STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
ROMULO MENDOZA	:	DETERMINATION DTA NO. 825355
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Year 2008.	:	

Petitioner, Romulo Mendoza, 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 2008.

On August 19, 2013 and August 27, 2013, respectively, petitioner, appearing pro se, and the Division of Taxation, appearing by Amanda Hiller, Esq. (Michelle M. Helm, Esq., of counsel), waived a hearing and submitted this matter for determination based on documents and briefs to be submitted by December 13, 2013, which date commenced the six-month period for issuance of this determination (Tax Law § 2010[3]). After due consideration of the documents and arguments submitted, Thomas C. Sacca, Administrative Law Judge, renders the following determination.

ISSUE

Whether the Division of Taxation properly disallowed Schedule E rental losses from certain rental properties located in Orlando, Florida, and Elmhurst, New York.

FINDINGS OF FACT

1. Petitioner filed a joint New York State resident income tax return, form IT-201, with his wife, Maria Dolores Mendoza. The supplemental income and loss statement, federal

schedule E, indicates that petitioner owned rental real estate property located at Palisades Avenue, Visa Lakes, Orlando, FL (Orlando vacation property), and 86-35 55th Avenue, Elmhurst, NY 11373 (Queens property). The federal schedule E and New York State resident income tax return indicate total rental losses of $31,981.00. This loss was split between the Orlando vacation property ($11,915.00) and the Queens property ($20,066.00).

2. Pursuant to a deed recorded in the Queens County City Clerk's Office and the Recording and Endorsement Cover Page recorded or filed in the Office of the City Register of the City of New York, petitioner obtained the Queens property on October 30, 2004.

3. Following a review of petitioner's income tax return, the Division of Taxation (Division) issued to petitioner a Statement of Proposed Audit Changes, dated January 24, 2012, which provided, in part, as follows:

> Your 2008 New York State income tax return has been selected for review. Our records indicate you reported a rental real estate loss on federal schedule E, Supplemental Income and Loss.
>
> According to Internal Revenue Service guidelines, all rental real estate activities are considered passive by default. Losses from rental activities are not permitted to offset other non-passive income. However, there are two exceptions that allow rental real estate losses to offset non-passive income.
>
> 1. If you meet all IRS requirements to be considered a real estate professional, rental real estate losses are not limited.
>
> 2. If your modified adjusted gross income (MAGI) is less than $150,000, you are eligible to offset an adjusted amount of your rental real estate loss against other income on your return.
>
> [Y]our modified adjusted gross income is federal adjusted gross income plus tuition and fees deduction (line 17), plus rental and real estate losses. ($121,041.00 + $2,375.00 + $31,981.00 = $155, 397.00)
>
> Since your MAGI for tax year 2008 is greater than $150,000, you must qualify as a real estate professional in order to claim your rental real estate loss as non-passive.

> A review of your 2008 federal Schedule E indicates you did not report any portion of your rental loss on line 43.
>
> Since you did not indicate that you qualify as a real estate professional, you are not eligible to claim the rental loss from line 26 of your federal Schedule E as non-passive and your rental loss is subject to the passive activity loss (PAL) rules. The PAL rules state that losses from passive activities are limited to any passive income and cannot offset non-passive income.
>
> A review of your return indicates that you do not have any passive income. Based on this, your rental real estate loss for the tax year 2008 is disallowed.

4. On March 21, 2012, the Division issued to petitioner a Notice of Deficiency (assessment number L-037221627) for the year 2008 assessing tax due of $2,693.78, plus interest.

CONCLUSIONS OF LAW

A. Petitioner acquired the Queens property on October 30, 2004, as indicated on the deed filed with the Queens County City Clerk's Office. He is therefore subject to the passive activity rules contained in Internal Revenue Code § 469. Under the passive activity rules, losses and expenses attributable to passive activities may only be deductible from income attributable to passive activities.

B. Taxpayers are allowed deductions for certain business and investment expenses under Internal Revenue Code §§ 162 and 212. Section 469(a) of the IRC, however, generally disallows any passive activity loss. A passive activity loss is defined as the excess of the aggregate losses from all passive activities for the taxable year over the aggregate income from all passive activities for that year (***see*** IRC § 469[d][1]). A passive activity is any trade or business in which the taxpayer does not materially participate (IRC § 469[c][1]). For the purposes of section 469 and to the extent provided in regulations, a trade or business includes any activity with respect to

which expenses are allowable as a deduction under section 212 (IRC § 469[c][6][B]). Rental activity is generally treated as a per se passive activity regardless of whether the taxpayer materially participates (IRC § 469[c][2], [4]). Material participation is defined as involvement in the operations of the activity that is regular, continuous, and substantial (IRC § 469[h][1]).

C. An exception to the rule that a rental activity is per se passive is found in IRC § 469(c)(7) , which provides that the rental activities of certain taxpayers in real property trades or businesses are not per se passive activities under section 469(c)(2), but are treated as a trade or business subject to the material participation requirements of section 469(c)(1) (***see*** Treas Reg § 1.4699[e][1]). A taxpayer may qualify as a real estate professional if (1) more than one half of the personal services performed in trades or businesses by the taxpayer during the taxable year are performed in real property trades or businesses in which the taxpayer materially participates and (2) the taxpayer performs more than 750 hours of services during the taxable year in real property trades or businesses in which the taxpayer materially participates (IRC § 469[c][7][B][I], [ii]). In the case of a joint tax return, either spouse may satisfy both requirements (IRC § 469[c][7][B]). As neither petitioner nor his wife have claimed to be real estate professionals, petitioner is not entitled to this exception to the passive activity rule.

D. Despite the limitations imposed by the passive loss rules, individual taxpayers may deduct up to $25,000.00 of passive activity losses attributable to rental real estate activities. However, the $25,000.00 limit is subject to a phase-out when a taxpayer's adjusted gross income exceeds $100,000.00 and is completely phased out at the $150,000.00 adjusted gross income level. Pursuant to IRC § 469(i)(3)(F), petitioner's modified adjusted gross income is computed by adding to federal adjusted income ($121,041.00) claimed passive losses ($31,981.00) and tuition and fee deductions ($2,375.00) to arrive at $155,397.00. As petitioner's modified

adjusted gross income exceeds $150,000.00, petitioner is not entitled to this second exception to the passive activity rule.

E. Pursuant to Internal Revenue Code § 469, the Division properly disallowed petitioner's claimed rental losses attributable to his Queens and Orlando vacation properties, as petitioner does not have any passive income to offset against the passive losses incurred in the tax year 2008.

F. The petition of Romulo Mendoza is denied, and the Notice of Deficiency, dated March 21, 2012, is sustained.

DATED: Albany, New York
March 13, 2014

/s/ Thomas C. Sacca
ADMINISTRATIVE LAW JUDGE