

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of
Peter A. Bakal

: AFFIDAVIT OF MAILING

for Redetermination of a Deficiency or a Revision :
of a Determination or a Refund of Personal Income :
Tax under Article 22 of the Tax Law for the :
Years 1976 & 1977.

State of New York
County of Albany

David Parchuck, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 6th day of May, 1983, he served the within notice of Decision by certified mail upon Peter A. Bakal, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Peter A. Bakal
32 Sunnyside Rd.
Scotia, NY 12302

and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the petitioner herein and that the address set forth on said wrapper is the last known address of the petitioner.

Sworn to before me this
6th day of May, 1983.

David Parchuck

Constance A. Haglund

AUTHORIZED TO ADMINISTER
OATHS PURSUANT TO TAX LAW
SECTION 174

STATE OF NEW YORK

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David Parchuck, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 6th day of May, 1983, he served the within notice of Decision by certified mail upon Usher Fogel the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Usher Fogel
1 Columbia Place
Albany, NY 12207

and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the representative of the petitioner herein and that the address set forth on said wrapper is the last known address of the representative of the petitioner.

Sworn to before me this
6th day of May, 1983.

David Parchuck

James R. Haglund

AUTHORIZED TO ADMINISTER
OATHS PURSUANT TO TAX LAW
SECTION 174

STATE OF NEW YORK
STATE TAX COMMISSION
ALBANY, NEW YORK 12227

May 6, 1983

Peter A. Bakal
32 Sunnyside Rd.
Scotia, NY 12302

Dear Mr. Bakal:

Please take notice of the Decision of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 690 of the Tax Law, any proceeding in court to review an adverse decision by the State Tax Commission can only be instituted under Article 78 of the Civil Practice Laws and Rules, and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 months from the date of this notice.

Inquiries concerning the computation of tax due or refund allowed in accordance with this decision may be addressed to:

NYS Dept. Taxation and Finance
Law Bureau - Litigation Unit
Albany, New York 12227
Phone # (518) 457-2070

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative
Usher Fogel
1 Columbia Place
Albany, NY 12207
Taxing Bureau's Representative

STATE TAX COMMISSION

II. Whether the Audit Division is bound to accept the results of an examination conducted by the Internal Revenue Service.

FINDINGS OF FACT

1. Petitioner herein, Peter A. Bakal, together with his wife, Margaret M. Bakal¹, timely filed separate New York State income tax resident returns for the years 1976 and 1977 on combined forms IT-208. For each of the years at issue, petitioner claimed a loss generated from the rental of a house located in Key Biscayne, Florida. The claimed rental loss in 1976 totaled \$6,138.47, while the claimed loss in 1977 amounted to \$13,250.00.

2. On October 4, 1979, the Audit Division issued a Notice of Deficiency to petitioner for the years 1976 and 1977, asserting that an additional \$2,806.57 of personal income tax was due, together with interest of \$440.94, for a total due of \$3,247.51. The aforementioned Notice of Deficiency was premised on a Statement of Audit Changes dated May 15, 1979, wherein losses claimed for 1976 and 1977 on rental property located in Key Biscayne, Florida were disallowed. The losses were disallowed pursuant to section 280A of the Internal Revenue Code and, for the year 1977, the loss was also disallowed as being a non-business loss pursuant to sections 162 and 212 of the Internal Revenue Code.

3. On November 1, 1974, petitioner purchased a residence located at 520 S. Mashta Drive, Key Biscayne, Florida (hereinafter "Florida dwelling") for approximately \$210,000.00. Title to said property was held in Peter A.

¹ Margaret M. Bakal's name appears on the petition for redetermination and on a majority of the papers submitted by both parties. The statutory Notice of Deficiency was issued to "Bakal, Peter A. & M.". The tax asserted due in the Notice of Deficiency was based on the disallowance of losses which were claimed entirely by Peter A. Bakal on his separate returns. Since separate returns were filed and the adjustments in question pertain solely to Peter A. Bakal, Margaret M. Bakal is considered to be neither a petitioner nor a party to this proceeding.

Bakal's name only. Immediately after its purchase, petitioner placed the Florida dwelling with The Keyes Co., a rental agency and realtor located in Key Biscayne, Florida. From 1974 through 1977 the Florida dwelling was continuously listed for rent and rented through The Keyes Co. The Florida dwelling was extensively advertised by petitioner in professional journals and in real estate publications by The Keyes Co.

4. On November 9, 1976, petitioner transferred the Florida dwelling to the Peter A. Bakal Trust dated September 21, 1976 (hereinafter "the trust"). The rental loss claimed for the year 1976 on the Florida dwelling represented the income earned and expenses incurred on said property from January 1, 1976 to November 8, 1976. Gross rents received totaled \$11,750.00, while claimed expenses totaled \$17,888.47.

5. During the year 1976 petitioner and his spouse personally used the Florida dwelling for a total of 15 days, while it was rented to others for a total of 82 days. Petitioner asserted that one-half of the 15 days spent at the Florida dwelling in 1976 were spent there making repairs to the property. It was argued that the days spent at the Florida dwelling making repairs should not be considered as days of personal use for the purposes of section 280A(d) of the Internal Revenue Code. No documentary or other credible evidence was adduced at the hearing to support the number of days actually spent working at the Florida dwelling or the number of hours actually spent each day making repairs or renovations.

6. The Peter A. Bakal Trust dated September 21, 1976 was an irrevocable inter vivos trust. Petitioner Peter A. Bakal, as settlor, retained no reversionary interest in the trust. The entire net income from the trust was payable to or for the benefit of petitioner's spouse. Petitioner's certified

public accountant, Mr. Alfred Moskowitz, was appointed trustee. The trust agreement granted the trustee broad powers, with the exception of Article III, which provided that the trustee could not sell any real property owned by the trust estate without written consent from petitioner.

7. On November 9, 1976, petitioner sold and conveyed the Florida dwelling to the trust for approximately \$225,000.00. Of the total purchase price, \$3,004.00 was paid in cash, an existing mortgage of \$68,995.19 was assumed by the trust and the balance, to wit \$153,000.00, was secured by a mortgage provided by petitioner. Petitioner elected to report the gain realized on the sale of the Florida dwelling on the installment basis.

8. Concurrent with the sale of the Florida dwelling to the trust, petitioner and his wife entered into a "Residence Lease"² with the trust whereby they leased the Florida dwelling for a term of one year beginning on November 9, 1976. The lease provided for an option to renew and the agreed monthly rental was set at \$2,000.00. The lease was signed by petitioner and his wife, however, the trustee did not sign the lease on behalf of the trust.

9. After entering into the residence lease with the trust for the rental of the Florida residence, petitioner sublet said residence on a weekly, bi-weekly or monthly basis. He continued to utilize the services of The Keyes Co. rental agency and to hold the property for rental purposes in the same manner as before the property was sold to the trust.

² The residence lease identified the landlord as the Peter A. Bakal Trust Dated July 21, 1976. It is presumed that the creation date of July 21, 1976 represents a typographical error as the trust instrument was actually executed on September 21, 1976.

10. For the year 1977 petitioner rented the Florida dwelling to others for 90 days and personally used the dwelling for 7 days. The Florida dwelling, in 1977, generated gross rental income of \$6,750.00 and, after deducting a claimed \$20,000.00 sublet expense, a net loss of \$13,250.00 resulted. The \$20,000.00 sublet expense represented the monthly rental payments made to the trust pursuant to the residence lease dated November 9, 1976. The following chart represents a breakdown of the actual rental payments made by petitioner to the trust.

| <u>DATE</u> | <u>AMOUNT</u> |
|-------------|-----------------|
| 1/18/77 | \$ 2,000.00 |
| 2/7/77 | 2,000.00 |
| 3/6/77 | 2,000.00 |
| 3/31/77 | 2,000.00 |
| 5/2/77 | 2,000.00 |
| 6/9/77 | 2,000.00 |
| 11/4/77 | 2,000.00 |
| 11/25/77 | <u>6,000.00</u> |
| TOTAL | \$20,000.00 |

11. At the hearing held herein, petitioner testified that during the peak rental months, January through April, he could get up to \$3,000.00 rent per month for the Florida dwelling and that during the summer months the rent would go as low as \$800.00 per month. Petitioner further testified that as of the date of the hearing, January 19, 1982, the Florida dwelling, for property tax purposes, had an assessed valuation of \$580,000.00 and that said dwelling had a market value of between \$800,000.00 and \$900,000.00.

12. Petitioner's 1977 U.S. Individual Income Tax Return was audited by the Internal Revenue Service. As the result of said examination, rental income was increased by \$1,140.00. For the year 1977 petitioner's schedule of income from rents indicated that a total of seven (7) rental properties were maintained. The record does not disclose which of the seven (7) properties the \$1,140.00

increase in rental income was applicable to. Petitioner maintains that the Internal Revenue Service examined the propriety of the rental loss claimed on the Florida dwelling for 1977 and that said loss was accepted without adjustment. Petitioner argued that the concept of Federal conformity was applicable in this matter and since the Internal Revenue Service accepted the rental loss on the Florida dwelling, that the Audit Division should do likewise.

CONCLUSIONS OF LAW

A. That for the year 1976 petitioner's personal use of the Florida dwelling exceeded the greater of 14 days or 10 percent of the number of days said dwelling was rented at a fair market value. Accordingly, petitioner is considered to have used the Florida dwelling as a residence within the meaning and intent of section 280A(d) of the Internal Revenue Code. That petitioner has failed to sustain the burden of proof under section 689(e) of the Tax Law to show that one-half of the 15 days of personal use of the Florida dwelling in 1976 were spent there engaged in repairs and maintenance on a substantially full time basis.

B. That section 280A(c)(5) of the Internal Revenue Code limits the amount of a deduction allowable on a rental dwelling used by the taxpayer as a residence to an amount not in excess of the gross income realized from the rental property. That the Audit Division has properly limited the deductions allowable on the Florida dwelling to the amount of total rental income realized from said dwelling. That the claimed rental loss for 1976 of \$6,138.47 has been properly disallowed.

C. That section 697(b) of the Tax Law provides:

"The tax commission for the purpose of ascertaining the correctness of any return, or for the purpose of making an estimate of taxable income of any person, shall have power to examine or to cause to have examined, by any agent or representative designated by it for that

purpose, any books, papers, records or memoranda bearing upon the matters required to be included in the return, and may require the attendance of the person rendering the return or any officer or employee of such person, or the attendance of any other person having knowledge in the premises, and may take testimony and require proof material for its information, with power to administer oaths to such person or persons."

D. That pursuant to 20 NYCRR 153.4 the Tax Commission is not required to accept as correct any Federal change in taxable income but may conduct an independent audit or investigation. Additionally, it has not been shown that the change made to rental income for 1977 by the Internal Revenue Service was applicable to the Florida dwelling or that the Internal Revenue Service examined the propriety of the loss claimed on said dwelling.

E. That for the year 1977 petitioner's personal use of the Florida dwelling did not exceed the greater of 14 days or 10% of the number of days said dwelling was rented at a fair market value. Accordingly, the Florida dwelling is not considered to have been used by petitioner as a residence for the year 1977 and rental expenses for said year cannot be limited to the amount of rental income using the provisions of section 280A of the Internal Revenue Code.

F. That the rental loss claimed for the year 1977 on the Florida dwelling has been properly disallowed as an activity not constituting a trade or business (I.R.C. §162) and an activity not engaged in for profit (I.R.C. §183 and Treasury Regulation §1.183-1(d) and §1.183-2). That on November 9, 1976, petitioner entered into the residence lease with the trust whereby the Florida dwelling was leased for a period of one year at a monthly rental of \$2,000.00. In 1976 petitioner realized gross rental income of \$11,750.00 and in 1977 gross rental income totaled \$6,750.00. Petitioner's own testimony revealed that for the four (4) prime months of the year the Florida dwelling was offered for rent

at a rate of \$3,000.00 per month and that thereafter the monthly rental would go as low as \$800.00 per month. Assuming, arguendo, a 100% occupancy rate, petitioner's gross rental income could not possibly have exceeded the total yearly lease payments of \$24,000.00. Also, it cannot be said that petitioner entered into the residence lease with a profit motive. It strains all credibility and reason to hold that a profit motive existed where a taxpayer entered into a lease providing for \$24,000.00 in lease payments where in the previous year the rental property had produced gross rental income of only \$11,750.00.

G. That the sale and contemporaneous leaseback of the Florida dwelling cannot be recognized for tax purposes. (See: Mathews et al. v. Comm., 520 F. 2d 323, Cert. denied 424 U.S. 967; Van Zandt v. Comm., 341 F. 2d 440, Cert. denied 382 U.S. 814; Furman v. Comm., 45 T.C. 360, aff'd 381 F. 2d 22; Wiles v. Comm., 59 T.C. 289, aff'd 74-1 U.S.T.C. §9379). That said transaction is not recognized for the following reasons:

- 1) That the record does not disclose any legitimate business purpose for the sale and leaseback of the Florida dwelling and the transaction as a whole lacks economic reality.

- 2) That the \$2,000.00 per month rental provided for in the residence lease was not reasonable.

- 3) That no payment of rent was made by petitioner to the trust for the months of November, 1976 and December 1976. Additionally, the rent was in arrears for four months from July, 1977 through October, 1977. That the residence lease dated November 9, 1976 was not executed by the trustee on behalf of the trust and the trust instrument prohibited the trustee from selling any real property owned by the trust.


All of the above raise serious questions as to the true independence of the trustee.

H. That the petition of Peter A. Bakal is denied and the Notice of Deficiency dated October 4, 1979 is sustained, together with such additional interest as may be lawfully due and owing.

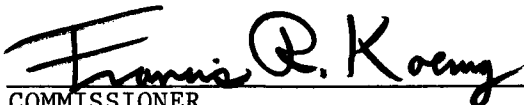
DATED, Albany, New York

STATE TAX COMMISSION


MAY 06 1983



PRESIDENT



COMMISSIONER



COMMISSIONER