STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
BRUCE M. AND CLAIRE M. MONTGOMERIE	:	DETERMINATION DTA NO. 812425
for Redetermination of a Deficiency or for Refund of New York State and City Personal Income Taxes under Article 22 of the Tax Law and the New York City Administrative Code for the Year 1986.	:	

Petitioners, Bruce M. and Claire M. Montgomerie, 17 Windabout Drive, Greenwich, Connecticut 06831, filed a petition for redetermination of a deficiency or for refund of New York State and City personal income taxes under Article 22 of the Tax Law and the New York City Administrative Code for the year 1986.[1]

On December 15, 1998 and December 23, 1998, respectively, petitioners and the Division of Taxation executed a consent to have the controversy determined on submission without a hearing, with all documents and briefs to be submitted by May 10, 1999 which date commenced the six-month statutory period for issuance of this determination. Petitioners appeared by Alison S. Wang, Esq. The Division of Taxation appeared by Terrence M. Boyle, Esq. (Michael J. Glannon, Esq., of counsel).

[1] Title T and Title U of the New York City Administrative Code which impose a personal income tax on New York City residents and nonresidents, respectively, contain provisions which are almost identical to corresponding provisions of Article 22 of the Tax Law. Unless otherwise specified, all references to particular sections of Article 22 shall be deemed references, though uncited, to the corresponding sections of Title T or Title U of the Administrative Code.

ISSUE

Whether the Division of Taxation properly required petitioners to prorate their partnership income between a period of time when they were residents of New York State and a period of time when they were nonresidents of New York State.

FINDINGS OF FACT

1. The Division of Taxation issued to petitioners, Bruce M. Montgomerie and Claire M. Montgomerie, a Statement of Audit Changes, dated July 5, 1988, asserting a deficiency of New York State income tax for 1986 in the amount of $18,344.82 plus interest.[2] Petitioner's taxable New York income was recomputed by the Division and the following explanation for the recomputation was provided:

> The limitation percentage must be computed and applied to itemized deductions, exemptions and child care credit on the nonresident return.
>
> When two returns are filed due to change in resident status during the tax year, the distributive share of partnership income or loss must be prorated by months between the resident and nonresident periods. Your return has been corrected and tax recomputed . . . .

2. By letter dated August 2, 1988, petitioner responded to the Division's statement and protested all of the adjustments made. As pertinent, his letter states:

> 1. The only explanation you give for our proposed adjustment is that when two returns are filed due to change in resident status, the distributive share of partnership income or loss must be pro rated. This is not correct and your statement is contrary to your own Regulation.
>
> Regulation § 148.6, in effect for 1986 and still in effect, explicitly states that a partner's distributive share is *not* pro rated between resident and non-resident periods. *Such shares are included in the period in which the partnership year ends*. (See copy of Regulation § 148.6 enclosed). (Emphasis added.)

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[2] It appears that the income which is the source of this dispute is that of Mr. Montgomerie, and Mrs. Montgomerie is included as a petitioner here only because she filed a joint return with her husband. Accordingly, all references in this determination to "petitioner" may be understood to mean Bruce M. Montgomerie.

> 2. Your N.Y. income, adjustments and additions all vary from mine as reported but you state no reason for this difference. I believe you must explain these changes or allow my reported position to stand, especially since your basic reason for your proposed audit adjustment, as discussed in point 1. above, is wrong.

3. The Division responded to petitioner in a letter dated in September 1988 (the day of the month is illegible). This letter explains the Division's position as follows:

> The Court of Appeals (*McNulty etal* [sic] *v. The New York State Tax Commission*) recently ruled the following:
>
> When two returns are required to be filed due to a change of residence, and the taxpayer is a member of a partnership or a shareholder of a New York S corporation, any distributive share should be prorated by months, over the entire tax year of the taxpayer.
>
> This change will apply to all tax years where the statute of limitations has not expired.
>
> Your partnership income/(losses), Federal adjustments and New York modifications have been prorated on an 11 month/1 month basis. In the nonresident period New York nonresident partnership income/(loss) were not included as income.
>
> New York State Regulation 148.6 is in the process of being revised.

4. On or about February 10, 1989, the Division issued a Notice of Deficiency to petitioners asserting a deficiency of income tax for 1986 in the amount of $18,344.82 plus interest. No penalty was imposed.

5. Following a conciliation conference held on January 10, 1990, the Division issued a Conciliation Order, dated April 6, 1990, reducing the asserted deficiency for 1986 to $11,861.00 but otherwise sustaining the deficiency. No penalty was imposed.

6. On July 6, 1990, petitioner mailed a petition to the Division of Tax Appeals protesting the Notice of Deficiency. The petition was dismissed by the Division of Tax Appeals on its own order on the ground that it was not filed within 90 days of the mailing of the Conciliation Order.

Petitioner then paid the asserted tax deficiency and filed a claim for refund of tax in the amount of $16,321.65.

7. On December 30, 1991, the Division issued to petitioner a Notice of Disallowance denying the claim for refund of taxes paid for 1986.

8. Petitioner then filed a petition in the Division of Tax Appeals. The petition was signed by Bruce M. Montgomerie and Claire M. Montgomerie under the following paragraph:

> WHEREFORE, the petitioner respectfully requests that this petition be granted. The statements in this petition are made with the knowledge that a willfully false representation is a misdemeanor punishable under section 210.45 of the Penal Law.

9. The facts as stated in this paragraph and in paragraph 10 are taken from the verified petition.[3] Petitioners filed their New York State tax return for 1986 on August 8, 1987. They filed a resident return for the period January 1, 1986 to December 1, 1986 and a nonresident return for the period December 1, 1986 through December 31, 1986. From January 1, 1986 through December 31, 1986, petitioner was a general partner of Willkie, Farr & Gallagher, a New York-based general partnership. Wilkie, Farr & Gallagher used the calendar year as its taxable year for 1986.

10. Petitioner reported his New York State partnership income in accordance with former section 148.6 of the Division's regulations, in effect at the time the New York State return was filed. Under the regulation, the distributive share of income received from a partnership was to be reported in the portion of the taxable year in which the taxable year of the partnership ends. The distributive share of income was not to be prorated between the resident and nonresident

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[3] Neither party submitted documentary evidence to establish facts crucial to this determination (e.g., petitioner's 1986 personal income tax returns), and they were unable to stipulate to agreed upon facts. Inasmuch as the petition was signed by petitioner and none of the critical facts contained in the petition were challenged by the Division, I deemed it appropriate to use the petition as the basis for relevant findings of fact.

income tax returns. Since the taxable year of Wilkie, Farr & Gallagher ended on December 31, 1986, regulation 148.6 directed that partnership income received by petitioner be reported on his New York nonresident return, and petitioner reported the income in this manner.

11. With a letter dated December 7, 1998, petitioner forwarded to the Division's attorney a proposed draft of a Stipulation of Facts. The parties never executed the proposed stipulation or any stipulation of facts. Petitioner submitted a copy of the proposed stipulation with his brief and other documents. However, the proposed stipulation was not submitted as documentary evidence, and it was not received in evidence or relied on for any finding of fact in this determination.

The Division's attorney submitted a reply brief on April 19, 1999. He also enclosed a copy of a revised draft of the proposed Stipulation of Facts with a letter showing that it had been forwarded to him, with revisions, by petitioner's attorney. This draft was not executed by the parties. The Division requested that this draft of the stipulation be received in evidence as Division's Exhibit "K". Inasmuch as the draft stipulation was not executed by the parties, it had no probative value, and it was not received in evidence. Moreover, no findings of fact have been made on the basis of this draft of the stipulation.[4]

CONCLUSIONS OF LAW

A. Tax Law former § 654(a)[5] provided as follows:

> If an individual changes his status during his taxable year from resident to nonresident, or from nonresident to resident, he shall file one return as a resident

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[4] Either party might have compelled stipulation by filing a motion pursuant to section 3000.11 of the Tax Appeals Tribunal Rules of Practice and Procedure. Having failed to do so, the parties also forfeited the opportunity to have any dispute regarding the proposed stipulation resolved by order of an administrative law judge.

[5] Section 654 was repealed by the Legislature effective January 1, 1988.

> for the portion of the year during which he is a resident, and one return as a nonresident for the portion of the year during which he is a nonresident, subject to such exceptions as the tax commission may prescribe by regulation.

In ***Matter of McNulty v. New York State Tax Commission*** (70 NY2d 789, 522 NYS2d 103), the taxpayers, whose sole source of income in 1979 was a distributive share of the earnings of a New York partnership, moved their residence from New York to New Jersey in August of 1979. In accordance with former section 654, they filed a resident return for January 1, 1979 through August 1979 and a nonresident return for the period August 1979 through December 31, 1979. Thus far, the taxpayers in ***McNulty*** and petitioner operated under similar circumstances. However, the ***McNulty*** taxpayers, unlike petitioner, did not comply with the related tax regulation, 20 NYCRR former 148.6, which required that taxpayers who move in or out of the State during the tax year treat partnership gains or losses as having all accrued in the "portion of the taxable year" in which the partnership's own tax year ends. As noted by the ***McNulty*** Court, the effect of this regulation was "to compel the taxpayer who has changed residence during the tax year to report all of his partnership income on one or the other of his separate tax returns for that year-regardless of when the income was actually received" (***id.***, 522 NYS2d at 104).

Application of regulation 148.6 in the ***McNulty*** case required the taxpayers to report all their income on their nonresident tax return and no income on their resident return. This resulted in an increase to the taxpayers' tax liability because Tax Law § 654(c)(e) required the taxpayers to prorate and allocate their personal exemptions and deductions between their resident and nonresident returns. In effect, the taxpayers were deprived of the beneficial use of the exemptions and deductions reported on the resident return because there was no income against which they could be applied.

The ***McNulty*** Court concluded that regulation 148.6 was an invalid exercise of the Tax Commission's authority because requiring annual partnership distributions to be reported in their entirety on one of the two returns "without regard either to when such distributions are received or to proration. . . is inconsistent with [the] legislative policy [of section 654 of the Tax Law]" (***id.***, 522 NYS2d at 104). With respect to the statute's legislative policy, the ***McNulty*** Court stated that section 654:

> evinces a clear legislative intention that most forms of income, as well as exemptions and standard deductions, be allocated between the taxpayer's resident and nonresident returns in a manner *that either reflects the actual date of receipt and expenditure or encompasses an annual amount distributed on a proportionate basis* (***see***, Tax Law § 654 [b], [e], [f]; ***cf.***, § 654 [c], [i] [governing "special accruals" and "lump sum" distributions]). (***Id.***, 522 NYS2d at 104 [emphasis added]).

B. Petitioner argues that the ***McNulty*** opinion permitted, but did not mandate, the proration of partnership income and losses. According to petitioner, the ***McNulty*** opinion created a rule of narrow application intended to redress an inequitable result which stemmed from application of regulation 148.6 under the facts of that case. Petitioner asserts that since substantial income was reported on the 1986 resident return there was no loss of the benefit of exemptions and deductions as was the case in ***McNulty***.[6] Based on this purported difference in the facts of the two cases, petitioners claim that application of regulation 148.6 does not lead to an inequitable result and must be permitted.

As noted by the Division, the Tax Appeals Tribunal's decision in ***Matter of Wertheimer*** (Tax Appeals Tribunal, January 12, 1995) mandates proration of petitioner's partnership income to the resident and nonresident returns filed for 1986. The key to understanding the Tribunal's

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[6] As noted, neither party placed petitioners' 1986 personal income tax returns in evidence, and the parties did not execute a stipulation of facts. Consequently, there is no basis in the record for these asserted facts.

decision is its explanation of certain provisions of the Internal Revenue Code. These provisions were summarized as follows:

> We believe that this case requires a brief summary of the basic principles governing the taxation of income earned by a partnership under the Internal Revenue Code. Although a partnership computes its net income, section 701 of the Internal Revenue Code provides that the partners are liable for the tax on the income. Pursuant to section 702 of the Internal Revenue Code, the tax is determined by each partner reporting his distributive share of, inter alia, the partnership's income, gain and losses. Section 706(a) of the Code requires that each partner's distributive share of the income, gain and loss be included in that partner's taxable income for the taxable year of the partnership ending within or with the partner's tax year. *A partner is required to report and pay tax on his distributive share of the net income of the partnership in this manner without regard to whether this amount was actually distributed or distributable to him in that year* (***United States v. Basye***, 410 US 441, ***reh denied*** 411 US 940). (***Matter of Wertheimer***, ***supra***; emphasis added.)

Based on this explanation, the Tribunal found that the ***McNulty*** opinion required an allocation of partnership income that reflects "either the *actual date of receipt* and expenditure or encompasses an annual amount distributed on a proportionate basis" (***Matter of Wertheimer***, ***supra***, quoting ***Matter of McNulty v. New York State Tax Commn., supra,*** 522 NYS2d 103, 104; emphasis added). The Tribunal went on to state that "where a partner's distributive share of income is reported without regard to actual receipt, the only possible method of allocation under section 654 is on a proportionate basis throughout the year." (***Matter of Wertheimer***, ***supra***.) Petitioner reported his distributive share of partnership income without regard to actual receipt, but based on the IRC § 706(a) requirement that such income be included in the partner's taxable income for the taxable year of the partnership ending within or with the partner's tax

year — in this case, December 1986.[7] The holdings of ***Wertheimer*** and ***McNulty*** require that this income be allocated between the resident and nonresident return on a proportionate basis.

C. Petitioner argues that ***Wertheimer*** is distinguishable because that case involved the proper reporting of partnership losses rather than income. Ironically, the petitioners in ***Werthiemer*** argued that the holding in ***McNulty*** applied only to allocation of partnership income and not to losses. The Tribunal held that the ***McNulty*** opinion created a general rule applicable to both partnership income and losses.

D. After deciding the primary issue raised by the parties, the Tribunal remanded the ***Wertheimer*** case to the Administrative Law Judge to determine whether the ***McNulty*** decision should be given retroactive application to the income tax return filed by the petitioners for 1986 (the same year at issue here). Following the issuance of a determination by the Administrative Law Judge, the Tribunal held that the construction of Tax Law § 654 by the Court of Appeals in ***McNulty*** must be applied retroactively to the petitioners' 1986 tax return (***see***, ***Matter of Wertheimer***, ***supra***). The Tribunal dismissed the argument that retroactive application was unfair because petitioners had relied on an established regulation which was in effect at the time they filed their return. The Tribunal opinion states:

> It is undisputed that the application of ***McNulty*** will require petitioners to pay more tax for 1986 than they reported on their return; however, it is not obvious to us that a taxpayer has a substantial equitable right to pay less tax than a rule announced by the Court of Appeals would require. Petitioners would have a stronger equitable argument if they could identify specific actions they took in reliance on rule 148.6 which now work to their detriment under the retroactive application of ***McNulty***. Petitioners' claim that they relied on the regulation when they filed their return would be pertinent if the Division had assessed penalty. However, the Division did not assert penalty and without penalty we do not see

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[7] Petitioner stated in his letter to the Division of August 2, 1988 that his distributive share of partnership income was reported in keeping with regulation 148.6 which required such shares to be "included in the period in which the partnership year ends," in effect conceding that the income was not reported when actually received.

> that petitioners were prejudiced by their reliance on the regulation. Thus, we see little weight to the equitable burden imposed on petitioners by the retroactive application of ***McNulty***. (***Id.***, footnote omitted.)

The Tribunal's holding in ***Wertheimer*** requires the application of the ***McNulty*** opinion to petitioner's 1986 tax year and rejection of his argument that such an application is inequitable.

E. The petition of Bruce M. and Claire M. Montgomerie is denied, and the Notice of Disallowance dated December 30, 1986 is sustained.

DATED: Troy, New York
October 28, 1999

/s/ Jean Corigliano
ADMINISTRATIVE LAW JUDGE