STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition of **ALLISON GREENBERG** for Redetermination of a Deficiency or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law and the New York City Administrative Code for the Years 2014 and 2015.	:	DETERMINATION DTA NOS. 829737 AND 829738
In the Matter of the Petition of **SCOTT J. AND MARTHA M. FARRELL** for Redetermination of a Deficiency or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law and the New York City Administrative Code for the Year 2014.	:	

Petitioner, Allison Greenberg, filed a petition for redetermination of a deficiency or for refund of personal income tax under article 22 of the Tax Law and the New York City Administrative Code for the years 2014 and 2015. Petitioners, Scott J. and Martha M. Farrell, filed a petition for redetermination of a deficiency or for refund of personal income tax under article 22 of the Tax Law and the New York City Administrative Code for the year 2014.

On August 9, 2021, petitioners, appearing by Akerman, LLP (Ira Stechel, Esq., of counsel), and on August 11, 2021, the Division of Taxation, appearing by Amanda Hiller, Esq. (Linda Farrington, Esq., of counsel), waived a hearing and submitted the matters for a consolidated determination based on documents and briefs, with the final brief to be submitted by January 20, 2022, which date began the six-month period for issuance of this determination.

After due consideration of the documents and arguments submitted, Barbara J. Russo, Administrative Law Judge, renders the following determination.

ISSUE

Whether the Division of Taxation properly denied a resident credit claimed by petitioner, Allison Greenberg, for the years 2014 and 2015, and by petitioners, Scott J. and Martha M. Farrell, for the year 2014.

FINDINGS OF FACT[1]

1. Petitioner Allison Greenberg was domiciled in New York State and City during tax years 2014 and 2015.

2. Ms. Greenberg filed a New York State resident income tax return, form IT-201, for tax year 2014 as a New York State and City resident. Ms. Greenberg then filed an Amended New York State resident income tax return, form IT-201-X, for tax year 2014 as a New York State and City resident.

3. Ms. Greenberg received a schedule K-1 as a partner of Hildene Holding Company, LLC (Hildene) for tax year 2014. The schedule K-1 received by Ms. Greenberg reported ordinary income of the partnership as well as carried interest. The carried interest was reported as interest income, dividends, and capital gains. As a New York resident, Ms. Greenberg correctly reported all of her schedule K-1 income from Hildene on her 2014 amended New York return.

4. With her original and amended New York returns, Ms. Greenberg filed form IT-112-R, New York State Resident Credit, to claim a resident tax credit (RTC) for taxes paid to Connecticut. On form IT-112-R attached to her amended return for 2014, Ms. Greenberg

[1] The parties entered into a joint stipulation of facts with attached exhibits. The relevant stipulated facts have been incorporated herein.

correctly reported all of her New York income in Column A for a total of $3,738,074.00. However, the Division of Taxation (Division) and Ms. Greenberg disagree about the treatment of Connecticut sourced income reported in Column B as follows:

Income Type	IT-112-R Column B Line #	Amount reported by Ms. Greenberg	Amount allowed on audit	Amount in dispute
Interest Income	2	$590,730.00	0	$590,730.00
Dividends	3	$385,832.00	0	$385,832.00
Capital Gains	7	$562,068.00	0	$562,068.00
Flow-through ordinary income	11	$2,135,805.00	$2,135,805.00	0
Total		$3,674,435.00	$2,135,805.00	$1,538,630.00

5. Ms. Greenberg filed a Connecticut nonresident return reporting and paying tax to Connecticut on the schedule K-1 income from Hildene sourced to Connecticut under Connecticut law in 2014. This return reported and paid tax on all of the income reported by Ms. Greenberg as Connecticut sourced on the IT-112-R ($3,674,435.00). The Division accepted the RTC for the taxes paid to Connecticut on the $2,135,805.00 of ordinary income sourced to Connecticut as filed. Therefore, the only dispute is whether the taxes paid on the $1,538,603.00 of carried interest income (reported on form IT-112-R as interest income, dividends and capital gains) to Connecticut are eligible for a RTC under Tax Law § 620 based on the source and character of the income.

6. Ms. Greenberg filed a New York State resident income tax return, form IT-201, for tax year 2015 as a New York State and City resident.

7. Ms. Greenberg also received a schedule K-1 as a partner of Hildene for tax year 2015. The schedule K-1 received by Ms. Greenberg reported an ordinary loss of the partnership as well as carried interest income. The carried interest was reported as interest

income, dividends, and capital gains. As a New York resident, Ms. Greenberg correctly reported all of her schedule K-1 income from Hildene on her 2015 New York return.

8. With her 2015 New York return, Ms. Greenberg filed form IT-112-R, New York State resident credit, to claim a RTC for taxes paid to Connecticut. On this form, Ms. Greenberg correctly reported all of her New York income in Column A for a total of $11,081,700.00. However, the Division and Ms. Greenberg disagree about the treatment of Connecticut sourced income reported in Column B as follows:

Income Type	IT-112-R Column B Line #	Amount reported by Ms. Greenberg	Amount allowed on audit	Amount in dispute
Interest Income	2	$4,819,778.00	0	$4,819,778.00
Dividends	3	$2,651,905.00	0	$2,651,905.00
Capital Gains	7	$22,102,196.00	0	$22,102,196.00
Flow-through ordinary income	11	($18,389,010.00)	($18,389,010.00)	0
Total		$11,184,849.00	0	$11,184,849.00

9. Ms. Greenberg filed a Connecticut nonresident return reporting and paying tax to Connecticut on the schedule K-1 income from Hildene sourced to Connecticut under Connecticut law in 2015. This return reported and paid tax on all of the income reported by Ms. Greenberg as Connecticut sourced on the IT-112-R ($11,184,849.00). The Division accepted the sourcing of the flow-through ordinary loss to Connecticut but, because no tax is paid on a loss, the Division disallowed the claimed RTC in its entirety. Therefore, the remaining dispute is whether the taxes paid on the $11,184,849.00 of carried interest income (reported on the form IT-112-R as interest income, dividends and capital gains reduced by the ordinary loss) to Connecticut are eligible for a RTC under Tax Law § 620 based on the source and character of the income.

10. The Division audited Ms. Greenberg for 2014 and 2015 and accepted her income, deductions, and residency status as filed. However, the Division concluded that Ms. Greenberg was only entitled to a RTC for taxes paid to Connecticut on the ordinary income of Hildene. Therefore, the Division adjusted Ms. Greenberg's returns to disallow the RTCs to the extent they were claimed for taxes paid to Connecticut on the carried interest income of Hildene.

11. As a result of the Division's adjustments disallowing the RTCs, the Division issued a notice of deficiency, number L-047839423, to Ms. Greenberg on March 27, 2018, assessing additional tax due for the years 2014 and 2015 in the amount of $839,932.00 plus interest.

12. Petitioners Scott J. and Martha M. Farrell were domiciled in New York State and City in 2014.

13. Mr. and Mrs. Farrell filed a New York State resident income tax return, form IT-201, as married filing jointly for tax year 2014. Mr. and Mrs. Farrell then filed an amended New York State resident income tax return, form IT-201-X, for tax year 2014 as New York State and City residents.

14. Mr. Farrell received a schedule K-1 as a partner of Hildene for tax year 2014. The Schedule K-1 received by Mr. Farrell reported ordinary income of the partnership as well as carried interest. The carried interest was reported as interest income, dividends, and capital gains. As a New York resident, Mr. Farrell correctly reported all of his Schedule K-1 income from Hildene on his New York return.

15. With their original and amended 2014 New York returns, Mr. and Mrs. Farrell filed form IT-112-R, New York State Resident Credit, to claim a RTC for taxes paid to Connecticut. On form IT-112-R attached to their amended return for 2014, Mr. Farrell correctly reported all of his New York income in Column A for a total of $7,975,710.00. However, the Division and

Mr. Farrell disagree about the treatment of Connecticut sourced income reported in Column B as follows:

Income Type	IT-112-R Column B Line #	Amount reported by Mr. Farrell	Amount allowed on audit	Amount in dispute
Interest Income	2	$1,272,346.00	0	$1,272,346.00
Dividends	3	$831,028.00	0	$831,028.00
Capital Gains	7	$1,210,615.00	0	$1,210,615.00
Flow-through ordinary income	11	$4,311,752.00	$4,311,752.00	0
Total		$7,625,741.00	$4,311,752.00	$3,313,989.00

16. Mr. and Mrs. Farrell filed a Connecticut nonresident return reporting and paying tax to Connecticut on the Schedule K-1 income from Hildene sourced to Connecticut under Connecticut law in 2014. This return reported and paid tax on all of the income reported by Mr. Farrell as Connecticut sourced on the IT-112-R ($7,625,741.00). The Division accepted the RTC for the taxes paid to Connecticut on the $4,311,752.00 of ordinary income sourced to Connecticut as filed. Therefore, the only dispute is whether the taxes paid on the $3,313,989.00 of carried interest income (reported on form IT-112-R as interest income, dividends and capital gains) to Connecticut are eligible for a RTC under Tax Law § 620 based on the source and character of the income.

17. The Division audited Mr. and Mrs. Farrell for 2014 and accepted their income, deductions, and residency status as filed. However, the Division concluded that Mr. and Mrs. Farrell were only entitled to a RTC for taxes paid to Connecticut on the ordinary income of Hildene. Therefore, the Division adjusted Mr. and Mrs. Farrell's returns to disallow the RTC to the extent it was claimed for taxes paid to Connecticut on the carried interest income of Hildene.

18. As a result of the Division's adjustments to the RTC, the Division issued a notice of deficiency, number L-047901877, to Mr. and Mrs. Farrell on April 10, 2018, assessing additional tax due for tax year 2014 in the amount of $131,761.00 plus interest.

19. During the course of the audit, petitioners' representative requested that the Division provide support for its position. By letter dated July 14, 2017, the Division stated, in part, as follows:

> "This letter is a follow up to your phone call on July 11, 2017. During our conversation, you had requested citation supporting our position. Please note that there are currently no citations in the tax law that define incentive fee v. incentive allocation income. However, we have enclosed an article labeled 'Structuring Hedge Fund Manager Compensation: Tax and Economic Consideration", from the Journal of Taxation, Volume 112, Number 05, May 2010. This article clearly explains the concept of incentive fee v. incentive allocation.
>
> We would like to again explain our position as was stated in our position letters dated April 11, 2017 and June 13, 2017. Pursuant to page 6 of the Operating Agreement of Hildene Holding Company, LLC, incentive compensation in the agreement is defined as incentive allocation paid to the fund. Incentive allocation is a form of carried interest (capital gains, interest, and dividends) and New York State does not consider carried interest to be intangible income employed in a trade or business. Please note that this type of allocation is treated as a special allocation under Internal Revenue Code Section 704(b). As the income passes down from the partnership to the partner, it retains its source and character (refer to New York State Tax Law Section 617(b) and New York State Regulation Section 137.6 which was previously provided.) Since the income generated is not considered as intangible income used in a trade or business, we would not currently tax this income if received by a nonresident.
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> In the current matter, the capital gains, interest, and dividends your client received from the Hildene Company was incentive allocation which is a form of carried interest. Given that New York State does not tax nonresidents on this type of income, we would not allow a resident tax credit on taxes paid to other states if those same taxes would not be imposed on a nonresident of New York."

20. Petitioner Allison Greenberg filed a request for conciliation conference with the Division's Bureau of Conciliation and Mediation Services (BCMS). A conciliation conference was held on December 4, 2018. BCMS issued a conciliation order dated August 23, 2019 sustaining the notice.

21. Petitioner Allison Greenberg timely filed a petition with the Division of Tax Appeals that was acknowledged on December 27, 2019. The Division filed an answer on February 19, 2020.

22. Petitioners Scott J. and Martha M. Farrell filed a request for conciliation conference with the BCMS. A conciliation conference was held on December 4, 2018. BCMS issued a conciliation order dated August 23, 2019 sustaining the notice.

23. Petitioners Scott J. and Martha M. Farrell timely filed a petition with the Division of Tax Appeals that was acknowledged on December 19, 2019. The Division filed an answer on February 12, 2020.

24. At all relevant times, Hildene was a Delaware Limited Liability Company and Ms. Greenberg and Mr. Farrell were members. On audit, petitioners provided an operating agreement, dated March 7, 2008, for Hildene.

25. The operating agreement of Hildene, dated March 7, 2008, lists its principal place of business as 140 East 45th Street, Suite 3C, New York, New York, and further states that "[t]he Company may have such other business offices within or without the State of Delaware as determined from time to time by the Managers." The operating agreement further states that Hildene's business "shall be to serve as a holding company, and that the Company shall not engage in any direct business activities."

26. Ms. Greenberg provided a revised member agreement, dated March 8, 2012, between her and Hildene. This member agreement stated in paragraph 4(a) that Ms. Greenberg would receive a profit allocation equal to 6.5%.

27. The revised member agreement between Ms. Greenberg and Hildene, dated March 8, 2012, lists Hildene's office address as 500 Fifth Avenue, Suite 1120, New York, New York.

28. Mr. Farrell provided a member agreement, dated March 8, 2012, between him and Hildene. This member agreement stated in paragraph 4(a) that Mr. Farrell would receive a profit allocation equal to 12%.

29. The revised member agreement between Mr. Farrell and Hildene, dated March 8, 2012, lists Hildene's office address as 500 Fifth Avenue, Suite 1120, New York, New York.

30. Both member agreements provided that net profits described in paragraph 4(a) would be allocated to the members in accordance with the terms of paragraph 4.1(b) of the operating agreement. This incentive income, otherwise known as "carried interest," was correctly categorized by Hildene as capital gains, interest and dividends and reported to each member on a schedule K-1 under those categories. Under federal law, this type of carried interest is treated as a special allocation under IRC (26 USC) § 704 (b) and, as the income passes down from the partnership to the partner, it retains its source and character.

31. Petitioners paid tax to both Connecticut and New York during the taxable years in issue on all of their dividends, interest and capital gains income reported to them by Hildene.

32. Hildene wholly owns Hildene Advisors, LLC, which has interest in two private investment hedge funds, Hildene Opportunity Fund I, LP, and Hildene Opportunity Fund II, LP (the Hildene funds). Hildene Advisors, LLC is the general partner of Hildene. Hildene Capital Management, LLC (Hildene Capital) is the investment manager of Hildene and is an active investment manager that invests on behalf of the two aforementioned Hildene funds. Hildene Capital is paid a performance-based fee and a percentage of assets fee for the management of the Hildene funds. Petitioners, in turn, receive flow-through investment income from Hildene in the form of carried interest, consisting of interest income, dividends, capital gains and ordinary business income or loss.

33. According to an affidavit, dated October 15, 2021, of John Scannell, a Senior Advisor at Hildene Capital, as of September 1, 2021, Hildene Capital managed assets comprising over $13 billion.

34. According to Mr. Scannell's affidavit, during the tax years in issue, Ms. Greenberg served as the Marketing Director of Hildene Capital.[2]

35. According to the affidavit of Mr. Scannell, during the tax years in issue, Mr. Farrell served as a co-portfolio manager reporting to the Chief Investment Officer of Hildene Capital.[3]

36. According to Mr. Scannell's affidavit, on account of Ms. Greenberg's services rendered to Hildene Capital in her capacity as Marketing Director, Hildene Capital awarded her additional contingent compensation (i) in the form of an interest in the performance incentive fee to be earned by Hildene Capital through its subsidiaries, and (ii) a performance allocation incentive in the form of a membership interest in Hildene Capital , entitling Ms. Greenberg to a share of the profits to be derived by Hildene Capital through its subsidiaries.[4]

37. Section 4 of the Revised Member Agreement between Hildene and Ms. Greenberg provides, in part, as follows:

"4. Compensation.

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[2] It is noted that in a number of petitioners' proposed findings of fact, they interchange Hildene Capital with Hildene. For example, petitioners' proposed finding of fact 37 alleges that Ms. Greenberg served as marketing director of Hildene, but Mr. Scannell's affidavit, which petitioners cite to in support for their proposed fact, states that Ms. Greenberg served as marketing director of Hildene Capital. Mr. Scannell's affidavit abbreviates Hildene Capital Management, LLC to "Hildene," while petitioners' brief abbreviates Hildene Holding Company, LLC to "Hildene."

[3] Petitioners' proposed finding of fact 38 alleges that Mr. Farrell served as co-portfolio manager reporting to the chief investment officer of Hildene, but Mr. Scannell's affidavit, which petitioners cite to in support for their proposed fact, states that Mr. Farrell served in that capacity for Hildene Capital.

[4] It is unclear from the affidavit whether petitioners are claiming that Ms. Greenberg received an incentive fee and profit allocation from Hildene Capital in addition to the "profit allocation" and "incentive compensation" she received from Hildene pursuant to the Revised Member Agreement, or if petitioners are again conflating Hildene Capital and Hildene. Ms. Greenberg's schedules K-1 reporting the income at issue are from Hildene.

> (a) As full consideration to the Member for the services to be rendered pursuant to this Agreement and the Operating Agreement, the Member shall be granted a profit allocation ("Profit Allocation") equal to a six and one-half percent (6.5%) Economic Interest in the Company. The foregoing percentage applies to the Member's Economic Interest in Net Profits other than in connection with Incentive Compensation. Net Profits attributable to Incentive Compensation shall be allocated to the Member in accordance with Section 4.1(b) of the Operating Agreement and reinvested in a Fund may be deferred in accordance with the terms of any deferred compensation plan established by the Company. The Member acknowledges and agrees that he or she will be solely responsible for payment of all foreign, federal, state and local income, unemployment, insurance, social security and other taxes, fees and contributions imposed or required to be paid, remitted or withheld with respect to the Profit Allocation. Furthermore, this Agreement shall in no manner be deemed to impose an employer-employee relationship between the parties hereto."

38. According to Mr. Scannell's affidavit, on account of Mr. Farrell's services rendered to Hildene Capital in his capacity as co-portfolio manager reporting to the Chief Investment Officer, Hildene Capital awarded him additional contingent compensation (i) in the form of an interest in the performance incentive fee to be earned by Hildene Capital through its subsidiaries, and (ii) a performance allocation incentive in the form of a membership interest in Hildene Capital, entitling Mr. Farrell to a share of the profits to be derived by Hildene Capital through its subsidiaries.[5]

39. Section 4 of the Member Agreement between Hildene and Mr. Farrell provides, in part, as follows:

> "4. Compensation.
>
> (a) As full consideration to the Member for the services to be rendered pursuant to this Agreement and the Operating Agreement, the Member shall be granted a profit allocation ("Profit Allocation") equal to a twelve percent (12%) Economic Interest in the Company. The foregoing percentage applies to the Member's Economic Interest in Net Profits other than in connection with Incentive Compensation. Net Profits attributable to Incentive Compensation shall be

[5] It is unclear from the affidavit whether petitioners are claiming that Mr. Farrell received an incentive fee and profit allocation from Hildene Capital in addition to the "profit allocation" and "incentive compensation" he received from Hildene pursuant to the Member Agreement, or if petitioners are again conflating Hildene Capital and Hildene. Mr. Farrell's schedule K-1 reporting the income at issue is from Hildene.

> allocated to the Member in accordance with Section 4.1(b) of the Operating Agreement and reinvested in a Fund may be deferred in accordance with the terms of any deferred compensation plan established by the Company. The Member acknowledges and agrees that he or she will be solely responsible for payment of all foreign, federal, state and local income, unemployment, insurance, social security and other taxes, fees and contributions imposed or required to be paid, remitted or withheld with respect to the Profit Allocation. Furthermore, this Agreement shall in no manner be deemed to impose an employer-employee relationship between the parties hereto."

40. The Division's tax field audit record for the audit of Ms. Greenberg contains an entry, dated September 15, 2016, which states that according to Hildene Capital's website, "the company is a New York-based asset management firm with HQs in NY and CT."

41. Pursuant to 20 NYCRR 3000.15 (d) (6), petitioners submitted 43 proposed findings of fact. To the extent that the proposed findings of fact cite to the stipulation of facts but seek to change the language of said stipulation, the language of the stipulation of facts has been incorporated herein. In accordance with State Administrative Procedure Act § 307 (1), proposed findings of fact 1 through 14, and 22 through 27 have been modified to more accurately reflect the stipulation of facts. Proposed findings of fact 15, and 34 through 42 have been modified or rejected in part and accepted in part to more accurately reflect the record. Proposed findings of fact 16 through 21, and 28 through 33 are supported by the record, and have been consolidated, condensed, combined, renumbered and substantially incorporated herein. Proposed finding of fact 43 has been rejected as conclusory.

CONCLUSIONS OF LAW

A. It is initially noted that determinations made in a notice of deficiency are presumed correct, and the burden of proof is upon petitioners to establish, by clear and convincing evidence, that those determinations are erroneous (***see Matter of Leogrande v Tax Appeals Trib.*** 187 AD2d 768 [3d Dept 1992], ***lv denied*** 81 NY2d 704 [1993]; ***see also*** Tax Law § 689 [e]).

The burden does not rest with the Division to demonstrate the propriety of the deficiency (***see Matter of Scarpulla v State Tax Commn.***, 120 AD2d 842 [3d Dept 1986]).

Moreover, where a statute authorizes an exemption from taxation on income which is otherwise subject to tax, it will be construed against the taxpayer, although the interpretation should not be so narrow and literal as to defeat its settled purpose (***see Matter of Mallinckrodt***, Tax Appeals Tribunal, November 12, 1992, citing ***Matter of Grace v New York State Tax Commn.***, 37 NY2d 193 [1975], ***rearg denied*** 37 NY2d 816 [1975], ***lv denied*** 338 NE2d 330 [1975]). Because a credit, like a deduction, is a "particularized species of exemption from taxation," the same rule applies to credits (***id.***; ***see also Matter of Taxel***, Tax Appeals Tribunal, July 9, 2020, citing ***Matter of Grace v New York State Tax Commn.***), and taxpayers bear the burden of establishing their entitlement thereto (***Matter of Golub Serv. Sta. v Tax Appeals Trib. of State of N.Y.***, 181 AD2d 216, 219 [3d Dept 1992]). Petitioners must establish that their interpretation of the statute is the only reasonable interpretation (***Matter of Hucko Trust***, Tax Appeals Tribunal, September 19, 2013).

B. Before addressing petitioners' legal argument that "petitioners are entitled to a resident credit for taxes paid to Connecticut on certain flow-through income derived from Hildene, *a business wholly-based in Connecticut*," a factual question must be addressed. Petitioners' legal argument is based on their factual premise that Hildene's business operations are conducted exclusively in Connecticut, and therefore, according to petitioners, the income from such operations should be sourced to Connecticut. However, this factual contention is not supported by the record, such that even if petitioners' argument that the intangible income at issue was derived from a business, trade, profession or occupation was accepted, petitioners have failed to establish that such was carried on solely in Connecticut and not New York. Contrary

to petitioners' assertion, Hildene's operating agreement lists its principal place of business as 140 East 45th Street, Suite 3C, New York, New York, and states that the company may have other business offices within or without Delaware as determined by the managers. Additionally, both Mr. Farrell's member agreement and Ms. Greenberg's revised member agreement list Hildene's office address at 500 Fifth Avenue, Suite 1120, New York, New York. While petitioners cite to a statement in the affidavit of the Division's auditor to support their claim that Hildene operated exclusively in Connecticut, such statement is directly contracted by the aforementioned operating agreement and member agreements, as well as the tax field audit record.[6] There is no explanation in the record for the contradiction, and petitioners have provided no evidence to show that the New York addresses listed in the operating agreement and member agreements were wrong or changed at some later date. As petitioners bear the burden of proof, it was incumbent upon them to prove the factual premise they assert and explain the contradictions. A careful review of the record shows that other than the contradicted statement in the auditor's affidavit, there is simply no evidence that Hildene operated exclusively in Connecticut. Petitioners' legal argument that the income at issue is from property employed in a business, trade, profession or occupation carried on in Connecticut relies on their factual premise that Hildene's business operations were conducted exclusively in Connecticut. They have failed to meet their burden of proof on this allegation. Therefore, based on the evidence presented in the record, petitioners' argument must be rejected.

C. Although petitioners' legal argument that the income at issue, which is derived from intangible personal property, is attributable to property employed in a business, trade, profession

[6] While petitioners also cite to the stipulation of facts in support of their proposed finding of fact that Hildene's business operations were conducted exclusively in Connecticut, the citations given do not support the proposed finding and a thorough review of said stipulation of facts reveals that the parties did not agree to such proposed fact.

or occupation carried on in Connecticut has been rendered moot based upon the conclusion reached above, such argument is nevertheless addressed herein for sake of a complete record on appeal (***see Matter of Riehm v Tax Appeals Tribunal***, 179 AD2d 970 [3d Dept 1992], ***lv denied*** 79 NY2d 759 [1992], ***reargument denied*** 80 NY2d 893 [1992]). As discussed below, assuming, arguendo, petitioners established that Hildene's business operations were conducted exclusively in Connecticut, they have not met their burden of proving that the intangible personal property from which the income at issue was derived was attributable to a business, trade, profession or occupation carried on in that state.

New York State residents are taxed on their worldwide income (***see*** Tax Law § 612; ***Matter of Tamagni v Tax Appeals Tribunal of the State of New York***, 91 NY2d 530 [1998]), while nonresidents are taxed only on their New York source income (***see*** Tax Law § 631; ***Matter of Tamagni v Tax Appeals Tribunal of the State of New York***). The New York taxable income of a resident individual is his New York adjusted gross income, less certain deductions and exemptions (***see*** Tax Law § 611). New York adjusted gross income of a resident individual is his federal adjusted gross income, subject to certain modifications (***see*** Tax Law § 612).

Resident partners in New York are taxed on their respective distributive shares of their partnership income (***see*** Tax Law § 617). Tax Law § 617 (b) provides, in part, that "each item of partnership income, gain, loss or deduction shall have the same character for a partner under [article 22] as for federal income tax purposes" (***see Caprio v New York State Dept of Taxation and Finance***, 25 NY3d 744 [2015] ["To ensure parallel state and federal treatment, each item of pass-through gain retains the same character for state and federal income tax purposes"]; ***see also*** 20 NYCRR 117.4). For federal income tax purposes, "[t]he character of any item of income, gain, loss, deduction, or credit included in a partner's distributive share . . . shall be determined

as if such item were realized directly from the source from which realized by the partnership, or incurred in the same manner as incurred by the partnership" (26 USC § 702 [b]).

The Division's regulations further provide that the character of items in tiered partnerships remains the same as follows:

> "Where a partner is a member in a partnership, and such partnership (hereinafter referred to as the 'upper tier partnership') is a partner in another partnership (hereinafter referred to as the 'lower tier partnership'), the character of such member's distributive share of each partnership item of the upper tier partnership which is attributable to the lower tier partnership retains the character determined at the level of the lower tier partnership using the provisions of subdivision (a) of this section. Such character is not changed by reason of the fact that such item flows through the upper tier partnership to such member" (20 NYCRR 117.4 [b]).

Petitioners here are New York State residents who received partnership income as members of Hildene. The income at issue was reported on petitioners' schedules K-1 as interest, dividends, and capital gains. The income flowed through Hildene's partnership tiers to petitioners (***see*** finding of fact 32). Petitioners contend that they are entitled to a resident credit for such income on which they paid taxes to Connecticut.

D. Tax Law § 620 (a) allows for a tax credit to a New York resident against the tax otherwise due under article 22 for any income tax imposed for the taxable year by another state on income both derived therefrom and subject to tax under article 22. Thus, in order to receive a credit for tax paid to Connecticut, petitioners must prove three elements: 1) that Connecticut imposed a tax on the subject income; 2) that the income was derived from Connecticut; and 3) that the income was subject to tax under article 22 of the New York Tax Law (***see Matter of Mallinckrodt***, Tax Appeals Tribunal, November 12, 1992). The parties do not dispute that Connecticut imposed tax on the income at issue and that it was also subject to tax under article 22 of the Tax Law. The only question is whether the income was derived from Connecticut sources.

The Division's regulations provide that:

> "[t]he term *income derived from sources within* another state, a political subdivision of another state, the District of Columbia, or a province of Canada, is construed so as to accord with the definition of the term *derived from or connected with New York State sources,* as set forth in section 631 of the Tax Law in relation to the New York source income of a nonresident individual. Thus, the resident credit against ordinary tax is allowable for income tax imposed by another jurisdiction upon compensation for personal services performed in the other jurisdiction, income from a business, trade or profession carried on in the other jurisdiction, and income from real or tangible personal property situated in the other jurisdiction. Conversely, the resident credit is not allowed for tax imposed by another jurisdiction upon income from intangibles, except where such income is from property employed in a business, trade or profession carried on in the other jurisdiction. Thus, for example, no resident credit is allowable for an income tax of another jurisdiction on dividend income not derived from property employed in a business, trade or profession carried on in such jurisdiction" (20 NYCRR 120.4 [d]).

As the New York Court of Appeals explained:

> "The credit is not generally available for intangible income because that income has no identifiable situs. Intangible income generally is not derived, at least directly, from the taxpayer's efforts in any jurisdiction outside of New York, and cannot be traced to any jurisdiction outside New York. It is simply investment income, and under the long-recognized doctrine of *mobilia sequuntur personam* (["(m)ovables follow the * * * person"] Black's Law Dictionary 905 [5th ed 1979]), it is subject to taxation by New York as the State of residence (*see,* *Maguire v. Trefry*, 253 U.S. 12, 16, 40 S.Ct. 417, 48-419, 64 L.Ed. 739). However, where the taxpayer can show that intangible income is in fact derived from the taxpayer's activities in a State other than New York, the taxpayer is entitled to the credit (20 NYCRR 120.4 [d] [credit allowed where the income is derived 'from property employed in a business, trade or profession carried on in' another State])" (***Matter of Tamagni v Tax Appeals Tribunal of the State of New York***).

There is no dispute that the income at issue in this matter is from intangibles, being the interest income, dividends and capital gains derived from Hildene's hedge funds that petitioners received from the partnership (***see id.***). A partnership interest is similarly considered to be intangible personal property (***see Matter of Murphy***, Tax Appeals Tribunal, December 16, 2016, citing Partnership Law § 52; ***Blodgett v Silberman***, 277 US 1, 11 [1928]).

Thus, the ultimate question to be resolved is whether the income attributable to intangible personal property is derived from property employed in a business, trade, profession or occupation carried on in Connecticut. As the definition of "income derived from sources within another state" specifically provides that the term is to be construed in accordance with the term as defined by Tax Law § 631 (***see*** 20 NYCRR 120.4 [d]), it is appropriate to look at that section and the corresponding sections of the Tax Law and regulations to determine whether the income at issue was derived from property employed in a business, trade, profession or occupation carried on in Connecticut, so as to be deemed "derived from or connected with" Connecticut sources.

Tax Law § 631, New York source income of nonresident individual, provides in relevant part, as follows:

> "(a) General. The New York source income of a nonresident individual shall be the sum of the following: (1) The net amount of items of income, gain, loss and deduction entering into his federal adjusted gross income, as defined in the laws of the United States for the taxable year, derived from or connected with New York sources, including: (A) his distributive share of partnership income, gain, loss and deduction, determined under section six hundred thirty-two . . .
>
> ***
>
> (b) Income and deductions from New York sources.
>
> (1) Items of income, gain, loss and deduction derived from or connected with New York sources shall be those items attributable to:
>
> (A) the ownership of any interest in real or tangible personal property in this state; or . . .
>
> (B) a business, trade, profession or occupation carried on in this state; or
>
> ***
>
> (2) *Income from intangible personal property, including annuities, dividends, interest, and gains from the disposition of intangible personal property, shall constitute income derived from New York sources only to the extent that such*

income is from property employed in a business, trade, profession, or occupation carried on in this state . . . . Income from the disposition of intangible personal property shall also constitute income derived from New York sources to the extent such gains are from the sale, conveyance or other disposition of shares of stock in a cooperative housing corporation in connection with the grant or transfer of a proprietary leasehold by the owner thereof and subject to the provisions of article thirty-one of this chapter, whether such shares are held by a partnership, trust or otherwise.

***

(d) *Purchase and sale for own account*.--- A nonresident, other than a dealer holding property primarily for sale to customers in the ordinary course of his trade or business, *shall not be deemed to carry on a business, trade, profession or occupation in this state solely by reason of the purchase and sale of property* or the purchase, sale or writing of stock option contracts, or both, *for his own account*. . . .” (emphasis added).

Tax Law § 632, pertaining to nonresident partners and electing shareholders of S corporations provides, in part:

“(a) Portion derived from New York sources.

(1) In determining New York source income of a nonresident partner of any partnership, there shall be included only the portion derived from or connected with New York sources of such partner's distributive share of items of partnership income, gain, loss and deduction entering into his federal adjusted gross income, as such portion shall be determined under regulations of the tax commission consistent with the applicable rules of section six hundred thirty-one.

****

(b) *Special rules as to New York sources. In determining the sources of a nonresident partner’s income, no effect shall be given to a provision in the partnership agreement which—*

(1) characterizes payments to the partner as being for services or for the use of capital, or

***

(c) Partner's and shareholder's modifications. Any modification described in subsection (b) or (c) of section six hundred twelve, which relates to an item of partnership or S corporation income, gain, loss or deduction, shall be made in accordance with the partner’s distributive share or the shareholder’s pro rata share for federal income tax purposes of the item to which the modification relates, but

> limited to the portion of such item derived from or connected with New York sources. . . .” (emphasis added).

Consistent with Tax Law § 631 (b) (2) regarding income from intangible personal property, the Division’s regulations provide that:

> “(a) Items of income, gain, loss and deduction attributable to intangible personal property of a nonresident individual, including annuities, dividends, interest, and gains and losses from the disposition of intangible personal property, do not constitute items of income, gain, loss and deduction derived from or connected with New York State sources, except to the extent attributable to property employed in a business, trade, profession or occupation carried on in New York State. (See also section 3 of article XVI of the New York State Constitution.)
>
> Example:
>
> A, a resident of New Jersey, owns 100 percent of the stock of X Corporation, which operates a store in New York State. In 1980, the corporation pays A a salary of $20,000, all of which was earned in New York State, and a dividend of $2,000. A’s income from New York State sources is his salary of $20,000, since the dividend is not income derived from New York State sources and thus not taxable for New York State personal income tax purposes.
>
> (b) Generally, where a nonresident individual sells real or tangible personal property located in New York State and, as a result of such sale receives intangible personal property (*e.g.*, a note) which generates interest income, such interest income is not attributable to the sale of the real or tangible personal property but is attributable to the intangible personal property. Therefore, such interest income to a nonresident does not constitute income derived from or connected with New York State sources. However, where the instrument used to generate interest income as a result of a sale of real or tangible personal property located in New York State is employed in a business, trade, profession or occupation carried on in New York State, such interest income does constitute income derived from or connected with New York State sources” (20 NYCRR 132.5).

Petitioners argue that their “intangible income [is] derived from an asset employed in a trade or business conducted out-of-state” and contend that their “active participation and interest in Hildene is an asset employed in a trade or business conducted in Connecticut which generated income.” In determining whether the intangible personal property from which the income is

attributable is employed in a business, trade, profession or occupation carried on in New York State, the Division's regulations provide that:

> "A business, trade, profession or occupation (as distinguished from personal services as an employee) is carried on within New York State by a nonresident when such nonresident occupies, has, maintains or operates desk space, an office, a shop, a store, a warehouse, a factory, an agency or other place where such nonresident's affairs are systematically and regularly carried on, notwithstanding the occasional consummation of isolated transactions without New York State. This definition is not exclusive. Business is carried on within New York State if activities within New York State in connection with the business are conducted in New York State with a fair measure of permanency and continuity. A taxpayer may enter into transactions 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. *However, see section 132.10 of this Part with regard to the effect of the purchase and sale of property by a nonresident for such nonresident's own account*" (20 NYCRR 132.4 [a] [2] emphasis added).

Section 132.10 of the regulations, in turn, specifically provides that trading for one's own account is not considered to be carrying on a business, trade, profession or occupation:

> "A nonresident individual, other than a dealer holding property primarily for sale to customers in the ordinary course of his trade or business, is not deemed to be carrying on a business, trade, profession or occupation in New York State solely by reason of the purchase and sale of property or the purchase, sale or writing of stock option contracts, or both, for his own account" (20 NYCRR 132.10; ***see also*** Tax Law § 631 [d]).

Contrary to petitioners' argument, the intangible property at issue here was not employed in a trade or business. Rather, the intangible assets that generated the income were Hildene's private hedge funds. The partnership owned the funds and traded intangible property for its own accounts. The Tax Law and regulations specifically provide that this type of activity, namely the purchase and sale of property for one's own account, is not a business, trade profession or occupation (***see*** Tax Law § 631 [d]; 20 NYCRR 132.10).

The intangible income at issue, reported on petitioners' schedules K-1 as interest, dividends and capital gains, flowed through to petitioners through the tiered partnership structure, and petitioners received the income as their distributive share of partnership profits from the operation of Hildene's hedge funds. As such, the principle of taxation on partners applies in determining the character of the carried interest. Partnerships are treated as pass-through entities for New York income tax purposes and any carried interest generated by the partnerships retains the same character when the income is passed through to the partners (***see*** Tax Law §§ 617 [b], 632 [e]; 20 NYCRR 117.4, 137.5, 137.6). Since the carried interest income was generated by the active investments by Hildene in its own hedge fund accounts, such income is from the purchase and sale of intangible property not used in a trade or business (***see*** Tax Law § 631 [d]; 20 NYCRR 132.10) and that same character is retained at that partner level (***see*** Tax Law §§ 617 [b], 632 [e]; 20 NYCRR 117.4, 137.5, 137.6). Thus, petitioners' income at issue was not attributable to property employed in a business, trade, profession or occupation carried on in Connecticut.

E. Petitioners' argument that the carried interest income should be sourced to Connecticut, claiming that the income was compensation in consideration of services Ms. Greenberg and Mr. Farrell actively rendered for Hildene in Connecticut, is without merit. First, as noted above, petitioners have failed to meet their burden of proving what business activities or services, if any, were rendered in Connecticut and not New York. Second, the characterization of the income as compensation for services in petitioners' member agreement is to be given no effect in determining the sources of the partners' share of partnership income (***see*** 20 NYCRR 137.2 [a]). Because the source of the income was from the partnership's purchasing and selling intangible property on its own account and thus not from carrying on a business, trade,

profession or occupation, and the character of the income is retained at the partner level, such income cannot be treated as compensation for services petitioners rendered in Connecticut, regardless of whether the members' agreement attempts to characterize the income as compensation for services.

F. Petitioners' reliance on the unpublished opinion in ***Sobel v Commissioner of Revenue Services*** (2017 WL 1240119 [Superior Ct of CT 2017]) in support of their position that the income at issue was derived from Connecticut sources is misplaced. In that matter, the court held that intangible investment income received by Mr. Sobel, a Connecticut resident and a partner in a partnership that served as the general partner and advisor of limited partnership investment funds, was New York source income and that Mr. Sobel was entitled to a resident credit under Connecticut Tax Law for taxes paid to New York. It must be noted, first, that a decision of a Connecticut State court is not binding precedent for purposes of New York Tax Appeal's decisions. Indeed, the court's holding that Mr. Sobel was entitled to a resident credit under Connecticut tax law from intangible income he received as a member of a partnership, where the partnership was trading its own assets, is inconsistent with New York Tax Law, as discussed above.

Moreover, the facts in ***Sobel*** are clearly distinguishable from the present matter. In determining that Mr. Sobel was not investing on his own account, the court noted that:

> "[t]he plaintiff further testified that he oversaw 'millions' of trades per year and traded 'other people's money.' The court credits this testimony. There was ample corroborating evidence. . . . That evidence consisted of letters to and from investors, telephone records, handwritten records of transactions, register letters, audited financial statements, and testimony from the plaintiff's accountant. In addition, a November 1997 list of investors for LIF, Ltd. contained the names of 91 persons and entities from the Atlantic islands, Hong Kong, Brazil, Argentina, and numerous European nations. A list of limited partners of LAM, LP contained six names from five states. As detailed below, the plaintiff reported receiving millions of dollars each year in capital gains income. All of this

> evidence is fully consistent with the proposition that the plaintiff engaged in a very high volume of trading with client money" (***Sobel v Commissioner of Revenue Services***).

Based on the evidence presented in ***Sobel***, the court found that:

> "The reality is that the plaintiff was in the full-time business of being an investment manager, not an investor. The investment partnerships were funded by others and the plaintiff was managing the property of unrelated limited partners. He was splitting large profits—wholly disproportionate and unrelated to his own minimal investment—with clients from trading the clients' securities. The plaintiff was not trading on his own account. . . . Here, although it could be said that the partnership traded on its own assets, these assets ultimately came from persons other than the taxpayer. Technically, these persons were limited partners but in reality they were clients or customers. The consequence is that the plaintiff was trading his clients' money, not his own" (***id.***).

The court's factual findings upon which it based its decision that Mr. Sobel was not trading on his own account are absent here. Indeed, the record here is devoid of any such facts. Petitioners have failed to present any evidence as to whether they were overseeing or investing other people's money, provided no list of investors or other unrelated members of the partnerships, and have provided no support for their conclusory assertion that "all of the foregoing criteria [discussed in ***Sobel***] are likewise satisfied by Petitioners." Such baseless assertion is rejected and it is determined that petitioners have failed to meet their burden of proving that they were not purchasing and selling property for their own account (***see*** 20 NYCRR 132.10; Tax Law § 631 [d]).

The court in ***Sobel*** further determined that Mr. Sobel's income was from property employed in a business, trade or profession in New York, finding that:

> "[th]e plaintiff maintained and operated an office in New York City. He conducted his business in a systematic, regular, permanent, and continuous basis by working at this office on a full-time, daily basis. The profit from the plaintiff's business activity in New York constituted the major source of his income. The plaintiff's presence in New York was not casual, isolated, or inconsequential. Thus, the plaintiff operated a 'business, trade, profession or occupation' in New York within the meaning of [Conn Agencies Regs] §

> 12–711(b)–4(a)(2). Similarly, he derived his income from New York property employed in a business, trade or profession . . . .
>
> . . . in the present case, the plaintiff was managing other people's money and not his own. The practice of investing and managing other people's money is invariably a trade or business . . . . Here the plaintiff commuted every work day to an office where he worked long hours, met with clients and investors, engaged in millions of trades, and managed approximately $250 million of their money. The daily frequency and enormous volume of the plaintiff's trading activity clearly satisfy the day trading standards. Hence, even under the standards urged by the commissioner, the plaintiff was engaged in a trade or business" (***Sobel v Commissioner of Revenue Services***).

Again, the record here is devoid of any such facts relied on by the Connecticut court as the basis for its decision. There is no evidence that petitioners maintained and operated an office in Connecticut; rather the operating agreement, member agreement and revised member agreement all list an address for Hildene in New York. While Mr. Scannell's affidavit, presented by petitioners, states that Hildene Capital is "based in Stamford, Connecticut," he does not state at what office location Ms. Greenberg and Mr. Farrell allegedly rendered services as marketing director and co-portfolio manager for Hildene Capital, respectively. The tax field audit record indicates that Hildene Capital had headquarters in both Connecticut and New York. Moreover, the income at issue received by petitioners, as reported on the schedules K-1, was from Hildene, not Hildene Capital. Thus, Mr. Scannell's statement that Hildene Capital was based in Connecticut does not support petitioners' argument that services they allegedly rendered for Hildene were conducted in Connecticut. There is no evidence that petitioners "conducted [their] business in a systematic, regular, permanent, and continuous basis by working at [a Connecticut office] on a full-time, daily basis" or that they commuted to a Connecticut office and worked there long hours, met with clients, or managed other people's money. Petitioners have simply failed to present any evidence to support a conclusion similar to that made by the court in ***Sobel***.

G. Petitioners further contend that they should be allowed the resident credit in order to avoid double taxation, and that the denial of the credit violates the Commerce Clause of the United States Constitution. To the extent that petitioners' argument constitutes a facial challenge of Tax Law § 620 (a), such argument is rejected because the Division of Tax Appeals does not have jurisdiction over facial constitutional challenges (***see Matter of Nelson Obus and Eve Coulson***, Tax Appeals Tribunal, January 25, 2021, citing ***Matter of Fourth Day Enters, Inc.***, Tax Appeals Tribunal, October 27, 1988). To the extent that petitioners' argument is on an "as applied" basis, it is likewise rejected based on the discussion below.

In ***Matter of Tamagni***, the Court of Appeals held that intangible investment income that was subjected to tax by New Jersey, on the basis that its recipient was a domiciliary and resident of that State, and also subjected to tax by New York, on the basis that its recipient was a statutory resident of New York, did not result in constitutionally impermissible double taxation. The Court noted that while residents are generally subject to income tax based upon their worldwide income, New York does provide a tax credit for income taxes paid by its residents to other states. "In order to qualify for this credit, the tax imposed by the other state must be on income 'derived therefrom' —i.e., earned in the other State (Tax Law § 620 [a]). As the accompanying regulations recognize, this provision protects residents actually engaged in interstate commerce from double taxation by ensuring that they are taxed only once upon income derived from interstate activities . . ." (***Matter of Tamagni v Tax Appeals Tribunal of the State of New York***, at 536). The Court explained that the income at issue was not "out-of-state income," but was "intangible income," which "has no identifiable situs," "is not derived, at least directly, from the taxpayer's efforts in any jurisdiction outside of New York, and cannot be traced to any jurisdiction outside of New York," and "is subject to taxation by New York as the

State of residence" (***id.***). Similar to the intangible income in ***Matter of Tamagni***, taxation of the income at issue here did not result in constitutionally impermissible double taxation, because under New York Tax Law, the income was not derived from sources outside New York but is instead taxed based on residency. New York would not tax a nonresident on such intangible income and thus there is no resulting Commerce Clause violation.

Petitioners rely on the United States Supreme Court decision in ***Comptroller of Treas. of Maryland v Wynne*** (575 US 542 [2015]) in support of their constitutional argument. In ***Wynne***, the Supreme Court invalidated, on dormant Commerce Clause grounds, the State of Maryland's taxation of the income its residents earned both inside and outside of Maryland, and the income that nonresidents earned inside the State, without providing its residents a full credit against the income taxes they paid to other states on the same income. The Court in ***Wynne*** explained, however, that states are within their authority to deny a resident credit if, as is the case in New York, the state does not impose tax on nonresidents for similar income earned within the state.

Subsequent to the ***Wynne*** decision, the issue of whether subjecting a statutory resident of New York to tax on all income, including income from intangible assets, without affording a resident credit, under circumstances where such income was also subjected to tax by another state, was again addressed. The post-***Wynne*** decisions addressed similar issues and concluded that ***Wynne*** does not abrogate the New York Court of Appeals' holding in ***Matter of Tamagni*** (***see Edelman v New York State Dept of Taxation & Fin.***, 162 AD3d 574 [1st Dept 2018]; ***Chamberlain v New York State Dept of Taxation & Fin.***, 166 AD3d 1112 [3d Dept 2018]). In ***Edelman***, the Court distinguished ***Wynne*** from ***Tamagni*** by noting "the income subject to tax in ***Wynne*** was not intangible investment income, but business income, traceable to an out-of-state source. Notably, New York tax law does not permit double taxation of such out-of-state

income, but provides a credit for taxes paid to the other state" (***Edelman v New York State Dept. of Taxation & Fin.***, 162 AD3d at 575). In turn, the Court in ***Chamberlain*** specifically accepted this analysis as persuasive and determined that the decision in ***Tamagni*** was not abrogated by ***Wynne***. As such, petitioners' argument is rejected.

H. The petitions of Allison Greenberg and Scott J. and Martha M. Farrell are denied and the notices of deficiency, dated March 27, 2018 and April 10, 2018, are sustained.

DATED: Albany, New York
July 14, 2022

/s/ Barbara J. Russo
ADMINISTRATIVE LAW JUDGE