STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
CRAIG A. OLSHEIM	:	DECISION DTA NO. 824218
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Year 2005.	:	

Petitioner, Craig A. Olsheim, filed an exception to the determination of the Administrative Law Judge issued on May 9, 2013. Petitioner appeared by Richards & Richards, P.C. (Gary Richards, CPA). The Division of Taxation appeared by Amanda Hiller (Marvis A. Warren, Esq., of counsel).

Petitioner filed a brief in support of his exception. The Division of Taxation filed a letter brief in lieu of a formal brief in opposition. Petitioner filed a letter brief in lieu of a formal reply brief.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUE

Whether petitioner, a nonresident, may allocate to New York State a capital loss arising from the disposition of a partnership interest in the year 2005.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge, except for findings of

fact 2 and 3, which have been modified to more accurately reflect the record. The Administrative Law Judge's findings of fact and the modified findings of fact are set forth below.

1. Petitioner, Craig A. Olsheim, was a resident of Colorado in the year 2005. He filed a New York State nonresident and part-year resident personal income tax return claiming, among other items, a long-term capital loss in the amount of $234,674.00 from Fifth Avenue Building Associates, LLC (Fifth Avenue).[1] It is the validity of this claimed loss that is at issue in this matter.

2. Petitioner was a limited partner in Fifth Avenue. He inherited his interest in the partnership on January 12, 2004 as a 50% beneficiary of a trust established by his father. Fifth Avenue was a New York partnership with one asset, a New York City building. The record contains no evidence as to the partnership's business or any other activities.

In 2005, the partnership sold the office building, creating an Internal Revenue Code (26 USC) § 1231 gain. Petitioner was allocated his portion of the gain ($234,674.00) through receipt of a Partner's Share of Income, Deductions, Credits, Etc. (Form K-1). Petitioner properly reported the gain from the sale of the office building on his 2005 New York State personal income tax return.

3. On the date petitioner inherited his interest in the partnership, he received a step-up in basis to the fair market value of the partnership interest, referred to as "outside basis" (***see*** 26 USC § 1014 [a] [1]). Petitioner assumed his pro rata share of the partnership's adjusted basis in the office building, referred to as "inside basis," but his basis in the partnership property did not automatically step-up, or equalize, with his interest in the partnership (***see*** 26 USC § 743 [a]).

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[1] Although a limited liability company (LLC), Fifth Avenue was treated as a partnership and its members as partners for purposes of New York State income tax, pursuant to Tax Law § 601 (f). All references to Fifth Avenue and its members herein will be as a "partnership" and its "partners."

Since the partnership did not make a 26 USC § 754 election to equalize petitioner's basis, the value of his outside basis, or partnership interest exceeded his inside basis in the partnership property.

Upon the sale of its only asset, Fifth Avenue completely dissolved. At that time, petitioner's outside basis in the partnership exceeded his inside basis in the New York City office building. The dissolution caused petitioner to realize a loss on his interest in the Fifth Avenue partnership equal to the difference between his outside and inside bases (hereafter, the "Loss"). On his 2005 federal return, petitioner claimed the Loss (***see*** 26 USC § 731 [a] [2]). Similarly, on his 2005 New York nonresident return, petitioner allocated the Loss to New York State, which offset his gain from the sale of the partnership asset.

4. Following an audit of petitioner's 2005 income tax return, the Division of Taxation (Division) sent a letter, dated December 5, 2008, to petitioner's representative explaining its reasons for disallowing the Loss. Referring to Technical Services Bureau (TSB) Memorandum, TSB-M-92-(2)I, the letter stated that:

> "a gain or loss from the sale of an interest in a New York partnership does not constitute gain or loss derived from or connected with New York sources and is not includible in the New York source income. Therefore, the capital loss relating to the disposition of the interest in Fifth Avenue Building Associates cannot be allocated to New York State. Furthermore, the gain relating to the sale of the Fifth Avenue Building Associates' property is considered New York source income and should be allocated to New York State."

5. On April 6, 2009, the Division issued to petitioner a Notice of Deficiency of personal income tax due in the amount of $12,058.00, plus interest.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge noted that the Tax Law imposes tax upon the New York source income of nonresidents. The Administrative Law Judge then explained that distributive

shares of partnership gain are allocable to New York to the extent that such gain is derived from property in this State. As such, the Administrative Law Judge determined that petitioner's share of the gain from Fifth Avenue's sale was properly allocated to New York State.

The Administrative Law Judge also determined that petitioner could not allocate the Loss to New York State. Relying upon TSB-M-92(2)I issued by the Division, as well as cases addressing the sourcing of interest on installment sales and notes, the Administrative Law Judge concluded that petitioner could not deduct the Loss because it was intangible property not used in a trade, business, or profession in New York. Therefore, the Administrative Law Judge determined that the Division properly adjusted petitioner's 2005 nonresident return by disallowing the Loss. Accordingly, the Administrative Law Judge sustained the Notice of Deficiency.

ARGUMENTS ON EXCEPTION

Petitioner takes exception to the determination insofar as the Administrative Law Judge concluded that the Loss could not be allocated to New York. He contends that it is inconsistent to conclude that New York State can assess tax on his share of the gain from the partnership's sale of its New York City building, while, at the same time, disallowing the Loss resulting from the dissolution of the partnership.

Petitioner contends that the Division's citations to TSB-M-92-(2)I and case law are not germane to the instant matter. He notes that the Loss was not due to a sale, but to the termination of the Fifth Avenue partnership. Additionally, citing to the New York State Constitution (NY Const, art XVI, § 3), petitioner argues that if his distributive share from the building's sale may be allocated to this State, then his loss should also be allocable to New York. As such, petitioner

contends that the Administrative Law Judge's determination must be reversed because, as argued, the Division's actions are irrational and inconsistent.

The Division argues that the Administrative Law Judge properly applied the law. The Division submits that petitioner correctly reported the partnership's gain from the sale of the New York City office building on his nonresident New York return. Adopting the rationale in the determination, it cites to the TSB-M-92(2)I and the interest income cases referenced for the proposition that the Loss cannot be attributed to New York because it is intangible property not used in a business carried on in this State. Therefore, the Division submits that it was proper to disallow the Loss from petitioners's interest in Fifth Avenue, and to assess tax on petitioner's gain derived from the sale of the New York City office building.

OPINION

We affirm the determination of the Administrative Law Judge for the reasons stated herein.

Initially, we turn to the sourcing of petitioner's gain from the sale of the partnership asset. New York State imposes income tax upon the New York source income of nonresidents (Tax Law § 601 [e]). New York source income includes gains attributable to real and tangible property located in this State (Tax Law § 631 [b] [1]). Nonresident partners must allocate their distributive share of New York source partnership gain to this State (Tax Law § 631 [a] [1]). Accordingly, petitioner's gain from Fifth Avenue's sale of the office building was properly allocated to New York and subject to personal income tax.

The remaining question is whether the Loss, which petitioner realized due to the dissolution of Fifth Avenue, may be allocated to New York. An interest in a partnership, such as petitioner's interest in Fifth Avenue, constitutes "personal property" (Partnership Law § 52).

"Not only is it personal property but it is intangible" (***Matter of Finkelstein***, 40 Misc2d 910, 914 [1963], ***citing Blodgett v Silberman***, 277 US 1 [1928]). Gains and losses from such intangible property are allocable to New York only to the extent that the intangible property itself is employed in a "business, trade, profession or occupation carried on in this state" (Tax Law § 631 [b] [2]; ***see*** 20 NYCRR 132.5 [a]).

Accordingly, petitioner may only allocate the Loss to this State upon proving that the partnership conducted business in New York. For tax purposes, an enterprise carries on a business in New York when "there is a reasonably systematic and continuous transactional nexus between this State and the enterprise" (***Matter of Ausbrooks v Chu***, 66 NY2d 281, 287 [1985]). The connection between the intangible and the state must be more than mere "investment and receipt of income" (***id.***). Indeed, the Division's regulation provides the following:

> "A taxpayer may enter into transaction for profit within New York State and yet not be engaged in a trade or business within New York State. If a taxpayer pursues an undertaking continuously as one relying on the profit therefrom for such taxpayer's income or part thereof, such taxpayer is carrying on a business or occupation" (20 NYCRR 132.4 [a] [2]).

Herein, the record shows that Fifth Avenue had a single connection to New York: its ownership of a New York City office building. There is no evidence in the record regarding the partnership's use of the property (e.g., whether it actively managed, or otherwise utilized the building). The only New York transaction in evidence is Fifth Avenue's sale of the office building, which terminated its connection to this State. Absent proof of continuous transactions regarding the property, the partnership's ownership and sale of its New York City office building constitute mere "investment and receipt of income" (***id.***; Tax Law § 631 [b] [2]). Having submitted no evidence regarding business carried on in New York, petitioner failed to overcome the statutory presumption that the Notice is correct (Tax Law § 689 [e]).

Petitioner's arguments fail to persuade us of an alternative outcome. Initially, we find that the Administrative Law Judge afforded undue deference to TSB-M-92(2)I (***see*** 20 NYCRR 2375.6 [c]; ***Matter of Friesch-Groningsche Hypotheebank***, Tax Appeals Tribunal, December 28, 1990, ***confirmed*** 185 AD2d 466 [1992], ***lv denied*** 80 NY2d 761 [1992]). However, relying upon proper legal authorities, we similarly conclude that the Loss cannot be allocated to New York. Additionally, the manner through which petitioner realized the Loss does not impact this analysis,[2] so much as the intangible nature of the partnership interest. Indeed, petitioner's reliance upon the New York State Constitution does not support his position:

> ". . . [I]ntangible personal property within the state not employed in carrying on any business therein by the owner shall be deemed to be located at the domicile for purposes of taxation . . ." (NY Const, art XVI, § 3).

As discussed above, petitioner's failure to introduce proof that Fifth Avenue conducted business in New York ultimately prevents the Loss from being allocated to this State. Therefore, we conclude that petitioner could not offset his gain from the sale of the partnership asset with his Loss, which was derived from partnership interest.

In reaching this conclusion, we do note that petitioner correctly asserts that current Tax Law § 631 (b) (1) (A) (1) would have permitted petitioner to deduct the capital loss from Fifth

[2] 26 IRC § 731 (a) provides: "Any gain or loss recognized under this subsection shall be considered as gain or loss from the sale or exchange of the partnership interest of the distributee partner." Therefore, it is inconsequential as to whether the loss originated from a sale of the partnership interest or the termination of the partnership.

Avenue.[3] Unfortunately, Tax Law § 631 (b) (1) (A) (1) does not impact our decision in this matter because it became effective in 2009 (***see*** L 2009, ch 57, pt F-1 § 2).

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Craig A. Olsheim is denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petition of Craig A. Olsheim is denied and;

4. The Notice of Deficiency dated April 6, 2009, is sustained.

DATED: Albany, New York
April 10, 2014

/s/ Roberta Moseley Nero
Roberta Moseley Nero
President

/s/ Charles H. Nesbitt
Charles H. Nesbitt
Commissioner

/s/ James H. Tully, Jr.
James H. Tully, Jr.
Commissioner

[3] Tax Law § 631 (b) (1) (A) (1) provides: "For the purposes of this subparagraph, the term 'real property located in this state' includes an interest in a partnership, limited liability corporation, S corporation, or non-publicly traded C corporation with one hundred or fewer shareholders (hereinafter 'entity') that owns real property that is located in New York and has a fair market value that equals or exceeds fifty percent of all the assets of the entity on the date of sale or exchange of the taxpayer's interest in the entity. Only those assets that the entity owned for at least two years before the date of sale or exchange of the taxpayer's interest in the entity are to be used in determining the fair market value of all the assets of the entity on the date of sale or exchange. . . ."