

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petition :  
of :  
B. Gerald & Iris Peck Cantor :  
for Redetermination of a Deficiency or for Refund :  
of Personal Income Tax under Articles 22 and 30 of :  
the Tax Law and Chapter 46, Title T of the :  
Administrative Code of the City of New York for :  
the Years 1976, 1977 and 1978. :

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AFFIDAVIT OF MAILING

State of New York }  
County of Albany } ss.:

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 9th day of November, 1984, he served the within notice of Decision by certified mail upon B. Gerald & Iris Peck Cantor, the petitioners in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

B. Gerald & Iris Peck Cantor  
9910 Tower Lane  
Beverly Hills, CA 90210

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office 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  
9th day of November, 1984.

David Parchuck

James A. McManus  
Authorized to administer oaths  
pursuant to Tax Law section 174

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :  
of  
B. Gerald & Iris Peck Cantor :

AFFIDAVIT OF MAILING

for Redetermination of a Deficiency or for Refund :  
of Personal Income Tax under Articles 22 and 30 of  
the Tax Law and Chapter 46, Title T of the :  
Administrative Code of the City of New York for  
the Years 1976, 1977 and 1978. :

State of New York }  
ss.:  
County of Albany }

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 9th day of November, 1984, he served the within notice of Decision by certified mail upon Laurence Keiser, the representative of the petitioners in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Laurence Keiser  
Hanigsberg, Stern & Keiser, P.C.  
99 Park Ave.  
New York, NY 10016

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office 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  
9th day of November, 1984.

David Parchuck

[Signature]  
Authorized to administer oaths  
pursuant to Tax Law section 174

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

November 9, 1984

B. Gerald & Iris Peck Cantor  
9910 Tower Lane  
Beverly Hills, CA 90210

Dear Mr. & Mrs. Cantor:

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 & 1312 of the Tax Law and Chapter 46, Title T of the Administrative Code of the City of New York, a proceeding in court to review an adverse decision by the State Tax Commission may be instituted only under Article 78 of the Civil Practice Law 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  
Building #9, State Campus  
Albany, New York 12227  
Phone # (518) 457-2070

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative  
Laurence Keiser  
Hanigsberg, Stern & Keiser, P.C.  
99 Park Ave.  
New York, NY 10016  
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

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| In the Matter of the Petition                  | : |          |
|  | : |          |
| of   | : |          |
|  | : |          |
| B. GERALD AND IRIS PECK CANTOR                 | : | DECISION |
|  | : |          |
| for Redetermination of a Deficiency or for     | : |          |
| Refund of Personal Income Tax under Articles   | : |          |
| 22 and 30 of the Tax Law and Chapter 46, Title | : |          |
| T of the Administrative Code of the City of    | : |          |
| New York for the Years 1976, 1977 and 1978.    | : |          |

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Petitioners, B. Gerald and Iris Peck Cantor, 9910 Tower Lane, Beverly Hills, California 90210, filed petitions for redetermination of deficiencies or for refund of personal income tax under Articles 22 and 30 of the Tax Law and Chapter 46, Title T of the Administrative Code of the City of New York for the years 1976, 1977 and 1978 (File Nos. 29983, 34273 and 34274).

A formal hearing was held before Doris E. Steinhardt, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on March 21, 1984 at 1:15 P.M., with all briefs to be submitted by June 27, 1984. Petitioners appeared by Hanigsberg, Stern & Keiser, P.C. (Laurence Keiser, CPA and David Stern, CPA). The Audit Division appeared by John P. Dugan, Esq. (Lawrence A. Newman, Esq., of counsel).

#### ISSUE

Whether in computing the New York State and City minimum taxable income for each year under consideration, petitioners properly modified the federal item of tax preference for adjusted itemized deductions: (a) by eliminating from itemized deductions New York State and City personal income taxes paid; (b) by eliminating from itemized deductions the interest expense attributable

to United States obligations; and (c) by netting investment interest expense on repurchase agreement transactions against the related interest income.

FINDINGS OF FACT

1. On her 1976 federal income tax return filed as a single individual, petitioner Iris Peck (Cantor) reported \$153,359.00 of interest income on repurchase agreement transactions (described infra), of which \$85,807.00 was earned from obligations of the United States, and \$114,392.00 of interest expense attributable to repurchase agreement transactions, of which \$70,591.00 was attributable to carrying the aforementioned obligations of the United States. She also claimed a deduction for New York State and City personal income taxes of \$1,467.00.

On their 1977 joint federal income tax return, petitioners, B. Gerald and Iris Cantor, reported \$1,047,715.00 of interest income on obligations of the United States, including \$506,815.00 on repurchase agreement transactions, and \$1,264,901.00 of interest expense attributable to carrying such obligations, including \$392,909.00 of interest expense attributable to repurchase agreement transactions. They also claimed a deduction for New York State and City personal income taxes of \$188,810.00.

On their 1978 joint federal income tax return, petitioners reported \$383,573.00 of interest income on obligations of the United States and \$425,520.00 of interest expense attributable to carrying such obligations. They also claimed a deduction for New York State and City personal income taxes of \$225,970.00.

In the course of computing the New York State and City minimum taxable income for each year under consideration, petitioner(s) modified the federal item of tax preference for adjusted itemized deductions as follows: (a) itemized

deductions were reduced by New York State and City personal income taxes; (b) income on United States obligations was excluded from adjusted gross income, and the interest expense attributable to such obligations was eliminated from itemized deductions; and (c) investment interest expense on repurchase agreement transactions was netted against the related interest income (as was done for federal income tax purposes).

2. On January 25, 1980, the Audit Division issued to petitioner Iris Cantor a Notice of Deficiency, asserting New York State personal income tax due under Article 22 of the Tax Law and New York City personal income tax due under Article 30 for the year 1976 in the respective amounts of \$5,212.42 and \$1,837.94, plus interest.

On April 1, 1981, the Audit Division issued to petitioner B. Gerald Cantor a Notice of Deficiency, asserting New York State personal income tax due under Tax Law Article 22 and New York City personal income tax due under Chapter 46, Title T of the Administrative Code of the City of New York for the year 1977 in the respective amounts of \$114,553.34 and \$41,376.69, plus interest.

On June 8, 1981, the Audit Division issued to petitioner B. Gerald Cantor a Notice of Deficiency, asserting New York State personal income tax due under Tax Law Article 22 and New York City personal income tax due under Administrative Code Chapter 46, Title T for the year 1978 in the respective amounts of \$31,137.00 and \$11,839.00, plus interest.

Each deficiency was premised upon the Audit Division's recomputation of the item of tax preference for adjusted itemized deductions, for purposes of the minimum income tax, to include as itemized deductions: (a) New York State and City personal income taxes; (b) interest expense attributable to carrying obligations of the United States; and (c) investment interest expense on repurchase agreement transactions.

3. During the years in issue, petitioners entered into repurchase agreement transactions, using United States Treasury securities and other interest-bearing debt securities such as large denomination negotiable certificates of deposit. A typical transaction involved the purchase of several million dollars of principal amount of debt securities. As much as 99 percent of the purchase price was financed by borrowings in the short-term funds markets. The cost of these funds, at the time of purchase of the securities, was perhaps  $\frac{1}{2}$  percent lower than the yield on the securities themselves, thus creating an "arbitrage situation" out of the differential between interest earned and interest paid. The yield on the securities was fixed, but the cost of the borrowed funds fluctuated daily (and sometimes, hourly). Thus, when interest rates rose generally, the "arbitrage" disappeared and became, perhaps, a situation in which an out-of-pocket loss would be incurred unless the transaction was swiftly terminated. Conversely, if interest rates fell, the "arbitrage" increased, thereby creating returns to the investor that were significant in relation to the amount of money invested, but were quite small in relation to the gross amounts of interest income and expense that were generated by the transaction.

4. Petitioners pose an example to illustrate the propriety of netting interest income against interest expense in repurchase agreement transactions. They assumed a taxpayer realized \$1,000,000.00 of interest income and short-term gains and incurred \$950,000.00 of interest expense. At the rates applicable to single individuals, and without netting, the taxpayer's federal income tax would amount to \$18,000.00 and his minimum tax \$51,000.00.

|                                     |                  |
|-------------------------------------|------------------|
| Itemized deductions                 | \$950,000        |
| 60 percent of adjusted gross income | 600,000          |
| Tax preference                      | <u>\$350,000</u> |
| $\frac{1}{2}$ of specific deduction | <u>(10,000)</u>  |
|                                     | \$340,000        |
| Tax rate                            | .15              |
| Minimum Tax                         | <u>\$ 51,000</u> |

Further, his New York State personal income tax would total \$6,000.00 and his New York State minimum income tax \$20,000.00. Further, in the event interest rates increased so that no economic profit was realized on the transaction, the taxpayer would nonetheless incur a federal minimum income tax of \$60,000.00 and a New York minimum tax of \$24,000.00.

CONCLUSION OF LAW

A. That Tax Law section 622, as in force during the years at issue, provided, in part, as follows:

"New York minimum taxable income of resident individual. --  
(a) The New York minimum taxable income of a resident individual shall be the sum of the items of tax preference, as described in subsection (b) of this section...

\* \* \*

(b) For purposes of this article, 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, ...for the taxable year...".

New York City Administrative Code section T46-122.0 contained essentially the same provision, with respect to the New York City minimum taxable income of a New York City resident individual.

B. That for the years 1976 through 1978, the federal items of tax preference included adjusted itemized deductions, which were computed using a percentage of certain deductions such as the deduction for interest. During the years in issue, the federal deduction for state and local income taxes was included in adjusted itemized deductions and thereby considered in the calculation of the federal items of tax preference.

During the years at issue, the Tax Law and the New York City Administrative Code did not contain a provision which allowed a portion of New York State or New York City income taxes to be deducted from federal items of tax preference



in arriving at New York State and New York City items of tax preference.<sup>1</sup>

Furthermore, there was no authority in the Tax Law or the New York City Administrative Code which permitted the use of New York adjusted gross income in determining adjusted itemized deductions subject to New York State or New York City minimum income tax.

Consequently, for 1976, 1977 and 1978, "the deductions for State and local income taxes were meant to be included in the calculation of State items of tax preference" notwithstanding that such inclusion "is not fair or equitable in light of the fact that petitioners received no benefit on their State returns for these deductions". (Matter of Marx v. State Tax Comm., 478 N.Y.S.2d 133 [3d Dept., 1984]).

C. That since the New York items of tax preference are defined as the federal items of tax preference, and since there exists no Tax Law or Administrative Code provision allowing interest expense attributable to United States obligations to be deducted from federal items of tax preference in arriving at New York State and New York City items of tax preference, petitioners improperly modified itemized deductions to eliminate such interest therefrom.

D. That petitioners have pointed to no authority, nor is this Commission aware of any authority, which would support the reduction of the amount of their investment interest expense incurred by the amount of investment interest income generated in repurchase agreement transactions, for purposes of calculating the tax preference item for adjusted itemized deductions. (Cf. Internal

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<sup>1</sup> Tax Law section 622(b)(5) and New York City Administrative Code section T46-122.0(5), which provide for the reduction of adjusted itemized deductions by a portion of income taxes includible therein, were added by Chapter 669 of the Laws of 1980. These amendments were effective June 30, 1980 and applicable to taxable years beginning after December 31, 1979.


Revenue Code section 1222, a definitional section which expressly allows, inter alia, the netting of the net short-term capital loss against the net long-term capital gain for the taxable year.) Their argument that investment interest expense should not be subject to the limitation on deductibility imposed by Code section 163(d), as well as comprise in part the item of tax preference for adjusted itemized deductions, is unpersuasive; for taxable years 1971 through 1975, investment interest was subject to the Code section 163(d) ceiling, and in addition, excess investment interest itself constituted an item of tax preference (Code section 57[a][1] as in effect during said years).<sup>2</sup>


E. That the petitions of B. Gerald and Iris Cantor are denied, and the Notices of Deficiency are sustained.

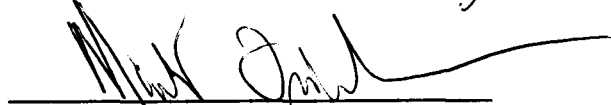
DATED: Albany, New York

STATE TAX COMMISSION

NOV 09 1984

  
PRESIDENT

  
COMMISSIONER

  
COMMISSIONER

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<sup>2</sup> It should be noted that any amount of investment interest disallowed as a deduction for a particular taxable year is permitted to be carried forward to the succeeding taxable year, again subject to the limitation. Code section 163(d)(2).