STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
MICHAEL R. AND BLANCHE B. DOHAN	:	DETERMINATION DTA NO. 819599
for Redetermination of a Deficiency or for Refund of Personal Income Taxes under Article 22 of the Tax Law and the New York City Administrative Code for the Years 1997, 1998, 1999 and 2000.	:	

Petitioners, Michael R. and Blanche B. Dohan, 1 St. Marks Place, Cold Spring Harbor, New York 11724, filed a petition for redetermination of a deficiency or for refund of personal income taxes under Article 22 of the Tax Law and the New York City Administrative Code for the years 1997, 1998, 1999 and 2000.

A hearing was held before Thomas C. Sacca, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on March 18, 2004 at 10:30 A.M., with all briefs to be submitted by July 23, 2004, which date began the six-month period for the issuance of this determination. Petitioners appeared by Barry Leibowicz, Esq. The Division of Taxation appeared by Christopher C. O'Brien, Esq. (Kevin Law, Esq., of counsel).

ISSUE

Whether reasonable cause existed for the late filing by petitioners of their election for treatment as a New York State S corporation.

FINDINGS OF FACT

1. Petitioners, Michael R. And Blanche B. Dohan, are married individuals who filed joint New York State personal income tax returns for the years at issue. In 1991, petitioners, with the assistance of an attorney, Edward Kramer, formed Infoservices International, Inc., a corporation involved in the publication of local telephone directories. Petitioners are each 50-percent shareholders of the corporation.

2. Petitioners chose Mr. Kramer because of his expertise in the area of corporate law. Anticipating large losses at the outset of the business operation, Mr. Dohan explained to Mr. Kramer that he wanted the corporation classified as a subchapter S corporation for Federal and New York State filing purposes. Mr. Kramer provided petitioners with an application for election as a Federal subchapter S corporation pursuant to Internal Revenue Code § 1362(a). Mr. Kramer advised that filing the election with the Federal government would also result in the corporation being treated as a New York State S corporation. The Federal S election was timely filed by petitioners and Infoservices properly filed as a Federal S corporation for the years at issue.

3. Following the consultation with their attorney, petitioners mistakenly believed, based upon the conversation with their attorney and the advice received, that the election for Federal purposes was effective for New York State purposes.

4. Consistent with their failure to elect subchapter S status for New York State tax purposes, petitioners received from the Division of Taxation general business corporation franchise tax returns and general business corporation MTA surcharge returns for the years at issue (Forms CT-3, CT-4 and CT-3M/4M). Mr. Dohan prepared and filed all of Infoservices'

returns for the years at issue on the forms received from the Division. However, during these years, it was Mr. Dohan's understanding that Infoservices was a valid New York S corporation.

5. For the years at issue, petitioners consistently prepared and filed their New York State personal income tax returns as if Infoservices had properly elected to be treated as a New York S corporation. They did not make any of the adjustments that would be required of a nonelecting S corporation. Items of corporation loss or deduction included in individuals' Federal gross income by reason of their being shareholders of a Federal S corporation which elects to be treated as a standard C corporation for New York State purposes must be added back to Federal adjusted gross income to determine New York gross income. Petitioners did not make this adjustment on their New York State personal income tax returns for the years at issue. In preparing their personal income tax returns, Mr. Dohan reviewed the required adjustments set forth in the instructions and determined that no adjustments were necessary as he believed that Infoservices had properly elected to be treated as both a New York and Federal S corporation.

6. Following an audit of their tax returns, the Division of Taxation issued to petitioners a Notice of Deficiency, dated August 26, 2002, assessing total personal income tax due of $104,113.88, plus interest, for the years 1997, 1998, 1999 and 2000. The New York State portion of the deficiency was based upon petitioners' failure to make the addback required under Tax Law § 612(b)(19) for a shareholder of a Federal S corporation which has not made the election to be treated as a New York State S corporation. In addition, New York City nonresident earnings tax was assessed for the year 1997 as petitioner, Michael Dohan, was a college professor at City University of New York and failed to compute the tax on his wages earned from such employment.

7. On December 6, 2001, petitioners wrote to then Commissioner Arthur J. Roth requesting approval of their application for S corporation status for New York State relating to Infoservices International, Inc. retroactive to September 17, 1991. The letter explained that petitioners failed to file form CT-6, Election by a Federal S Corporation to be Treated as a New York S Corporation, because of erroneous advice received from their attorney at the time the corporation was formed. Petitioners explained that their attorney informed them that New York State would recognize the filing for Federal S corporation status and that not electing New York State S corporation status would not cause any harm.

8. In a response dated January 10, 2002, the Commissioner pointed out that petitioners, as shareholders of Infoservices International, Inc., had failed to file a New York S corporation election until the lack of one was discovered on audit. More importantly, according to the Commissioner, the corporation's filing as a New York C corporation since its inception precluded a finding that reasonable cause existed for the late filing of the New York S corporation election. The correspondence explained: "[t]hat standard [for reasonable cause] is to allow New York S corporation status to Federal S corporations that (a) have been given professional advice indicating that filing a New York election is not necessary to be a New York S corporation and (b) then acted as a New York S corporation by filing New York S returns." The letter then advised petitioners that their request for retroactive New York State S corporation status was denied.

CONCLUSIONS OF LAW

A. Tax Law § 660(a) provides that the election of all shareholders of a Federal subchapter S corporation is required for the corporation to be eligible for tax treatment as a New York S

corporation, whereby each shareholder is then taxed on his or her proportionate share of the S corporation's items of income, gain, loss or deduction.

B. Tax Law § 612(a) defines the New York adjusted gross income of a resident individual as Federal adjusted gross income for the taxable year, with the modifications specified. Section 612(b) includes a list of modifications that must be added back to Federal adjusted gross income. Paragraph 19 of Tax Law § 612(b) provides the following modification:

> 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 . . . .

In the present matter, petitioners concede that a timely New York State S election was not made by the corporation. Under these circumstances, Tax Law § 612(b)(19) requires an add-back of the Federal S corporation losses in computing New York taxable income. However, petitioners have asked for relief under section 660(b)(5) of the Tax Law which provides for retroactive election of New York S corporation status if reasonable cause for failure to timely make the election is established.

C. Tax Law § 660(b)(5) provides the Division with the authority to treat late elections as timely where:

> (A) an election under subsection (a) of this section is made for any taxable year (determined without regard to paragraph three of this subsection) after the date prescribed by this subsection for making such election for such taxable year, or if no election is made for any taxable year, and
>
> (B) the commissioner determines that there was reasonable cause for failure to timely make such election, then
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> (C) the commissioner may treat such an election as timely made for such taxable year (and paragraph three of this subsection shall not apply).

D. Following the enactment of Tax Law § 660(b)(5) in 1997, the Division issued, on September 9, 1997, a Technical Service Bureau Memorandum (TSB-M-97[6]C) in an effort to explain to taxpayers the effect of the amendment to the Tax Law. The Memorandum provided in relevant part as follows:

IMPORTANT NOTICE
ATTENTION SHAREHOLDERS OF S CORPS

> The Tax Law has been amended to conform to changes in federal tax treatment of S corporations, primarily those enacted by the 1996 Small Business Job Protection Act, in the following respects:
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> * * *
>
> grants the Commissioner of Taxation and Finance authority to validate certain late or invalid New York S elections, effective for the taxable years beginning after 1982.

On December 1, 1997, the Division issued a second Technical Service Bureau Memorandum (TSB-M-97[9]C), which stated that the Tax Law had been amended to "conform to changes in federal tax treatment of S corporations," and again explained that the Commissioner of Taxation and Finance now had the authority to validate certain late filed New York S elections.

E. Internal Revenue Code § 1362(b)(5) was enacted in 1996 and is effective for taxable years beginning after 1982. Its purpose is to provide relief to shareholders who inadvertently fail to elect S corporation status under IRC § 1362(a), and provides the authority to treat late elections as timely where it is determined that reasonable cause exists for the failure to timely make such election. It is this amendment of Federal tax treatment of S corporations that prompted the New York State legislature to enact Tax Law § 660(b)(5).

F. The Division made it clear in the issuance of the two cited Technical Service Bureau Memoranda that the enactment of Tax Law § 660(b)(5) was intended to conform to the Federal

government's treatment of late filed S corporation elections. In addition, the courts have consistently held that:

> It has long been the policy of our courts to adopt, whenever reasonable and practical, the Federal construction of substantially similar tax provisions (***Matter of Marx v. Bragalini***, 6 NY2d 322, 189 NYS2d 846). This doctrine of conformity furthers the legislative policy of administering the state and federal tax laws uniformly, and should be applied where, as here, the state statute is modeled on a federal law. (***Matter of Delese v. Tax Appeals Tribunal of the State of New York***, 3 AD3d 612, 771 NYS2d 191.)

Under Federal practice and procedure, relief is provided when the taxpayer intended pass-through treatment but failed to elect such treatment. In general, relief is provided by private letter ruling (Announcement 97-4, 1997-3 I.R.B. 14).[1]

G. The Division of Taxation stated as one of the reasons for the denial of granting petitioners retroactive relief pursuant to Tax Law § 660(b)(5) petitioners' filing of a CT-3 or CT-4 on behalf of Infoservices, rather than a CT-3S. According to the Division, this failure negated a finding of reasonable cause.

Although petitioners did not file a CT-3S for Infoservices for the years at issue, they consistently filed their personal income tax returns as if they had properly elected to be treated as a New York S corporation. Their personal income tax returns for the years at issue included pass-through items from the corporation which is consistent with the filing of an S corporation return. Shareholders of a Federal S corporation who have not elected New York State S corporation treatment must show additions and subtractions on their personal income tax returns (Tax Law § 612[b][19], [22]). These adjustments were not made by petitioners on their returns as filed, actions consistent with their belief that the filing of the Federal election was also

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[1] At the hearing, petitioners presented a compact disc which contains approximately 1,200 private letter rulings of the Internal Revenue Service granting retroactive relief to taxpayers who had failed to timely file an election to be treated as a Federal S corporation.

effective for New York State tax purposes. Under the Federal standard as stated in the numerous letter rulings, petitioners are entitled to have their late filed New York S corporation election treated as timely for the years at issue pursuant to Tax Law § 660(b)(5) as they have established that they intended pass-through treatment but failed to elect such treatment.

H. Petitioners reliance on the advice of a professional also provides a reasonable basis for the late filing of the New York State election for S corporation treatment. The Tax Appeals Tribunal has stated that:

> In making a determination as to whether reasonable cause exists when a taxpayer has relied on the erroneous advice of a professional, it must be shown that the taxpayer relied in good faith on the advice which he received and it must have been "reasonable" for the taxpayer to rely upon the particular advice he was given (***see***, ***Auerbach v. State Tax Commn.***, 142 AD2d 390, 536 NYS2d 557; ***LT & B Realty v. State Tax Commn.***, 141 AD2d 185, 535 NYS2d 121). When determining whether the taxpayer has shown that his reliance was reasonable, the burden is on the taxpayer to demonstrate that he acted with ordinary business care and prudence in attempting to ascertain his liability for taxes (***see***, ***United States v. Boyle***, 469 US 241). Further, the nature and complexity of the matter giving rise to the dispute should be considered when making a determination as to whether a taxpayer's reliance was reasonable (***see***, ***Betson v. Commr.***, 802 F2d 365). (***Matter of Erikson***, Tax Appeals Tribunal, March 22, 1990.)

There are numerous areas of the New York State Tax Law which either specifically depend or diverge from Federal tax law, such as the basic calculation of New York adjusted gross income, which is defined as Federal adjusted gross income, with various modifications. It would be reasonable for a taxpayer to believe that an election made on the Federal level would similarly apply to New York State. This reliance would be more rational and reasonable where, as here, the taxpayer sought out a lawyer with an expertise in corporate law for his advice on the proper procedure for electing S corporation status for Federal and New York State purposes. It is also noted that the numerous private letter rulings of the Internal Revenue Service on the question of late filed elections illustrate that many taxpayers have made the same or similar

mistake as petitioners when attempting to elect S corporation treatment. Under the circumstances herein, considering the complexity of the area of the Tax Law involved, the consistency of their filed personal income tax returns with S corporation status, petitioners' efforts to obtain the advice of a corporate attorney and the Internal Revenue Service private letter rulings, petitioners have established reasonable cause for their failure to timely file a New York State S corporation election. Therefore, such election is determined to be timely for the years at issue.

I. In their reply brief, petitioners have conceded liability for the New York City nonresident earnings tax on Mr. Dohan's City University earnings.

J. The petition of Michael R. and Blanche B. Dohan is granted to the extent indicated in Conclusion of Law "H", and accordingly, the Division of Taxation is directed to modify the Notice of Deficiency dated August 26, 2002. In all other respects, the petition is denied.

DATED: Troy, New York
January 6, 2005

/s/ Thomas C. Sacca
ADMINISTRATIVE LAW JUDGE