

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition :  
of :  
**MAHMOOD J. KHIMJI** :  
: :  
for Redetermination of a Deficiency or for Refund of :  
Personal Income Tax under Article 22 of the Tax Law :  
for the Years 2006 through 2008. :  
:

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DETERMINATION  
DTA NOS. 825508  
AND 825514

In the Matter of the Petition :  
of :  
**ST. GILES TRUST** :  
: :  
for Redetermination of a Deficiency or for Refund of :  
Personal Income Tax under Article 22 of the Tax Law :  
for the Year 2007. :  
:

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Petitioner Mahmood J. Khimji filed a petition for redetermination of a deficiency or for refund of personal income tax under article 22 of the Tax Law for the years 2006 through 2008.

Petitioner St. Giles Trust 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 2007.

A consolidated hearing was held before Donna M. Gardiner, Administrative Law Judge, in New York, New York, on June 10, 2014 at 11:00 A.M., with all briefs to be submitted by October 23, 2014, which date began the six-month period for the issuance of this determination<sup>1</sup>.

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<sup>1</sup> By letter to the parties dated April 14, 2015, this due date was extended pursuant to Tax Law § 2010 (3).

Petitioners appeared by Roberts & Holland, LLP (Joseph Lipari, Esq. of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (Marvis A. Warren, Esq., of counsel).

***ISSUE***

Whether petitioners are eligible to participate in the New York State Voluntary Disclosure and Compliance Program for the years at issue.

***FINDINGS OF FACT***

The parties entered into a stipulation of facts. In addition, petitioners proposed 51 findings of fact. These proposed findings of fact have been incorporated below except for findings of fact numbered 7-10, which were rejected as irrelevant and 33, 35 - 36 and 38, which were rejected as conclusory in nature.

*Petitioner Mahmood J. Khimji*

1. During the years 2006 - 2008 (tax years), petitioner was a resident of Texas.
2. Petitioner's address on his federal tax returns during the tax years was 545 E. John Carpenter FWY, Suite 1400, Irving TX 75062.
3. Petitioner received a Juris Doctor from Columbia Law School located in New York, New York.
4. Petitioner owned a 49.50% interest in KFP Properties, L.P. (KFP) during the tax years.
5. KFP's mailing address during the tax years was 545 E. John Carpenter FWY, Suite 1400, Irving, TX 75062.
6. KFP owned a 100% interest in Halifax SoHo Owner GP LLC during the years 2005 - 2007. Halifax SoHo Owner GP LLC is a disregarded entity for tax purposes.

7. Halifax SoHo Owner GP LLC owned a 30% interest in GSHI Soho Hotel, LLC (Hotel LLC), the entity that owned the Soho Holiday Inn Hotel for income tax purposes during two of the tax years, 2006 and 2007.

8. HI SoHo Owner, LP was the legal owner of the Soho Holiday Inn Hotel, located at 138 Lafayette Street (Hotel), New York, New York. HI SoHo Owner, LP sold the Hotel on September 9, 2007 for \$125,595,000.00. "HI Soho Owner, LP et al" is listed as the grantor on the real estate transfer file.

9. 100% of the selling price, cost basis and gain were reported on the tax return of Hotel LLC. It reported the following transaction on form IT-204 for the tax year 2007:

Line 96 Net section 1231 gain (attach federal form 4797) .....\$81,695,867.00

Line 126 business allocation percentage.....100.000%

10. As part of Hotel LLC's 2007 IT-204, Hotel LLC issued an IT-204-IP (NYS K-1) to 30% owner Halifax Soho Owner GP, LLC. The entity was a single member limited liability corporation (SMLLC) of KFP in 2007. The mailing address for Halifax Soho Owner GP LLC and KFP is the same: 545 E. John Carpenter FWY, Suite 1400, Irving, TX 75062. KFP reported a capital gain of \$47,228,569.00 on its form 1065 - US Return of Partnership Income for 2007. The federal return was filed timely on September 30, 2008. KFP properties did not file a New York State tax return.

11. Petitioners' advisor, Rickey Whitworth, the tax director of Highgate Hotels, LP, testified that, at such time, he did not believe KFP or petitioners had sufficient nexus to New York that would require the filing of New York State tax returns. For the same reason that KFP did not file a New York State partnership tax return, petitioner did not file timely New York State nonresident personal income tax returns for the years 1999 through 2009.

12. Petitioner is also a shareholder in Highgate Hotels, Inc. During 2006, petitioner owned 66.666% of Highgate Hotels, Inc. Effective April 2007, petitioner owned 100% of Highgate Hotels, Inc.

13. Highgate Hotels, Inc.'s mailing address during all relevant years was 545 E. John Carpenter FWY, Suite 1400, Irving, TX 75062.

14. Highgate Hotels, Inc., is a C corporation for New York State purposes and has timely filed its corporation franchise tax returns. It maintained an office and personnel in New York City.

15. Highgate Hotels, Inc., owned a membership interest in Halifax Soho Management, LLC, which managed the Hotel. During 2006, Highgate Hotels, Inc. owned 100% of Halifax Solo Management, LLC. Effective April 2007, Highgate Hotels, Inc. owned 49.95% of Halifax Soho Management, LLC.

16. Petitioner did not timely file new York State nonresident personal income tax returns for the years 1999 through 2009.

17. GSHI SoHo Hotel, LLC filed a partnership return, IT-204, in April 2008 reporting the sale of the New York City property. The preparer was KPMG LLP, Dallas, Texas. The capital gain reported is \$81,695,867.00. The gain was "passed through" to the partners as follows:

a. Halifax Soho Owner GP LLC (SMLLC) of KFP Properties, LP in the amount of \$47,228,569.00.

b. REP SEIH Realty, LLC in the amount of \$34,467,298.00.

18. On November 29, 2010, Michael Busby, the tax manager of Highgate Hotels, LP, spoke with Rosalie Capeci, a Division of Taxation (Division) Team Leader. On the call, Mr. Busby said that he had information requested by Ms. Capeci on KFP Properties, LLC, but he

asked for assurance that Ms. Capeci was an auditor from New York State and was authorized to request the information.

19. In response to Mr. Busby's request, on November 29, 2010, Ms. Capeci sent a facsimile letter to Mr. Busby with name and contact information on district office letterhead. The letter also requested the names and identification numbers for all entities and individuals with an ownership interest in KFP Properties, LP, and stated that Ms. Capeci had left a voicemail with Mr. Busby requesting the same information. The facsimile included a copy of the schedule K-1 issued by Hotel LLC to KFP at 545 E. John Carpenter FWY, Suite 1400, Irving, Texas.

20. Later on November 29, 2010, Mr. Busby called Ms. Capeci and provided the names of petitioner and St. Giles Trust, the investors in KFP Properties, LP and their ID numbers.

21. On November 29, 2010, Ms. Capeci sent an email to Jeffrey Mason, also of the Division, requesting the creation of a new case number with respect to petitioner.

22. On December 1, 2010, petitioner filed an application to participate in the New York State Voluntary Disclosure and Compliance Program (the Program) for the years 1999 through 2009.

23. Petitioner was not a party to any criminal investigation being conducted by any agency or political subdivision of New York State when he filed an application to participate in the Program.

24. Petitioner's application did not seek to disclose participation in a tax avoidance transaction that is a federal or New York State reportable or listed transaction.

25. The Division prepared a letter dated December 9, 2010, to petitioner stating that he was selected for an audit.

26. The December 9, 2010 letter was faxed to Mr. Busby on December 10, 2010.

27. The December 9, 2010 letter was postmarked December 15, 2010.

28. In a letter dated December 20, 2010, the Division accepted petitioner's application to the Program for the years 1999 through 2005 and the year 2009.

29. The Division rejected petitioner's application to participate in the Program for the years 2006, 2007 and 2008.

30. On December 1, 2011, the Division issued a Notice of Deficiency, ID No. L-036999495, to petitioner for the years 2006, 2007 and 2008. The Notice of Deficiency assessed tax in the amount of \$2,076,485.00, interest in the amount of \$483,239.49, penalties in the amount of \$862,239.45, and credited payments made in the amount of \$2,554,949.00.

31. Nonfiling penalties were imposed under Tax Law § 685(a)(1) and negligence penalties were imposed pursuant to Tax Law § 685(b)(1) and (2).

32. Petitioner made a payment of \$1,990,968.00 of tax and interest on March 3, 2011 and \$563,981.00 of tax and interest on July 22, 2011.

33. On February 24, 2012, petitioner filed a request for conciliation conference disputing the outstanding penalty amount.

34. A conciliation conference was held on August 13, 2012.

35. A conciliation order was issued on December 7, 2012 sustaining the Notice of Deficiency.

36. Petitioner filed a petition in this matter on February 7, 2013.

*Petitioner St. Giles Trust*

37. During the year 2007, petitioner was a Texas trust.

38. Petitioner's address on its federal tax return for the year 2007 was 545 E. John Carpenter FWY, Suite 1400, Irving, TX 75062.

39. Petitioner owned a 49.50% interest in KFP Properties, L.P. (KFP) during the relevant years.

40. KFP's mailing address during the relevant years was 545 E. John Carpenter FWY, Suite 1400, Irving, TX 75062.

41. KFP owned a 100% interest in Halifax SoHo Owner GP LLC during the years 2005 - 2007. Halifax SoHo Owner GP LLC is a disregarded entity for tax purposes.

42. Halifax SoHo Owner GP LLC owned a 30% interest in GSHI Soho Hotel, LLC (Hotel LLC), the entity that owned the Soho Holiday Inn Hotel for income tax purposes during 2007.

43. HI SoHo Owner, LP was the legal owner of the Soho Holiday Inn Hotel, located at 138 Lafayette Street (Hotel), New York, New York. HI SoHo Owner, LP sold the Hotel on September 9, 2007 for \$125,595,000.00. "HI Soho Owner, LP et al" is listed as the grantor on the real estate transfer file.

44. 100% of the selling price, cost basis and gain were reported on the tax return of Hotel LLC. It reported the following transaction on form IT-204 for the tax year 2007:

Line 96 Net section 1231 gain (attach federal form 4797) .....	\$81,695,867.00
Line 126 business allocation percentage.....	100.000%

45. As part of Hotel LLC's 2007 IT-204, Hotel LLC issued an IT-204-IP (NYS K-1) to 30% owner Halifax Soho Owner GP LLC. The entity was a SMLLC of KFP in 2007. The mailing address for Halifax Soho Owner GP LLC and KFP is the same: 545 E. John Carpenter FWY, Suite 1400, Irving, TX 75062. KFP reported a capital gain of \$47,228,569.00 on its form 1065 - US Return of Partnership Income for 2007. The federal return was filed timely on September 30, 2008. KFP properties did not file a New York State tax return.

46. As set forth in finding of fact 11, petitioners' advisor testified that he did not believe there was sufficient nexus to New York such that filing a New York State return was required. For the same reason, petitioner did not timely file New York State nonresident personal income tax returns for the years 1999 through 2009.

47. Petitioner did not timely file New York State nonresident personal income tax returns for the years 1999 through 2009.

48. GSHI SoHo Hotel, LLC filed a partnership return, IT-204, in April 2008 reporting the sale of the New York City property. The preparer was KPMG LLP, Dallas, Texas. The capital gain reported is \$81,695,867.00. The gain was "passed through" to the partners as follows:

a. Halifax Soho Owner GP LLC (SMLLC) of KFP Properties, LP in the amount of \$47,228,569.00.

b. REP SEIH Realty, LLC in the amount of \$34,467,298.00.

49. On November 29, 2010, Mr. Busby, the tax manager of Highgate Hotels, LP, spoke with Ms. Capeci, a Division Team Leader on the matter. On the call, Mr. Busby said that he had information requested by Ms. Capeci on KFP Properties, LLC, but he asked for assurance that Ms. Capeci was an auditor from New York State and was authorized to request the information.

50. In response to Mr. Busby's request, on November 29, 2010, Ms. Capeci sent a facsimile letter to Mr. Busby with name and contact information on district office letterhead. The letter also requested the names and identification numbers for all entities and individuals with an ownership interest in KFP Properties, LP, and stated that Ms. Capeci had left a voicemail with Mr. Busby requesting the same information. The facsimile included a copy of the schedule K-1 issued by Hotel LLC to KFP at 545 E. John Carpenter Freeway, Suite 1400, Irving, Texas.

51. Later on November 29, 2010, Mr. Busby called Ms. Capeci and provided the names of petitioner and Mahmood J. Khimji, the investors in KFP Properties, LP and their ID numbers.

52. On November 29, 2010, Ms. Capeci sent an email to Jeffrey Mason, also of the Division, requesting the creation of a new case number with respect to petitioner.

53. On December 1, 2010, petitioner filed an application to participate in the New York State Voluntary Disclosure and Compliance Program (the Program) for the years 1999 through 2009.

54. Petitioner was not a party to any criminal investigation being conducted by any agency or political subdivision of New York State when he filed an application to participate in the Program.

55. Petitioner's application did not seek to disclose participation in a tax avoidance transaction that is a federal or New York State reportable or listed transaction.

56. The Division prepared a letter dated December 9, 2010, to petitioner stating that he was selected for an audit.

57. The December 9, 2010 letter was faxed to Mr. Busby on December 10, 2010.

58. The December 9, 2010 letter was postmarked December 15, 2010.

59. In a letter dated December 20, 2010, the Department accepted petitioner's application to the Program for the years 1999 through 2006 and the years 2008- 2009.

60. The Department rejected petitioner's application to participate in the Program for the year 2007.

61. On December 5, 2011, the Department issued a Notice of Deficiency, ID No. L-037010962, to petitioner for the year 2007. The Notice of Deficiency assessed tax in the amount

of \$1,595,773.00, interest in the amount of \$377,878.70, penalties in the amount of \$665,663.00, and credited payments made in the amount of \$1,969,455.00.

62. Nonfiling penalties were imposed under Tax Law § 685(a)(1) and negligence penalties were imposed under Tax Law § 685(b)(1) and (2).

63. Petitioner made payments of \$1,364,890.00 on March 3, 2011 and \$604,565.00 on July 26, 2011.

64. On February 24, 2012, petitioner filed a request for a conciliation conference disputing the outstanding penalty amount.

65. A conciliation conference was held on August 13, 2012.

66. A conciliation order was issued on December 7, 2012 sustaining the Notice of Deficiency.

67. Petitioner filed a petition in this matter of February 7, 2013.

68. At the hearing, petitioners presented the testimony of Mr. Whitworth. He explained that in the summer of 2010, he concluded that petitioners had nexus with New York State and that they should file and pay taxes to New York with respect to the real property physically located in New York State that was indirectly owned by entities in which KFP had an interest.

69. Both Mr. Whitworth and Mr. Busby investigated the Program and concluded that it was necessary to prepare returns for the earlier years in order to project petitioners aggregate New York tax liability.

70. On September 17, 2010, petitioners' advisors created a tax summary spreadsheet calculating New York State tax owed for the years 1999-2009 by petitioner Mr. Khimji. A few weeks later, Mr. Khimji was advised of his New York State tax liability.

71. After discussion with Mr. Khimji, petitioners' advisors began the process of completing tax returns for petitioners applications to the Program.

### ***CONCLUSIONS OF LAW***

A. The sole issue in this case is whether petitioners are eligible to participate in the New York State Department of Taxation and Finance Voluntary Disclosure Program established pursuant to Tax Law § 1700. Under this statute, subdivision (2) sets forth the following criteria that must be met in order for a taxpayer to be eligible for the program:

- (1) The taxpayer is not currently under audit by the department;
- (2) The taxpayer is one who is voluntarily disclosing a New York tax liability that the department has not determined, calculated, researched or identified at the time of the disclosure;
- (3) The taxpayer is not currently a party to any criminal investigation being conducted by an agency of the state or any political subdivision thereof; and
- (4) The taxpayer is not seeking to disclose participation in a tax avoidance transaction that is federal or New York State reportable or listed transaction.

As set forth in the facts, both petitioners meet the third and fourth requirements for eligibility in the Program.

A taxpayer challenging the statutory interpretation of an administrative agency bears a heavy burden of proof.

“As a general rule, ‘the construction given statutes . . . by the agency responsible for their administration, if not irrational or unreasonable, should be upheld’” (citations omitted) (*Matter of Brooklyn Assembly Halls of Jehovah’s Witnesses v Department of Env’tl. Protection of City of NY*, 11 NY3d 327, 334).

When interpreting statutes:

"words of ordinary import are to be construed according to their ordinary and popular significance, and are to be given their ordinary and usual meaning" (McKinney's Cons Laws of NY, Book 1, Statutes § 232).

B. The first criterion to meet in order to be eligible for the Program is that the taxpayer cannot be under audit. The Division argues that petitioners were under audit and, thus, ineligible to participate in the Program at the time their application was filed on December 1, 2010. The Division notes that it initially contacted Mr. Busby on November 29, 2010 for information regarding KFP. Specifically, the Division requested the names and identification numbers for all entities and individuals with an ownership interest in KFP. On that date, Mr. Busby provided the requested information to the Division. In response, Ms. Capeci created a new case number for petitioners. Thus, the Division maintains that at the time these new case numbers were assigned to petitioners, this action resulted in petitioners being under audit. This position is without merit.

Given that there is no case law or regulation to provide guidance on what constitutes “currently under audit,” it is necessary to use the plain meaning of this phrase to determine its proper interpretation. The facts in this case establish that, on December 9, 2010, a letter to petitioners was prepared by the Division stating that petitioners were selected for audit. Despite the facts surrounding the dates of mailing and faxing the letter, it cannot be concluded that petitioners were under audit prior to the letter of December 9, 2010. Therefore, at the time that petitioners’ application for the Program was filed on December 1, 2010, they were not currently under audit.

C. Next, it must be determined whether, at the time of the applications, the Division had not determined, calculated, researched or identified a New York tax liability with respect to petitioners. The interpretation of this criterion of eligibility is also not addressed in case law or regulations. Again, focusing on the plain meaning of the words used in the statute, this criterion focuses on the “New York tax liability” of petitioners.

At the time of the initial contact with Mr. Busby, it is clear that the Division was focused on KFP. On November 29, 2010, there was no calculation or determination of any tax liability with respect to petitioners. However, the phrase “researched or identified at the time of disclosure” is the interpretation that impacts petitioners’ eligibility for the Program.

The Division argues that its request for information regarding the entities and individuals with an ownership interest in KFP is the point at which petitioners were identified as having a New York tax liability and that the Division’s research into KFP constituted “researched” a New York tax liability such that petitioners were no longer eligible for the Program.

The focus of the inquiry on November 29, 2010 was the tax liability of KFP, not petitioners. Clearly, the information gathered by the Division led them in the direction of petitioners, yet it cannot be said that the New York tax liability of petitioners was either identified or researched on November 29, 2010.

The timing of the Division’s contact with Mr. Busby and the applications filed on behalf of petitioners for this Program cannot be viewed as anything other than coincidental. Petitioners’ advisors had identified the need to file New York State returns as early as the summer of 2010, prior to any contact from the Department. Moreover, the credible testimony explained a chronology of events leading up to the filing of the returns and the filing of the application to the Program.

Although the timing was very close, it would be an error for petitioners to be denied eligibility under the Program. The purpose of the Program was to encourage compliance with the Tax Law. Petitioners were advised, as early as October 1, 2010, that returns were required to be filed. Since the returns were filed and taxes paid, petitioners’ applications were improperly denied.

D. The petitions of Mahmood J. Khimji and St. Giles Trust are granted, penalty and penalty interest are canceled and the notices of deficiency, L-036999495, dated December 1, 2011 and L-037010962, dated December 5, 2011, respectively, are so modified.

DATED: Albany, New York  
May 14, 2015

/s/ Donna M. Gardiner  
ADMINISTRATIVE LAW JUDGE