

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
Malcom P. & Margaret S. McLean : AFFIDAVIT OF MAILING
:
for Redetermination of a Deficiency or for :
Refund of New York State Personal Income Tax :
under Article 22 of the Tax Law and New York :
City Personal Income Tax under Chapter 46, :
Title T of the Administrative Code of the :
City of New York for the Year 1980. :
_____:

State of New York :

ss.:

County of Albany :

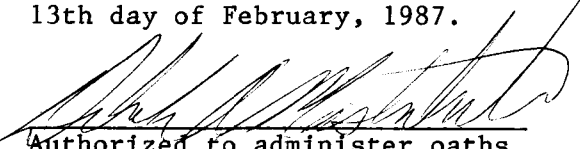
David Parchuck/Janet M. Snay, being duly sworn, deposes and says that he/she is an employee of the State Tax Commission, that he/she is over 18 years of age, and that on the 13th day of February, 1987, he/she served the within notice of Revised Decision by certified mail upon Malcom P. & Margaret S. McLean the petitioners in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Malcom P. & Margaret S. McLean
660 Madison Ave.
New York, NY 10021

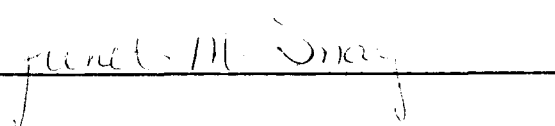
and by depositing same enclosed in a postpaid properly addressed wrapper in a post office under the exclusive care and custody of the United States Postal Service within the State of New York.

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
13th day of February, 1987.



Authorized to administer oaths
pursuant to Tax Law section 174



Janet M. Snay

STATE OF NEW YORK

STATE TAX COMMISSION

| | | |
|--|---|----------------------|
| In the Matter of the Petition | : | |
| of | : | |
| Malcom P. & Margaret S. McLean | : | AFFIDAVIT OF MAILING |
| for Redetermination of a Deficiency or for | : | |
| Refund of New York State Personal Income Tax | : | |
| under Article 22 of the Tax Law and New York | : | |
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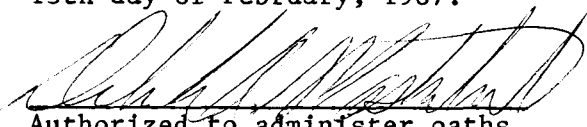
David Parchuck/Janet M. Snay, being duly sworn, deposes and says that he/she is an employee of the State Tax Commission, that he/she is over 18 years of age, and that on the 13th day of February, 1987, he served the within notice of Revised Decision by certified mail upon Henry T. Benedetto, the representative of the petitioners in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

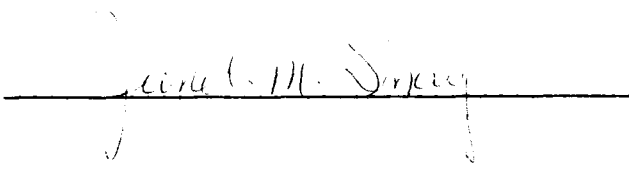
Henry T. Benedetto
Meyner and Landis
Gateway One, Suite 2500
Newark, NJ 07102

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
13th day of February, 1987.


Authorized to administer oaths
pursuant to Tax Law section 174



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

February 13, 1987

Malcom P. & Margaret S. McLean
660 Madison Ave.
New York, NY 10021

Dear Mr. & Mrs. McLean:

Please take notice of the Revised 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
Audit Evaluation Bureau
Assessment Review Unit
Building #9, State Campus
Albany, New York 12227
Phone # (518) 457-2086

Very truly yours,

STATE TAX COMMISSION

cc: Taxing Bureau's Representative

Petitioner's Representative:
Henry T. Benedetto
Meyner and Landis
Gateway One, Suite 2500
Newark, NJ 07102

STATE OF NEW YORK

STATE TAX COMMISSION

| | | |
|--|---|----------|
| In the Matter of the Petition | : | |
| of | : | |
| MALCOM P. McLEAN AND MARGARET S. McLEAN | : | REVISED |
| | : | DECISION |
| for Redetermination of a Deficiency or for | : | |
| Refund of New York State Personal Income Tax | : | |
| under Article 22 of the Tax Law and New York | : | |
| City Personal Income Tax under Chapter 46, | : | |
| Title T of the Administrative Code of the City | : | |
| of New York for the Year 1980. | : | |

Petitioners, Malcom P. McLean and Margaret S. McLean, 660 Madison Avenue, Suite 601, New York, New York 10021, filed a petition for redetermination of a deficiency or for refund of New York State personal income tax under Article 22 of the Tax Law and New York City personal income tax under Chapter 46, Title T of the Administrative Code of the City of New York for the year 1980 (File No. 51017).

A hearing was held before Daniel J. Ranalli, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on January 30, 1986 at 9:45 A.M., with all briefs to be submitted by April 20, 1986. Petitioners appeared by Meyner & Landis, Esqs. (Henry T. Benedetto, Esq. of counsel). The Audit Division appeared by John P. Dugan, Esq. (Lawrence A. Newman, Esq., of counsel).

ISSUE

Whether the Tax Benefit Rule, as provided under section 58(h) of the Internal Revenue Code, is applicable for New York State and City purposes.

FINDINGS OF FACT

1. On September 21, 1981, Malcom P. McLean and his wife, Margaret S. McLean, late filed a joint New York State Income Tax Resident Return (with City of New York Personal Income Tax) for the year 1980. On such return, petitioners showed no New York State or City personal income tax liability, based primarily on a claimed net operating loss carryforward of \$11,961,766.16. However, New York State and City minimum income taxes were computed and paid on the following reported items of tax preference:

| | <u>Amount</u> |
|---|------------------------|
| Accelerated depreciation on real property | \$ 590,625.00 |
| Capital gain deduction | <u>\$13,544,930.00</u> |
| Total federal items of tax preference | \$14,135,555.00 |
| New York addition - section 622(a)(3) | |
| restoration of net operating loss deduction | <u>\$ 3,265,241.00</u> |
| Balance | <u>\$17,400,796.00</u> |
| Less: 20% capital gain deduction | <u>\$ 2,708,986.00</u> |
| Total New York items of tax preference | <u>\$14,691,810.00</u> |

2. On their return, petitioners claimed a basis adjustment of \$2,025,000.00 with respect to stock sold in 1980.

3. On November 7, 1983, the Audit Division issued a Statement of Audit Changes to petitioners wherein their New York State and City minimum income taxes were recomputed based on the following explanation:

"In regards to the basis adjustment of \$2,025,000.00 deducted from your Federal capital gain in arriving at your New York capital gain please be advised of the following:

The subtraction modification permitted under Section 612(c)(4) applies to the disposition of property where the rules for computation of the basis under Article 16 are different from the federal rules. If the computation of the basis under Article 16 results in a higher basis than the basis for Federal income tax purposes and the property was owned by the taxpayer at the end of the last year taxable under Article 16 is not determined as being the fair market value as of December 31, 1959. The basis determined as starting with the date of acquisition of the property. [sic]

There is no deduction that basis computed under Article 16 of stock sold in 1980 would be any different than the basis for federal income tax purposes." [sic]

4. Based on the above statement, a Notice of Deficiency was issued against petitioners on January 5, 1984, asserting additional New York State and City minimum income taxes of \$216,896.14, plus interest of \$70,845.07, for a total due of \$287,741.21.

5. On April 3, 1984, petitioners filed a petition wherein, in addition to contesting the disallowance of the section 612(c)(4) modification, they further claimed that:

"In arriving at petitioners' 1980 minimum taxable income \$3,265,241 was included as the New York State Addition for Restoration of Net Operating Loss Deductions (Section 622(a)(3) of Article 22). However, the full net operating loss carryover reflected in the 1980 return was not utilized to reduce 1980 taxable income. Therefore to the extent the net operating loss was not 'restored' it should not increase 1980 minimum taxable income."

Relief sought, according to said petition, was as follows:

"a. Redetermination and full abatement of the \$216,896.14 deficiency...

b. Refund in the amount of \$118,829..."

6. At the hearing, petitioners filed an Amended Petition. Redetermination was claimed therein on the amended ground that:

"-- to the extent the net operating loss carryover was not utilized (a) the net operating deduction for minimum tax purposes was not 'restored' and (b) 1980 minimum taxable income should not include items of tax preference to the extent that no tax benefit was derived in 1980 by petitioners for such items of tax preference."

Relief sought, according to the Amended Petition, was as follows:

"a. Redetermination and full abatement of the \$216,896.14 deficiency...

b. Refund in the amount of \$272,178..."

7. During the hearing, petitioners conceded the issue with respect to the basis adjustment. However, petitioners maintained that they are properly due a refund because the New York return as filed incorrectly included in minimum taxable income \$3,265,241.00 of prior years' tax preference items for which no tax benefit was derived and such return also failed to exclude \$1,516,569.00 of 1980 tax preference items which did not reduce the petitioners' 1980 taxable income. Petitioners argued that application of the "tax benefit rule" results in their being entitled to a net refund in the amount of \$189,558.00 rather than being liable for the deficiency of \$216,896.14.

8. Petitioners' 1980 federal taxable income before application of the \$11,961,766.00 net operating loss from prior years was \$7,179,956.00; therefore, \$4,781,810.00 of the net operating loss carried to 1980 was not used to reduce 1980 federal taxable income. By operation of Internal Revenue Code section 172(d)(2)(B), the \$4,781,810.00 unused net operating loss could not be carried forward to any subsequent year. Said section required the long-term capital gain deduction for 1980 of \$17,468,919.00 to be added back to 1980 income to determine whether any of the net operating loss for years prior to 1980 could be carried forward from 1980 to subsequent years. Adding back the \$17,468,919.00 capital gain deduction to 1980 income more than offset the \$4,781,810.00 net operating loss remaining to be carried over.

9. In their 1980 New York income tax return as originally filed, petitioners claim that they erroneously "restored" the tax preference items of prior years in the amount of \$3,265,241.00. In the Amended Petition, petitioners omitted this restoration and, in addition, reduced 1980 tax preference items by the difference between \$3,265,241.00 and \$4,781,810.00, or \$1,516,569.00, the

extent to which 1980 tax preference items did not serve to reduce 1980 taxable income.

10. Petitioners contend that section 58(h) of the Internal Revenue Code (the tax benefit rule) is properly applicable to New York State and City minimum income tax. Accordingly, they argued that they are properly due a refund of \$189,558.00, computed as follows:

COMPUTATION OF REFUND

Recalculation of Minimum Tax:

1980 Tax Preference Items:

1. Capital gain deduction

Federal Capital Gain

\$29,114.866

Capital Gain deduction at 60%

\$17,468,919

2. Accelerated depreciation

590,625

Total 1980 Tax Preference Items

18,059,544

Less - Amount of 1980 Tax Preference items for which federal taxable income was not reduced and no tax benefit derived -

Total unused net operating loss carryover to 1980

\$4,781,810

Less - prior year net operating loss deductions included in the unused net operating loss carryover to 1980

\$3,265,241

1980 Tax Preference items for which no tax benefit was derived

1,516,569

1980 Tax Preference items for which tax benefit was derived

16,542,975

Less - 20% of capital gain deduction

3,493,783

13,049,192

Less specific deduction

5,000

Minimum Taxable Income

13,044,192

Minimum Tax at 8.5%

1,108,756

Tax Paid

1,298,314

Refund

\$ 189,558

11. The Audit Division's position is that petitioners properly computed the net operating loss restoration on their original return in accordance with section 622(a)(3) of the Tax Law and that since Internal Revenue Code section 58(h) does not change the meaning of items of tax preference, said section is not applicable for New York State and City purposes.

12. During the hearing, the Audit Division submitted a notice of additional deficiency wherein an additional deficiency of \$5,112.16 was asserted as follows:

"Audit failed to recognize 'adjusted itemized deductions' as an item of tax preference as follows:

| | |
|-----------------------------|---------------------------|
| Itemized Deductions | \$68,804.50 |
| Less Medical Deductions | <u>8,543.80</u> |
| | \$60,260.70 |
| Less 60% AGI | <u>-0-</u> |
| Adjusted Itemized Deduction | \$60,260.70 |
| | |
| New York State Minimum Tax | 3,615.64 |
| New York City Minimum Tax | <u>1,506.52</u> |
| Total Tax | \$ 5,112.16" ¹ |

13. Petitioners did not challenge the addition to items of tax preference of adjusted itemized deductions.

CONCLUSIONS OF LAW

A. That the Audit Division's adjustment disallowing petitioners' claimed adjustment to the basis of stock sold during 1980 is sustained since petitioners have conceded said adjustment by the Audit Division (see Findings of Fact "2", "3" and "7", supra).

B. That section 622 of the Tax Law provides, in pertinent part, that:

1 The Audit Division erroneously calculated the total tax as \$5,112.16 due to an addition error. The correct total should have been \$5,122.16.

"(a) The New York minimum taxable income...shall be the sum of the items of tax preference...reduced (but not below zero) by the aggregate of the following:

* * *

(3) ...the amount of any net operating loss of the taxpayer, as determined for federal income tax purposes, which remains as a net operating loss carryover to a succeeding taxable year. In such case, however, the amount of such net operating loss used to reduce the sum of the items of tax preference shall be treated as an item of tax preference in the next succeeding taxable years, in order of time, in which such net operating loss carryover reduced federal taxable income."

C. That Internal Revenue Code section 58(h) and the regulations promulgated thereunder govern a taxpayer's treatment under the tax benefit rule. Section 58(h) was enacted to eliminate the inequities that resulted for taxpayers who were required to pay a minimum tax on items for which they did not receive a tax benefit.

D. That recently, the New York State Court of Appeals has interpreted the language found within sections 622 and 607 of the Tax Law (and consequently, sections T46-122.0 and T46-107.0 of the Administrative Code of the City of New York) to provide for the application of section 58(h) of the Internal Revenue Code to the New York State (and City) laws except in those instances when section 622(b) (and section T46-122.0[b]) specifically modify the federal rules (see Matter of Hunt v. State Tax Commn., 65 NY2d 13).

E. That although section 622(a)(3) of the Tax Law provides for the "restoration" of \$3,265,241.00 of prior year tax preference items, petitioners received no tax benefit from such prior year tax preference items. Accordingly, section 58(h) of the Internal Revenue Code is applicable and the aforesated amount should not be added to petitioners' 1980 items of tax preference.

F. That, additionally, petitioners may properly exclude \$1,516,569.00 of 1980 tax preference items for which no tax benefit was received.

G. That section 689(e) of the Tax Law and section T46-189.0(e) of the Administrative Code of the City of New York provide that:

"In any case before the tax commission...the burden of proof shall be upon the petitioner except for the following issues, as to which the burden of proof shall be upon the tax commission:

* * *

(3) whether the petitioner is liable for any increase in a deficiency where such increase is asserted initially after a notice of deficiency was mailed and a petition under this section filed..."

H. That the adjusted itemized deductions of \$60,260.70 are properly includible as an item of tax preference during the year at issue. Since said amount was computed from amounts reported by petitioners on their return, the Audit Division has sustained its burden of proof.

I. That petitioners are properly due a refund of New York State and City minimum income tax of \$184,435.00 computed as follows:

| | |
|--------------------------------------|------------------------|
| Minimum Taxable Income as | |
| computed by petitioners (see | |
| Finding of Fact "10", <u>supra</u>) | \$13,044,192.00 |
| Add: Adjusted Itemized Deductions | 60,260.70 |
| Corrected Minimum Taxable Income | <u>\$13,104,452.70</u> |
| Minimum Tax at 8.5% | \$ 1,113,879.00 |
| Tax Paid | <u>1,298,314.00</u> |
| Refund Due | <u>\$ 184,435.00</u> |

J. That the petition of Malcom P. McLean and Margaret S. McLean is granted to the extent provided in Conclusions of Law "E", "F" and "I"; that the Notice of Deficiency issued January 5, 1984 is cancelled and the Audit Division is directed to refund the sum of \$184,435.00, together with such interest as may be lawfully owing.

DATED: Albany, New York

STATE TAX COMMISSION

FEB 13 1987

Roderick A. Allen
PRESIDENT

Francis R. Kolmy
COMMISSIONER

Mark J. Taw
COMMISSIONER