STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:
of	:
THOMAS R. TOOTHAKER AND NANCY J. TOOTHAKER	: DETERMINATION DTA NO. 809302
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Year 1988.	:

Petitioners Thomas R. Toothaker and Nancy J. Toothaker, 235 Thayer Pond Road, Wilton, Connecticut 06897-2821 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 1988.

On July 24, 1992 and July 27, 1992, respectively, the Division of Taxation by its representative, William F. Collins, Esq. (Andrew J. Zalewski, Esq., of counsel), and petitioners, by Thomas R. Toothaker, executed a consent to have the controversy determined on submission without hearing, with all documents and briefs to be submitted by November 13, 1992. Petitioners filed a brief on September 30, 1992. The Division of Taxation filed a brief on October 30, 1992. After due consideration of the record, Jean Corigliano, Administrative Law Judge, renders the following determination.

ISSUES

I. Whether the Division of Taxation properly recalculated petitioners' 1988 nonresident personal income tax by including the additional tax on unearned income.

II. Whether the statutory scheme for taxing the New York source income of a nonresident taxpayer violates the due process clause, the equalprotection clause, the commerce clause or the privileges and immunities clause of the United States Constitution.

III. Whether petitioners established that certain amounts treated by the Division of Taxation as unearned income were, in fact, amounts paid to Thomas R. Toothaker as compensation for personal services rendered to a corporation.

IV. Whether petitioners, who filed a joint 1988 personal income tax return, should be allowed to file an amended 1988 personal income tax return, filing separately on one return.

V. Whether the interest imposed on the tax deficiency may be cancelled.

FINDINGS OF FACT

Petitioners, Thomas R. Toothaker and Nancy J. Toothaker, filed a timely 1988 nonresident income tax return (form IT-203) under filing status "Married filing joint return."

A wage and tax statement attached to petitioners' return states that Thomas R. Toothaker received wages, tips and other compensation in the amount of $253,752.00 from Swiss Bank Corporation of New York, New York. On the IT-203, petitioners allocated $228,487.00 of this amount to New York State, based on an allocation of days worked in and out of New York City by Mr. Toothaker.

Petitioners reported additional Federal income of $94,015.00, calculated as follows:

Taxable interest income:	$ 64,883.00
Dividend income:	598.00
Taxable refunds of state and local income taxes:	2,712.00
Rents, royalties, partnerships, etc.	25,822.00

A Federal schedule E attached to petitioners' return indicates that a portion of the income reported as rental income was from real property located in California and from a partnership distribution.

Pursuant to the State Administrative Procedure Act § 306(4), official notice is taken of the contents of the 1988 Instructions for Form IT-203, a publication of the Division of Taxation ("Division"). In a section entitled Income Subject to Tax (1988 Instructions for Form IT-203, at 5), the Division provided the following information:

"New York source income

"Nonresident - The New York source income of a nonresident is the sum of the income, gain, loss or deduction derived from or connected with New York State included in your federal adjusted gross income."

Petitioners properly reported items of Federal income, totalling $347,767.00, and correctly followed an instruction on the face of the form IT-203 which states: "Enter in the New York State Amount column the amounts from New York State sources." Thus, petitioners

did not include income from interest, dividends and rents, royalties and partnerships in the "New York amount". They reported a total New York amount (or New York source income) of $228,487.00, all of it attributable to Mr. Toothaker's salary and wage income.

On line 32 of form IT-203, petitioners reported New York adjusted gross income of $345,055.00.[1] Line 53 of the form IT-203 states:

> "Additional tax on unearned income (if line 32 is more than $100,000.00, or more than $50,000 if you are married filing a separate return), see instructions, page 17; all others enter '0' on lines 53 and 54".

The instruction for line 53 on page 17 of the Instruction for Form IT-203 states:

> **"Additional tax on unearned income**
>
> "If line 32 is **more than $100,000** (or more than $50,000.00 if you are married filing a separate return), enter the additional tax on unearned income from Form IT-203-ATT, worksheet line 39 (see instructions on page 23).
>
> * * *
>
> "You may be subject to the additional tax on unearned income even if you have no New York taxable income on line 51."

Petitioners filed a form IT-203-ATT (completing Schedule A of that form); however, they did not complete the worksheet pertaining to the tax on unearned income as instructed. On line 53 of their 1988 IT-203, petitioners entered "0".

Petitioners' calculated an income percentage (total income allocable to New York State)

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[1]Under Tax Law § 601(e), New York imposes a tax "on the taxable income which is derived from sources in this state of every nonresident." Section 601(e) sets forth a two-step process to determine the tax due. First, a preliminary tax is calculated "as if such nonresident . . . were a resident" (Tax Law § 601[e][1]; emphasis added). Once the tax is initially fixed as though the nonresident was a resident taxpayer, it is then multiplied by a fraction, the numerator of which is the nonresident's New York income and the denominator of which is that person's Federal adjusted gross income,in order to arrive at the final tax due (see, Tax Law § 601[e][1]). Thus, the initial tax computation for the liability of a nonresident takes into account the taxpayer's income from all sources, in and out of New York State, but the actual tax due is a fraction of the tax initially calculated that is equivalent to the ratio of the taxpayer's New York income to total income. Petitioners' New York adjusted gross income, as reported on line 32, was derived by subtracting taxable refunds of State and local income taxes from Federal adjusted gross income (see, Tax Law § 612). It correctly includes income from all sources, in and out of New York State.

of 65.70% by dividing the "New York amount" of $228,487.00 by Federal adjusted gross income of $347,767.00. This percentage was applied to petitioners' calculation of New York State tax to calculate a final New York tax of $15,410.00.

On September 25, 1989, the Division issued to petitioners a Statement of Proposed Audit Changes which explained that an additional amount of income tax, in the amount of $1,910.00, was found due based on an audit of petitioners' filed 1988 income tax return. An attachment to the Statement of Proposed Audit Changes provides an explanation for the Division's adjustments to petitioners' return. Of several adjustments made only two are pertinent here. The Division determined that the total number of days worked in New York by Mr. Toothaker was 211, rather than the 207 days claimed. This resulted in an allocation of $235,866.00 to New York wages. Also, using the worksheet on the IT-203-ATT, the Division calculated the additional tax on unearned income, as follows:

New York adjusted gross income		$345,055.00
Deductions and subtractions	-0-	
Earned income		253,752.00
Allowable deductions	-0-	
Unearned income		91,303.00
Tax rate		x .02
Additional tax on unearned income		$ 1,826.00

In response to the Statement of Proposed Audit Changes, petitioners executed a "Payment Document" indicating that they disagreed with the amount due as calculated by the Division. Petitioners attached a statement to this document explaining their own calculation of tax due. In their statement, they asserted that the total number of days worked in New York was 209, and on this basis they calculated total New York wages of $234,664.00. They stated their agreement with certain minor adjustments made by the Division, but they expressed their total disagreement with the Division's calculation of the additional tax on unearned income. Based on their own calculations, petitioners conceded additional tax due of $579.00 and included payment in that amount with the Payment Document.

On or about November 6, 1989, the Division issued to petitioners a Notice of

Deficiency, asserting a balance due for the year ended December 31, 1988 calculated as follows:

"Tax Amount Assessed"		$1,910.00
Interest Assessed		89.08
Penalty	-0-	
Payments		579.00
Balance Due		1,420.00

Following a conciliation conference, the Division recalculated the tax deficiency based upon its acceptance of petitioners' assertion of days worked in and out of New York State. After crediting petitioner for the payment of $579.00, the Division determined a balance of personal income tax due of $1,277.94. On or about December 28, 1990, the Division issued a Conciliation Order reducing the asserted tax deficiency to this amount. The only audit adjustment which remains in contention is the Division's calculation of the additional tax on unearned income.

SUMMARY OF PETITIONERS' POSITION

Petitioners assert that the Division improperly included non-New York source income in its calculation of the tax on unearned income pursuant to Tax Law § 601(e). It is petitioners' position that section 601(d)(8) of the Tax Law precludes the Division from including in the New York source income of a nonresident income from real property not located in New York or from intangible personal property such as interest and dividends. Based upon this statutory provision, petitioners argue that the Division may not include income from property located in California and dividend and interest income in its calculation of the additional tax on unearned income.

Petitioners claim that the inclusion of non-New York source income in the calculation of the additional tax on unearned income violates the due process and commerce clauses of the United States Constitution. They also argue that the effect of Tax Law § 601(e) is to tax nonresidents at a higher rate than residents of New York in violation of the equal protection clause. Finally, petitioners argue that denying nonresidents a tax credit for taxes paid to other states while granting such a credit to New York residents (Tax Law § 620) violates the privileges and immunities clause and the equal protection clause of the United States

Constitution.

Petitioners contend that the amounts reported as income from rentals and partnerships ($25,822.00) was earned income as defined in section 911(d)(2) of the Internal Revenue Code. Petitioners claim that this represents personal service income paid to Mr. Toothaker as reasonable compensation for personal services rendered in connection with managing real property located in California. Based on these assertions, petitioners maintain that the Division erred by including the amount of $25,822.00 in its calculation of unearned income.

Petitioners argue that the interest imposed on the deficiency should be cancelled because petitioners relied in good faith on the Instructions for Form IT-203 where it states: "A nonresident is also subject to . . . the additional tax on unearned income derived from or connected with New York sources."

Petitioners request permission to file an amended 1988 return, filing separately on one return. This would exclude income received by Mrs. Toothaker from the additional tax on unearned income, since she is not a resident of New York and is not required to file a New York nonresident income tax return.

CONCLUSIONS OF LAW

A. The New York State Tax Reform and Reduction Act of 1987 (L 1987, ch 28), as amended by the Tax Reform Technical Corrections and New York City Tax Reduction Act of 1987 (L 1987, ch 333) amended the Tax Law to impose an additional tax on unearned income for taxable years beginning in 1987 and 1988 only. The additional tax does not apply to taxable years beginning after 1988. The tax is imposed on resident and nonresident individuals who have unearned income and also have New York adjusted gross income over $100,000.00 ($50,000.00 for married couples filing separately) (Tax Law § 601[d], [e]). For tax year 1987, the New York unearned income of nonresidents and part-year residents is computed "using only those [unearned income] items derived from or connected with New York sources" (Tax Law

§ 601[d][8]). Tax Law § 601(d)(8) applies only to tax years beginning in 1987.[2] For tax year 1988, nonresidents are required to compute the additional tax on unearned income as if they were residents for the entire year and then prorate the tax based upon the ratio of New York source income (both earned and unearned) to all sources (Tax Law § 601[e]).

Petitioners' contention that the Division improperly included non-New York source income in calculating the tax on unearned income is predicated entirely on paragraph (8) of section 601(d). Since petitioners' 1988 tax year did not begin in 1987, Tax Law § 601(d)(8) has no application to the

calculation of petitioners' additional tax on unearned income for 1988. Petitioners have not established any error in the Division's calculation of their unearned income or the additional tax on unearned income.

B. Petitioners contend that Tax Law § 601(e) is unconstitutional on its face. The jurisdiction of the Division of Tax Appeals and the Tax Appeals Tribunal, as prescribed in its enabling legislation, does not encompass challenges to the constitutionality of a statute on its face (Matter of Brussel, Tax Appeals Tribunal, June 25, 1992; Matter of Wizard Corp., Tax Appeals Tribunal, January 12, 1989). At this level of administrative review, it is presumed that statutes are constitutional. Moreover, the validity of Tax Law § 601(d) and (e) has successfully withstood constitutional challenge (Matter of Brady v. State of New York (___ NY2d ___

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[2]Section 176(d) of chapter 333 of the Laws of 1987 provides:

> "This act (L. 1987, c 333 . . .) shall take effect immediately [July 20, 1987] provided that:
>
> * * *
>
> "(d) So much of section five as adds paragraph eight to subsection (d) of section six hundred one of the tax law . . . shall take effect on the same date as chapter twenty-eight of the laws of nineteen hundred eighty-seven takes effect [April 20, 1987] and shall apply to taxable years beginning in 1987." (Emphasis added.)

[December 22, 1992]). Petitioners have not presented any evidence to show that section 601(e) was unconstitutionally applied in this instance (see, Matter of Brussel, supra).

C. In their brief, petitioners state that $25,822.00 of the amount included by the Division in its computation of unearned income was, in fact, compensation for personal services rendered. Given Mr. Toothaker's wage and tax statements and the total lack of any evidence to substantiate the statements made in the brief, it must be concluded that petitioners failed to prove that the Division's characterization of the income was wrong (see, Matter of Benisch, Tax Appeals Tribunal, November 27, 1991).

D. Tax Law § 651(b)(2) requires a nonresident having no New York source income to file a joint New York income tax return if that person's nonresident spouse earned New York income and the couple filed a joint Federal income tax return for the same taxable year. The Appellate Division, Third Department, has concluded that Tax Law § 651(b)(2) violates due process insofar as it may be applied to require the filing of a joint return solely by reason of the marital relationship and the filing by the couple of a joint Federal income tax return (Matter of Brady v. State of New York, 172 AD2d 17, 576 NYS2d 896, affd ___ NY2d ___ [December 22, 1992]).[3]

In accordance with section 651(b)(2), petitioners filed a joint income tax return for 1988. Petitioners now ask to be allowed to file amended separate returns. There is no provision in the Tax Law authorizing the Division of Tax Appeals to grant the relief requested. In this proceeding, petitioners have the burden of proof to show any error in the Division's calculation of a tax deficiency (Tax Law § 689[e]). If petitioners had evidence that Mrs. Toothaker had separate income not connected with a New York source, it was incumbent upon them to place such evidence in the record. Since they failed to do so, the Division's calculation of the additional tax on unearned income must be upheld.

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[3]This portion of the decision of the Appellate Division was not appealed by the State of New York; consequently, it was not reviewed by the Court of Appeals (see, Matter of Brady v. State of New York, ___ NY2d ___ [December 22, 1992], affg 172 AD2d 17, 576 NYS2d 896).

E. Petitioners ask that interest on the tax deficiency be cancelled on the ground that they relied in good faith on the Instructions for Form IT-203. As shown in Findings of Fact "6", "7" and "8", petitioners failed to follow the instructions on the form. The instructions warn that a taxpayer might be liable for the additional tax on unearned income, even if the taxpayer has no New York taxable income (Instructions for Form IT-203 at 17). Moreover, it instructs the taxpayer to complete the additional tax on

unearned income worksheet, which petitioners failed to do. Had petitioners followed the instructions and completed the worksheet as directed, they would have calculated the additional tax. I cannot find that the Division's publications or instructions were responsible in any way for petitioners' failure to calculate the additional tax on unearned income.

F. The petition of Thomas R. Toothaker and Nancy J. Toothaker is denied, and the Notice of Deficiency, as modified by the Conciliation Order, is sustained.

DATED: Troy, New York
February 4, 1993

/s/ Jean Corigliano
ADMINISTRATIVE LAW JUDGE