STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition

of

BRUCE BERGER AND BARBARA BERGER

DETERMINATION

for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Year 1981.

Petitioners, Bruce and Barbara Berger, 400 East 54th Street, Apartment #25C, New York, New York 10022, 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 1981 (File No. 61437).

On February 20, 1987, petitioners, by their duly authorized representative Spahr, Lacher, Berk & Naimer, C.P.A.'s (Jack Mitnick, C.P.A.), waived a hearing in the Division of Tax Appeals and submitted their case for determination based on the entire Division of Taxation file, including briefs to be filed by July 31, 1987. After due consideration of the record, Dennis M. Galliher, Administrative Law Judge, hereby renders the following determination.

ISSUE

Whether petitioners properly calculated the dollar amount of their items of tax preference when filing their New York State and New York City income tax returns for 1981.

FINDINGS OF FACT

1. Petitioners, Bruce and Barbara Berger, husband and wife, timely filed (pursuant to extensions of time granted) a New York State and City of New York Resident Income Tax Return for the year 1981 (Form IT-201), indicating thereon filing status "3" (married filing separately on one return). Included with

petitioners' filing for 1981 was Form IT-220 (New York State and City of New York Minimum Income Tax Computation Schedule).

2. On April 5, 1985 the Audit Division issued to petitioners a Notice of Deficiency asserting additional personal income tax due for 1981 in the aggregate amount of $4,482.73, plus interest. A Statement of Audit Changes previously issued to petitioners on February 26, 1985 revealed that the asserted deficiency for 1981 consisted of $3,105.85 of New York State income tax and $1,376.88 of New York City income tax (specifically New York State and City minimum income tax).

3. In computing their Federal adjusted gross income on their 1981 U.S. Individual Income Tax Return (Form 1040), petitioners took a deduction from gross income per Internal Revenue Code ("I.R.C.") § 1202 in the amount of $413,274.00 (60 percent of petitioner's $688,790.00 capital gain income). The resultant amount ($275,516.00) was combined with petitioners' other items of income and loss, thus leaving petitioners with an adjusted gross income of $89,553.00. Thereafter, petitioners' excess itemized deductions of $150,265.00 and personal exemptions of $4,000.00 served ultimately to reduce petitioners' Federal taxable income to a negative $64,712.00.

4. In completing their New York State and City tax returns (Form IT-201), petitioners' reported capital gain income of $275,516.00 (total capital gain income of $688,790.00 less the I.R.C. § 1202 deduction of $413,274.00).

5. In computing their New York State minimum income tax liability (Form IT-220), petitioners listed the following items of tax preference:

Accelerated depreciation	$ 108.00
Adjusted itemized deductions	27,068.00
Capital gain deduction	348,562.00
Total	$375,738.00

It is noted that petitioners' capital gain deduction shown as an item of tax preference on Form IT-220 ($348,562.00), represents the difference between petitioners' I.R.C. § 1202 deduction ($413,274.00) and the amount of (negative) Federal taxable income computed by petitioners ($64,712.00).

6. It is petitioners' position that Internal Revenue Code § 58(h) (the "Tax Benefit Rule") requires, in this case, that petitioners' net capital gain deduction under **I.R.C.** § 1202, which constitutes an item of tax preference, must be reduced to the extent that a Federal tax benefit was not received. Petitioners assert specifically that they received no Federal tax benefit on $64,712.00 of their I.R.C. § 1202 deduction (the extent to which their Federal taxable income was a loss). Thus, petitioners maintain that as an item of tax preference their section 1202 deduction should be reduced to $348,562.00, with such reduced amount constituting petitioners' item of tax preference for capital gains both for Federal purposes and, through conformity, (Tax Law § 607[a]) for New York State purposes.

7. The Audit Division asserts, by contrast, that due to the effect of the "addition" modifications contained in the Tax Law, petitioners did receive a New York State benefit to the full extent of their I.R.C. § 1202 deduction, and hence no reduction of the amount of petitioners' I.R.C. § 1202 deduction is warranted in computing petitioners' items of tax preference subject to New York minimum income tax. Accordingly, the Audit Division maintains petitioners' item of tax preference for their capital gain deduction should be $413,274.00.

CONCLUSIONS OF LAW

A. That Tax Law § 601-A imposes a "minimum income tax'' on the New York "minimum taxable income" of every individual, estate or trust.

B. That Tax Law § 622(b) provides that:

> "the term 'items of tax preference' shall mean the federal items of tax preference, as defined in the laws of the United States, of a resident individual, estate, or trust..." (emphasis added).

C. That Internal Revenue Code § 57, as it existed during the year in question, enumerated those items constituting items of tax preference to include specifically "an amount equal to the net capital gain deduction for the taxable year determined under section 1202." (I.R.C. § 57[a][9][A].)

D. That I.R.C. § 58(h) provides as follows:

> "Regulations to include tax benefit rule. -- The Secretary shall prescribe regulations under which items of tax preference shall be properly adjusted where the tax treatment giving rise to such items will not result in the reduction of the taxpayer's tax under this subtitle for any taxable years."

E. That the purpose behind the enactment and imposition of the minimum income tax was to "limit the ability of high income taxpayers to avoid any tax burden through various tax shelters by requiring such taxpayers to pay a tax on certain 'items of tax preference' from which they benefit." (Matter of Hunt v. State Tax Commn., 65 NY2d 13 [emphasis added].)

F. That as noted above with emphasis, and as is bolstered by the descriptive term "tax benefit rule", the essential thrust of such rule is that one should not pay a tax on a preference item where no benefit was derived from such item (see I.R.C. § 58[h]; Matter of Hunt v. State Tax Commn., supra). The tax benefit rule has been held to be applicable in the computation of the New York State minimum income tax (Matter of Hunt v. State Tax Commn., supra).

G. That initially, petitioners were required to compute their Federal items and amounts of tax preference in accordance with I.R.C. § 57, which items and amounts as computed thereunder also constitute the items of tax preference for purposes of New York State's minimum income tax (Tax Law § 622[b]).

Thereafter, in computing their Federal income tax liability, petitioners were entitled, under I.R.C. § 58(h), to adjust the dollar amount of their items of tax preference to the extent that no benefit had been derived therefrom (the $64,712.00 "unused" portion of their I.R.C. § 1202 deduction).

H. That, however, in computing their New York State personal income tax liability, petitioners properly made the modifications required by Tax Law § 612 (the "addition" modifications), the result of which was to leave petitioners with sufficient New York income to absorb as a deduction petitioners' entire I.R.C. § 1202 deduction. Thus, petitioners did, in fact, receive the full dollar benefit of their section 1202 deduction at the New York State level. Accordingly, there was not a proper basis for petitioners to have included less than the full amount of their section 1202 deduction as an item of tax preference (as adjusted by Tax Law § 622[b][4]) in computing their New York minimum income tax liability. In sum, since a full tax benefit for their section 1202 deduction was received for New York purposes, the tax benefit rule does not apply in the computation of petitioners' New York minimum income tax liability (Matter of Hunt v. State Tax Commn., supra).

I. That the petition of Bruce and Barbara Berger is hereby denied and the Notice of Deficiency issued April 5, 1985 is sustained.

DATED: Albany, New York

SEP 11 1987

ADMINISTRATIVE LAW JUDGE