STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
THEODORE PANEBIANCO	:	DETERMINATION DTA NO. 815378
for Retermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Years 1987 through 1991.	:	

Petitioner, Theodore Panebianco, 20 Greenleaf Drive, Huntington, New York 11743, 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 1987 through 1991.

On June 3, 1997 and June 11, 1997, respectively, petitioner, by Jerri A. Cirino, Esq., and the Division of Taxation, by Steven U. Teitelbaum, Esq. (Kevin R. Law, Esq., of counsel), waived a hearing and agreed to submit this matter for determination based on documents and briefs submitted by October 3, 1997, which date began the six-month period for the issuance of this determination. After review of the evidence and arguments presented, Timothy J. Alston, Administrative Law Judge, renders the following determination.

ISSUE

Whether the Division of Taxation properly limited the amount of petitioner's net operating loss carryback deduction to the amount of petitioner's positive Federal taxable income in the carryback year.

FINDINGS OF FACT

1. On October 15, 1993, petitioner, Theodore Panebianco, filed claims for refund of personal income tax for the years 1987 through 1991 in the following amounts:

1987	1988	1989	1990	1991
$36,079.00	$110,128.00	$3,977.00	$616.00	$41.00

The amounts listed above were the refund claim amounts listed on the Forms IT-113-X (Claim for Credit or Refund of Personal Income Tax) filed by petitioner. Petitioner's New York income tax returns for the years 1989, 1990 and 1991, which were filed with petitioner's refund claims, report tax due for those years of $70,704.00, $15,572.00 and $1,628.00, respectively.

2. Petitioner's claims were based on the carryback of net operating losses incurred by certain Federal subchapter S corporations of which petitioner was a shareholder. According to the various tax returns submitted as part of his refund claims, petitioner was a shareholder of the following corporations which had elected subchapter S status for Federal income tax purposes: Ozone Ford, Ltd., Gold Coast Cadillac, Ltd., Bran Pan Corp., 235 G-C Corp., and Jontos Imports, Ltd. None of these Federal S corporations made the election pursuant to Tax Law § 660 to receive subchapter S treatment for New York State tax purposes.

3. In its review of petitioner's refund claims, the Division of Taxation ("Division") first determined that petitioner had incurred net operating losses (NOL's) of $898,807.00 in 1990, $1,421,383.00 in 1991 and $771,985.00 in 1992. (In documents submitted as part of his refund claims, petitioner claimed net operating losses of $898,807.00 in 1990, $1,422,883.00 in 1991 and $781,585.00 in 1992.)

4. The NOL incurred in 1990 was then carried back to 1987. Petitioner's 1987 Federal taxable income, as indicated by his Federal return, was $390,495.00. The Division limited petitioner's 1987 NOL to that amount. (On his refund claim, petitioner claimed an NOL deduction of $439,704.00 in 1987.) The Division then subtracted the allowed NOL carryback from petitioner's New York adjusted gross income ("AGI") as originally reported of $438,680.00. After subtracting $14,799.00 of New York itemized deductions and $2,700.00 in New York exemptions as claimed on petitioner's New York return, the Division determined petitioner's 1987 taxable income to be $30,686.00, with tax due thereon of $1,905.00. Since petitioner had previously paid $36,079.00 in tax for 1987, the Division determined an overpayment of $34,174.00 for that year.

5. For 1988, the Division carried over to 1988 the amount of the 1990 NOL remaining after the 1987 application, along with the NOL incurred in 1991. The Division limited petitioner's allowable NOL deduction to $1,278,118.00, petitioner's reported Federal taxable income for 1988 prior to the carryback. (Petitioner claimed an NOL deduction for 1988 of $1,534,644.00 on his refund claim.) The Division then subtracted the allowed NOL deduction from petitioner's reported New York AGI of $1,353,301.00 and, after subtracting New York itemized deductions of $34,045.00 and a New York exemption of $1,000.00, determined New York taxable income for 1988 of $40,138.00, with tax due thereon of $2,489.00. Petitioner had previously paid $110,128.00 of income tax for 1988. The application of the NOL carryback thus resulted in an overpayment of $107,639.00 for 1988.

6. For 1989, the Division first recomputed petitioner's Federal and New York income based on a business loss adjustment of $141,091.00 as reported on a 1989 Form 1040X filed by petitioner. This adjustment was computed exclusive of any NOL carrybacks for 1989. The

$141,091.00 business loss adjustment was subtracted from $447,775.00, petitioner's Federal AGI as originally reported, to arrive at petitioner's amended 1989 Federal AGI of $306,684.00. To this Federal AGI figure, the Division added New York additions of $765,639.00 as originally reported on petitioner's 1989 IT-201. The Division also added back the $141,091.00 business loss because the corporations which generated this loss were Federal subchapter S corporations but were "C" corporations for New York State tax purposes. After taking into account New York subtractions of $226,811.00 as reported on petitioner's 1989 New York return, the Division determined petitioner's 1989 New York adjusted gross income to be $986,603.00. Next, the Division determined petitioner's 1989 Federal taxable income and thereby determined the allowable NOL carryback for 1989 by subtracting the $141,091.00 business loss from $297,629.00, the amount reported as petitioner's 1989 Federal taxable income on petitioner's 1992 Federal form 1045 (Application for Tentative Refund). This resulted in Federal taxable income and allowable NOL carryback for 1989 of $156,538.00. (On his refund claim, petitioner claimed an NOL deduction for 1989 of $794,675.00.) After subtracting the allowable NOL and New York itemized deductions and exemptions as reported, the Division determined New York taxable income of $800,995.00, with $62,361.00 in tax computed thereon. Petitioner also reported $74.00 in City of New York nonresident earnings tax and had prepayments of $4,051.00, which resulted in tax due for 1989 of $58,383.00.

7. The Division did not allow any NOL deductions for 1990 and 1991 (other than those used to arrive at Federal AGI) because, as petitioner's Federal tax returns for those years indicate, petitioner had no positive Federal taxable income for either 1990 or 1991. Upon review of petitioner's returns for those years, the Division determined, as the returns themselves indicate, tax liability of $15,572.00 and $1,628.00, respectively, for 1990 and 1991.

8. Petitioner filed his 1989, 1990 and 1991 New York State personal income tax returns with his refund claims on October 15, 1993. The Division asserted late-filing penalties with respect to these returns and also asserted penalties for nonpayment of tax shown due on the 1989 and 1990 returns.

9. In computing the amount of refund payable to petitioner, the Division computed and applied interest to both underpayments and overpayments of tax and also applied penalties asserted against petitioner. In addition, petitioner did not remit payment of the amounts shown due on his 1989, 1990 or 1991 returns. Accordingly, the overpayments for 1987 and 1988, plus interest, were offset against the amounts due for 1989, 1990 and 1991, plus penalty and interest. The refund was also offset against an Internal Revenue Service liability and an unrelated New York State income tax liability. Petitioner was thus issued a net refund of $3,680.07.

CONCLUSIONS OF LAW

A. Tax Law § 612(a) defines New York adjusted gross income of a resident individual as Federal adjusted gross income with modifications as specified in that section. Among the modifications increasing Federal adjusted gross income are pass-through items of loss or deduction included in the calculation of Federal AGI for shareholders of Federal S corporations where no New York S election has been made (***see***, Tax Law § 612[b][19][A]). Federal AGI is thus the starting point in calculating New York AGI and is defined, generally, as gross income less certain deductions (Internal Revenue Code [IRC] § 62[a]). Among the deductions subtracted from gross income to arrive at Federal AGI is the net operating loss deduction (***see***, IRC § 172). The net operating loss deduction is therefore accounted for in the calculation of Federal AGI. The net operating loss deduction is allowable only to the extent of positive Federal taxable

income (IRC § 172[b]). There is no statutory provision in the New York State Tax Law for a New York net operating loss deduction.

B. The Division of Taxation properly limited petitioner's allowable net operating loss deduction for State income tax purposes to positive Federal taxable income and thus properly computed petitioner's personal income tax liability for the years at issue herein. In ***Matter of Berg v. Tully*** (92 AD2d 436, 461 NYS2d 562, ***lv denied*** 60 NY2d 552, 467 NYS2d 1026) the Appellate Division affirmed a former State Tax Commission decision which, as in the instant matter, limited the amount of a taxpayer's net operating loss carryback deduction to positive Federal taxable income. In reaching its conclusion, the Court in ***Berg*** first noted the lack of any statutory provision in New York State's Tax Law which specifically provides for a net operating loss deduction to be carried forward or carried back. Second, the Court noted that the Division's limitation of the net operating loss deduction to positive Federal taxable income was consistent with Federal law which limits the use of losses to an amount which offsets Federal taxable income (***see***, Internal Revenue Code § 172[b]). Third, the Court noted that the limitation of the net operating loss deduction to the amount of positive Federal taxable income was "tacitly approved" by the Court of Appeals in ***Matter of Sheils v. State Tax Comm.*** (95 Misc 2d 605, 407 NYS2d 823, ***revd*** 72 AD2d 896, 422 NYS2d 479, ***revd*** 52 NY2d 954, 437 NYS2d 968). Finally, the Court noted that the former State Tax Commission's interpretation of the law prevented unauthorized "double deductions". That is, the use of losses which have already been

used in a prior carry back year from being used a second time in the following year.[1] The Court thus upheld the former State Tax Commission's decision.

Petitioner contended that ***Berg*** is in error in that once IRC § 172 is used to determine the NOL, such amount is then modified pursuant to Tax Law § 612, and the resulting amount becomes a New York NOL as distinguished from a Federal NOL. Petitioner asserted that this New York NOL should then be applied to New York taxable income with carryovers and carry backs limited to the amount of the New York NOL. Petitioner contended that under this scheme, there would never be an unauthorized double deduction as noted in ***Berg***.

This contention is rejected; ***Matter of Berg v. Tully*** (***supra)*** is controlling in this matter. As that decision makes clear, there is simply no statutory provision for a New York net operating loss deduction and thus no statutory basis to support petitioner's position.

C. Petitioner also hypothesized that, in this case, if the subchapter S election had not been made for Federal purposes, but had been made for New York State purposes, under the rule of ***Berg*** the Federal net operating loss applied would exceed the amount available for New York purposes. Petitioner asserts that such a result would be inequitable. As the Division correctly notes in its brief, however, petitioner's hypothesis rests on the flawed premise that *could* be a

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[1] The "double deduction" problem arises in situations where New York AGI exceeds Federal AGI. Such a situation will commonly occur in the case of a Federal S/New York C corporation because shareholders of such corporations must add back items of loss in computing their New York AGI (e.g., the instant matter). In such a situation, if the full amount of the loss carryback is allowed for New York purposes, rather than the amount required to reduce Federal taxable income to zero, the NOL deduction could offset more New York income than Federal income. Then, in computing the carryforward loss for succeeding years, since deductions may not reduce Federal taxable income below zero, the portion of the loss not utilized to offset *Federal* taxable income can be carried forward (***see***, IRC § 172[b][2]). Consequently, a portion of the amount carried forward, which has already reduced a portion of the State taxable income the first year, would again be available as an offset in the succeeding year. (***See***, ***Matter of Berg v. Tully***, ***supra***, 461 NYS2d at 564.)

shareholder of a New York S corporation that was not a Federal S corporation. Tax Law § 660 precludes such a possibility, for that section allows only Federal S corporation shareholders to make an S election for New York purposes. The Division also appears to have hit the mark in its analysis that the inequities perceived by petitioner result from the fact that his corporations did not elect S status for New York tax purposes. As a result of this failure, petitioner was required to add back items of loss in computing his New York AGI. However, as discussed previously, this addback treatment is required under the law. It is also logically consistent, for a non-pass-through entity (a New York C corporation) should not benefit from pass-through treatment.

D. Petitioner did not contest the Division's subtraction of the $141,091.00 business loss from his 1989 Federal AGI and corresponding addback of the same amount to petitioner's New York AGI. Moreover, the Division's treatment of this item was proper (***see***, Tax Law § 612[b][19]; IRC § 1366).

E. Petitioner did not contest the Division's imposition of penalties. Such penalties are thus sustained.

F. The petition of Theodore Panebianco is denied.

DATED: Troy, New York
March 26, 1998

/s/ Timothy J. Alston
ADMINISTRATIVE LAW JUDGE