STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
JOSEPH AND DOREEN DEGLOMINI	:	DETERMINATION DTA NOS. 819242
for Redetermination of a Deficiency or for Refund of New York State and City of New York Personal Income Tax under Article 22 of the Tax Law and the New York City Administrative Code for the Year 1994.	:	AND 819312

In the Matter of the Petition	:	
of	:	
MICHAEL AND MERRIE CONTILLO	:	
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 New York City Administrative Code for the Years 1994, 1996 and 1997.	:	

Petitioners Joseph and Doreen Deglomini, P.O. Box 1175, Hemlock Drive, Alpine, New Jersey 07620, filed a petition for redetermination of a deficiency or for refund of New York State and City of New York personal income tax under Article 22 of the Tax Law and the New York City Administrative Code for the year 1994.

Petitioners Michael and Merrie Contillo,[1] 4 Mansion Drive, Old Westbury, New York 11568, filed a petition for redetermination of a deficiency or for refund of New York State and

[1] Merrie Contillo passed away on May 8, 2000.

New York City personal income tax under Article 22 of the Tax Law and the New York City Administrative Code for the years 1994, 1996 and 1997.

On June 16, 2003 and June 26, 2003, respectively, petitioners,[2] by their authorized representative, Roberts & Holland LLP (Carolyn Joy Lee, Esq., and Howard J. Levine, Esq., of counsel) and the Division of Taxation by Mark F. Volk, Esq. (Barbara J. Russo, Esq., and Peter B. Ostwald, Esq., of counsel), waived hearings and agreed to submit these matters for determination based on documents and briefs submitted by December 4, 2003, which date commenced the six-month period for the issuance of this determination. After review of the evidence and arguments presented, Winifred M. Maloney, Administrative Law Judge, renders the following determination.

ISSUES

I. Whether petitioners Michael and Merrie Contillo made valid elections to carry forward the net operating losses that they sustained in 1993 and 1995.

II. Whether petitioners Joseph and Doreen Deglomini made a valid election to carry forward the net operating loss that they sustained in 1993.

III. Whether reasonable cause exists to abate the penalties

FINDINGS OF FACT

1. On September 13, 2001, the Division of Taxation (the "Division") issued to petitioners Joseph and Doreen Deglomini ("the Deglominis") a Notice of Deficiency, Notice Number L-019863509, asserting additional New York State and City of New York tax due in the amount of $8,592.98 plus penalty and interest for the year 1994.

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[2] All references to petitioners will mean Joseph and Doreen Deglomini and Michael and Merrie Contillo collectively, unless otherwise noted.

2. On May 21, 2001, the Division issued three notices of deficiency to petitioners Michael and Merrie Contillo ("the Contillos"). The first Notice of Deficiency, Notice Number L-019206520-1, asserts additional New York State and City of New York tax due in the amount of $36,466.08 plus penalty and interest for the year 1994. The second Notice of Deficiency, Notice Number L-019206531, asserts additional New York State and City of New York tax due in the amount of $4,448.58. The third Notice of Deficiency, Notice Number L-019206529-1, asserts additional New York State tax in the amount of $41,596.96 plus penalty and interest for the year 1997.

3. Prior to and during the periods in issue, Michael Contillo and Joseph Deglomini were members of numerous pass-through entities - - partnerships and New York State S corporations - - ("the entities") that engaged in, among other things, plumbing, masonry and contracting businesses in the New York City area. Each man calculated his Federal and State income tax liabilities by including in his individual income his respective share of the income or the losses of such entities.

4. Sometime in 1992, Messrs. Contillo and Deglomini, and certain entities affiliated with them, retained the law firm of Litman, Asche & Gioiella, LLP to advise them in connection with a criminal investigation being conducted in New York.[3]

5. For the year 1993, Mr. and Mrs. Deglomini filed an Application for Automatic Extension of Time to File for Individuals, form IT-370, which extended the due date for filing the form IT-203, Nonresident and Part-Year Resident Income Tax Return until August 15, 1994. For the year 1993, Mr. and Mrs. Contillo also filed an Application for Automatic Extension of

[3] The exact date that the law firm was retained is not part of the record.

Time to File for Individuals, which extended the due date for filing the form IT-201 until August 15, 1994.

6. On April 22, 1994, Michael Contillo, Joseph Deglomini, eight other individuals and ten entities affiliated with either Messrs. Contillo and Deglomini or the other individuals were indicted by a New York State grand jury[4] on a total of 318 criminal charges, including charges that they engaged in criminal tax fraud in the preparation and filing of New York State income tax returns. The indictment accuses the defendants of committing various crimes from on or about 1989 through on or about the date of the indictment, i.e., April 22, 1994.[5]

7. During the summer of 1994, Joseph Leshkowitz, C.P.A., a partner in the accounting firm of Leshkowitz & Co. LLP, was retained as the tax accountant for Mr. and Mrs. Deglomini, Mr. and Mrs. Contillo and various entities owned or controlled by Messrs. Deglomini and Contillo.

8. The Deglominis filed an Application for Additional Extension of Time to File for Individuals, form IT-372, to extend the due date for filing their 1993 return until October 17, 1994. In the form IT-372, the Deglominis stated that they needed the additional extension because they were "awaiting additional information necessary to file a complete and accurate return." The Contillos also filed an Application for Additional Extension of Time to File for Individuals, form IT-372, to extend the due date for filing their 1993 return until October 17, 1994. In the form IT-372, the Contillos stated that they needed the additional extension because they were "awaiting additional information necessary to file a complete and accurate return."

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[4] The grand jury proceedings were conducted in New York County.

[5] The individuals and entities indicted included the accounting firm and the individual accountants who had performed accounting services for Messrs. Deglomini and Contillo and their affiliated entities.

Mr. Leshkowitz prepared the applications for additional extension of time to file for individuals for both the Deglominis and the Contillos.

9. Richard M. Asche, Esq., a partner in the law firm of Litman, Asche & Gioiella, advised Messrs. Deglomini and Contillo that they should not file their individual Federal, State or City income tax returns for 1993 and subsequent years, nor those for the indicted entities until the criminal matters were resolved.

10. On or about September 1994, the Deglominis and the Contillos instructed Mr. Leshkowitz that, based on the advice of the criminal defense attorneys for Messrs. Deglomini and Contillo and the entities, Federal and New York State income tax returns should not be filed for the Deglominis, the Contillos or the various entities for 1993 and subsequent years until the criminal matters were resolved.

11. For the year 1994, the Deglominis filed an Application for Automatic Extension of Time to File for Individuals, form IT-370, which extended the due date for filing the form IT-203 until August 15, 1995. They filed an Application for Additional Extension of Time to File for Individuals, form IT-372, to extend the due date until October 16, 1995. In the form IT-372, the Deglominis stated that they needed the additional extension because they were "awaiting addtl [sic] third-party info [sic] necessary to file complete return."

12. For the year 1994, the Contillos filed an Application for Automatic Extension of Time to File for Individuals, form IT-370, which extended the due date until August 15, 1995. They filed an Application for Additional Extension of Time to File for Individuals, form IT-372, to extend the due date until October 16, 1995. In the form IT-372, the Contillos stated that they needed the additional extension because they were "awaiting addtl [sic] third-party info [sic] necessary to file complete return."

13. For the year 1995, the Contillos filed an Application for Automatic Extension of Time to File for Individuals, form IT-370, which extended the due date until August 15, 1996. They filed an Application for Additional Extension of Time to File for Individuals, form IT-372, to extend the due date until October 15, 1996 because they were "awaiting third party info. necessary to file a complete & accurate return."

14. For the year 1996, the Contillos filed an Application for Automatic Extension of Time to File for Individuals, form IT-370, which extended the due date until August 15, 1997. They filed an Application for Additional Extension of Time to File for Individuals, form IT-372, to extend the due date until October 15, 1997 because they were "awaiting additional necessary third party information."

15. For the year 1997, the Contillos filed an Application for Automatic Extension of Time to File for Individuals, form IT-370, which extended the due date until August 15, 1997. They filed an Application for Additional Extension of Time to File for Individuals, form IT-372, to extend the due date until October 15, 1997.[6]

16. In January 1998, Messrs. Deglomini and Contillo each pleaded guilty to a single Class A misdemeanor charge, Falsifying Business Records in the Second Degree, in satisfaction of all charges under the indictment. As part of the plea agreement, Messrs. Contillo and Deglomini agreed to pay the sum of $1,000,000.00 to cover the cost of prosecution. Additionally, certain entities entered into felony pleas.

17. On September 23, 1998, Messrs. Contillo and Deglomini, and two other individuals, were indicted by a Federal grand jury. The Federal indictment accused Messrs. Contillo and

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[6] The record does not include copies of either the form IT-370 or the form IT-372 that were filed by the Contillos for the year 1997.

Deglomini and the other individuals of various tax-related crimes, including criminal tax fraud for the years 1989 through 1991.

18. On July 24, 2000, the Honorable Allyne R. Ross, United States District Court Judge for the Eastern District of New York, issued an Opinion and Order dismissing the criminal indictments against all defendants: "[b]ecause the government unreasonably delayed unsealing the indictment after the limitations period, the prosecution is barred by the statute of limitations." Shortly thereafter, Mr. Asche advised Messrs. Deglomini and Contillo that their income tax returns for 1993 and subsequent years should be filed. Subsequently, Mr. Leshkowitz was instructed to prepare the Federal and New York income tax returns for 1993 through 1999 for the Deglominis, the Contillos and the various entities.

The Deglominis

19. On November 10, 2000, Mr. and Mrs. Deglomini, filed their 1993 Nonresident and Part-Year Resident Income Tax Return (form IT-203) and City of New York Nonresident Earnings Tax Return (form NYC-203). On their form IT-203, the Deglominis reported the following items as part of their Federal adjusted gross income of negative $796,420.00: wages of $352,300.00, taxable interest income of $55,151.00, dividend income of $2.00, taxable refunds of state and local income taxes of $52,178.00, a capital loss of $3,000.00, other gains (Federal Form 4797) of $6,890.00, losses from partnerships and S-corporations of $1,248,332.00, other income of negative $5,719.00 - - consisting of S-corp health insurance premiums of $7,560.00 plus Williamsbridge property tax refund (no benefit) of $4,666.00 minus benefit in prior year of $17,945.00 - - and Federal adjustments to income (for an IRA deduction and self-employed health insurance) of $5,890.00. The New York source income reported on the return consisted of wages of $352,300.00, taxable interest income of $33,538.00, dividend income of $2.00, a

capital loss of $3,000.00, other gains (Federal Form 4797) of $6,890.00, losses from partnerships and S-corporations of $1,248,332.00, and other income of $12,226.00, consisting of S- corp health insurance premiums of $7,560.00 and the Williamsbridge property tax refund (no benefit) of $4,666.00. To the Federal adjusted gross income of negative $796,420.00, the Deglominis added a "NYS Tax Addback" of $17,945.00 and subtracted the taxable refunds of state and local income taxes of $52,178.00 and arrived at a New York adjusted gross income of negative $830,653.00. They claimed itemized deductions of $28,306.00 and a dependent exemption of $1,000.00. The Deglominis determined their New York State taxable income to be negative $859,959.00. Based upon Mr. and Mrs. Deglomini's total wages of $351,300.00, they computed the City of New York nonresident earnings tax to be $1,581.00. They determined their State and City taxes to be $1,581.00 and claimed an overpayment of $35,127.00 of the total State and City taxes withheld and paid with the form IT-370. The Deglominis requested that the overpayment of $35,127.00 be applied to their 1994 estimated tax. Their election to credit their 1994 estimated tax account was not made before November 10, 2000.

20. Annexed to Mr. and Mrs. Deglomini's 1993 Nonresident and Part-Year Resident Income Tax Return is an attachment entitled "Election to Forego Carryback of Net Operating Loss" wherein they state that they elect to forego the carryback of the net operating loss incurred in the taxable year. Mr. and Mrs. Deglomini's election to forego the carryback of the net operating loss for 1993 was not made before November 10, 2000.

21. On November 10, 2000, Mr. and Mrs. Deglomini, filed their 1994 Nonresident and Part-Year Resident Income Tax Return (form IT-203) and City of New York Nonresident Earnings Tax Return (form NYC-203). On their form IT-203, the Deglominis reported the following items as part of their Federal adjusted gross income of $205,135.00: wages of

$404,300.00, taxable interest income of $41,699.00, dividend income of $7,274.00, taxable refunds of state and local income taxes of $35,127.00, a capital loss of $3,000.00, other losses (Federal Form 4797) of $13,990.00, partnerships and S-corporations income of $592,603.00, other income of negative $852,854.00 - - consisting of S-corp health insurance premiums of $8,004.00 plus Williamsbridge properties income of $1,666.00 minus the 1993 net operating loss of $862,524.00 - - and Federal adjustments to income (for an IRA deduction, self-employed health insurance and a self-employed tax deduction) of $6,024.00. The New York source income reported on the return, totaling $149,554.00, consisted of wages of $404,300.00, taxable interest income of $7,941.00, a capital loss of $3,000.00, other losses (Federal Form 4797) of $13,900.00, partnerships and S-corporations income of $592,603.00, and other income of negative $852,854.00 - - consisting of S-corp health insurance premiums of $8,004.00 plus Williamsbridge properties income of $1,666.00 minus the 1993 net operating loss of $862,524.00 - - and Federal adjustments to income (for an IRA deduction and self-employed health insurance) of $6,001.00. From the Federal adjusted gross income of $205,135.00, the Deglominis subtracted the taxable refunds of state and local income taxes of $35,127.00 and interest income on U.S. government bonds of $20,454.00 and arrived at a New York adjusted gross income of $149,554.00. They claimed itemized deductions of $33,003.00 and a dependent exemption of $1,000.00. The Deglominis determined their New York State taxable income to be $115,551.00 and the New York State tax due on that amount to be $9,094.00. Using an income percentage of 86.26%,[7] the Deglominis determined their allocated New York State tax to be $7,844.00. Based upon Mr. and Mrs. Deglomini's total wages of $403,300.00, they computed

[7] The New York State income percentage was determined by dividing the State adjusted gross income of $128,999.00 by the Federal adjusted gross income of $149,554.00.

the City of New York nonresident earnings tax to be $1,815.00. They determined their State and City taxes to be $9,659.00 and claimed an overpayment of $65,141.00 of the total State and City taxes withheld and estimated taxes paid. The Deglominis requested that the overpayment of $65,141.00 be applied to their 1995 estimated tax. Their election to credit their 1995 estimated tax account was not made before November 10, 2000.

22. As a result of an audit of Mr. and Mrs. Deglomini's 1994 New York State Nonresident and Part-Year Resident Income Tax Return, the Division disallowed the reduction to their 1994 Federal adjusted gross income for the claimed carry forward of the 1993 net operating loss in the amount of $852,854.00[8] because the election to carry forward a net operating loss must be made by the due date of the loss year return and their 1993 return was filed late. The Division determined that the 1993 net operating loss must be carried back to the year 1990. For the year 1990, Mr. and Mrs. Deglomini's reported Federal adjusted gross income was $2,721,233.00, reported Federal taxable income was $2,487,507.00 and reported New York State adjusted gross income was $2,678,731.00. The Division determined that their claimed 1993 net operating loss would be fully absorbed in 1990. The Deglominis reported a net operating loss on their 1995 Nonresident and Part-Year Resident Income Tax Return in the amount of $497,055.00 and had elected to carry forward the net operating loss to their 1996 return. Because the Deglominis filed the 1995 return in November 2000,[9] the Division determined that their claimed 1995 net operating loss must be carried back to the years 1992, 1993 and 1994. It determined that $165,595.00 would be absorbed in 1992, $0.00 would be

[8] Although the amount of the net operating loss claimed was actually $862,524.00, the Division only disallowed $852,854.00.

[9] The exact date on which Mr. and Mrs. Deglomini filed their 1995 return is not part of the record.

absorbed in 1993 and $329,692.00 would be absorbed in 1994. The Division determined that Mr. and Mrs. Deglomini's 1994 Federal income should be adjusted to include an additional $523,162.00.

23. A Statement of Proposed Audit Changes for the year 1994 was issued to Mr. and Mrs. Deglomini on July 20, 2001 that reflected the disallowance of the carry forward of the 1993 net operating loss and the allowance of a carryback of the 1995 net operating loss described above. In that Statement of Proposed Audit Changes the following adjustments were made: Federal adjusted gross income was increased by $523,162.00 to $728,297.00, the New York State amount of Federal adjusted gross income was increased by $523,162.00 to $651,361.00[10] and New York itemized deductions were decreased by $17,482.00 to reflect a New York itemized deduction adjustment. As a result of the audit adjustments, New York State taxable income was determined to be $656,195.00 and the base New York State tax on that amount was determined to be $51,675.36. The New York State income percentage of 89.89% ($651,361.00/$728,297.00) was multiplied by the base New York State tax of $51,675.36 and the recomputed New York State tax was determined to be $46,450.98. No additional New York City earnings tax was determined to be due. The statement shows a corrected tax liability for New York State in the amount of $46,450.98 and for New York City in the amount of $1,815.00. A credit for New York State and New York City taxes withheld in the amount of $38,775.00 and $898.00, respectively, was allowed. However, the Division disallowed Mr. and Mrs. Deglomini's claimed credit of their 1993 overpayment to the 1994 tax year in the amount of $35,127.00 because the three-year period in which to claim the 1993 overpayment to be applied to the 1994 tax year had expired. The

[10] Although the statement's computation section states that the adjustment to the New York State amount of Federal gross income was $475,728.00, that is incorrect, the increase was $523,162.00

statement shows additional New York State tax due in the amount of $7,675.98 and the New York City tax due in the amount of $917.00. Late filing and late payment penalties pursuant to Tax Law § 685(a)(1) and (2) in the total amount of $2,471.54 plus interest were added to the additional tax asserted as due.

24. As noted in Finding of Fact "1," the Division issued a Notice of Deficiency, dated September 13, 2001, to Mr. and Mrs. Deglomini asserting additional tax, interest and penalty due for the year 1994.

25. Mr. and Mrs. Deglomini requested a conciliation conference which was conducted on May 16, 2002. By order dated September 6, 2002, the conciliation conferee sustained the statutory notice.

26. On December 11, 2002, Mr. and Mrs. Deglomini filed a petition challenging the Division's disallowance of the carry forward of the 1993 net operating loss in calculating taxable income for 1994. The petition also challenges the imposition of penalties.

The Contillos

27. On November 14, 2000, Mr. and Mrs. Contillo filed a form IT-201, Resident Income Tax Return, and City of New York Nonresident Earnings Tax Return (form NYC-203) for 1993. On their return, Mr. and Mrs. Contillo reported the following items as part of their Federal adjusted gross income of negative $917,723.00: wages of $352,300.00, taxable interest income of $36,348.00, dividend income of $2.00, taxable refunds of state and local income taxes of $14,793.00, a capital loss of $3,000.00, other gain (Federal Form 4797) of $6,857.00, losses from partnerships and S-corporations of $1,311,790.00, other income of negative $7,233.00 and an adjustment to income (for an IRA deduction and self-employed health insurance) of $5,890.

The Contillos added a "NYS Tax Addback" of $14,983.00 and subtracted the taxable refund of state and local income taxes of $14,793.00 and arrived at a New York adjusted gross income of negative $917,423.00. They claimed itemized deductions of $64,807.00, and dependent exemptions of $5,000.00. The Contillos determined their New York State taxable income to be negative $987,230.00, with zero New York State tax due. Based upon Mr. and Mrs. Contillo's total wages of $351,300.00, they computed the City of New York nonresident earnings tax to be $1,581.00. They determined their State and City taxes to be $1,581.00 and claimed an overpayment of $60,592.00 of the total State and City taxes withheld and paid with the form IT-370. Mr. and Mrs. Contillo requested that the overpayment of $60,592.00 be applied to their 1994 estimated tax.

28. Annexed to their 1993 return is an attachment entitled "Election to Forego Carryback of Net Operating Loss" wherein Mr. and Mrs. Contillo state that they elect to forego the carryback of the net operating loss incurred in the taxable year. Their election to forego the carryback of the net operating loss for 1993 was not made before November 14, 2000.

29. On November 14, 2000, Mr. and Mrs. Contillo filed a form IT-201, Resident Income Tax Return and City of New York Nonresident Earnings Tax Return (form NYC-203) for the year 1994. On their return, Mr. and Mrs. Contillo reported the following items as part of their Federal adjusted gross income of $221,980.00: wages of $404,300.00, taxable interest income of $11,534.00, taxable refunds of state and local income taxes of $60,592.00, a capital loss of $3,000.00, other losses (Federal Form 4797) of $16,563.00, gains from partnerships and S-corporations of $715,747.00, other income of negative $944,629.000 - - consisting of the 1993 net operating loss of $952,633.00 plus S-corp health insurance premiums of $8,004.00 - - and an

adjustment to income (for an IRA deduction and self-employed health insurance) of $6,001.00. The Contillos subtracted the taxable refund of state and local income taxes of $60,592.00 and arrived at a New York adjusted gross income of $161,388.00. They claimed itemized deductions of $58,027.00, and dependent exemptions of $5,000.00. Mr. and Mrs. Contillo determined their New York State taxable income to be $98,361.00, and New York State tax due in the amount of $7,746.00. Based upon Mr. and Mrs. Contillo's total wages of $403,300.00, they computed the City of New York nonresident earnings tax to be $1,815.00. They determined their State and City taxes to be $9,561.00 and claimed an overpayment of $63,441.00 of the total State and City taxes withheld and estimated tax paid. Mr. and Mrs. Contillo requested that the overpayment of $63,441.00 be applied to their 1995 estimated tax.

30. On November 22, 2000, Mr. and Mrs. Contillo filed a form IT-201, Resident Income Tax Return, and City of New York Nonresident Earnings Tax Return (form NYC-203) for the year 1995. On their return, the Contillos reported the following items as part of their Federal adjusted gross income of negative $613,640.00: wages of $44,232.00, taxable interest income of $18,103.00, taxable refunds of state and local income taxes of $63,441.00, a capital loss of $3,000.00, other losses (Federal Form 4797) of $24,243.00, losses from partnerships and S-corporations of $643,687.00, other income of negative $55,797.00 - - consisting of S-corp health insurance premiums of $7,644.00 minus the 1994 income tax refund (no benefit) of $63,441.00 - - and an adjustment to income (for an IRA deduction, self-employed tax deduction and self-employed health insurance) of $12,689.00. The Contillos added a "NYS Addback" of $74,079.00.00 and subtracted the taxable refund of state and local income taxes of $63,441.00 and arrived at a New York adjusted gross income of negative $603,002.00. They claimed

itemized deductions of $70,739.00, and dependent exemptions of $5,000.00. Mr. and Mrs. Contillo determined their New York State taxable income to be negative $678,741.00, with zero New York State tax due. Based upon Mr. Contillo's wages of $12,166.00 and his self-employed income of $250,636.00 as well as Mrs. Contillo's wages of $32,066.00, they computed the City of New York nonresident earnings tax to be $1,828.00. They determined their State and City taxes to be $1,828.00 and claimed an overpayment of $63,893.00 of the total State and City taxes withheld and the estimated tax paid. The Contillos requested that the overpayment of $63,893.00 be applied to their 1996 estimated tax.

31. Annexed to Mr. and Mrs. Contillo's 1995 return is an attachment entitled "Election to Forego Carryback of Net Operating Loss" wherein they state that they elect to forego the carryback of the net operating loss incurred in the taxable year. Their election to forego the carryback of the net operating loss for 1995 was not made before November 22, 2000.

32. On November 22, 2000, Mr. and Mrs. Contillo filed a form IT-201, Resident Income Tax Return, and City of New York Nonresident Earnings Tax Return (form NYC-203) for the year 1996. On their return, the Contillos reported the following items as part of their Federal adjusted gross income of negative $458,903.00: wages of $36,832.00, taxable interest income of $28,268.00, dividend income of $5.00, taxable refunds of state and local income taxes of $63,893.00, a capital loss of $3,000.00, other losses (Federal Form 4797) of $44,456.00, gains from partnerships and S-corporations of $98,546.00, other income of negative $624,283.00 - - consisting of the 1995 net operating loss of $630,094.00 plus S-corp health insurance premiums of $5,811.00 - - and Federal adjustments to income (for an IRA deduction, self-employed tax deduction and self-employed health insurance) of $14,708.00. The Contillos added the "NYS

Addback" of $15,804.00 and subtracted the taxable refund of state and local income taxes of $63,893.00 and arrived at a New York adjusted gross income of negative $506,992.00. They claimed itemized deductions of $58,194.00, and dependent exemptions of $4,000.00. The Contillos determined their New York State taxable income to be negative $569,186.00, with zero New York State tax due. Based upon Mr. Contillo's wages of $2,166.00, his self-employment earnings of $389,234.00 and Mrs. Contillo's wages of $34,666.00, they computed the City of New York nonresident earnings tax to be $2,696.00. They determined their State and City taxes to be $2,696.00 and claimed an overpayment of $63,504.00 of the total State and City taxes withheld and estimated tax paid. Mr. and Mrs. Contillo requested that the overpayment of $63,504.00 be applied to their 1997 estimated tax.

33. On November 22, 2000, Mr. and Mrs. Contillo filed a form IT-201, Resident Income Tax Return, and City of New York Nonresident Earnings Tax Return (form NYC-203) for the year 1997. On their return, the Contillos reported the following items as part of their Federal adjusted gross income of $614,690.00: wages of $569,732.00, taxable interest income of $61,319.00, taxable refunds of state and local income taxes of $63,504.00, capital gain of $89,824.00, other losses (Federal Form 4797) of $24,243.00, partnerships and S-corporations income of $429,583.00, other income of negative $592,260.00 - - consisting of S-corp health insurance premiums of $5,011.00 minus the 1995 net operating loss of $597,271.00 - - and Federal adjustments to income (for IRA deductions for Mr. and Mrs. Contillo, one-half of self-employment tax deduction and self-employed health insurance deduction) of $7,012.00. The Contillos added a "NYS Addback" of $999.00 and subtracted the taxable refund of state and local income taxes of $63,504.00 and arrived at a New York adjusted gross income of

$552,185.00. They claimed itemized deductions of $39,043.00, and dependent exemptions of $4,000.00. The Contillos determined their New York State taxable income to be $509,142.00, and New York State tax due in the amount of $34,876.00. Based upon Mr. Contillo's wages of $537,666.00 and his net earnings from self-employment of $75,275.00 as well as Mrs. Contillo's wages of $32,066.00, they computed the City of New York nonresident earnings tax to be $3,052.00. They determined their State and City taxes to be $37,928.00 and claimed an overpayment of $80,125.00 of the total State and City taxes withheld and the estimated tax paid. Mr. and Mrs. Contillo requested that the overpayment of $80,125.00 be applied to their 1998 estimated tax.

34. The Division conducted an audit of Mr. and Mrs. Contillo's tax returns for the years 1994 through 1997. With respect to their 1994 return, the Division disallowed the reduction to Mr. and Mrs. Contillo's Federal adjusted gross income for the claimed carry forward of the 1993 net operating loss in the amount of $952,633.00 because the election to carry forward a net operating loss must be made by the due date of the loss year return and their 1993 return was filed late. The Division determined that the 1993 net operating loss must be carried back to the year 1990. For the year 1990, Mr. and Mrs. Contillo's reported Federal adjusted gross income was $2,727,050.00, reported Federal taxable income was $2,454,515.00, and reported New York State taxable income was $2,682,330.00. The Division determined that their claimed 1993 net operating loss would be fully absorbed in 1990. With respect to their 1995 return, Mr. and Mrs. Contillo had reported a net operating loss in the amount of $630,094.00 and had elected to carry forward that net operating loss to their 1996 tax return. Since their 1995 return was filed late, the Division did not allow the carry forward of the net operating loss. The Division determined

that their claimed 1995 net operating loss must be carried back to the years 1992, 1993 and 1994. For tax year 1992, Mr. and Mrs. Contillo's reported Federal adjusted gross income was $162,906.00, reported Federal taxable income was $111,548.00, and reported New York State taxable income was $113,077.00. The Division determined that $130,648.00 of their claimed 1995 net operating loss would be absorbed in 1992. It also determined that $3,000.00 would be absorbed in 1993 and the remaining $482,406.00 would be absorbed in 1994. The Division determined that Mr. and Mrs. Contillo's 1994 Federal adjusted gross income should be adjusted to include an additional $470,227.00 ($952,633.00 disallowed minus $482,406.00 allowed).

35. A Statement of Proposed Audit Changes for the year 1994 was issued to Mr. and Mrs. Contillo on March 26, 2001 that reflected the disallowance of the carry forward of the 1993 net operating loss and the allowance of a carryback of the 1995 net operating loss described above. In the Statement of Proposed Audit Changes the following adjustments were made: Federal adjusted gross income was increased by $470,227.00 to $692,207.00 and New York itemized deductions were decreased by $29,013.00 to reflect a New York itemized deduction adjustment. As a result of the audit adjustments, New York taxable income was determined to be $597,601.00 and the New York State tax was determined to be $47,061.08. No additional New York City nonresident earnings tax was determined to be due. The statement shows a corrected tax liability for New York State in the amount of $47,061.08 and for New York City in the amount of $1,815.00. A credit for New York State and New York City taxes withheld in the amount of $12,012.00 and $398.00, respectively, was allowed. However, the Division disallowed Mr. and Mrs. Contillo's claimed credit of their 1993 overpayment to their 1994 tax year because the three-year period in which to claim the 1993 overpayment to be applied to the

1994 tax year had expired. The statement shows additional New York State tax due in the amount of $35,049.08 and New York City tax due in the amount of $1,417.00. Late filing penalty pursuant to Tax Law § 685(a)(1) in the total amount of $9,572.29 plus interest were added to the additional tax asserted as due.

36. With respect to Mr. and Mrs. Contillo's 1996 return, the Division disallowed the reduction to their Federal adjusted gross income for the claimed carry forward of the 1995 net operating loss in the amount of $630,094.00 because the election to carry forward the 1995 net operating loss was not timely made. Since the 1995 net operating loss was fully absorbed in 1994, there was no net operating loss remaining to carry forward to 1996. The Division determined that Mr. and Mrs. Contillo's 1996 Federal adjusted gross income should be adjusted to include an additional $630,094.00.

37. A Statement of Proposed Audit Changes for the year 1996 was issued to Mr. and Mrs. Contillo on March 26, 2001 that reflected the disallowance of the carry forward of the 1995 net operating loss described above. In that Statement of Proposed Audit Changes, Federal adjusted gross income of negative $458,903.00 was increased by $630,094.00 to $171,191.00. As a result of the audit adjustment, New York taxable income was determined to be $60,908.00 and the New York State tax was determined to be $4,059.58. No additional New York City nonresident earnings tax was determined to be due. The statement shows a corrected tax liability for New York State in the amount of $4,059.58 and for New York City in the amount of $2,696.00. A credit for New York State and New York City taxes withheld in the amount of $2,207.00 and $100.00, respectively, was allowed. However, the Division disallowed Mr. and Mrs. Contillo's claimed credit of their 1995 overpayment to their 1996 tax year because the three-year period in

which to claim the 1995 overpayment to be applied to the 1996 tax year had expired. The statement shows additional New York State tax due in the amount of $1,852.58 and New York City tax due in the amount of $2,596.00. Late filing and late payment penalties pursuant to Tax Law § 685(a)(1) and (2) in the total amount of $1,670.24 plus interest were added to the additional tax asserted as due.

38. With respect to Mr. and Mrs. Contillo's 1997 return, the Division disallowed the reduction to their Federal adjusted gross income for the claimed carry forward of the 1995 net operating loss in the amount of $597,271.00 because the election to carry forward the 1995 net operating loss was not timely made and the 1995 net operating loss was fully absorbed in 1994. The Division determined that Mr. and Mrs. Contillo's 1997 Federal adjusted gross income should be adjusted to include an additional $597,271.00.

39. A Statement of Proposed Audit Changes for the year 1997 was issued to Mr. and Mrs. Contillo on March 26, 2001 that reflected the disallowance of the carry forward of the 1995 net operating loss described above. In that Statement of Proposed Audit Changes, the following adjustments were made: Federal adjusted gross income was increased by $597,271.00 to $1,211,961.00 and New York itemized deductions were decreased by $9,984.00 to $29,059.00. As a result of the audit adjustments, New York taxable income was determined to be $1,116,397.00 and the New York State tax was determined to be $76,473.19. No additional New York City nonresident earnings tax was determined to be due. The statement shows a corrected tax liability for New York State in the amount of $76,473.19 and for New York City in the amount of $3,052.00. A credit for New York State and New York City taxes withheld in the amount of $34,876.23 and $3,052.00, respectively, was allowed. Because Mr. and Mrs.

Contillo's 1996 tax return was corrected and resulted in a balance due, there was no overpayment to apply to their 1997 estimated tax account. The statement shows additional New York State tax due in the amount of $41,596.96. Late filing penalty pursuant to Tax Law § 685(a)(1) in the amount of $10,399.20 plus interest were added to the additional tax asserted to be due.

40. As noted in Finding of Fact "2," on May 21, 2001, the Division issued three notices of deficiency to Mr. and Mrs. Contillo asserting additional tax, interest and penalty for the years 1994, 1996 and 1997.

41. Mr. and Mrs. Contillo requested a conciliation conference that was conducted on August 22, 2002. By order dated October 25, 2002, the conciliation conferee sustained the statutory notices.

42. On January 21, 2003, the Contillos filed a petition challenging the Division's disallowance of the carry forward of their 1993 net operating loss in calculating their taxable income for 1994 and the disallowance of the carry forward of their 1995 net operating loss in calculating their taxable income for 1996 and 1997. The petition also challenges the imposition of penalties.

43. As part of their submission of documentary evidence, petitioners submitted the September 24, 2003 affidavit of Joseph Leshkowitz with attached exhibits. In that affidavit, Mr. Leshkowitz explains the duration and the scope of his professional relationship as the tax accountant for the Deglominis, the Contillos and the various entities. In addition, the affidavit identifies the amount of the net operating loss sustained by both the Contillos and the Deglominis in the years 1993 and 1995 as well as the manner in which Mr. Leshkowitz reported

those net operating losses on the Federal and New York State income tax returns that he prepared for the Deglominis and the Contillos for the years 1993 through 1997.

44. Attached to Mr. Leshkowitz's affidavit are unsigned and undated copies of the Federal (form 1040) and New York income tax returns that, as the paid preparer, he prepared for the Deglominis and the Contillos for the years 1993 through 1997.

45. A review of the Federal income tax returns prepared for Mr. and Mrs. Deglomini for the years 1993 through 1995 reveal the following. On their 1993 Federal income tax return, the Deglominis claimed that they sustained a net operating loss of $862,524.00. Included as an attachment to that return is a statement entitled "Election to Forego Carryback of Net Operating Loss" wherein, pursuant to Internal Revenue Code ("IRC") § 172(b)(3), they elected to forego the three-year carryback of the net operating loss incurred in the taxable year. On their 1993 Federal return, Mr. and Mrs. Deglomini claimed that no tax was due and requested that their overpayment of tax in the amount of $193,853.00 be applied to 1994 estimated tax. On their 1994 Federal return, in computing their Federal adjusted gross income, Mr. and Mrs. Deglomini claimed a net operating loss of $862,524.00 as part of their computation of "other income." They claimed total tax due in the amount of $85,375.00 and requested that an overpayment of $144,187.00 be applied to the 1995 estimated tax. On their 1995 Federal return, Mr. and Mrs. Deglomini claimed that they sustained a net operating loss of $497,055.00. Included as an attachment to that return is a statement entitled "Election to Forego Carryback of Net Operating Loss" wherein pursuant to IRC § 172(b)(3), they elected to forego the three-year carryback of the net operating loss incurred in the taxable year. Mr. and Mrs. Deglomini claimed that only

$12,792.00 in self-employment taxes were due and requested an overpayment of $136,926.00 be applied to the 1996 estimated tax.

46. A review of the Federal income tax returns prepared for Mr. and Mrs. Contillo for the years 1993 through 1997 reveal the following. On their 1993 Federal income tax return, the Contillos claimed that they sustained a net operating loss of $952,633.00. Included as an attachment to that return is a statement entitled "Election to Forego Carryback of Net Operating Loss" wherein, purusant to IRC § 172(b)(3), they elected to forego the three-year carryback of the net operating loss incurred in the taxable year. On their 1993 Federal return, Mr. and Mrs. Contillo claimed that no tax was due and requested that their overpayment of tax in the amount of $215,999.00 be applied to the 1994 estimated tax. On their 1994 Federal return, in computing their Federal adjusted gross income, Mr. and Mrs. Contillo utilized all of the "prior net operating loss carryover" (i.e., the 1993 net operating loss) of $952,633.00 in their computation of "other income." They claimed total tax due in the amount of $83,509.00 and requested that an overpayment of $168,199.00 be applied to the 1995 estimated tax. On their 1995 Federal return, Mr. and Mrs. Contillo claimed that they sustained a net operating loss of $630,094.00. Included as an attachment to that return is an statement entitled "Election to Forego Carryback of Net Operating Loss" wherein, pursuant to IRC § 172(b)(3), they elected to forego the three-year carryback of the net operating loss incurred in the taxable year. Mr. and Mrs. Contillo claimed that only $12,792.00 in self-employment taxes were due and requested an overpayment of $160,944.00 be applied to the 1996 estimated tax. On their 1996 Federal return, in computing their Federal adjusted gross income, Mr. and Mrs. Contillo utilized only $32,823.00 of the prior net operating loss carryover (i.e., the 1995 net operating loss) of $630,094.00 in their

computation of "other income." In the statement containing the prior net operating carryover deduction worksheet, a carryover of $597,271.00 of the prior net operating loss to the year 1997 is claimed. The last page attached to Mr. and Mrs. Contillo's 1996 Federal return contains the following:

Footnote:

> The net operating loss carryover and the tax overpayments applied from prior years are subject to change upon completion of an agreement with the Internal Revenue Service regarding prior years.

Mr. and Mrs. Contillo claimed that only $17,930.00 in self-employment taxes were due and requested an overpayment of $164,124.00 be applied to the 1997 estimated tax. On their 1997 Federal return, in computing their Federal adjusted gross income, Mr. and Mrs. Contillo utilized the remaining $597,271.00 of the prior (1995) net operating loss in their computation of "other income." They claimed that the total tax due was $168,839.00 and requested an overpayment of $228,281.00 be applied to the 1998 estimated tax.

47. Also attached to Mr. Leshkowitz's September 2003 affidavit are copies of some correspondence that the Deglominis and the Contillos received from either the Internal Revenue Service or the Division as well as some correspondence sent by the accounting firm of Leshkowitz & Co. LLP on behalf of both the Deglominis and the Contillos to either the Internal Revenue Service or the Division.

48. The substance of the correspondence sent by the Internal Revenue Service ("IRS") to Mr. and Mrs. Deglomini follows. For the year 1993, two notices issued by the IRS are included in the record. The first, a notice dated July 9, 2001, informs Mr. and Mrs. Deglomini that the $193,853.00 overpayment reported on their 1993 return could not be applied to the 1994

estimated tax because the IRS had changed their return and there was no overpayment left. The notice states that a separate notice containing an explanation of the changes was being sent. That separate notice is not part of the record. The July 9, 2001 notice recommended that Mr. and Mrs. Deglomini pay $193,853.00 because they would have underpaid their 1994 estimated tax and the IRS may charge a penalty. The second, a letter dated July 18, 2001, is the legal notice that disallowed the claim for refund or credit for the year 1993 because the tax return, showing the overpayment, was filed more than three years after its due date.

For the year 1994, three notices issued by the IRS are part of the record. The first, a letter dated July 9, 2001 states that the IRS changed the 1994 estimated tax total and the amount of $115,421.40 is due. The second, a notice dated November 19, 2001, shows a current balance due of $118,403.00. The third, a notice dated June 24, 2002 states that the 1994 account information was changed to reflect an interest charge and the amount owed now is $54,604.68.

For the year 1995, three notices issued by the IRS are part of the record. The first, a notice dated July 9, 2001, states that the IRS changed Mr. and Mrs. Deglomini's 1995 return, specifically, the 1995 estimated tax total, and as a result of those changes, they owed $15,563.26. The second, a letter dated September 24, 2001, is the legal notice disallowing Mr. and Mrs. Deglomini's claim for refund or credit for the year 1995 because the statute for filing Form 8697 for 1995 had expired, the returns referred to (1993 and 1994) were not timely filed and the claim for credit or refund was filed more than three years after the 1995 return due date, including any extensions.

49. The substance of the correspondence sent by the IRS to Mr. and Mrs. Contillo follows. For the year 1993, two notices issued by the IRS are part of the record. The first, a

notice dated May 21, 2001, informs Mr. and Mrs. Contillo that the $215,999.00 overpayment reported on the 1993 return could not be applied to the 1994 estimated tax because the IRS had changed their return and there was no overpayment left. The notice states that a separate notice containing an explanation of changes was being sent. That separate notice is not part of the record. The May 21, 2001 notice recommended payment of $215,999.00 because Mr. and Mrs. Contillo would have underpaid their 1994 estimated tax and the IRS may charge a penalty. The second, a letter dated June 12, 2001 sent in response to Mr. and Mrs. Contillo's inquiry of May 6, 2001,[11] states that the IRS has not resolved this matter and is still conducting research necessary "for a complete response." This letter further states that the IRS will respond within 30 days explaining the action it is taking. A letter dated May 23, 2001 from the accounting firm sent in response to the IRS notice dated May 21, 2001 (issued with respect to the year 1993) is part of the record. In this letter, the taxpayers (Mr. and Mrs. Contillo) express their disagreement with the IRS's conclusion that they filed their 1993 tax return more than three years after the date it was due. Also within this letter are references to a letter from the IRS dated January 4, 2001 and a protective refund claim on form 1040X for the period ended December 31, 1996 - - neither referenced document is part of the record.

For the year 1994, three notices issued by the IRS are part of the record. The first, a notice dated April 23, 2001, states that the IRS changed Mr. and Mrs. Contillo's 1994 return, specifically, the 1994 estimated tax total and, as a result of those changes, they owed $109,450.05. The second, a notice dated July 30, 2001, shows a current balance due of

[11] A copy of Mr. and Mrs Contillo's May 6, 2001 inquiry is not part of the record.

$111,734.30. The third, a notice dated December 17, 2001, shows a current balance due of $144,774.63.

For the year 1995, three notices issued by the IRS are part of the record. The first, a notice dated April 23, 2001, states that the IRS changed Mr. and Mrs. Contillo's 1995 return, specifically, the 1995 estimated tax total and, as a result of those changes, they owed $15,323.86. The second, a letter dated June 4, 2001, acknowledges receipt of information sent by the Contillos and states that the IRS will notify them within 30 days of the action it is taking. The third, a notice dated December 17, 2001, shows a current balance due of $16,069.35.

For the year 1996, two notices issued by the IRS are part of the record. The first, a notice dated June 26, 2000, states that the IRS changed Mr. and Mrs. Contillo's 1996 return, specifically, their 1996 estimated tax total and, as a result, they are due a refund of $3,180.00.[12] This notice also states that an adjustment is being made to Mr. and Mrs. Contillo's account and a separate notice will be mailed explaining the correction. That separate notice is not part of the record. The second notice, dated April 7, 2003, states that the IRS has applied $3,445.06 of the overpaid tax on the Contillos' 1996 tax return to unpaid taxes on their Federal form 1040 for the year 2000.

50. On June 30, 2003, the Division of Tax Appeals received an executed consent to have this matter heard by submission of documents without a hearing. By letter dated July 8, 2003 addressed to petitioners' representative and the Division, the Division of Tax Appeals established the schedule for submission of documentary evidence and briefs as follows: 1). filing

[12] It appears that the reference to Mr. and Mrs. Contillo's 1996 return in the June 26, 2000 notice is to a protective claim for 1996, form 1040X, that they apparently timely filed. However, neither the 1996 form 1040X nor any other documentation concerning the protective claim is part of the record.

of documents by the Division - August 15, 2003; 2). filing of petitioners' documents and brief - September 25, 2003; 3). filing of the Division's brief - October 31, 2003; and, 4). filing of petitioners' reply brief - December 4, 2003. The last paragraph of the July 8, 2003 letter stated:

> *Documents and briefs not filed in accordance with this schedule will be returned to the filing party.* Copies of any documents submitted to me should be sent to your opposing party. Each party is responsible for meeting its own due dates regardless of whether anything is received from the other party. If you need an extension of time for filing, you must make a request to me in writing within the time limits prescribed for filing your brief. (Emphasis in original.)

51. None of the parties filed requests for an extension of time to file their documents or briefs in these matters. The Division's documents were received on August 14, 2003. Petitioners' documents and brief were filed on September 25, 2003. The Division's brief was filed on October 27, 2003. Petitioners' reply brief was timely filed on December 4, 2003.

52. Along with their reply brief, petitioners moved to reopen the record for the submission of an additional affidavit of Joseph Leshkowitz, dated December 4, 2003. The Division's response was filed on December 29, 2003 and received on December 30, 2003. By letter, the parties were informed that the decision on the motion to reopen the record for the submission of the additional affidavit would be addressed in the determination.

53. Petitioners submitted proposed findings of fact numbered "1" through "12." All proposed findings of fact have been substantially incorporated into this determination with the exception of proposed finding of fact "9" which is in the nature of legal argument. The Division submitted proposed findings of fact numbered "1" through "59." All proposed findings of fact have been substantially incorporated into this determination with the exception of proposed findings of fact "34" and "58" which are unnecessary since they merely state when the Division filed its answers in these matters; proposed findings of fact "35" and "59" which are unnecessary

since they merely state that the notices to admit served on petitioners are deemed admitted and the admitted facts are included in the findings of fact set forth in this determination and proposed finding of fact "44" which incorrectly states the amount of the claimed 1993 net operating loss.

CONCLUSIONS OF LAW

A. The first matter that must be addressed is petitioners' motion to reopen the record for the submission of an additional affidavit of Joseph Leshkowitz. Petitioners request that this additional affidavit be admitted into the record because, as the Division emphasized in its October 27, 2003 brief, the timing of the Federal income tax net operating loss deductions is considered directly relevant to the issue presented here. Although they made their documentary submissions in September 2003, petitioners assert that, as of November 2003, the Federal statutes of limitation on their tax returns for the years at issue expired. Petitioners maintain that the December affidavit explains that and summarizes the net operating losses that were finally allowed to them for Federal income tax purposes. They claim that the fact that the timing of the Federal deductions has now been finally established is, therefore, a fact that should properly be considered by the Division of Tax Appeals.

The Division opposes petitioners' motion to reopen the record on a number of grounds. It asserts that petitioners' motion to reopen the record is premature and should be denied because there is no provision in the Tax Appeals Tribunal's Rules of Practice and Procedure for a motion to reopen the record at this juncture. Citing ***Matter of Wachsman***, (Tax Appeals Tribunal, November 30, 1995, ***confirmed*** 241 AD2d 708, 660 NYS2d 462), the Division points out that while the Tribunal has recognized that, although it has more discretion to reopen the record of a pending matter than a proceeding that had been the subject of a final agency action, that

discretion should be used sparingly in accordance with the Tribunal's well established policy of not allowing additional evidence to be submitted after the record has been closed. It further points out that, in ***Wachsman***, the Tribunal held that the party moving to reopen the record must show that the "newly discovered evidence" could not have been discovered with due diligence in time for the hearing. The Division argues that Mr. Leshkowitz's December 2003 affidavit cannot be considered newly discovered evidence because the basis for the affidavit was an event - - the alleged expiration of the three-year statute of limitations with respect to petitioners' returns in November 2003 - - that was not in existence at the time of petitioners' initial submission.

B. The provisions of 20 NYCRR 3000.16 pertain to motions to reopen the record or for reargument made after the Administrative Law Judge has rendered a determination. Since no determination has yet been rendered, the regulation is inapplicable in this matter. Rather, the procedure for cases which are heard on submission without a hearing is set forth succinctly at 20 NYCRR 3000.12. The regulation dictates that petitioner may submit documents in support of his petition "in accordance with the schedule established." (20 NYCRR 3000.12[b][2].)

In this matter, by letter from the Administrative Law Judge, dated July 8, 2003, petitioners were afforded time to submit documents until September 25, 2003. Petitioners' motion to reopen the record was made in conjunction with the filing of their reply brief, after both petitioners and the Division had filed their briefs.

The Tax Appeals Tribunal has established a firm policy of not allowing the submission of evidence after the record is closed. In ***Matter of Saddlemire*** (Tax Appeals Tribunal, June 14, 2001), a question was presented of whether the Administrative Law Judge erred by rejecting

exhibits that were attached to the taxpayer's brief. The Tribunal affirmed the decision to reject the documents and stated:

> We have held that in order to maintain a fair and efficient hearing system, it is essential that the hearing process be both defined and final. If the parties are able to submit additional evidence after the record is closed, there is neither definition nor finality to the hearing. Further, the submission of evidence after the closing of the record denies the adversary the right to question the evidence on the record (***Matter of Emerson***, Tax Appeals Tribunal, May 10, 2001; ***Matter of Schoonover***, August 15, 1991).

Consistent with the reasoning in ***Saddlemire***, the additional affidavit of Joseph Leshkowitz, that was submitted after the record was closed, may not be considered. Accordingly, petitioners' motion to reopen the record is denied.

C. As noted in the above findings of fact, both the Contillos and the Deglominis sustained net operating losses in the years 1993 and 1995. For the year 1993, the Contillos reported the net operating loss on their Resident Income Tax Return that they filed on November 14, 2000. On that return, they elected to forego the carryback of the net operating loss. For the year 1995, the Contillos reported the net operating loss on their Resident Income Tax Return that they filed on November 22, 2000. On that return, they elected to forego the carryback of the net operating loss. For the year 1993, the Deglominis reported the net operating loss on their Nonresident and Part-Year Resident Income Tax Return that they filed on November 10, 2000. On that return, they elected to forego the carryback of the net operating loss. The Contillos are challenging the Division's disallowance of their election to carry forward their 1993 and 1995 net operating losses to their 1994, 1996 and 1997 returns. The Deglominis are challenging the Division's disallowance of their election to carry forward their 1993 net operating loss to their 1994 return.

I will first address the issue of whether Mr. and Mrs Contillo are entitled to carry forward the net operating losses that they incurred in 1993 and 1995, where they failed to make a timely election to relinquish the carryback period pursuant to IRC § 172(b)(3).

D. Mr. and Mrs. Contillo assert that New York has discretion to allow their elections to relinquish the net operating loss carrybacks made with the 1993 and 1995 returns that they filed in November 2000. They claim that, in analyzing the discretion available in this case, it is useful to compare the personal income tax to New York's corporate franchise tax treatment of net operating loss carrybacks. Mr. and Mrs. Contillo assert that New York first had a specific corporate tax regulation prescribing the procedure for electing to relinquish the carryback (20 NYCRR 3-8.1[d]); then it overrode the Federal carryback regime by mandating the relinquishment of all but $10,000.00 of the carryback (Tax Law § 208[f][5]); and then promulgated TSB-M-89(13)C indicating that the New York procedures for the $10,000.00 no longer were necessarily tied to the Federal procedures. They maintain that, in contrast, under Article 22 of the Tax Law, there never have been such detailed procedures for relinquishing a net operating loss carryback. Mr. and Mrs. Contillo point out that there is no statutory provision in Article 22 allowing net operating loss carry forwards or carrybacks. They argue that there is nothing in the personal income tax regulations that specifies the manner in which a taxpayer elects to relinquish his net operating loss carryback for New York purposes. Mr. and Mrs. Contillo assert that the election to relinquish a net operating loss carryback is not listed in 20 NYCRR 161.2, which lists examples of Federal elections that are binding for New York purposes. They further assert that the election to relinquish a net operating loss carryback is also not listed in 20 NYCRR 161.3, which lists examples of Federal elections that are binding for

New York purposes. Therefore, Mr. and Mrs. Contillo argue that since relinquishing the net operating loss carryback period is not addressed at all in either Article 22 or the regulations, New York has discretion to allow them to validly elect to relinquish the carryback period, without regard to the time for filing the Federal or New York returns, or the timing of the Federal election.

Mr. and Mrs. Contillo's reliance on the franchise tax regulations for net operating losses is misplaced. As the Division correctly points out in its brief, personal income tax is at issue here, not franchise tax, therefore, it is appropriate to look at Article 22 of the Tax Law and the personal income tax regulations rather than the franchise tax regulations.

The New York adjusted gross income of a resident individual means his Federal adjusted gross income, with certain modifications (Tax Law § 612[a]). Federal adjusted gross income is, therefore, the starting point in calculating New York adjusted gross income and is defined in the Internal Revenue Code generally as gross income less certain deductions (IRC § 62[a]). Among the deductions subtracted from gross income to arrive at Federal adjusted gross income is the net operating loss deduction (***see***, IRC § 172). The net operating loss deduction is therefore accounted for in the calculation of Federal adjusted gross income. There is no statutory provision in the New York State Tax Law which authorizes a New York net operating loss deduction to be carried forward or carried backwards. New York taxpayers are permitted to carry back or carry forward net operating losses only insofar as such items are, for Federal income tax purposes, deducted from gross income to arrive at adjusted gross income (***see, Matter of Berg v. Tully***, 92 AD2d 436, 461 NYS2d 562, ***lv denied*** 60 NY2d 552, 467 NYS2d 1026; ***Matter of Sheils v. State Tax Commn.***, 95 Misc 2d 605, 407 NYS2d 823, ***revd*** 72 AD2d 896,

422 NYS2d 479, ***revd*** 52 NY2d 954, 437 NYS2d 968). Therefore, taxpayers cannot determine a net operating loss or claim a deduction for such loss in a manner different from that provided in IRC § 172 (***see, Matter of Sheils v. State Tax Commn.***, ***supra***; ***Matter of Berg v. Tully, supra***).

Mr. and Mrs. Contillo's argument that, because the election to relinquish a net operating loss carryback is not listed in 20 NYCRR 161.2, New York is not bound by the Federal election is also misplaced. The regulation states that the examples listed "include, but are not limited to . . ." those elections listed (20 NYCRR 161.2[c]). Moreover, 20 NYCRR 161.3 also does not mention the election to relinquish a net operating loss carryback. If the drafters of the personal income tax regulations intended to treat this election differently from the Federal provisions, they would have so stated. Unless a different meaning is clearly required, any term used in Article 22 "shall have the same meaning as when used in a comparable context in the laws of the United States relating to federal income taxes" (Tax Law § 607[a]). Since neither the New York Tax Law nor the regulations require a different interpretation of the election to forego a net operating loss carryback, New York must follow the provisions set forth in IRC § 172(b) regarding the election to forego a net operating loss.

E. IRC §172(b), as in effect for the years at issue, required that a net operating loss first be carried back to each of the three previous years and, if unabsorbed by those years, that the remaining portion be carried forward to each of the 15 years following the loss year (IRC former § 172 [b][1], [2]). IRC § 172(b)(3) provides that a taxpayer may elect to relinquish the entire carryback period and carry forward the loss to the taxable years following the loss year. IRC § 172(b)(3) further provides that:

> Such election shall be made in such manner as may be prescribed by the Secretary, and shall be made by the due date (including extensions of time) for

> filing the taxpayer's return for the taxable year of the net operating loss for which the election is to be in effect. Such election, once made for any taxable year, shall be irrevocable for such taxable year.

The election to forego the carry back of a net operating loss under IRC § 172(b)(3) has been analyzed numerous times by Federal courts. In ***Young v. Commissioner*** (83 TC 831, ***affd*** 783 F2d 1201, 86-1 US Tax Cas ¶ 9235), the Fifth Circuit affirmed the Tax Court's decision that, in their timely filed 1976 Federal income tax return (after allowable extensions), the taxpayers failed to make an effective binding election, pursuant to IRC § 172(b)(3), to carry forward to 1977 rather than carry back to prior years their 1976 net operating loss. The Fifth Circuit concluded that the essence of IRC § 172(b)(3) is that a taxpayer unequivocally communicates his election and binds himself to his decision concerning the best use of his net operating loss. In reaching its conclusion, the Fifth Circuit reviewed the legislative history of the statute and found that Congress made the election to relinquish the entire carry back period irrevocable and required that the election be made within the time allowed for filing the return in the year of loss. In ***Menaged v. Commissioner*** (61 TCM 1995), the Tax Court held that the taxpayer must unequivocally communicate his election to forego the carry back period within the period allowed for filing the return in the year of loss. It found that Mr. Menaged's statement of his intention to carry forward the loss on his amended return filed more than two years after the due date of the loss year return was insufficient to make an effective election. The Tax Court stated that an election under IRC § 172(b)(3) must be made in a timely return for the loss year. In ***Garland v. Commissioner*** (65 TCM 2532), the Tax Court held that Mr. and Mrs. Garland failed to properly elect to carry forward net operating losses on their late filed original returns for the years 1977 through 1981. It further held that since their returns for 1977 through 1981 were

filed late, even if those returns had contained an election (which they did not), the election would have been ineffective.

Although petitioners concede that where an original tax return fails to include a specific election to relinquish the net operating loss, such an election cannot be made on an amended return filed after the original due date for the first return, they argue that where a taxpayer's original return is not filed until after its due date but that first return explicitly makes the election to relinquish the carry back, the case law is "somewhat murky" (Petitioners' Reply Brief, pp. 5-6). In support of their argument, petitioners cite ***Young v. Commissioner (supra)*** and ***Curran v. United States*** (88 AFTR 2d 2001-7172). However, neither case supports their argument. As noted above, in ***Young***, after reviewing the legislative history of the statute, the Fifth Circuit found that Congress required the irrevocable election be made within the time allowed for filing the return in the year of loss. ***Curran v. United States (supra)*** was, as petitioners concede, not decided on the merits and there is no holding in that case to support petitioners' argument. As the case law makes clear, there is no distinction between late filed returns and late filed amended returns for purposes of the time in which to make an election to forego the carry back of a net operating loss pursuant to IRC § 172(b)(3). The plain language of the statute requires that the irrevocable election "be made by the due date (including extensions of time) for filing the taxpayer's return for the taxable year of the net operating loss for which the election is to be in effect" (IRC § 172[b][3]).

F. Michael and Merrie Contillo filed their 1993 Resident Income Tax Return on November 14, 2000. On that late filed return, the Contillos reported a net operating loss in the amount of $952,633.00 and annexed an attachment stating that they elected to forego the carry

back of the net operating loss incurred in that year. On audit, the Division disallowed the election to forego the carry back period because it was untimely. The Division determined that the claimed 1993 net operating loss must be carried back to the previous three years. It further determined that Mr. and Mrs. Contillo's 1993 net operating loss would be fully absorbed in 1990. Since Mr. and Mrs. Contillo did not elect to forego the carry back period for the 1993 net operating loss until November 14, 2000, the election to forego the carry back period is untimely and the Division's disallowance of that election is proper (***see,*** IRC § 172[b][3]). In accordance with IRC former § 172(b)(1), the Division's determination to carry back the 1993 net operating loss to the previous three years is proper.

Mr. and Mrs. Contillo filed their 1995 Resident Income Tax Return on November 22, 2000. On that late filed return, the Contillos reported a net operating loss of $630,094.00 and annexed an attachment stating that they elected to forego the carry back of the net operating loss incurred in that year. On audit, the Division disallowed the election to forego the carry back period because it was untimely. The Division determined that the claimed 1995 net operating loss must be carried back to the previous three years. It determined that $130,648.00 of the net operating loss would be absorbed in 1992; $3,000.00 would be absorbed in 1993 and $482,406.00 of the net operating loss would be absorbed in 1994. Because the 1995 net operating loss was fully absorbed by 1994, the Division determined that there was no net operating loss remaining to be carried forward to either the 1996 or 1997 tax years. Since Mr. and Mrs. Contillo did not elect to forego the carry back period for the 1995 net operating loss until November 22, 2000, the election to forego the carry back period is untimely and the Division's disallowance is proper (***see***, IRC § 172[b][3]). In accordance with IRC former §

172(b)(1), the Division's determination to carry back the 1995 net operating loss to the previous three years is proper.

G. Mr. and Mrs. Contillo argue that the Division errs in using ***Matter of Berg v. Tully (supra)*** and ***Matter of Sheils v. State Tax Commn. (supra)*** to assert that New York follows only the procedural rule specified in IRC § 172(b)(3) and ignores the actual timing of the Federal net operating loss deductions. They assert that ***Sheils*** states that New York taxpayers may deduct a net operating loss and carry back and carry forward "the unused portion of the deduction only insofar as such items are, for Federal income tax purposes, deducted from the gross income of the taxpayer to arrive at the adjusted gross income of that taxpayer" (***Matter of Sheils v. State Tax Commn.***, ***supra***, 407 NYS2d at 825). Mr. and Mrs. Contillo maintain that what matters is what was actually deducted federally, not the procedures for claiming the Federal deduction.

Mr. and Mrs. Contillo's interpretation of ***Matter of Sheils v. State Tax Commn. (supra)*** is erroneous. In ***Sheils***, three partners each reported his distributive share of a net operating loss from a partnership on his respective joint 1969 Federal and New York State resident income tax return. Each petitioner filed amended Federal and State tax returns for the years immediately preceding 1969 and claimed a refund for income taxes paid in those years. The claims for refund were granted in part and denied in part by the Division. On October 3, 1973, the State Tax Commission issued three separate decisions and held in each decision that the amount of the net operating loss deduction which may be claimed by a New York State resident on his personal income tax return may not exceed the amount which that individual claimed on his Federal income tax return for the year. After the net operating loss deduction was taken on the Federal return of each taxpayer, the adjusted gross income of that taxpayer for that year was zero.

Modifications under Tax Law § 612(a) were added to that Federal adjusted gross income of zero. The taxpayers contended that they should be allowed a net operating loss equal to the amount of the deduction on their Federal income tax returns plus an amount equal to the sum of the modifications required by Tax Law § 612(a). The Court of Appeals ultimately confirmed the Division's limitation of the net operating loss deduction to the amount of positive Federal taxable income. Therefore, the Division's carryback of Mr. and Mrs. Contillo's 1993 net operating loss to 1990 and its determination that the entire amount of that net operating loss would be absorbed in 1990 was proper. The Division's carryback of Mr. and Mrs. Contillo's 1995 net operating loss to the years 1992, 1993 and 1994 and its determination that $130,648.00 of that net operating loss would be absorbed in 1992; $3,000.00 of the net operating loss would be absorbed in 1993 and the remaining $482,406.00 of the net operating loss would be absorbed in 1994 was proper. Accordingly, the Division properly computed Mr. and Mrs. Contillo's personal income tax liabilities for 1994, 1996 and 1997.

H. The next issue to be addressed is whether petitioners Joseph and Doreen Deglomini have proven that they are entitled to carry forward the net operating loss that they incurred in 1993, where they failed to timely make the election to relinquish the carryback period pursuant to IRC § 172(b)(3).

Tax Law § 631(a) provides, in pertinent part that:

> [t]he New York source income of a nonresident individual shall be the sum of the following: (1) The net amount of items of income, gain, loss and deduction entering into his federal adjusted gross income as defined in the laws of the United States for the taxable year, derived from or connected with New York sources including: (A) his distributive share of partnership income, gain, loss and deduction . . . and

> (B) his pro rata share of New York S corporation income, loss and deduction, . . . and
>
> (C) his share of estate or trust income. . . .

Tax Law § 631(b)(4) provides that:

> [d]eductions with respect to . . . net operating losses shall be based solely on income, gain, loss and deduction derived from or connected with New York sources, under regulations of the commissioner of taxation and finance, but otherwise shall be determined in the same manner as the corresponding federal deductions.

20 NYCRR 132.7 provides, in pertinent part, as follows:

> (a) The deductions entering into the Federal adjusted gross income of a nonresident individual with respect to . . . net operating losses are included in his New York adjusted gross income only to the extent that the items of income, gain, loss and deduction entered into his Federal adjusted gross income and are based solely on items of income, gain, loss and deduction derived from or connected with New York sources.
>
> (b) The amount of any deduction under this section must be computed as it would be computed for Federal income tax purposes if the New York State items of income, gain, loss and deduction were the only items making up the corresponding Federal items of income, gain, loss and deduction for the particular year.
>
> (c) (1) Any deduction computed under this section may, by way of carryback or carryover, affect the computation of New York adjusted gross income for other years as long as such carryback or carryover is based solely on items of income, gain, loss and deduction from New York State sources.

Thus, it is clear that where a nonresident taxpayer incurs a net operating loss for Federal income tax purposes which are connected with New York sources, the deduction must be computed as it would be for Federal income tax purposes. Therefore, the taxpayer is required to follow the provisions set forth in IRC § 172, including the requirement under IRC § 172(b)(3) to make a timely election to forego the carryback period.

I. Joseph and Doreen Deglomini filed their 1993 Nonresident and Part-Year Resident Income Tax Return on November 10, 2000. On that late filed return, the Deglominis reported a net operating loss in the amount of $862,524.00 and annexed an attachment stating that they elected to forego the carryback of the net operating loss incurred in that year. On audit, the Division disallowed the election to forego the carryback period because it was untimely. The Division determined that the 1993 net operating loss must be carried back to the previous three years. It further determined that Mr. and Mrs. Deglomini's 1993 net operating loss would be fully absorbed in 1990. Since Mr. and Mrs. Deglomini did not elect to forego the carryback period for the 1993 net operating loss until November 10, 2000, the election to forego the carryback period is untimely and the Division's disallowance of that election is proper (***see,*** IRC § 172[b][3]). In accordance with IRC former § 172(b)(1), the Division's determination to carry back the 1993 net operating loss to the previous three years is proper. In November 2000, Mr. and Mrs. Deglomini filed their 1995 Nonresident and Part-Year Resident Income Tax Return. On that late filed return, the Deglominis reported a net operating loss of $497,055.00 and elected to carry forward that net operating loss to their 1996 return. On audit, the Division disallowed the election to forego the carryback period because it was untimely. The Division determined that the 1995 net operating loss must be carried back to the previous three years. It determined that $165,595.00 of the net operating loss would be absorbed in 1992; $0.00 would be absorbed in 1993 and $329,692.00 of the 1995 net operating loss would be absorbed in 1994. Since Mr. and Mrs. Deglomini did not elect to forego the carryback period for the 1995 net operating loss until November 2000, the election to forego the carryback period is untimely and the Division's disallowance is proper (***see,*** IRC § 172[b][3]). In accordance with IRC former § 172(b)(1), the

Division's determination to carry back the 1995 net operating loss to the previous three years is proper. The Division properly computed Mr. and Mrs. Deglomini's personal income tax liability for the year 1994.

J. Petitioners assert that the IRS did not invalidate their late filed elections to relinquish the net operating loss carrybacks or challenge the net operating loss deductions that were carried forward and claimed in later years. They argue that New York's net operating loss deductions should conform to those actually allowed for Federal income tax purposes. Petitioners' argument is without merit. The record includes only unsigned and undated copies of the Federal income tax returns for both Mr. and Mrs. Contillo and Mr. and Mrs. Deglomini for the years at issue. It also only includes some miscellaneous pieces of correspondence from the IRS, many of which reference other pieces of correspondence which are not part of the record. Therefore, it is impossible to determine what the IRS may or may not have done with respect to petitoners' late filed Federal returns. The Division is correct that it is not bound by a determination of an issue by the IRS, but may conduct its own determination (***see***, 20 NYCRR 159.4; ***Matter of Dufton***, Tax Appeals Tribunal, April 6, 1995).

K. Petitioners contend that the circumstances which led to the delay in the filing of their 1993 and 1995 returns and their delay in filing their elections to relinquish the net operating loss carrybacks are very unusual. They point out that, in 1994, New York State indicted them and various entities on hundreds of criminal charges, including numerous specific charges of crimes relating to New York State taxes. Petitioners claim that in 1998, Messrs. Deglomini and Contillo each pleaded guilty to one count, a misdemeanor which had nothing to do with taxes, and all the remaining charges, including all of the tax charges, were dismissed. They further claim that

when the Federal government brought the same charges, they too were rebuffed by the Federal court, which dismissed each and every Federal charge, including every tax charge. Petitioners aver that when their 1993 returns were due to be filed in the fall of 1994 and for the years thereafter, New York State was actively engaged in a specific, determined and ultimately unjustified effort to convict them of tax crimes. They argue that they were unable to file their returns when they were due because filing the returns while New York's criminal charges were pending impinged upon their constitutional rights. Petitioners claim that where the State's conduct blocked a taxpayer's ability to file an election, the State must be precluded from later disallowing the election as untimely.

Equitable estoppel, usually referred to simply as estoppel, is not, as a general proposition available as a defense to governmental acts absent a showing of exceptional facts which require its application to avoid manifest injustice (***see, Matter of Sheppard-Pollack, Inc. v. Tully***, 64 AD2d 296, 409 NYS2d 847). This rule applies particularly to a taxing authority because sound public policy favors full enforcement of the Tax Law (***Matter of Turner Constr. Co. v. State Tax Commn.***, 57 AD2d 201, 394 NYS2d 78). Exceptions to the doctrine have been rare and limited to unusual fact situations.

The Tax Appeals Tribunal has adopted a three-part test to determine the applicability of equitable estoppel to specific cases. Briefly, the test asks whether petitioner had the right to rely on the Division's representation; if, in fact, there was such reliance and whether the reliance was to the deteriment of petitioner (***Matter of AGL Welding Supply Co.***, Tax Appeals Tribunal, May 11, 1995, ***confirmed Matter of AGL Welding Supply Co. v. Commissioner of Taxation & Fin.***,

238 AD2d 734, 656 NYS2d 502, ***lv denied*** 90 NY2d 808, 664 NYS2d 270; ***Matter of Harry's Exxon Serv. Sta.***, Tax Appeals Tribunal, December 6, 1988).

The criminal proceedings against petitioners were brought by the New York County District Attorney and the Federal government, not the Division. Contrary to petitioners' contention, those proceedings were not baseless. With respect to the New York proceedings, petitioners each pleaded guilty to the charge of falsifying business records and they stipulated to pay the sum of $1,000,000.00. The Federal charges were dismissed because the statute of limitations had expired. Petitioners have failed to show that the Division made any representations that induced their reliance. Furthermore, taxpayers are required to file timely returns, regardless of whether there may be a threat of self-incrimination (***United States v. Sullivan***, 274 US 259, 71 L Ed 841). Therefore, a pending criminal indictment does not relieve taxpayers of the requirement to timely file their income tax returns. Since petitioners chose to follow the advice of their criminal defense attorney and not file their returns, they must bear the consequences of their decision.

L. The last issue to be addressed is whether petitioners have established reasonable cause for the abatement of penalties. With respect to petitioners Joseph and Doreen Deglomini, the Division imposed a penalty pursuant to Tax Law § 685(a)(1), a late filing penalty, and a penalty pursuant to Tax Law § 685(a)(2), a late payment penalty, for the year 1994. With respect to petitoners Michael and Merrie Contillo, the Division imposed a penalty pursuant to Tax Law § 685(a)(1), a late filing penalty, for the years 1994, 1996 and 1997 and a penalty pursuant to Tax Law § 685(a)(2), a late payment penalty, for the year 1996.

Petitioners contend that the criminal proceedings filed against them and their related entities led their criminal defense attorney to advise them that the reporting of items of income and expense from various pass-through entities was potentially incriminating. They further contend that he advised them not to file and they followed his advise to preserve their constitutional privilege against self-incrimination. Petitioners therefore claim that they had reasonable cause for filing their tax returns and the annexed elections under IRC § 172(b)(3), promptly after the conclusion of the criminal proceedings. In addition, they assert that they had reasonable cause for claiming the 1993 and 1995 net operating loss deductions as carry forwards in 1994, 1996 and 1997. They argue that their elections under IRC § 172(b)(3) were clear and unequivocal, and were made with their original 1993 and 1995 returns. Petitioners claim that they "irrevocably committed themselves to carry their net operating loss deductions forward, the standard federal courts have said governs the validity of the election" (Petitioners' Reply Brief, p. 16).

Petitioners' arguments are without merit. In ***United States v. Sullivan***, (274 US 259, 71 L Ed 841), the Supreme Court held that the privilege against compulsory self-incrimination is not a defense to prosecution for failing to file a return at all. However, the Supreme Court indicated that the privilege could be claimed against specific disclosure sought on a return, saying "[i]f the form of return provided called for answers that the defendant was privileged from making he could have raised the objection in the return, but could not on that account refuse to make any return at all" (***id.***, at 263). As ***Sullivan*** clearly holds, petitioners are required to timely file their returns and raise an objection based on the privilege in those returns if necessary. Thus, petitioners could have timely filed their returns, stated their elections to forego the carryback of

any net operating loss they may have had, and raised objections for certain calculations based on the privilege against self-incrimination. Petitioners did not and chose not to file any returns until years later. Therefore, petitioners have no excuse for either failing to timely file their returns or failing to timely make their elections to forego the carryback periods. Accordingly, the penalties imposed against both Joseph and Doreen Deglomini and Michael and Merrie Contillo are sustained.

M. The petition of Joseph and Doreen Deglomini is denied and the Notice of Deficiency dated September 13, 2001 is hereby sustained. The petition of Michael and Merrie Contillo is denied and the notices of deficiency dated May 21, 2001 are hereby sustained.

DATED: Troy, New York
June 3, 2004

/s/ Winifred M. Maloney
ADMINISTRATIVE LAW JUDGE