STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
HAROLD M. UNGER	:	DETERMINATION DTA NO. 818785
for Redetermination of a Deficiency or for Refund of New York State and New York City Personal Income Tax under Article 22 of the Tax Law and the Administrative Code of the City of New York for the year 1997.	:	

Petitioner, Harold M. Unger, 220 East 65th Street, New York, New York 10021, filed a petition for redetermination of a deficiency or for refund of New York State and New York City personal income tax under Article 22 of the Tax Law and the City of New York Administrative Code for the year 1997.

A hearing was held before Gary R. Palmer, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on May 23, 2002 at 10:30 A.M., with all briefs to be submitted by August 9, 2002, which date began the six-month period for the issuance of this determination. Petitioner appeared by Albinder, Altman & Block LLP (Joel M. Helman, CPA). The Division of Taxation appeared by Barbara G. Billet, Esq. (Kevin R. Law, Esq., of counsel).

ISSUE

Whether the small business corporation losses reported by petitioner on his 1997 New York State and City of New York personal income tax return were required to be added back to

petitioner's Federal adjusted gross income by reason of the failure of the corporation's shareholders to elect to be treated as a New York small business corporation for such year.

FINDINGS OF FACT

1. Pursuant to an audit of petitioner's 1997 New York State and City of New York resident income tax return, the Division of Taxation ("Division") issued to petitioner a statement of proposed audit changes dated January 10, 2000, asserting additional New York State personal income tax in the sum of $13,993.04 and City of New York personal income tax in the sum of $8,940.80 plus interest. The statement included the following explanation:

> If a Subchapter S Corporation does NOT make the election provided under section 660 of the New York Tax Law, each shareholder must increase his federal adjusted gross income by an amount equal to his proportionate share of the net operating loss of the corporation to the extent the shareholder deducted such loss in determining his federal adjusted gross income.

2. On April 3, 2000 the Division issued to petitioner a notice of deficiency as follows:

Tax Year/Jurisdiction	Tax Amount	Interest Amount	Total
1997 NYS	$13,993.04	$2,027.35	$16,020.39
1997 NYC	$8,940.80	$1,295.37	$10,236.17
Totals	$22,933.84	$3,322.72	$26,256.56

3. Petitioner requested a conciliation conference with the Division's Bureau of Conciliation and Mediation Services whereby a conciliation conference was held on May 15, 2001. On July 13, 2001 a conciliation order was issued sustaining the notice of deficiency.

4. Petitioner developed a software program and, prior to the year at issue, had formed a corporation in New Jersey, D'Oodles, Ltd., which had elected Federal subchapter S treatment.

By 1997 the corporation had started doing business in New York City, but its shareholders neglected to make the Tax Law § 660(a) election as a New York S corporation for New York State and New York City tax purposes. Mr. Helman testified that the corporation generated large losses with the result that it was only required to pay the minimum New York corporation tax, and that the failure to make the New York subchapter S election was an innocent mistake that did not operate to petitioner's advantage.

5. D'Oodles, Ltd. generated a loss in 1997 from its New York operations which was reported in petitioner's Federal adjusted gross income as stated in his New York State and City of New York resident income tax return. The flow through of this corporate loss to petitioner was sufficient to fully offset all of his New York State and City of New York income tax liability for that year, and to generate an overpayment which petitioner sought to apply to his 1998 estimated tax.

SUMMARY OF THE PARTIES' POSITIONS

6. Petitioner maintains, through his representative, that when the corporation started doing business in New York City, it was his intention as a shareholder to file in New York as a subchapter S corporation, and that the failure to elect pursuant to section 660(a) was an error on the part of petitioner's accountant and not that of petitioner. Mr. Helman advised that because the error was not that of petitioner and because it did not operate to petitioner's advantage, petitioner had no motive not to file a New York subchapter S election, and to compel petitioner to live with the consequences of his accountant's failure is unjust.

7. The Division contends that because the shareholders of D'Oodles, Ltd. did not elect to file as a New York S corporation, the corporate loss that flowed through to petitioner must be

added back to petitioner's Federal adjusted gross income as a matter of law, with the result that petitioner owes the personal income tax with interest asserted in the statutory notice.

CONCLUSIONS OF LAW

A. Tax Law § 660(a) requires the election by all shareholders of a Federal subchapter S corporation for it to be eligible for tax treatment as a New York S corporation, whereby each shareholder may then be taxed on his or her proportionate share of the S corporation's items of income, gain, loss and deduction.

B. Tax Law § 612(a) defines the New York adjusted gross income of a resident individual as:

> [H]is federal adjusted gross income as defined in the laws of the United States for the taxable year, with the modifications specified in this section.

Section 612(b) includes a list of modifications that must be added back to Federal adjusted gross income. The modification that is specified in paragraph 19 of Tax Law § 612(b), reads as follows:

> (19) In the case of a shareholder of an S corporation (A) where the election provided for in subsection (a) of section six hundred sixty has not been made with respect to such corporation, any item of loss or deduction of the corporation included in federal gross income pursuant to thirteen hundred sixty-six of the internal revenue code[1] . . . .

From the plain language of the statute it is clear that the Legislature left no room for the exercise of discretion where the failure to make an election for the treatment of a Federal small business corporation as a New York S corporation was due to error. It follows that the S corporation loss reported by petitioner on his New York State and City of New York personal income tax return

[1] IRC § 1366 addresses "pass thru" of items to shareholders.

must be added back to his Federal adjusted gross income (***see, Matter of Jurist***, Tax Appeals Tribunal, September 30, 1993).

C. The petition of Harold M. Unger is denied and the notice of deficiency dated April 3, 2000 is sustained.

DATED: Troy, New York
January 2, 2003

/s/ Gary R. Palmer
ADMINISTRATIVE LAW JUDGE