in these proceedings and advised him over the years, did inform petitioner that as a nonresident he was not subject to New York personal income tax. This single fact does not warrant the cancellation of penalties, because "[t]o permit consulting with a tax professional to act as immunity to penalties would effectively remove the penalty provisions" (Matter of LT & B Realty Corp. v. State Tax Commn., 141 AD2d 185, 535 NYS2d 121).

To determine whether reliance on the erroneous advice of a professional constitutes reasonable cause, all of the facts must be examined. The factors to be considered are these: whether the taxpayer relied in good faith on the advice he received; whether it was reasonable for the taxpayer to rely upon the particular advice given (see, id.); and whether the taxpayer acted with ordinary business care and prudence in attempting to ascertain his liability for taxes (see, Matter of Kenneth J. Erikson, Tax Appeals Tribunal, March 22, 1990). In determining whether the taxpayer's reliance was reasonable, the nature and complexity of the matter giving rise to the dispute must be considered (id.).

Weighed against these standards, the conclusion is inescapable that petitioner has not demonstrated reasonable cause. Petitioner made no inquiries of his own to ascertain his tax liability but relied on the advice of the attorney who prepared his returns. The record contains no evidence of the experience, expertise or competence of the attorney involved to show that the advice relied upon by petitioner was given by competent tax counsel (id.). The tax issue involved is not extraordinarily complex. The statute clearly states that income attributable to the ownership of an interest in real property in New York State is to be treated as New York source income. Even if petitioner did not receive copies of the partnership's New York partnership returns, it is obvious from the Federal returns that were transmitted to him that he was receiving distributions of ordinary income from the Partnership and not merely interest income and dividends. His testimony shows that he was aware that this ordinary income was from the Partnership's interest in real property in New York State. These facts should have alerted petitioner to the possibility that he was liable for New York taxes. Under these circumstances it was not reasonable for petitioner to have relied solely upon the advice of his attorney.

F. The petition of Joseph H. Meyer is granted to the extent indicated in Conclusion of Law "C"; the Notice of Deficiency issued on March 16, 1989 shall be modified accordingly; and in all other respects, the petition is denied.

DATED: Troy, New York

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ADMINISTRATIVE LAW JUDGE