STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
RONALD K. AND MAXINE H. LINDE	:	DETERMINATION DTA NO. 823300
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Year 2005.	:	

Petitioners, Ronald K. and Maxine H. Linde, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the year 2005.

On October 26, 2010 and November 1, 2010, respectively, the Division of Taxation, appearing by Mark F. Volk, Esq. (Christopher O'Brien, Esq., of counsel), and petitioners, appearing pro se, waived a hearing and submitted this matter for determination based on documents and briefs to be submitted by April 8, 2011, which date commenced the six-month period for issuance of this determination (Tax Law § 2010[3]). After due consideration of the documents and arguments submitted, Thomas C. Sacca, Administrative Law Judge, renders the following determination.

ISSUE

Whether income realized as a result of the sale by a nonresident partnership of real property located in New York is properly allocated solely to New York State.

FINDINGS OF FACT

1. During the year 2005, petitioners, Ronald K. and Maxine H. Linde, were residents of the state of Arizona. For the tax year 2005, petitioners filed a joint New York State Nonresident and Part-Year Resident Income Tax Return. During the year at issue, petitioners were partners in Strategic Hotel Capital, LLC (Strategic), which was headquartered in and managed from Chicago, Illinois. Included in petitioners' income for the year 2005 were partnership distributions received from Strategic.

2. The business of Strategic was the purchase, renovation and management of hotel properties with the ultimate objective of selling the properties at a gain. Strategic owned hotels in several states including New York. When Strategic acquired a hotel, it usually renovated the hotel and furnishings to enhance the quality of the hotel, thereby increasing its usage, rates and value.

Strategic purchased the Marriott East Side Hotel on March 4, 1998 and the Essex House Hotel on March 12, 1999, both located in New York City. Each hotel was subsequently renovated. Strategic included the costs of maintaining the hotels plus the associated depreciation deductions in the calculation of its operating income from the operations of the hotels. Strategic allocated the operating income from all of its hotels to New York by using the three-factor business allocation percentage.

Over the years, most of Strategic's income had been the result of gains from the sale of real property. During 2005, Strategic sold the Marriott East Side and Essex House hotels, as well as hotels located in other states. At the time, Strategic had a business plan to divest itself of all remaining hotel properties, and it was completely liquidated in 2009. On its 2005 New York State partnership return, Form IT-204, Strategic apportioned the gains using a business allocation

percentage of 16.29. On their return, petitioners allocated the same portion of the gain derived from the sale of the two hotels to New York.

3. Following an audit, the Division of Taxation (Division) determined that Strategic did not properly allocate New York source income to its partners. The income at issue was the sale of the two hotel properties located in New York City. It was the position of the Division that the entire gains should have been allocated to New York as the situs of the hotel properties was in New York.

4. On September 21, 2009, the Division issued to petitioners a Notice of Deficiency (assessment number L-032511120-6) for personal income tax due of $51,169.00, plus interest.

CONCLUSIONS OF LAW

A. New York State imposes personal income tax on the income of nonresident individuals to the extent that their income is derived from or connected to New York sources (Tax Law § 601[e]). Included in such income is that which is attributable to a business, trade, profession or occupation carried on in New York State (Tax Law § 631[b][1][B]). If a taxpayer's business, trade, profession or occupation is carried on partly within and partly without this state, as determined under regulations of the Commissioner of Taxation and Finance, the items of income, gain, loss and deduction derived from or connected with New York sources shall be determined by apportionment and allocation under such regulations (***Matter of Schibuk v. Tax Appeals Tribunal***, 289 AD2d 718, 733 NYS2d 801 [2001], ***lv dismissed*** 98 NY2d 720, 748 NYS2d 900 [2002]).

B. The New York source income of a nonresident individual includes the sum of the net amount of items of income, gain, loss and deduction entering into the individual's federal adjusted gross income "derived from or connected with New York sources, including: (A) his

distributive share of partnership income, gain, loss and deduction, determined under [Tax Law] section six hundred thirty-two . . .” (Tax Law § 631[a][1]). The New York source income of a nonresident partner includes his distributive share of all items of partnership income, gain, loss and deduction entering into his federal adjusted gross income to the extent such items are derived from or connected with New York sources (Tax Law § 632[a][1]). The New York source of partnership income is determined by the partnership’s business in New York, with the allocation percentage thereof determined by the business activity of the partnership both within and without New York calculated as the partnership’s business allocation percentage (or as calculated by an alternative method authorized by the Division). The business allocation percentage results from the three percentages of partnership property, partnership payroll and partnership gross income (20 NYCRR 132.15[d], [e], [f]). However, pursuant to 20 NYCRR 132.16, income and deductions connected with the rental of real property and gain and loss from the sale or exchange of real property are not subject to allocation, but are considered as entirely derived from the situs of the real property.

C. Petitioners contend that 20 NYCRR 132.16, upon which the Division relies, when read together with 20 NYCRR 132.15, is limited to gains derived from the sale of rental property, which the hotels were not. According to 20 NYCRR 132.15(a), petitioners argue, if a nonresident individual, or a partnership of which a nonresident individual is a member, carries on a business both within and without New York State, the items of gain attributable to such business must be apportioned and allocated to New York State on a fair and equitable basis, in accordance with approved methods of accounting. Strategic used the three-factor formula, as set forth in section 132.15(c) to allocate its business income. Section 132.15(d) provides that the formula’s property percentage includes real property connected with the business, except for real

property the gain from which is allocated pursuant to section 132.16. According to petitioners, applying section 132.16 to gains from the sale of all real property would effectively remove all real property from the property percentage. Therefore, petitioners argue, to give effect to both provisions, regulation 132.16 must be limited to rental properties. In support of their position that the source of income from real estate activities is not necessarily confined to the location of the property, petitioners cite ***Matter of Ausbrooks v. Chu*** (66 NY2d 281, 496 NYS2d 969 [1985]); ***Matter of Vogt v. Tully*** (53 NY2d 586, 444 NYS2d 441 [1981]); ***Matter of Domber v. Tax Appeals Tribunal*** (210 AD2d 529, 619 NYS2d 829 [1994], ***lv denied***, 85 NY2d 810, 629 NYS2d 724 [1995]) (***Domber I***) and ***Matter of Domber v. Tax Appeals Tribunal*** (263 AD2d 277, 714 NYS2d 321 [2000], ***lv denied*** 95 NY2d 760 [2000]) (***Domber II***).

D. Unfortunately for petitioners, the regulations are contrary to their position. Section 132.15(c) requires the inclusion of the property percentage as part of the three-factor business allocation percentage where a business is carried on partly within and partly without New York State. However, section 132.15(d) of the regulations specifically states that the income or gain from real property that is allocated pursuant to section 132.16 is disregarded in computing the property percentage. Section 132.16 provides that gains from the sale or exchange of real property are not subject to allocation under section 132.15, but are considered as entirely derived from the situs of such real property. Furthermore, it is obvious that section 132.16 is not limited in its application solely to rental property, as petitioners claim, as it refers to both the income and deductions connected with the rental of real property *and* the gain and loss from the sale, exchange or other disposition of real property.

It is well established that the interpretation given to a statute by the agency authorized with its enforcement should generally be given weight and judicial deference if the interpretation is

not irrational, unreasonable or inconsistent with the statute (***Matter of Trump-Equitable Fifth Avenue Co. v. Gliedman***, 62 NY2d 539, 478 NYS2d 846 [1984]). Here, the interpretation of the Division that the entire gain should have been allocated to New York where the situs of the hotel properties was in New York is neither irrational nor unreasonable and is wholly consistent with Tax Law §§ 631 and 632.

E. The cases cited by petitioners in support of their position are factually distinguishable from the present matter as none involve the allocation of the proceeds of the sale of real property located in New York State (***see Matter of Ausbrooks v. Chu*** [allocation of ordinary business income based upon determination of partnership's activities in state]; ***Matter of Vogt v. Tully*** [allocation of partnership losses to nonresident taxpayers based upon determination of partnership's activities in state]; ***Domber I*** [allocation of ordinary income from management fees involving out-of-state real property based upon determination that income was derived from New York State activities of law firm] and ***Domber II*** [allocation of partnership income earned from ownership of out-of-state property deemed distribution of share of partnership income based upon determination that taxpayer had failed to establish nature of income].

F. In the initial ***Matter of Domber*** (Tax Appeals Tribunal, April 1, 1993, ***confirmed*** 210 AD2d 529, 619 NYS2d 829 [1994], ***lv denied*** 85 NY2d 810 [1995]), the issue presented was whether the income from development and management fees involving out-of-state real property was allocable to New York. In resolving this issue, the Tribunal considered the effect of the personal income tax former regulation 131.16[1] and concluded:

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[1] 20 NYCRR 132.16 was added by renumbering 20 NYCRR former 131.16. 20 NYCRR 132.16 is identical to former section 131.16 except for the references to 20 NYCRR 132.13 and 132.15, which were also added by renumbering 20 NYCRR former 131.13 and 131.15.

> Based on the language of the statute and regulations, the focus of the present inquiry is on where the income was generated notwithstanding the location of the real property. Specifically, our inquiry is whether the revenue from out-of-state real property was generated by active management which took place in New York State, or whether the revenue represents passive investment income flowing from the out-of-state real property to a recipient in New York. Although this passive/active distinction is not explicitly set forth in 20 NYCRR former 131.16, the type of activities which are mentioned in the regulation, as well as the decisions in ***Matter of Vogt v. Tully*** (53 NY2d 580, 444 NYS2d 441) and ***Matter of Ausbrooks v. Chu*** (66 NY2d 281, 496 NYS2d 969), indicate that this is the required inquiry.

After considering the facts and holdings in ***Matter of Vogt v. Tully*** and ***Matter of Ausbrooks v. Chu***, the Tribunal concluded that income would be attributable to New York State if:

> (i) the business was systematically conducted in New York State; (ii) activities related to the business were conducted in a permanent and continuous manner in New York State; and (iii) the out-of-state assets of the business were actively managed from New York State [citation omitted] (***Matter of Domber***).

On the basis of the foregoing active/passive analysis, the Tribunal determined that the taxpayers had not shown the income in issue, which arose from development and management fees, was not properly allocated to New York State on the basis of the criteria established in ***Matter of Ausbrooks v. Chu***.

In the Article 78 proceeding which followed, the decision of the Tribunal was confirmed (***see Domber I***). In its opinion, the Appellate Division noted:

> As fees generated by real estate activities are not the equivalent of income from the rental of real property (and there being no proof of real estate sales gains), the passive/active analysis relating to petitioners' New York business activities used by the Tribunal was reasonable [footnote omitted] (***Domber I***, 619 NYS2d at 831).

The foregoing comment shows that the active/passive analysis, which was premised upon ***Ausbrooks***, does not apply when the gain is from the sale of real estate. When the gain is from

the sale of real estate, 20 NYCRR 132.16 is applicable (***Domber I***, 619 NYS2d at 831, footnote 2) and, in accordance with this regulation, the gain is "considered as entirely derived from or connected with the situs of such real property" (20 NYCRR 132.16; ***see also Domber II***). Since each item of income retains the same character in the hands of the partner that it had in the hands of the partnership (IRC § 702[b]), the entire gain realized from the sale of the two hotels is attributable to New York.

G. Petitioners' position that they are entitled to the waiver of all interest based upon the Division's intentional delay of this matter is without merit. Tax Law § 684(a) provides that:

> If any amount of income tax is not paid on or before the last date prescribed in this article for payment, interest on such amount . . . shall be paid for the period from such last date to the date paid, whether or not any extension of time for payment was granted.

Petitioners have presented no evidence to support an abatement of interest. By requesting that the interest charges be abated, petitioners, in essence, seek an interest-free loan from the State of New York. As noted by the Tribunal in the ***Matter of Rizzo*** (Tax Appeals Tribunal, May 13, 1993):

> Failure to remit tax gives the taxpayer the use of funds which do not belong to him or her, and deprives the State of funds which belong to it. Interest is imposed on outstanding amounts of tax due to compensate the State for its inability to use the funds and to encourage timely remittance of tax due . . . . It is not proper to describe interest as substantial prejudice, as it is applied to all taxpayers who fail to remit . . . tax due in a timely manner. Rather, a more accurate interpretation would be to say that interest represents the cost to the taxpayer for the use of the funds . . . .

While Tax Law § 3008(a) provides for the abatement of interest attributable to certain unreasonable errors or delays by the Division, such has not been shown here. The application of this provision is limited to unreasonable errors or delays by Division employees in performing "ministerial or managerial" acts, and only if no significant aspect of the unreasonable error or

delay can be attributed to the taxpayer involved. Petitioner has neither alleged nor proven any unreasonable errors or delays by the Division. As such, petitioners have not met their burden of proving that interest should be abated.

Finally, it is noted that if petitioners were under the impression that the settlement discussions the parties were involved in were taking an unreasonable amount of time, they had the option of paying the amount of tax and interest due to stop the further accrual of interest.

H. The petition of Ronald K. and Maxine H. Linde is denied and the Notice of Deficiency dated September 21, 2009 is sustained.

DATED: Troy, New York
July 21, 2011

/s/ Thomas C. Sacca
ADMINISTRATIVE LAW JUDGE