

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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| In the Matter of the Petition | : | |
| of | : | |
| ADRIAN R. LAZAR | : | DETERMINATION |
| | : | DTA NO. 816186 |
| for Redetermination of a Deficiency or for Refund | : | |
| of New York State Personal Income Tax under | : | |
| Article 22 of the Tax Law and New York City | : | |
| Nonresident Earnings Tax under the Administrative | : | |
| Code of the City of New York for the Year 1993. | : | |

Petitioner, Adrian R. Lazar, 3978 Carrel Boulevard, Oceanside, New York 11572, filed a petition for redetermination of a deficiency or for refund of New York State personal income tax under Article 22 of the Tax Law and New York City nonresident earnings tax under the Administrative Code of the City of New York for the year 1993.

A small claims hearing was held before Dennis M. Galliher, Presiding Officer, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on January 24, 2002 at 1:15 P.M., with petitioner's brief to be filed by February 17, 2002, which date began the three-month period for the issuance of this determination. Petitioner appeared by Lawrence F. Ruggiero, Esq. The Division of Taxation appeared by Barbara G. Billet, Esq. (Jose K. Baby).

ISSUES

I. Whether petitioner has established entitlement to a deduction based on the loss of payments she made pursuant to a contract for the purchase of real estate which was allegedly to be used as rental property.

II. Whether petitioner has established that penalties should be reduced or canceled.

FINDINGS OF FACT

1. Petitioner, Adrian Lazar, and her husband Herbert Lazar, lived for some 29 years, including 1993 (and thereafter) at 229 Beach 19th Street, Far Rockaway, Queens, New York. Petitioner's home at this address was a large house which included three kitchens (one of which was a Passover kitchen), two full baths and one half bath, a large playroom, a living room, a dining room, and a number of bedrooms.

2. On May 9, 1985, petitioner and her husband, as purchasers, and Shoratlantic Development Co., Inc. ("Shoratlantic"), as seller, entered into a purchase agreement titled "The Breakers at Atlantic Beach," pursuant to which petitioner agreed to purchase a condominium from Shoratlantic. Petitioner's condominium was to be built on Lot 47, known as 1609 Ocean Boulevard, Atlantic Beach, which was part of a multi-condominium development at Pebble Cove being built by Shoratlantic in the Village of Atlantic Beach, Nassau County, New York.

3. The purchase price for petitioner's condominium was \$420,000.00. The purchase agreement provided for the initial payment of a reservation deposit of \$1,000.00, a payment of \$41,000.00 upon signing the purchase agreement, further periodic payments to be made by the purchasers as various stages of construction were completed (a "framed and enclosed" payment of \$42,000.00 and a "sheet rock completion" payment of \$36,000.00), and a final payment of \$300,000.00 for the balance due at the closing of title. The purchase agreement was subject to

the purchasers' obtaining a mortgage commitment in the amount of \$300,000.00. The purchase agreement further provided, in relevant part, as follows:

In the event Purchaser fails to make any of the scheduled payments, Seller may, at its option, exercise whatever remedy it may have by reason of the Purchaser's failure to make any of the scheduled payments, or it may continue with its performance of the contract in which event Purchaser agrees to pay interest on any of said unpaid payments at the prevailing rate for mortgages to individuals from the originally scheduled due date of said payment to the actual date of said payment.

Paragraph "6" of the purchase agreement provided as follows:

Breach of Purchase Agreement by Purchaser. Should Purchaser violate, repudiate, or fail to perform any of the terms of this Agreement, Seller may, at its option, retain all or any part of the monies paid on account hereunder, to a maximum of 10% of the purchase price plus the price of any custom work or optional extras ordered, as liquidated damages, in which event the parties shall be discharged of all further liability hereunder, or Seller may otherwise avail himself of any legal or equitable rights which he may have under this Agreement. These provisions shall apply whether or not construction has commenced and regardless of any sale of the property subsequent to Purchaser's default.

4. While construction of petitioner's condominium was ongoing, petitioner engaged the services of M.A. Salazar, Inc. ("Salazar"), a well-known real estate, management and insurance firm in Atlantic Beach. Petitioner listed her condominium with Salazar for the purpose of marketing the condominium to potential rental tenants.¹ Salazar's rental agent showed the condominium to at least two interested tenants. In addition, petitioner herself sought tenants to rent the condominium. Petitioner was advised that rents for condominiums such as hers, which was located at the southeast corner of the development and featured a view of the beach from all of its windows, averaged \$10,000.00 per month in the summer months and \$6,000.00 to \$8,000.00 per month for other months. In contrast, petitioner projected her monthly mortgage

¹ A copy of the listing agreement, if any, was not included in the record.

payment would be approximately \$3,300.00, thus allowing for a significant profit on rental of the condominium. Petitioner was aware of a number of other people who had, similarly, contracted to purchase one or more of the condominiums being built in the same development at Pebble Cove for the purpose of renting the units.

5. Petitioner was able to secure a mortgage commitment for the premises from G & M Wolkenberg, Inc. in the amount of \$400,000.00. However, at some point prior to completion of the condominium and closing of title, petitioner and Shoratlantic disagreed over the nature and quality of certain aspects of the construction of the unit. While petitioner alluded to disagreements over a number of upgrades and other items, the primary issues involved Shoratlantic's construction and installation of a wooden walkway instead of a concrete walkway at the premises, and disputes over certain interior design services and item purchases. Petitioner, at some point and as a result of these disagreements, refused to make required payments to Shoratlantic pursuant to the terms of the purchase agreement. In response, Shoratlantic held petitioner in default under the purchase agreement.

6. Petitioner challenged Shoratlantic's default claim by filing suit on September 21, 1987 against Shoratlantic, and certain other named defendants, seeking (in general) enforcement of the purchase agreement, transfer of title to the premises, and money damages. Petitioner claimed in her lawsuit, and noted in these proceedings, that the value of the condominiums had appreciated substantially (to approximately twice the contract purchase price) within a short period of time after petitioner signed the purchase agreement, and that it was this appreciation in value which motivated Shoratlantic's actions and determination to hold petitioner in default under the purchase agreement. Petitioner was unsuccessful in her lawsuit, and on her appeal therefrom. As a result, she was not able to compel Shoratlantic to transfer title to the premises to her, and

was unable to recover, apparently as the result of the impact of paragraph “6” of the purchase agreement, some \$84,250.00 in payments she had made prior to default under the purchase agreement.

7. On March 25, 1996, the Division of Taxation (“Division”) issued to petitioner, Adrian R. Lazar, a Notice of Deficiency asserting additional New York State personal income tax and New York City nonresident earnings tax due for the year 1993 in the aggregate amount of \$6,993.05, plus penalties for failure to file a tax return (Tax Law § 685[a][1][A]), deficiency due to negligence (Tax Law § 685[b]) and substantial understatement of liability (Tax Law § 685[p]), plus interest. A Statement of Personal Income Tax Audit Changes dated January 9, 1996 reveals that the asserted deficiency resulted solely from the Division’s disallowance of a loss in the amount of \$84,250.00 claimed by petitioner on her 1993 New York State and City of New York tax returns.²

SUMMARY OF THE PARTIES’ POSITION

8. There is no dispute as to the dollar amount of the claimed loss. Rather, the Division’s sole basis for denying the loss is that it was a personal loss as opposed to one resulting from an activity entered into for profit and thus is not deductible. In this regard, the Division finds a lack of support for the proposition that the transaction was one entered into for profit in the fact that there was no closing of title and thus the premises were never rented. The Division also notes that the mortgage commitment obtained by petitioner provided that “[y]ou must occupy the Premises as your primary residence during the term of your loan,” thus indicating the purchase was a personal transaction and not a rental profit motivated transaction.

² The Statement of Audit Changes describes the loss as “other loss disallowed from Fed Form 4797.” Neither Federal Form 4797 nor petitioner’s Federal or State (or City of New York) personal income tax returns were included in the record.

9. Petitioner and her husband testified credibly at hearing that they had no intent to sell or vacate their long-time home at Far Rockaway, or live in the condominium at any time. Rather, they stated that the only purpose in contracting to purchase the condominium was to rent the premises. In this regard, petitioner points to the clear difference, and resulting profit, between the projected monthly mortgage payment and the anticipated monthly rent for the premises, and to the fact that she, and the realtor she engaged, actively sought tenants for the premises.

CONCLUSIONS OF LAW

A. Internal Revenue Code (“IRC”) § 165(a) allows a deduction against income for any loss sustained during a taxable year and not compensated for by insurance or otherwise.³ Petitioner claims entitlement to a deduction under IRC § 165(c)(2), based on her loss of the \$84,250.00 forfeited as the result of her default under the purchase agreement for her condominium. IRC § 165(c)(2) provides as follows:

(c) LIMITATION OF LOSSES OF INDIVIDUALS.—In the case of an individual, the deduction under subsection (a) shall be limited to—

(2) losses incurred in any transaction entered into for profit, though not connected with a trade or business;

B. The Division raises no challenge to the dollar amount of the claimed loss, or to the propriety of claiming such loss in 1993. Instead, the only challenge articulated by the Division against petitioner’s claimed loss deduction is that the loss was a personal loss rather than one incurred in a transaction entered into for profit. Essentially the Division asserted that petitioner and her husband were purchasing the condominium for their own use. However, petitioner and

³ At hearing and in his brief, petitioner’s representative cited to IRC § 165(c)(2) and also to IRC § 47 in support of the claimed loss deduction. IRC § 47 pertains to rehabilitation credits for certified historic structures. Its relevance to this matter, if any, was not explained and is unknown.

her husband established by credible testimony that they had no intent to sell or abandon their long-time home in Far Rockaway and occupy or use the condominium at Atlantic Beach, either on a full-time basis or as a second (or summer) home. Rather, petitioner entered into the purchase agreement with the intent of acquiring a rental property with a clear potential for generating a very attractive monthly rental profit. In furtherance of this plan, and while the premises were being constructed, petitioner engaged the services of a well-known Atlantic Beach realtor who actively sought out tenants for the property. Unfortunately, as detailed above, differences between petitioner and the developer ultimately led to the default under the purchase agreement, the ensuing and ultimately unsuccessful legal challenge by petitioner, and the loss of the sums paid by petitioner in connection with her attempt to purchase the condominium for use as a rental property. Under these circumstances, petitioner has established that the loss was incurred in a transaction entered into for profit and thus she is entitled to deduct the same pursuant to IRC § 165(c)(2).

C. The petition of Adrian R. Lazar is hereby granted and the notice of deficiency dated March 25, 1996 is canceled.

DATED: Troy, New York
May 9, 2002

/s/ Dennis M. Galliher
PRESIDING OFFICER