STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
MICHAEL AND SYDNEY GIANTURCO	:	DETERMINATION DTA NO. 819818
for Redetermination of a Deficiency or for Refund of New York State and New York City Personal Income Taxes under Article 22 of the Tax Law and the Administrative Code of the City of New York for the Year 1997.	: : :	

Petitioners, Michael and Sydney Gianturco, 940 Park Avenue, Apartment 12B, New York, New York 10028, filed a petition for redetermination of a deficiency or for refund of New York State and New York City personal income taxes under Article 22 of the Tax Law and the Administrative Code of the City of New York for the year 1997.

On December 28, 2004 and January 6, 2005, respectively, petitioners, by their authorized representative Marcum & Kliegman LLP (Steven A. Bryde, Esq., of counsel), and the Division of Taxation, appearing by Christopher C. O'Brien, Esq. (Peter B. Ostwald, Esq., of counsel), waived a hearing and agreed to submit this matter for determination based on documents and briefs submitted by June 2, 2005, 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 the Division of Taxation properly determined that petitioners' share of the capital gain income recognized from two Nevada limited liability companies for the taxable year in which a change of residency occurred should be allocated using a proration formula between the resident and nonresident periods.

II. Whether the Division of Taxation's retroactive application of the Tax Appeals Tribunal's decision in ***Matter of Greig*** (September 16, 1998) is arbitrary and capricious.

III. Alternatively, whether the Division of Taxation properly denied a New York resident credit for taxes paid to Connecticut on the capital gain income recognized to the extent of approximately 7/12ths of the total capital gain income recognized.

FINDINGS OF FACT

1. Petitioners, Michael and Sydney Gianturco, filed a timely Nonresident and Part-Year Resident Income Tax Return (Form IT-203), with a Change of City Resident Status form (Form IT-360.1) attached, for the year 1997. Part F of Form IT-203 asks part-year residents to check the box which describes their situation on the last day of the tax year. Petitioners checked "(3) moved out of New York State and received no income from New York State sources during your nonresident period." Petitioners entered July 31, 1997 as the date of their move. On their Form IT-203, petitioners reported the following as their Federal adjusted gross income:

	Federal Amount	New York State Amount
Wages, salaries, tips	$ 35,000.00	$20,417.00
Taxable interest income	618.00	
Dividend income	3,201.00	
Business income (Federal Schedule C)	9,185.00	3,408.00
Capital gain (Federal Schedule D)	1,962,091.00	
Rental real estate, royalties, partnerships, S corporations, trusts (Federal Schedule E)	(938.00)	

Total federal adjustments to income (one-half self-employment tax)	(649.00)	
Federal adjusted gross income	$2,008,508.00	$23, 825.00

Petitioners added $28,499.00 in interest income on state and local bonds to their Federal adjusted gross income and determined their New York adjusted gross income computed as residents of New York for the entire year to be $2,037,007.00. After claiming the standard deduction of $13,000.00, they determined their New York State taxable income to be $2,024,007.00 and the base New York State tax on that amount to be $138,644.00. Petitioners then multiplied the New York State income percentage of 1.17 percent[1] by the base New York State tax of $138,644.00 and determined their New York State tax to be $1,622.00. Petitioners determined their part-year City of New York resident tax to be $498.00. They determined their total State and City taxes to be $2,120.00 and claimed a refund of $52,115.00 of the reported State and City taxes withheld, estimated tax payments and the amount paid with the extension form. Petitioners did not claim a resident credit for taxes paid to Connecticut.

2. Attached to petitioners' IT-203 is a Federal Schedule D (Capital Gains and Losses) on which they reported $1,962,091.00 in net long-term capital gain, consisting entirely of net long-term gain from partnerships, S-corporations, estates and trusts from Schedules K-1 reported on Part II, Line 12 of the Schedule D. In accordance with 20 NYCRR former 154.6, petitioners did not include in New York source income any of the K-1 income reported on Line 12 of the Federal Schedule D because they were Connecticut residents on December 31, 1997 and the flow-through income entities had taxable years ending December 31, 1997.

[1] Petitioners determined the New York State income percentage by dividing the New York State amount of Federal adjusted gross income of $23,825.00 by the Federal adjusted gross income of $2,037,007.00.

3. The record includes an unsigned copy of petitioners' Connecticut Nonresident or Part-Year Resident Income Tax Return (Form CT-1040NR/PY) for the year 1997. On the Form 1040NR/PY, taxpayers were required to check the box which described their resident status for the year 1997. Petitioners checked part-year resident. On this return, petitioners reported Connecticut adjusted gross income of $2,053,880.00 and income from Connecticut sources of $1,985,332.00, which consisted of wages and salaries of $14,583.00; taxable interest income of $618.00; dividend income of $3,201.00; business income of $5,777.00; capital gain income of $1,962,091.00 and rental real estate, royalties, partnerships, S-corporations, trusts, etc. loss in the amount of $938.00. Using the Connecticut adjusted gross income, petitioners determined the base Connecticut income tax to be $92,237.00. They then multiplied the Connecticut income tax percentage of 96.66%[2] by the base Connecticut income tax and determined the allocated Connecticut income tax to be $89,156.00. To the allocated Connecticut income tax amount, petitioners added Connecticut alternative minimum tax of $8,744.00 and determined total Connecticut income tax due in the amount of $97,900.00 for 1997. Although the Form CT-1040NR/PY allowed a part-year resident to compute and subtract a net credit for income taxes paid to other jurisdictions from the allocated Connecticut income tax, petitioners failed to do so.

4. Attached to petitioners' 1997 Form CT-1040NR/PY are a Nonresident or Part-Year Resident Schedule of Income from Connecticut Sources (Schedule CT-SI) and a Part-Year Resident Allocation Worksheet (CT-1040AW). Part 3 of Schedule CT-SI asks part-year Connecticut residents to check the appropriate boxes and enter the information that applies for the taxable year. Mr. Gianturco checked "(5) You moved into Connecticut and received income

[2] Petitioners determined the Connecticut income percentage by dividing the income from Connecticut sources in the amount of $1,985,332.00 by the Connecticut adjusted gross income of $2,053,880.00.

from Connecticut during your nonresident period." His spouse did not check any box concerning her income during her nonresident period. Mr. Gianturco and Mrs. Gianturco each entered August 1, 1997 as the date of their respective move into Connecticut, and New York was identified as the State of their prior residence. Part 1 of the CT-1040AW worksheet, the part-year resident income allocation worksheet, listed the items of income that comprised petitioners' Federal adjusted gross income and then allocated those income items to either the Connecticut resident period or the Connecticut nonresident period. Only one item of income from Connecticut sources during the Connecticut nonresident period was listed on this worksheet, capital gain in the amount of $1,962,091.00.

5. On or about April 10, 2001, the Division commenced an audit of petitioners' 1997 part-year resident income tax return. The audit focused upon petitioners' domicile and allocation of their Schedule K-1 flow-through capital gain income. Upon review of petitioners' response to the audit questionnaire, the Division determined that petitioners changed their domicile from New York to Connecticut as of August 1, 1997 and they were not residents of New York after July 31, 1997. The documentation submitted to the auditor concerning the entities with Schedule K-1 flow-through capital gain income indicated that the two entities were Nevada limited liability companies that did not conduct any business in New York. As a result, the Division determined that, pursuant to the Tax Appeals Tribunal's decision in ***Matter of Greig*** (September 16, 1999), the amount of petitioners' items of Schedule K-1 flow-through capital gain income to be included in New York source income for 1997 should be computed using a proration formula between the resident and nonresident periods. Using 212 days divided by 365 days, the auditor calculated the amount of petitioners' 1997 capital gain subject to tax in New York for the resident period to be $1,139,625.00 (212/365 times $1,962,091.00 equals

$1,139,625.00). The auditor also determined that interest income in the amount of $618.00 and dividend income in the amount of $629.00 should be allocated to and subject to tax in New York as well.

6. On June 18, 2001, the Division issued a Statement of Personal Income Tax Audit Changes to petitioners asserting additional New York State and New York City personal income tax due in the total amount of $127,773.29, plus interest, for a total amount due of $161,681.98 for the year 1997. This statement explained that based upon the Tax Appeals Tribunal's decision in ***Matter of Greig*** (***supra***), petitioners were required to prorate all items of income, loss, gain and partnership or subchapter S corporation income between the resident and nonresident period. The statement further explained that petitioners' items of income, gain, loss and deduction were prorated for the seven months that petitioners were residents of New York State and City in 1997.

The Statement of Personal Income Tax Audit Changes reflected the auditor's determinations and contained a corrected tax computation as follows. Petitioners' New York State adjusted gross income per their tax return in the amount of $23,825.00 was increased by a total of $1,140,327.00 - - the sum of capital gain income for the resident period in the amount of $1,139,625.00 plus interest income in the amount of $618.00 plus dividend income in the amount of $629.00 - - and the corrected adjusted gross income was determined to be $1,164,152.00. A standard deduction of $13,000.00 was allowed and the corrected New York State taxable income was determined to be $1,151,152.00. Based upon a corrected taxable income or base for New York State in the amount of $1,151,152.00, the New York State recomputed tax liability was determined to be $78,853.91, less tax previously paid of $1,622.00, for additional New York State tax due in the amount of $77,231.91. Based upon a corrected taxable income or base for New York City in the amount of $1,151,152.00, the New York City recomputed tax liability was determined to be $51,039.38, less tax previously paid of $498.00, for additional New York City tax due in the amount of $50,541.38.

7. On July 19, 2001, petitioners paid the proposed assessment under protest. On August 13, 2001, the Division issued a Notice of Deficiency, Notice Number L-019976580-5, asserting additional New York State and City personal income tax for 1997 in the total amount of $127,773.29 plus interest. No penalty was imposed.

8. Following a conciliation conference held on February 10, 2003, the Division issued a Conciliation Order dated October 17, 2003 sustaining the statutory notice.

9. On January 14, 2004, a petition was filed seeking a redetermination of the deficiency asserted by the Division. Petitioners alleged that the Division erred in taxing any part of the capital gain income from the two limited liability companies, VMP, LLC, ("VMP") and PAMI, LLC, ("PAMI"), because it was business income that should be sourced to Connecticut and considered to be earned on December 31, 1997. They also alleged that the application of the Tribunal's decision in ***Matter of Greig*** (***supra***), to their Federal Schedule K-1 items of income for the year 1997 was arbitrary and capricious. Alternatively, petitioners alleged that if the prorated amount of capital gain income was taxable in New York, a resident credit should be allowed for taxes paid to Connecticut on the capital gain income to the extent of 7/12ths of that capital gain income.

10. A review of the auditor's Tax Field Audit Log ("audit log") indicates that Mr. Gianturco's father invented some medical supplies and the capital gains were the royalties received. In her audit log, the auditor also noted that the two limited liability companies were incorporated in Nevada because Nevada does not tax intangibles.

11. The record includes a document dated April 17, 1997 from Cook Incorporated ("Cook") to Mr. Gianturco and his sister, Paola Gianturco, as members of PAMI. This document was written by Cook "[t]o confirm our mutual understandings with regard to patent rights on the device known as the GR-II Coronary Stent." According to the document, Cook agreed to pay PAMI "a royalty of 5½% of the net selling price of sales of the GR-II during the twenty-year period which commenced in July 1993. Payments with respect to sales during any year will be made between January 1 and March 31 of the following year." The document went on to state, among other things, that if the device is modified, but its character is not completely changed, sales of the modified product would be subject to this agreement. The document also stated that if the device is modified so that it is completely changed, but remains based on the original Gianturco concept, Cook agreed to enter into a new royalty agreement covering the new and changed product. It is unclear whether the members of PAMI agreed to the terms set forth by Cook in this document. The record does not include any other documents between PAMI and Cook concerning royalty payments, nor does the record include any agreements between PAMI and any other companies concerning royalty payments.

12. The record also includes a May 8, 2000 letter from Cook's accounting manager to Paola Gianturco that reported, "per Dr. Gianturco's agreements with Cook Incorporated," the royalty information regarding sales of the GR-II sold during 1999. According to this letter, returns on this product exceeded the sales resulting in a "negative royalty" in the amount of $42,952.68. However, because there were no other royalties payable to PAMI in which to offset the loss and the likelihood of sales were slim, Cook was not sure how to proceed. The letter went on to state that Cook did not want to subtract the royalty from any other checks "due to the

unique payment arrangements" in place. Sometime in August 2000, PAMI sent Cook a reimbursement check in the amount of $42,952.68.

13. The record does not include any agreements between Dr. Gianturco and Cook.

14. The record does not include any agreements between VMP and any companies concerning patents and any related royalty payments.

15. The record does not include the Schedule K-1 issued to Mr. Gianturco for the year 1997 by either VMP or PAMI, nor does the record include any documentation indicating the exact dates when the two limited liability companies received royalty payments from Cook or any other company during 1997.

CONCLUSIONS OF LAW

A. Tax Law § 601(e) imposes personal income tax for a part-year resident on the individual's taxable income that is derived from New York sources. Tax Law § 638(a) provides that New York source income of a part-year resident shall be the sum of:

> (1) New York adjusted gross income for the period of residence, determined in accordance with part II of this article as if the taxpayer's taxable year for federal income tax purposes were limited to the period of residence.
>
> (2) New York source income for the period of nonresidence determined in accordance with section six hundred thirty-one as if the taxpayer's taxable year for federal income tax purposes were limited to the period of nonresidence.

B. In 1997, the Division's regulations in 20 NYCRR former 154.6(a)(3) provided, in pertinent part, as follows:

> For taxable years beginning in 1990 and thereafter, where an individual or a trust is a member of a partnership[3] and such individual or trust changes resident status during the taxable year from resident to nonresident, or from nonresident to

[3] A partnership includes a limited liability company that is treated as a partnership for Federal income tax purposes (Tax Law § 601[f]).

resident, the distributive share of partnership income, gain, loss and deduction of such individual or trust to be included in the determination of the numerator of the New York source fraction under section 601(e) of the Tax Law shall be determined in accordance with subparagraph (i) of this paragraph, and the items of tax preference of the partnership to be included in the determination of the New York minimum taxable income of such individual or trust shall be determined in accordance with subparagraph (ii) of this paragraph.

(i)(a) The distributive share of partnership income, gain, loss and deduction to be included in the numerator of the New York source fraction under section 601(e) of the Tax Law shall be determined as follows:

(1) where the taxable year of the partnership ends during the period the individual or trust was a resident of New York State, the distributive share of partnership income, gain, loss and deduction included in Federal adjusted gross income shall be included in such numerator; or

(2) where the taxable year of the partnership ends during the period the individual or trust was a nonresident of New York State, the distributive share of partnership income, gain, loss and deduction to be included in such numerator shall be only the portion of such items that are derived from or connected with New York State sources that are included in Federal adjusted gross income.

C. In the instant matter, in accordance with 20 NYCRR former 154.6(a)(3)(i), petitioners did not include any of the capital gain income received by Mr. Gianturco from the two limited liability companies on the part-year New York personal income tax return that they filed for 1997 because they were nonresidents of New York State and City on December 31, 1997, the same date on which the two limited liability companies' taxable years ended. The Division determined that, pursuant to the Tax Appeals Tribunal decision in ***Matter of Greig*** (***supra***), petitioners' share of the limited liability companies' capital gain income to be included in New York source income for 1997 should be computed using a proration formula between the resident and nonresident periods.

Petitioners contend that the capital gain income at issue should be deemed earned on December 31, 1997, in the nonresident period, and should not be taxed by New York State and

City. The Division argues that the Technical Services Memorandum, TSB-M-00(1)(I), issued as a result of the ***Greig*** decision, requires that for all open tax years prior to 1999, the pro rata share of a partnership capital gain should be computed using a proration formula between the resident and nonresident periods.

D. In ***Matter of McNulty v. New York State Tax Commn.*** (70 NY2d 788, 522 NYS2d 103), the taxpayers, whose sole source of income in 1979 was a distributive share of the earnings of a New York partnership, moved their residence from New York to New Jersey in August 1979. In accordance with Tax Law former § 654, the taxpayers filed a resident return from January 1, 1979 through August 1979 and a nonresident return for the period August 1979 through December 31, 1979. However, the taxpayers did not comply with the related tax regulation, 20 NYCRR former 148.6, that required taxpayers who moved in or out of the State during the tax year to treat partnership gains or losses as having all accrued in the "portion of the taxable year" in which the partnership's own tax year ended (***id***., 522 NYS2d at 103). Pursuant to the regulation, taxpayers were prohibited from prorating gains and losses between their resident and nonresident periods. As noted by the ***McNulty*** Court, the effect of this regulation was "to compel the taxpayer who has changed residence during the tax year to report all of his partnership income on one or the other of his separate tax returns for that year - regardless of when the income was actually received" (***id***., 522 NYS2d at 104). The ***McNulty*** Court concluded that the regulation was an invalid exercise of the Tax Commission's authority and held that the taxpayers must be allowed to report their partnership distributions in a manner that "either reflects the actual date of receipt and expenditure or encompasses an annual amount distributed on a proportionate basis" (***id***, 522 NYS2d at 104).

E. When the Tax Appeals Tribunal rendered its decision in ***Matter of Wertheimer*** (January 12, 1995), it applied the Court of Appeals decision in ***Matter of McNulty v. New York State Tax Commn. (supra)***. At the time the taxpayers in ***Wertheimer*** filed their 1986 personal income tax return, the statutory and regulatory scheme was the same as that found in ***McNulty***, with 20 NYCRR former 148.6 prohibiting taxpayers from prorating gains or losses between their resident and nonresident periods. Mr. and Mrs. Wertheimer became New York residents on October 1, 1986. Accordingly, they filed a nonresident return for the nine-month period from January 1, 1986 through September 30, 1986 and a resident return for the period from October 1, 1986 through December 31, 1986. Mr. Wertheimer was a limited partner in several limited partnerships which all had a December 31st taxable year ending date. These partnerships generated large losses, resulting in an allocation to Mr. Wertheimer of losses in excess of $1.5 million. In accordance with 20 NYCRR former 148.6, Mr. Wertheimer reported all of the losses on the resident return since he was a resident of New York on the last day of the partnership's taxable year. Shortly after the return was filed by the Wertheimers, the Court of Appeals issued its decision in ***McNulty***. On audit, the Division, relying on ***McNulty***, prorated Mr. Wertheimer's distributive share of partnership losses between the resident and nonresident periods based on the number of months in each period. As a result, the Division allowed only 25% of the partnership losses to be taken on the resident return, i.e., 3/12 of the total losses representing the three months that the taxpayers were residents of New York State during 1986.

The Administrative Law Judge's determination in ***Wertheimer*** held that ***McNulty*** did not mandate the proration of partnership distributions between a partner's New York resident and nonresident returns. Rather, the Administrative Law Judge held that the taxpayers had the option to either prorate the income or loss or follow the rule of 20 NYCRR former 148.6. The Tax

Appeals Tribunal reversed the determination of the Administrative Law Judge, and the case was remanded to the Administrative Law Judge to determine whether ***McNulty*** could be applied retroactively as was contended by the Division. In ***Wertheimer***, the Tax Appeals Tribunal discussed the relationship of section 706(a) of the Internal Revenue Code (which requires that each partner's distributive share of the income, gain and loss be included in that partner's taxable income for the taxable year of the partnership ending within or with the partner's tax year), the Court of Appeals' decision in ***McNulty*** and the Tax Law and regulations as they existed at that time. The Tribunal stated:

> Recognizing that the taxpayer's distributive share of partnership income did not indicate actual receipt of the income, the Court of Appeals in ***McNulty*** found the harm of regulation 148.6 to be that it compelled the taxpayer to report all of his partnership income on one of two returns 'regardless of when the income was actually received'(***Matter of McNulty v. New York State Tax Commn., supra***, 522 NYS2d 103, 104). The Court concluded that this was inconsistent with section 654 which required an allocation that reflects 'either the actual date of receipt and expenditure or encompasses an annual amount distributed on a proportionate basis' (***Matter of McNulty v. New York State Tax Commn.***, ***supra***, 522 NYS2d 103, 104). In our view, the holding of ***McNulty*** is that where a partner's distributive share of income is reported without regard to actual receipt, the only possible method of allocation under section 654 is on a proportionate basis throughout the year.

On remand, the Administrative Law Judge concluded that the Court of Appeals decision in ***McNulty*** should be applied retroactively. This conclusion was affirmed on different grounds by the Tax Appeals Tribunal in ***Matter of Wertheimer*** (Tax Appeals Tribunal, March 14, 1996).

F. In ***Matter of Montgomerie v. Tax Appeals Tribunal*** (291 AD2d 129, 740 NYS2d 141, ***lv denied*** 98 NY2d 606, 746 NYS2d 456), the taxpayer, a partner in a New York law firm who moved out of New York State on November 30, 1986, argued that his share of the partnership income should be included entirely in his nonresident period, consistent with 20 NYCRR former 148.6. The Tax Appeals Tribunal and the Appellate Division, Third Department, disagreed with the taxpayer, requiring the partnership income to be prorated between the taxpayer's resident and nonresident periods. The Court, relying on ***McNulty*,** stated that:

> Tax Law former § 654 'evinces a clear legislative intention that most forms of income . . . be allocated between the taxpayer's resident and nonresident return in a manner that either reflects the actual date of receipt and expenditure or encompasses an annual amount distributed on a proportionate basis' (citation omitted) (***Matter of Montgomerie v. Tax Appeals Tribunal***, ***supra***, 740 NYS2d at 145).

G. In ***Matter of Greig*** (***supra***), the taxpayer was a partner in a New York law firm who had moved into New York during the year 1992. Instead of reporting his partnership income pursuant to 20 NYCRR former 154.6, which required a partner who had changed residency status to New York during the taxable year to include all of the distributive share of partnership income in the residency period, without any allocation to the nonresident period, the taxpayer allocated his partnership income on a pro rata basis between the two periods. Affirming the determination of the Administrative Law Judge, the Tribunal held that "the decision in ***McNulty*** continues to apply to this situation" and confirmed that the statutory scheme indicates a legislative intent that most forms of income should be allocated between the resident and nonresident periods to reflect the actual date of receipt or an annual distribution on a proration basis. The Tribunal also held the Division's regulations (20 NYCRR former 154.6) to be invalid.

H. It is clear from the language in the above-referenced cases that partners and shareholders of S corporations have the option of either reporting their distributions in a way which reflects the actual date of receipt or on a proportionate basis that allocates the income throughout the year. Indeed, in ***Wertheimer***, the Tribunal seemed to indicate that reporting on the actual receipt basis would be preferable, when it stated that "[i]n our view, the holding of

McNulty is that where a partner's distributive share of income is reported without regard to actual receipt, the only possible method of allocation under section 654 is on a proportionate basis throughout the year." Accordingly, it is determined that pursuant to the decisions discussed above, a partner or shareholder of an S corporation who changes his resident status during the year in issue may report his distribution of income or loss in a manner that either reflects the actual date of receipt and expenditure or be allocated on a prorated basis between the resident and nonresident periods.

I. In response to the ***Greig*** decision, the Division issued Technical Services Bureau Memorandum TSB-M-00(1)(I) on February 23, 2000. The TSB-M sets forth the Division's policy on the manner in which a partner of a partnership or shareholder of a New York S corporation reports his or her share of the income, gain, loss and deduction of the partnership or New York S corporation where the partner or shareholder changes residence status during the year. The memorandum states that the Division's policy is that the amount of partnership or New York S corporation income, gain, loss and deduction for the year in which the change in residence occurs must be prorated between the resident and nonresident periods. This is accomplished by first multiplying the individual's distributive or pro rata share of income, gain, loss and deduction for Federal income tax purposes for the tax year by a fraction, the numerator of which is the number of days in the individual's tax year that the individual was a resident of New York State and the denominator of which is the total number of days in the individual's tax year. The second calculation in the formula is similar to the first except that the numerator is the number of days in the individual's tax year that the individual was a nonresident of New York State and the result is multiplied by the partnership's or New York S corporation's New York allocation percentage for the year. Finally, the two amounts computed are combined and included in New York source income. The same steps are used to determine the amount of the distributive or pro rata share of New York addition and subtraction modifications from the partnership or New York S corporation to be included in New York source income.

J. The Division's memorandum properly addresses the factual circumstances found in ***Matter of McNulty v. New York State Tax Commn.*** (***supra***); ***Matter of Wertheimer*** (***supra***); ***Matter of Montgomerie v. Tax Appeals Tribunal*** (***supra***); and ***Matter of Greig*** **(*supra*)**. Each of these cases involved a partner who had changed his resident status during the year at issue, and the question concerned the treatment of his partnership distribution. It is well established that the income of a partnership is not deemed earned on the last day of the partnership taxable year, but rather is treated as earned ratably throughout the year (***Williams v. United States***, 680 F2d 382, 82-2 US Tax Cas ¶ 9467). It is also a well established concept that a partner is deemed to earn income as it is earned by the partnership (***see, Richardson v. Commissioner***, 693 F2d 1189, 83-1 US Tax Cas ¶ 9109; ***Snell v. United States***, 680 F2d 545, 82-2 US Tax Cas ¶ 9434, ***cert denied*** 459 US 989, 74 L Ed 2d 384; ***Williams v. United States, supra; Rodman v. Commissioner***, 542 F2d 845, 76-2 US Tax Cas ¶ 9710; ***Marriott v. Commissioner***, 73 TC 1129; ***Moore v. Commissioner***, 70 TC 1024). Absent a direct accounting for each item of partnership income and expenditure, TSB-M-00(1)(I) is consistent with the decisions of the courts and Tax Appeals Tribunal as well as Tax Law §§ 631, 632 and 638 in requiring the proration of items earned or incurred by the partnership between the resident and nonresident period. Additionally, absent a direct accounting of each item of partnership or New York S corporation income and expenditure, and considering that such items are earned and incurred throughout the year, prorating the items between the resident and nonresident periods of the partner or shareholder most accurately reflects when the items were earned or incurred.

K. The capital gain income at issue in this matter is Mr. Gianturco's share of partnership income from two limited liability companies, PAMI and VMP, for the year 1997. Petitioners claim that PAMI and VMP both have royalty agreements, associated with patents of various medical devices, with an unrelated Indiana medical supply company, Cook, that manufactures, sells and distributes the medical devices worldwide and pays PAMI and VMP royalty income based upon a percentage of sales revenues, net of sales returns. Petitioners maintain that royalty payments to PAMI are deposited into a California bank and the royalty payments to VMP are deposited into an Illinois bank. They also maintain that, since their inception, the two limited liability companies have not incurred any labor costs or any research and development costs. Rather, petitioners claim that the only expenses incurred by PAMI and VMP are minimal and relate solely to the companies' investment activity (e.g., investment fees and professional fees). Since Cook is an unrelated company, petitioners assert that PAMI and VMP do not have any control over the amount of royalties that they receive from Cook. They further assert that the advanced royalty payments made to PAMI and VMP are not fixed and determinable until Cook finishes its accounting and closes its books at the end of the year, December 31st. Furthermore, petitioners aver that the royalty payments that PAMI received from Cook in 1998 were reduced by amounts repaid because of returns of medical devices on which royalties had been previously paid to PAMI in 1997. They claim that the two documents from Cook clearly establish that the royalty payments received by PAMI and VMP were not fixed and determinable until December 31, 1997. Therefore, petitioners argue that since the royalty income received by these companies was neither fixed nor determinable until the end of the calendar year, the correct place to source the capital gain income from these companies was petitioners' domicile on December 31, 1997, i.e., Connecticut.

L. Petitioners have failed to establish the exact date of receipt of royalty income by either PAMI or VMP in 1997. The two documents from Cook, dated April 17, 1997 and May 8, 2000, respectively, submitted by petitioners in support of their position, pertain only to PAMI and Cook. After careful review of these documents, I find that neither of these documents establishes that PAMI received all of its royalty payments on December 31, 1997. The April 17, 1997 document allegedly summarizes, among other things, the agreement Cook and PAMI had concerning patent rights on a specific medical device, the GR-II coronary stent, and the related royalty payments during the 20-year period which commenced in July 1993. Since the agreement entered into in July 1993 is not part of the record, it is impossible to determine whether this document accurately summarizes the agreement of the parties with respect to the patent rights on the GR-II coronary stent and the related royalty payments. In addition, it is unclear whether PAMI agreed to the terms set forth in this document. With respect to the second document, Cook's letter dated May 18, 2000, it sets forth the royalty information regarding sales of the GR-II coronary stent sold during 1999, not 1997. Contrary to petitioners' claim, this letter does not establish that the royalty payments PAMI received in 1997 based upon Cook's sales of the GR-II coronary stent during 1997 were repaid in 1998 via a reduction in royalty payments received by PAMI in 1998 based upon Cook's 1998 sales of that medical device. Based upon the record, it is impossible to determine whether PAMI received royalty payments related to the patent rights on a single medical device or a number of medical devices. Furthermore, the record does not include any documentation setting forth the date or dates on which any royalty payments were received by PAMI in 1997. Petitioners did not submit any agreements between VMP and either Cook or any other medical supply company. Nor did they submit any documentation setting forth the date or dates on which VMP received royalty payments in 1997.

Since petitioners have failed to prove the actual date of receipt of the capital gain income by the two Nevada limited liability companies, each of these partnership's income must be treated as earned ratably throughout its taxable year (***see, Williams v. United States***, ***supra***). As such, Mr. Gianturco, a member of both PAMI and VMP, earned his distributive share of partnership income ratably throughout each partnership's taxable year. Mr. Gianturco became a Connecticut domiciliary on August 1, 1997; therefore, his distributive share of the capital gain income must be prorated between the resident and nonresident periods (***Matter of Greig***, ***supra***). The proper method for reporting Mr. Gianturco's distributive or pro rata share of the partnerships' capital gain income recognized throughout 1997 was by computing it using the proration formula between the resident and nonresident periods articulated in TSB-M-00(1)(I), i.e., multiplying the individual's distributive or pro rata share of income, gain, loss and deduction for Federal income tax purposes for the tax year by a fraction, the numerator of which is the number of days in the individual's tax year that the individual was a resident of New York State and the denominator of which is the total number of days in the individual's tax year. Accordingly, the Division properly determined petitioners' distributive or pro rata share of 1997 capital gain income subject to tax in New York for the resident period by using a proration formula between the resident and nonresident period.

M. The Court of Appeals in ***McNulty*** found that 20 NYCRR former 148.6 was inconsistent with the legislative intent of Tax Law former § 654. In its decision, the Court stated that:

> [s]ection 654 of the Tax Law, which establishes specialized reporting requirements for taxpayers who change resident status during the tax year, evinces a clear legislative intention that most forms of income, as well as exemptions and standard deductions, be allocated between the taxpayer's resident and nonresident returns in a manner that either reflects the actual date of receipt

> and expenditure or encompasses an annual amount distributed on a proportionate basis (***Matter of McNulty v. New York State Tax Commn., supra***, 522 NYS2d at 104).

The Court also stated that "the regulation was an invalid exercise of the tax authority's power" (***id***., 522 NYS2d at 104). Accordingly, the regulation created unfair results for certain taxpayers and was inconsistent with the applicable statute. "Therefore, to deny retroactive effect to the rule stated in ***McNulty*** would be directly contrary to the legislative design identified by the Court in ***McNulty*** and would retard the operation of the rule" (***see, Matter of Wertheimer, supra***). In ***Matter of Greig*** (***supra***), the Administrative Law Judge held that the statutory scheme present in ***McNulty*** was similar to the one found in that matter. He concluded that the statutory exceptions found in Tax Law § 637 and former § 638(c) indicated that it continued to be the intent of the Legislature that most forms of income be allocated between petitioner's resident and nonresident periods "in a manner that either reflects the actual date of receipt or expenditure or encompasses an annual amount distributed on a proportionate basis" (***citing Matter of McNulty v. New York State Tax Commn.***, ***supra***). In affirming the Administrative Law Judge's determination, the Tax Appeals Tribunal in ***Matter of Greig*** (***supra***) held that "the decision in ***McNulty*** continues to apply to this situation" and confirmed that the statutory scheme indicates a legislative intent that most forms of income should be allocated between the resident and nonresident periods to reflect the actual date of receipt or an annual distribution on a proration basis. The Tribunal concluded that the Division's regulation 20 NYCRR former 154.6(a)(3)(i) was not in harmony with the statute and invalidated it.

As noted above, in accordance with 20 NYCRR former 154.6(a)(3)(i), petitioners did not include any of the capital gain income received by Mr. Gianturco from the two limited liability companies on the part-year New York personal income tax return that they filed for 1997 because they were nonresidents of New York State and City on December 31, 1997, the same date on which the two limited liability companies' taxable year ended. The Division determined that, pursuant to the Tax Appeals Tribunal decision in ***Matter of Greig*** (***supra***), petitioners' share of the limited liability companies' capital gain income to be included in New York source income for 1997 should be computed using a proration formula between the resident and nonresident periods. Petitioners contend that the Division's retroactive application of the Tax Appeals Tribunal's decision in ***Matter of Greig*** (***supra***) is arbitrary and capricious. Petitioners rely on the determination of a Division of Tax Appeals administrative law judge in ***Matter of Rawl*** (Division of Tax Appeals, December 10, 1998), and ***Matter of Hilton Hotels Corp. v. Commissioner of Fin. of City of New York*** (219 AD2d 470, 632 NYS2d 56), in support of their position. However, under Tax Law § 2010(5), determinations of administrative law judges are not considered precedent, nor are they given any force or effect in other proceedings in the Division of Tax Appeals (***see also***, 20 NYCRR 3000.15[e][2]). Petitioners point out that in ***Hilton Hotels Corp.***, the Court concluded that a retroactive change in the law should not be imposed on the taxpayer where the taxpayer had acted in good faith and relied on the position that the Department had espoused. They further point out that, in reaching its conclusion, the Court relied on the three-part test for determining the nonretroactivity of a judicial decision, enunciated in ***Chevron Oil Co. v. Huson*** (404 US 97, 106-107, 30 L Ed 2d 296) and adopted by the Court of Appeals in ***Gager v. White*** (53 NY2d 475, 442 NYS2d 463, ***cert denied sub nom Guertin Co. v. Cachat***, 454 US 1086, 70 L Ed 2d 621) and by the Tax Appeals Tribunal in ***Matter of NewChannels Corp. & Upstate Community Antenna*** (Tax Appeals Tribunal, September 23, 1993). Petitioners assert that the retroactive application of the change in the

Division's policy required by the Tribunal's decision in ***Matter of Greig*** (***supra***) cannot be applied to them based on the three-factor test applied by the Supreme Court in ***Chevron***.

N. Applying the three factors identified by the Supreme Court in ***Chevron,*** I conclude that the Tribunal's decision in ***Matter of Greig*** (***supra***) may be retroactively applied to petitioners' 1997 tax return. The three factors to be considered are as follows:

> 'First, the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied . . . or by deciding an issue of first impression whose resolution was not clearly foreshadowed' . . . . Second, the prior history of the rule at issue and the impact of retroactive application upon its purpose and effect should be considered. Finally, the court should take into account any inequity that would be created by retroactive application . . . (***Gurnee v. Aetna Life & Cas. Co.*** 55 NY2d 184, 484 NYS2d 145, 147, quoting ***Chevron Oil Co. v. Huson***, ***supra***, at 106-107).

With respect to the first factor, petitioners argue that the regulation, 20 NYCRR former 154.6(a)(3)(i), on which they relied had been in effect since the 1980s. Petitioners' argument is without merit. In ***Greig***, based on its review of Tax Law former § 654 and Tax Law former § 638, the Tribunal concluded that the statutory scheme of allocating income to the taxpayer's resident and nonresident periods for reporting a partner's distributive share of income, gain, loss and deductions from the partnership remained essentially the same, i.e., it continued to be the intent of the Legislature that most forms of income be allocated between the taxpayer's resident and nonresident periods in a manner that either reflects the actual date of receipt or expenditure or encompasses an annual amount distributed on a proportionate basis. The Tribunal invalidated 20 NYCRR former 154.6(a)(3)(i) because it did not permit taxpayers to prorate the annual amount of their partnership distributions and allocate that amount proportionately between resident and nonresident periods (***see, Matter of Greig, supra***). The regulation, 20 NYCRR former 154.6(a)(3)(i), invalidated by the Tribunal in ***Greig***, is similar to the regulation, 20

NYCRR former 148.6, invalidated in ***McNulty***. It appears that ***McNulty*** represented the Court of Appeals' first opportunity to construe Tax Law former § 654. Such an interpretation is not considered a new legal principle (***see, Gurnee v. Aetna Life & Cas. Co., supra***, 448 NYS2d at 147). The Court of Appeals was construing the statute which had been in effect for several years, thus its holding was not a "new" rule of law (***id***., 448 NYS2d at 147; ***see also, Matter of Montgomerie v. Tax Appeals Tribunal***, ***supra***, 740 NYS2d at 144).

With respect to the second factor, petitioners assert that uncertainty regarding an individual's tax obligations could discourage individuals and businesses from moving to New York, which could hinder growth of the tax base, thereby retarding the amount of taxes collected. They further assert that retroactivity would result in the opposite effect of the intent of the Tax Law, by lowering tax revenues. Petitioners have not made a persuasive showing that retroactive application would retard the effect of the statute. The Court of Appeals clearly stated in ***Matter of McNulty v. New York State Tax Commn***. (***supra***) that 22 NYCRR former 148.6 was an invalid exercise of the tax authority's power which was inconsistent with Tax Law former § 654 and created unfair results for certain taxpayers. "Accordingly, we cannot agree that its retroactive application would not further the purposes of Tax Law former § 654" (***Matter of Montgomerie v. Tax Appeals Tribunal***, ***supra***, 740 NYS2d at 144). The Tax Appeals Tribunal followed the established rules of judicial decision making by deciding ***Matter of Greig*** (***supra***) in accord with the established precedent articulated by the Court of Appeals in ***McNulty***.

With respect to the third factor, petitioners assert that they have been forced to pay state income taxes on more than 150% of their income as well as having been required to pay New York interest on taxes that were determined to be due because of the retroactive application of the Tribunal's decision in ***Greig***. There is insufficient support for petitioners' assertion that they detrimentally relied on the prior rule such that it would be inequitable for them to be required to pay the correct amount of tax due under a proper interpretation of Tax Law § 638 (***cf., Matter of Hilton Hotels Corp. v. Commissioner of Fin. of City of New York***, ***supra*)**. Petitioners were not assessed a penalty as a result of the Division's actions. While I appreciate petitioners' argument, "[s]ince tax legislation is not a governmental promise" (***Matter of Varrington Corp. v. City of New York Dept. of Fin.,*** 85 NY2d 28, 33, 623 NYS2d 534, 536; ***Matter of Montgomerie v. Tax Appeals Tribunal***, ***supra***, 740 NYS2d at 145), petitioners had no vested right in the benefits of 20 NYCRR former 154.6(a)(3)(i) and cannot establish unjustifiable prejudice as a result.

In sum, the application of the three ***Chevron*** factors indicates that the circumstances in this case do not warrant a departure from the normal rule that "a change in decisional law usually will be applied retrospectively to all cases still in the normal litigating process" (***Gurnee v. Aetna Life & Cas. Co.***, ***supra***, 448 NYS2d at 147, quoting ***Gager v. White***, ***supra***, 442 NYS2d at 466), i.e., "all claims not barred by the Statute of Limitations" (***Ulster Sav. Bank v. Watson***, 168 AD2d 839, 840, 564 NYS2d 793, 794, quoting ***Gurnee v. Aetna Life & Cas. Co.***, ***supra***, 448 NYS2d at 146). Therefore, retroactivity is mandated. Accordingly, the Tax Appeals Tribunal's decision in ***Matter of Greig*** (***supra***) does apply to petitioners' 1997 tax return.

O. In the alternative, petitioners contend that they are entitled to a resident tax credit provided for in Tax Law § 620(a), for taxes paid to Connecticut on the capital gain income recognized to the extent of approximately 7/12ths of the total capital gain income recognized. Petitioners rely on two administrative law judge determinations, ***Matter of Black*** (Division of Tax Appeals, April 13, 1995) and ***Matter of Rosenthal*** (Division of Tax Appeals, December 23, 1999), in support of their position. However, as previously noted, under Tax Law § 2010(5), determinations of administrative law judges are not considered precedent, nor are they given any force or effect in other proceedings in the Division of Tax Appeals (***see also,*** 20 NYCRR 3000.15[e][2]).

P. Tax Law § 620(a) provides, in pertinent part, that:

> A resident shall be allowed a credit against the tax otherwise due under this article for any income tax imposed for the taxable year by another state of the United States, a political subdivision of such state, the District of Columbia or a province of Canada, upon income both derived therefrom and subject to tax under this article . . . .

The term "income derived from sources within another state" is construed so as to be in accord with the definition of the term "derived from or connected with New York sources" as set forth in 20 NYCRR 132.2. Thus, the credit is allowable for income taxes imposed by another state upon compensation for personal services performed in such other state, income from a business, trade or profession carried on in such other state and income from real or tangible personal property situated in such other state (***see***, 20 NYCRR 120.4[d]). Accordingly, a resident tax credit would be available if the capital gain income was earned in Connecticut while petitioners were residents of New York.

Q. In the instant matter, the capital gain income upon which New York tax was imposed was derived from Mr. Gianturco's membership in two Nevada limited liability companies. Each of these limited liability companies have royalty agreements associated with patents for various medical devices sold worldwide. As a result, they receive royalty payments based upon sales of the various medical devices throughout the year. Therefore, the income generated ratably throughout the year was not business income earned in Connecticut; rather, it was income from intangible personal property located in Nevada. Based upon the New York sourcing rule, this capital gain income cannot be deemed to be from petitioners' domicile state of Connecticut. Furthermore, petitioners paid tax to Connecticut because of their resident status as domiciliaries of Connecticut, from August 1, 1997 through December 31, 1997, not because the income was earned in Connecticut.[4] It is noted that no tax was paid to Nevada on this capital gain income. Since the tax paid to Connecticut does not qualify as tax paid to another jurisdiction pursuant to Tax Law § 620(a) and the Division's regulation 20 NYCRR 120.4(d), petitioners are not entitled to a resident tax credit for taxes paid to Connecticut on the capital gain income recognized to the extent of approximately 7/12ths of the total capital gain income recognized.

R. The petition of Michael and Sydney Gianturco is denied and the Notice of Deficiency dated August 13, 2001 is sustained.

DATED: Troy, New York
November 23, 2005

/s/ Winifred M. Maloney
ADMINISTRATIVE LAW JUDGE

[4] During the year at issue, Conn. Agencies Regs. § 12-717-4(a)(1) required a part-year resident to include his distributive share of partnership income, gain, loss and deduction as Connecticut source income, when the taxable year of the partnership ended during the period the individual was a resident. Subsequently, Conn. Agencies Regs. § 12-717-4 was amended effective as of January 1, 2001. Conn. Agencies Regs. § 12-717-4(a)(1) now requires a part-year resident to include, based on the number of days such individual was a resident, a prorated amount of the individual's distributive share of partnership income, gain, loss and deduction as Connecticut source income.