STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition

of

CUSHLIN LIMITED

for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the years 2002 through 2008.

DETERMINATION
DTA NO. 829939

Petitioner, Cushlin Limited, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under article 9-A of the Tax Law for the years 2002 through 2008.

A videoconferencing hearing via CISCO WebEx was held on July 19, 2022, and continued on July 20, 2022, with briefs to be submitted by February 9, 2023, which date began the six-month period for issuance of this determination. Petitioner appeared by Roberts and Holland, LLP (Richard A. Levine, Esq. and Ellen Seiler Brody, Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (David Markey, Esq., of counsel). After reviewing the entire record in this matter, Jessica DiFiore, Administrative Law Judge, renders the following determination.

ISSUES

I. Whether the Division of Taxation's notices of deficiency had a rational basis.

II. Whether the Division of Taxation properly disallowed petitioner's claimed deductions.

III. Whether the Division of Taxation properly imposed a penalty for petitioner's failure to timely file its tax returns.

IV. Whether the Division of Taxation properly imposed penalties for petitioner's failure to properly compute its tax due.

FINDINGS OF FACT

The parties entered into a stipulation of facts, which has been incorporated into the findings of fact below.

1. Petitioner, Cushlin Limited, was a corporation formed under the laws of the Isle of Man.

2. Petitioner's business model was to acquire and refurbish three- and four-star hotels.

3. Petitioner owned an equity interest in the following limited liability companies (the underlying entities), each of which did business in New York during the years at issue:

(a) Central Park Hotel Associates LLC
(b) President Hotel Associates LLC
(c) Sheffield Hotel Associates LP
(d) Hampshire Hotels & Resorts LLC
(e) Consulate Hotel Associates LLC
(f) Kensington Hotel Associates LP
(g) Beverly Hotel Associates LLC
(h) Cornwall Hotel Associates LLC
(i) Dover Hotel Associates LLC
(j) Surrey Hotel Associates LLC
(k) Hampshire Hotels Manhattan LLC
(l) 310 W 52 Realty LLC (starting in 2004)
(m) 310 W 52 Holdings LLC (starting in 2004)

4. In 2008, the Division of Taxation (Division) commenced an audit of President Hotel Associates LLC (President), for the year 2005. President sold real property located in New York but did not file New York State partnership returns, forms IT-204.

5. During the audit of President, the Division learned of other underlying entities, as well as of petitioner, who had an ownership interest in these entities. Because of its ownership interest, petitioner was required to report the gains and losses of such entities, including from the real estate transaction of President. The Division commenced a limited scope field audit of petitioner in 2009.

6. The Division performed the audit of petitioner for years 2002 through 2006 (audit period 1), to determine whether the taxpayer reported the gains and losses correctly.

7. A second audit of petitioner for the same purpose was opened for the years 2007 through 2009 (audit period 2). The Division determined no additional tax was due for 2009.

8. The Division had an initial meeting with petitioner on May 13, 2009.

9. The Division met with petitioner multiple times from 2010 through 2013 and exchanged multiple phone calls. Throughout that time, petitioner repeatedly stated it was working on the returns and requested more time to prepare the returns for the underlying entities and for petitioner. Petitioner provided some draft tax returns for entities related to the underlying entities during that time.

10. In January of 2013, the auditor conducted a field visit of petitioner, where draft copies of tax returns for all entities were provided.

11. On November 29, 2013, the audit was transferred to a new auditor with the Division, Mr. Souren Das.

12. On June 24, 2014, Mr. Das received notice that petitioner had engaged Mr. Richard A. Levine of Roberts & Holland, LLP, as its representative for the audit.

13. In August of 2014, the Division met with Mr. Levine and provided him with a summary of the case history.

14. In March of 2015, petitioner began filing New York State partnership returns for the years at issue for certain of the underlying entities.

15. In April of 2015, petitioner's representative claimed that the returns for the other underlying entities would be finalized within a month and that he would send the original of petitioner's returns with a copy of the underlying entities returns at that time.

16. In September of 2015, the Division prepared an audit adjustment for taxes due from petitioner and sent it to petitioner's representative.

17. On May 4, 2016, the Division sent petitioner's representative a letter advising that an audit of petitioner's tax returns for audit period 1 had resulted in an increase to the tax liability in the amount of $45,306,458.00. The letter enclosed a consent to field audit adjustment (consent 1) reflecting the details of the proposed audit adjustments. Consent 1 listed a total tax due of $13,626,240.00 for audit period 1, plus interest and penalties.

18. On the same date, the Division sent petitioner's representative a letter advising that an audit of petitioner's tax returns for audit period 2 has resulted in an increase to the tax liability in the amount of $3,825,713.00. The letter enclosed a consent to field audit adjustment (consent 2) reflecting the details of the proposed audit adjustments. Consent 2 listed a total tax due of $1,557,414.00 for audit period 2, plus interest and penalties.

19. On or before June 15, 2016, petitioner late filed New York State general business corporation franchise tax returns (CT-3), for 2007 and 2008; general business corporation franchise tax return short forms (CT-4), for 2002 through 2006; and general business corporation MTA surcharge returns (CT-3M/4M), for all of the years at issue.

20. The forms CT-3 and CT-4 filed by petitioner showed negative capital for the years 2002 and 2003.

21. Petitioner's returns showed losses on federal form 8810, corporate passive activity loss and credit limitations, for each year at issue. The Division determined that petitioner failed to substantiate these claimed losses.

22. Petitioner deducted expenses on its federal and state tax returns that were incurred pursuant to its Management & Administrative Services Agreements with Kent Properties Limited for each year at issue. The Division determined that petitioner failed to support these expenses.

23. Petitioner retained Kent Properties Limited to assist with the refurbishment of the hotels by the underlying entities.

24. Petitioner also deducted expenses on its federal and state tax returns that were incurred in connection with the loan and guarantee agreement it entered into with Securelink Holdings Limited. The Division determined petitioner failed to support these expenses.

25. Petitioner needed the assistance of Securelink Holdings Limited to acquire funds to refurbish the hotels and to cover operating costs when cash flow was low.

26. The underlying entities deducted interest expenses each year at issue on their federal and state tax returns. The Division determined petitioner failed to support these expenses.

27. The underlying entities had to borrow funds for working capital, repairs, and capital improvement.

28. When petitioner filed the tax returns, the income reported on the returns was higher than the income amount it originally informed the Division it would be. The taxpayer also deducted larger expenses against that income.

29. After receiving petitioner's returns, and to verify the expenses reported thereon, on July 8, 2016, the Division sent petitioner's representative a letter enclosing Information

Document Request (IDR) number 1, covering both audit periods. This IDR requested that petitioner explain the source of the passive activity losses and how the losses allow the company to reduce the taxable income to zero by deducting passive losses every year. The IDR also requested that petitioner explain the decrease in its United States (U.S.) equity amount.

30. On July 29, 2016, petitioner's representative sent the Division a letter in response to IDR number 1. In response to the request for an explanation as to the source of passive activity losses, petitioner's representative stated that the taxpayer holds an interest in various limited liability companies that operate in New York. He continued that as petitioner does not materially participate in the entities within the meaning of Internal Revenue Code § 469 (h), all income and losses realized by those entities are passive activity losses which flow through to petitioner and may be used by petitioner to offset passive activity income. He explained that any net unused passive activity losses realized in one year carry forward to future years indefinitely and may be used by petitioner to offset passive activity income in the subsequent year. He enclosed a schedule setting forth the sources of the passive activity for each year and the forms 8810 from which they were derived.

When asked to explain the decrease in U.S. equity, petitioner's representative responded that the decrease each year reflects the losses that flow to the taxpayer from its interests in the LLCs. The letter stated that "U.S. equity is equivalent to corporate retained earnings."

31. On September 8, 2016, the Division sent petitioner's representative a letter acknowledging information received with a letter dated July 29, 2016, in response to the Division's IDR number 1 and enclosing IDR number 2 for both audit periods. IDR number 2

requested documentation supporting the losses claimed on form 8810 from tax year 2000 to 2008, and documentation supporting a decrease in U.S. equity.[1]

32. On November 7, 2016, petitioner's representative sent a letter to the Division in response to IDR number 2. In response to the Division's request for documentation supporting the losses claimed in form 8810 from 2000 through 2008, petitioner's representative stated that the losses reported primarily came from passive losses for the entities in which petitioner owns an interest. Petitioner received a schedule K-1 each year from those entities that set forth petitioner's aliquot share of those losses. The letter stated that petitioner had previously sent a schedule reflecting, by year, the losses that flow through to petitioner as indicated in the schedules K-1 it received. Enclosed with the letter, were the schedules K-1 received by petitioner for each tax year from 2000 through 2008.

In response to the Division's request for documentation regarding a decrease in U.S. equity, the letter stated that it was primarily from the losses generated each year that flow through to petitioner. Petitioner's representative also enclosed a schedule setting forth the activity from form 1120-F, U.S. income tax return of a foreign corporation, page 5, section III, lines 4a, 4b, 4c (where applicable) and 4d (where applicable) regarding the decrease in U.S. net equity for each tax year 2000 through 2008.

33. Petitioner's responses to both IDRs included invoices and schedules but did not provide any third-party verifiable documentation or proof of payments.

34. On January 18, 2017, Mr. Das met with Mr. Levine to discuss passive losses. At that meeting, Mr. Das informed Mr. Levine that "[w]e said we want itemization of income and

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[1] The caption of IDR number 2 states that the audit years included only those ended December 31, 2002 through December 31, 2006. However, the requests within IDR number 2 involve information from both audit periods.

expenses for all entities that will tie to the loss claimed. Rep will do it as a sample for one year and if that is acceptable [sic] they will do the rest."

35. On February 8, 2017, petitioner's representative sent the Division a letter enclosing returns for 310 W 52 Realty LLC, 310 W 52 Holdings LLC, and Central Park Hotel Associates LLC, for the years 2004 through 2011, and for Cornwall Hotel Associates LLC, Dover Hotel Associates LLC, and Sheffield Hotel Associates LP, for the years 2004 through 2011.

36. On May 2, 2017, Mr. Levine provided Mr. Das with a schedule itemizing income and expenses for petitioner and for the underlying entities for the year 2004.

37. On May 8, 2017, Mr. Das sent petitioner's representative a letter acknowledging receipt of the reconciliation and detailed breakdown by entity of petitioner's losses for 2004 and requesting the same information for every other year for the period 2000 through 2009 by June 8, 2017.

38. On June 12, 2017, Mr. Levine provided similar schedules itemizing income and expenses of the underlying entities and reconciling them to petitioner's income and loss for calendar years 2002, 2003, and 2006 through 2009. These schedules were prepared in the same manner and using the same template that were previously accepted by Mr. Das for 2004.

39. On August 9, 2017, Mr. Levine provided similar schedules itemizing income and expenses of the underlying entities and reconciling them to petitioner's income and loss for calendar years 2000 and 2001. These schedules were prepared in the same manner and using the same template that was previously accepted by Mr. Das for the year 2004. The letter stated that petitioner was not able to locate copies of the returns for all the entities, and for those entities where the return could not be located, the schedule reflected the information reported on the schedule K-1 that was provided by the entity.

40. On August 29, 2017, Mr. Das sent petitioner's representative a letter acknowledging receipt of the information he provided. The letter also advised that additional information was requested, and he enclosed IDR number 3. At that point, the audit of petitioner had been open for approximately eight years.

41. IDR number 3, dated August 29, 2017, requested the following: (i) reconciliations and detailed breakdowns by entity of petitioner's income and loss for 2005; (ii) documentation and details to support "other passive deductions" for all years under audit; (iii) loan agreements and details for the loans related to interest expenses deducted for all years under audit, including principal amount, interest paid, purpose of each loan, how loan proceeds were used, work papers used to compute the interest expense deduction; and (iv) an explanation of how ordinary income was negative for some entities in some years, with work papers showing the calculations for the negative ordinary income.

42. On October 3, 2017, petitioner's representative sent the Division a letter enclosing a schedule for tax year 2005 that showed the income or loss for each entity that flowed to petitioner.

43. On October 25, 2017, petitioner's representative sent the Division an additional response to IDR number 3, enclosing a schedule detailing the items that comprise "other passive deductions" for tax years 2001 through 2009 that was referred to in the previously provided schedules.

The letter also stated that the Division had inquired about the category "ordinary income," which for some entities was reported as a profit, and for others, a loss. This category only appeared on the schedules for 2000 and 2001 for those entities and the tax returns for those years could not be found. In the absence of tax returns, the accountants who prepared the

schedules did not have information regarding the amount of revenue and details regarding the expenses. In order to complete the schedules, the accountants used the net income or net loss shown in the tax returns of Hampshire Hotels Manhattan LLC.

44. On February 5, 2018, the Division sent petitioner's representative a letter regarding IDR number 3. The letter stated that the Division received two mailings, dated October 3, 2017, and October 25, 2017, respectively, but that these letters were incomplete and/or unsubstantiated. The letter also provided that the Division had multiple conversations with petitioner's representative, on October 30, 2017, December 21, 2017, and January 22, 2018, and that, to date, the Division had not received a complete response to IDR number 3. The letter stated that if the Division did not receive a response by February 19, 2018, it would issue an assessment based on the information it had available.

45. In further response to the Division's IDR number 3, with a letter dated February 20, 2018, petitioner's representative sent a schedule showing the details of expenses incurred by petitioner that qualified as "other passive deductions" for the tax years 2002 through 2009. Petitioner's representative explained that these expense items were shown on petitioner's financial statements under the heading "operating expenses." He also enclosed copies of petitioner's financial statements for tax years 2002 through 2009, as well as copies of invoices for the years 2002 through 2009 for the annual management fee from Kent Properties Limited, and invoices for the Loan and Guarantee fee from Securelink Holdings Limited. Petitioner also enclosed schedules showing the calculation of interest charges incurred for the loan agreements of Hampshire Hotels Manhattan LLC.

46. Because petitioner failed to meet the deadline stated in the Division's letter of February 5, 2018, the Division sent petitioner's representative a letter on March 1, 2018,

advising that an audit of petitioner's New York State tax returns for audit period 1 has resulted in an increase to the tax liability in the amount of $52,744,930.00. Enclosed with the letter was a consent to field audit adjustment (consent 3), detailing the proposed audit adjustments. The letter provided that if petitioner's representative disagreed with the findings, he should contact the auditor by March 14, 2018, and that he may submit evidence to substantiate his position.

Consent 3 listed a tax due of $13,626,240.00, plus interest and penalties. Penalties were imposed pursuant to Tax Law § 1085 (a) (1), for failure to file a return, Tax Law § 1185 (b) (1), for deficiency due to negligence, and Tax Law § 1185 (b) (2), for a subsequent deficiency due to negligence.

47. The schedule E, that forms the entire net income basis for the determination of the tax due by petitioner for audit period 1, provides the following:

Year:	2002	2003	2004	2005	2006	**Total**
President			264,946.00	40,481,937.00	8,903,651.00	**49,650,534.00**
Kensington				(4,688,113.00)	(1,179,919.00)	**(5,868,032.00)**
Surrey					(1,021,339.00)	**(1,021,339.00)**
Beverly				(1,001,660.00)	(49,829.00)	**(1,051,489.00)**
Sheffield (N/F)			(170,089.00)	49,733,469.00	1,367,030.00	**50,930,410.00**
Dover (N/F)			13,553,168.00	(295,973.00)	63,070.00	**13,320,265.00**
Cornwall (N/F)	1,862,024.00	1,653,273.00	30,692,079.00	(52,794.00)	-	**34,154,582.00**
Central Park (N/F)			82,714.00	5,141,462.00	6,077.00	**5,230,253.00**
	1,862,024.00	**1,653,273.00**	**44,422,818.00**	**89,318,328.00**	**8,088,741.00**	**145,345,184.00**

48. The schedule E for audit period 1 does not indicate the source of the figures included in the schedule. The figures on the schedule E were used as the entire net income for the years 2002 through 2006, to determine the entire net income tax base for those years. Schedule E does not show disallowances of any deductions claimed by petitioner on the returns that were filed thereafter.

49. On the same date, the Division sent petitioner's representative a letter advising that an audit of petitioner's New York State tax returns for audit period 2 has resulted in an increase of tax liability in the amount of $4,466,426.00. Enclosed with the letter was a consent to field audit adjustment (consent 4), detailing the proposed audit adjustments. The letter provided that if petitioner's representative disagreed with the findings, he should contact the auditor by March 14, 2018, and that he may submit evidence to substantiate his position.

Consent 4 listed a tax due of $1,557,414.00, plus interest and penalties. Penalties were imposed pursuant to Tax Law § 1085 (a) (1), for failure to file a return, Tax Law § 1185 (b) (1), for deficiency due to negligence, and Tax Law § 1185 (b) (2), for a subsequent deficiency due to negligence.

50. The schedule E, that forms the entire net income basis for the determination of the tax due by petitioner for audit period 2, provides the following:

Year:	2007	2008	Total
President	(10,493.00)	(14,666.00)	**(25,159.00)**
Kensington	70.00	(1,880,819.00)	**(1,880,749.00)**
Surrey	(482,499.00)	(822,268.00)	**(1,304,767.00)**
Beverly	(2,625,014.00)	1,895,901.00	**(729,113.00)**
Sheffield (N/F)	1,457,527.00	15,695,188.00	**17,152,715.00**
Dover (N/F)	(266,990.00)	(1,564,101.00)	**(1,831,091.00)**
Cornwall (N/F)	(2,003.00)	(4,321.00)	**(6,324.00)**
Central Park (N/F)	(11,634.00)	(3,471.00)	**(15,105.00)**
	(1,941,036.00)	**13,301,443.00**	**11,360,407.00**

51. The schedule E for audit period 2 does not indicate the source of the figures included in the schedule. The figures on the schedule E were used as the entire net income for the years 2007 and 2008 to determine the entire net income tax base for those years. Schedule E does not show disallowances of any deductions claimed by petitioner on the returns that were filed thereafter.

52. The capital basis the Division used for determination of capital base tax due for each year for both audit periods was $196,629,210.00. The Division verified the fair market value of

real estate for purposes of the capital base tax by reviewing real estate transfer tax returns (RETT returns) that were filed for some of the underlying entities during the periods at issue. Based on the amounts listed in the RETT returns, the auditor determined that the fair market value of petitioner's real estate holdings exceeded the amount that would result in the maximum capital tax for the years at issue. Accordingly, the Division used $196,629,210.00 for the total capital, because that amount multiplied by the tax rate resulted in the maximum capital tax allowed by statute of $350,000.00.

53. On March 12, 2018, petitioner's representative sent the Division a letter stating that petitioner disagreed with the Division's adjustments for years ended December 31, 2002 through December 31, 2006. Petitioner's representative asserted that the proposed adjustments ignore petitioner's submissions made to the Division during the audit, including the tax returns filed for tax years 2002 through 2006, and its responses to the Division's IDRs. Petitioner's representative also asserted that the proposed audit adjustment in the amount of $350,000.00 in tax for 2002 and 2003 was based on an erroneous amount of capital, and that the actual capital for those years was negative. He also asserted that the proposed audit adjustments fail to indicate how the amount of capital, which is claimed to be the same for tax years 2002 through 2008, was determined. Petitioner's representative requested that the Division provide justification for the amount of capital asserted as the basis for its calculations. Petitioner's representative also stated that the proposed audit adjustments fail to reflect the figures used for the tax returns for the underlying entities.

54. In a second letter dated March 12, 2018, petitioner's representative sent the Division a letter stating that petitioner disagreed with petitioner's adjustments for years ended December 31, 2007 and December 31, 2008. Petitioner's representative asserted that the proposed

adjustments ignore petitioner's submissions made to the Division during the audit, including the tax returns filed for tax years 2007 and 2008, and its responses to the Division's IDRs. Petitioner's representative also asserted that the proposed audit adjustment in the amount of $350,000.00 in tax for tax year 2007 was based on an erroneous amount of capital, and that the actual capital for those years was negative. He also asserted that the proposed audit adjustments fail to indicate how the amount of capital, which is claimed to be the same for tax years 2002 through 2008, was determined. Petitioner's representative requested that the Division provide justification for the amount of capital it determined was the basis for its calculations. Petitioner's representative also asserted that the proposed audit adjustments fail to reflect the figures used for the tax returns for the underlying entities.

55. The Division sent petitioner two closing letters dated March 19, 2018, each of which included a statement of the tax due, plus interest and penalties, for the two audit periods. The amounts in the closing letters were the same as the amounts in consents 3 and 4, respectively.

56. On March 22, 2018, the Division issued a notice of deficiency, assessment ID number L-047830045, for audit period 1, asserting tax in the amount of $13,626,240.00 plus interest and penalties, and notice of deficiency, assessment ID number L-047829734, for audit period 2, asserting tax in the amount of $1,557,414.00, plus interest and penalties. The notices do not provide the relevant sections of the Tax Law upon which the assessment is based or the specific tax periods.

57. Petitioner requested a conciliation conference before the Bureau of Conciliation and Mediation Services (BCMS) protesting the notices. A conciliation conference was held on November 26, 2018.

58. On November 30, 2018, Mr. Das sent petitioner's representative a letter requesting additional documentation. The letter stated that petitioner had previously provided invoices to support management and administration fees but that the Division needed more extensive documentation substantiating management and administration fees. The letter asked petitioner to refer to the schedule it had previously provided, breaking down management and administration fees per year and asked for the management agreements and payment schedules, with proof of payment, payees, worksheets for fee calculation, and any other relevant information related to the management and administration fees.

The letter also acknowledged that petitioner had previously provided invoices to support some of the loan and guarantee fees but stated that the Division needed more extensive documentation to substantiate the loan and guarantee fees. The Division requested that petitioner refer to the schedule it had previously provided, breaking down the loan and guarantee fees per year and asked for the loan agreements/contracts, payment schedules with proof of payment, payees, worksheets for fee calculation as well as any other relevant information related to these loan and guarantee fees.

The letter further asked for documentation substantiating interest expenses claimed in the schedules the petitioner had previously provided. This included loan agreements or contracts containing the principal amount, interest paid, purpose of each loan, how loan proceeds were used and work papers for interest computation as well as any other relevant information related to these interest expenses.

The letter also requested a breakdown of ordinary income (loss) with work papers showing how the negative ordinary income was calculated per the following schedule:

Year	Entity	Amount ($)
2000	Central Park Hotel Associates	(642,241)
2000	Hampshire Hotels and Resorts	(51,557)
2000	Surrey Hotel Associates	(3,073,761)
2001	Hampshire Hotels and Resorts	(1,268,699)
2001	Consulate Hotel Associates	(1,096,908)
2001	Beverly Hotel Associates	(1,805,568)

59. On March 28, 2019, petitioner's representative sent the conferee a letter as an initial response to the Division's request for documents, enclosing an intercompany payable schedule between petitioner and its parent company, two management and administrative service agreements between Kent Properties Limited and petitioner, the first effective as of January 9, 2001, and the second effective as of January 4, 2006, and copies of various notes for the claimed expenses.

60. On July 29, 2019, petitioner's representative sent the conferee a second later stating that obtaining additional documentation is challenging because the documents are more than 20 years old, the taxpayer has undergone several moves and personnel changes, and the parent company who maintained the records is located outside of the United States. Petitioner's representative also requested a detailed calculation of the tax the Division asserted is due. Enclosed with this letter, petitioner's representative provided schedules for the calculation of interest charges on some of the loans.

61. By conciliation order dated February 14, 2020, the conferee sustained the statutory notices.

62. The Division did not respond to petitioner's request for a detailed calculation of the tax due.

63. The petitioner timely filed a petition with the Division of Tax Appeals on or about May 14, 2020, in protest of the conciliation order.

64. During the hearing, petitioner called Peter Allmark, an accountant in the United Kingdom who petitioner hired as a consultant in May of 2014. As an accountant, Mr. Allmark primarily works with hotels. He testified that he reviewed petitioner's books and records as well as its financial statements for 2002 through 2008.

65. Mr. Allmark testified that petitioner did not have its own bank account. He asserted that petitioner's parent company, which he referred to as a "participation company," Simlle Limited, made payments on its behalf and charged petitioner in an intercompany accounts payable/accounts receivable. However, when asked during cross-examination whether all invoices were paid, Mr. Allmark responded that he would "presume" that they were being paid but that he did not provide proof of payment of the invoices during the audit or work with the auditors during the audit.

66. Mr. Allmark also testified that Hampshire Hotels Manhattan LLC (Hampshire) was the borrower for the loans that were arranged by Securelink, and that Hampshire was a subsidiary of petitioner.

67. During the hearing, petitioner elicited testimony from John Bartiuk, CPA, the accountant who prepared petitioner's federal and state tax returns for the periods at issue. Mr. Bartiuk testified that he prepared the returns using the financial statements for petitioner, a trial

balance and financial statement for Hampshire, and K-1s. He explained that Hampshire was an entity mostly owned by petitioner through 2004 and owned entirely after 2004 as a single member limited liability company that held many of the underlying investments. Mr. Bartiuk did not look at any of the source documents to prepare the returns.

68. Mr. Bartiuk testified that the calculation of capital base that was reported on the returns included petitioner's investment in the underlying entities.

69. Mr. Das, who inherited the instant audit, did not perform a calculation of the capital base for any of the years at issue.

70. During the hearing, Mr. Das confirmed that he determined the amounts due based on the schedules E that he received from the prior auditor and that he did not use any of the information that was reported on the tax returns for the audit periods.

71. Mr. Das testified that the total tax determined to be due was based on the "pro forma" numbers that were previously provided by the petitioner to the prior auditor, because those were verified by the Division using its real estate transaction database. He cited to the relevant pages in his audit file showing the prior auditors draft schedules and the pages reflecting the real estate transfers of the underlying entities.

72. Mr. Das testified that when the Division received the returns in 2016, he reviewed them and saw that the numbers, especially the income amounts reported, were higher than what the taxpayer originally said they would be pursuant to the pro forma numbers. He also found that the taxpayer had been deducting large expenses against that income. The Division wanted to confirm the high expenses that petitioner had reported so Mr. Das issued IDRs. Mr. Das testified that initially, petitioner provided explanations through invoices and schedules but no third-party verifiable documentation or any proof of payment. Petitioner gave partial responses, but no

complete information backed up by supporting documents. He stated that for IDR number 3, the petitioner did not respond by the deadline given, and that the Division felt that petitioner had been given reasonable time to provide the information, so he prepared consents 3 and 4.

Mr. Das then testified that petitioner did respond after the deadline provided, but again, the documentation was limited to schedules and explanations without third-party documentation for the expenses, and proof of payments. At that time, the Division closed the audit.

73. Mr. Das testified that on the CT-3 and CT-4 returns there were some years where petitioner did not calculate the entire net income base correctly, and, for other years, where the entire net income did not apply, the capital base tax was not calculated correctly. He explained that the capital base had to be adjusted for the fair market value of real property and marketable securities and the returns did not include the calculation.

74. Mr. Das also testified that some of the documents submitted at BCMS substantiated some of the interest expenses reported on the returns but explained that they were only a small part of what petitioner deducted. He explained that for the expenses petitioner claimed, there were different categories of expenses and for some of the categories, petitioner did not substantiate what they reported at all, and for others, they only provided minimal substantiation.

75. The auditor who initially commenced the audit of petitioner did not appear or testify at the hearing.

76. Pursuant to 20 NYCRR 3000.15 (d) (6), petitioner submitted 60 proposed findings of fact and the Division submitted 19 proposed findings of fact. In accordance with State Administrative Procedure Act § 307 (1), petitioner's proposed findings of fact 1, 2, 4 through 7, 9 through 17, 19 through 25, 27 through 43, 49, 53, and 58 are supported by the record, and have been consolidated, condensed, combined, renumbered, and substantially incorporated herein.

Petitioner's proposed findings of fact 3, 8, 18, 45 through 47, 50, 51, 54, 56, 57, 59 and 60 have been modified to more accurately reflect the record and/or accepted in part and rejected in part as conclusory, irrelevant and/or not supported by the record; to the extent accepted they have been consolidated, condensed, combined, renumbered, and substantially incorporated herein, as modified. Petitioner's proposed findings of fact 26, 44, 48, 52, and 55 are rejected as conclusory, irrelevant and/or not supported by the record.

77. The Division's proposed findings of fact 1, 2, 4, 5, 10, 12, 14, 17 are supported by the record, and have been consolidated, condensed, combined, renumbered, and substantially incorporated herein. The Division's proposed findings of fact 3, 6 through 9, 11, 13, 15, 16, 18, 19 have been modified to more accurately reflect the record and/or accepted in part and rejected in part as conclusory, irrelevant and/or not supported by the record; to the extent accepted they have been consolidated, condensed, combined, renumbered, and substantially incorporated herein, as modified.

SUMMARY OF THE PARTIES' POSITIONS

78. Petitioner argues that the notices of deficiency are invalid because they do not have a rational basis. In support of this position, petitioner points to the fact that there is no explanation in the notices for the basis of the deficiencies and claims that the schedules E that the Division provided as the basis for the tax due for each audit period are not supported as there was no specific items that were being added back or expenses that were being disallowed. Petitioner also notes that the Division's calculation of the tax due was prepared before petitioner's returns were filed and before most of the returns for the underlying entities were filed. They were also prepared before petitioner was sent and responded to the Division's IDRs. In support of its argument, petitioner also relies on the fact that Mr. Das, the second auditor, admitted that he

relied on a schedule he inherited from the prior auditor that failed to take into consideration the returns that were actually filed when making his audit adjustments.

Petitioner stated that Mr. Das testified that the returns which were filed showed more gross income and deductions than the pro forma schedule he relied on, but that he knew the pro forma figures had been "verified" based on the real estate property transactions, *i.e.*, the sale of those properties that were sold by the underlying entities. Petitioner argues that Mr. Das ignored the tax returns that reflected more than just the sale of real property, including the operating income and expenses incurred each year. Petitioner also asserts that as none of the underlying entities engaged in more than one real estate sale, it is unclear how the adjustments for the years in which there was no transaction were "verified." Petitioner claims that the tax determined to be due does not relate to any expenses claimed by petitioner on its returns and that no explanation was provided as to why there were issues for some years and not others and for some underlying entities and not others.

Petitioner also argues that the matters raised by the Division at BCMS should not be considered because petitioner repeatedly requested explanations for the determination of tax due in the notices so that it could explain why the deficiency was incorrect, but the Division never provided an explanation. Petitioner also asserts that it substantiated the deductions questioned by the Division at BCMS, including the following: (i) the Management and Administrative Services Agreements between petitioner and Kent Properties Limited that were in effect during the years at issue; (ii) invoices from Kent Properties Limited from each year under audit; (iii) an intercompany payables schedule between petitioner and its parent company, Simlle Limited; (iv) annual invoices for the Loan and Guarantee fees from Securelink Holdings Limited; and (v)

notes showing the principal amount and applicable interest rate for loans for many of the underlying entities.

Petitioner also argues that the Division failed to calculate the capital base when determining the proper tax to impose, and instead assumed that the capital base was at least $196,629,210.00, which is the maximum amount of capital that results in $350,000.00, the maximum tax allowed under this method. It also asserts that the Division used the wrong method for calculating the capital base for 2002 and 2003, and asserted that for those years, the value of a partnership interest owned by a taxpayer was based on the book value of the partnership and not the fair market value of the assets owned by the partnership, and that since the partnership interests are personal property, such interest should be valued at book value pursuant to generally accepted accounting principles (GAAP) rules for the purpose of computing liability under the capital base. Petitioner further argues that for all three of the years where the Division determined additional tax due using the capital base, the capital base was negative due to the losses incurred in each of those years.

79. The Division contends that petitioner has not substantiated its claimed losses and deductible expenses, and, therefore, the notices should be sustained. The Division asserts that the notices provide that they are based on petitioner's recent audit, and that the amount due on each notice was the same as the amount due in the closing letter, as well as the applicable consent to field audit adjustment that the Division previously sent to petitioner at the completion of the audit. The Division states that Mr. Das explained at the hearing that the amount of tax due on the notices was based on the schedules that were attached to the consents sent to petitioner, and that the schedules were created from numbers that the Division obtained from the taxpayer that they were able to verify on their real property transactions database. The Division also

claims that at BCMS, the Division gave petitioner yet another opportunity to substantiate its deductions. However, petitioner was not able to adequately do so. The Division asserts that petitioner failed to provide proof to substantiate its claimed losses and deductible expenses.

The Division also claims that petitioner did not calculate the entire net income (ENI) base correctly for some years and for other years where the entire net income base did not apply, the capital base tax was not calculated correctly. The Division asserts that the capital base tax is computed using assets less liabilities adjusted for the fair market value of the real estate and marketable securities. The Division claims that petitioner failed during the audits to substantiate an alternative capital base tax computation or to respond to the Division's computation. The Division contends that petitioner's interpretation of the correct method for computing the capital base tax relates only to 2002 and 2003, as those were the years in which the capital base tax was the highest of the four bases. The Division states that, therefore, under petitioner's interpretation, the tax due would be reduced for only those two years, by utilizing the ENI base plus the Metropolitan Transportation Authority tax as the ENI was the next highest of the four bases.

The Division further argues that the penalties were properly imposed and should not be abated. It asserts that petitioner has failed to establish that its failure to timely file its returns was due to reasonable cause and not due to willful neglect, and that it has not proven that its deficiency was not attributable to negligence.

CONCLUSIONS OF LAW

A. There is a presumption of correctness that attaches to a notice of deficiency issued by the Division to a taxpayer (***see Matter of Greenfeld***, Tax Appeals Tribunal, March 7, 2019, citing ***Matter of Leogrande v Tax Appeals Trib.***, 187 AD2d 768 [3d Dept 1992], ***lv denied*** 81

NY2d 704 [1993]). Petitioner bears the burden of proving by clear and convincing evidence that the assessment on such notice is erroneous (***see Matter of Greenfeld***; ***see also Matter of O'Reilly***, Tax Appeals Tribunal, May 17, 2004).

An estimated audit of a taxpayer's income, whether under personal income tax or corporation franchise tax, requires only a rational basis to be sustained on review (***see Mediabuss Systems, Inc.***, Tax Appeals Tribunal, March 18, 2014). If a taxpayer fails to file a tax return, the Division may estimate the taxpayer's New York tax liability from any information in its possession (***see*** Tax Law § 1081 [a]; ***Matter of Rujak Trucking Corp.***, Tax Appeals Tribunal, April 1, 1993). Additionally, where there is some factual basis for determining that the tax returns, as filed, do not accurately reflect the true income received by a taxpayer, the Division may determine proper income by using an indirect audit method (***see R & J Automotive, Inc.***, Tax Appeals Tribunal, June 15, 1989).

During the audit, petitioner provided the Division with pro forma numbers that petitioner alleged were based on the returns petitioner was eventually going to file. However, the numbers repeatedly changed. Nevertheless, as testified to by the Division's auditor, the Division was able to verify the numbers for the real estate transactions from information in its records. When petitioner finally filed returns seven years after the audit began, it was unable to substantiate the deductions claimed. Accordingly, where the Division utilized the numbers provided by petitioner that were verified on its real estate transaction database, the Division established a rational basis for the tax due in the notices of deficiency.

B. Article 9-A of the Tax Law imposes a franchise tax on all domestic and foreign corporations doing business, employing capital, owning or leasing property, or maintaining an office in New York State (***see*** Tax Law § 209 [1] [a]). Corporations located within the

Metropolitan Commuter Transportation District are also subject to an additional surcharge tax (***see*** Tax Law former § 209-B). During the years at issue, corporations reported their article 9-A tax liability on the greatest of four alternative bases, including the ENI base; the capital base; the minimum taxable income base; and the fixed dollar minimum (Tax Law former § 210 [1]; 20 NYCRR3-1.2 [a]). When reviewing petitioner's returns, the Division found that, in some years, petitioner did not calculate the entire net income base correctly and for other years, where the entire net income base did not apply, the capital base tax was not calculated correctly.

C. Petitioner bears the burden of establishing entitlement to the claimed deductible expenses at issue herein (***see*** Tax Law § 1089 [e]; ***Matter of Macaluso***, Tax Appeals Tribunal, September 22, 1997 ***confirmed*** 259 AD2d 795 [1999]). The burden is not on the Division to establish why it disallowed them (***see id.***). Here, petitioner failed to meet its burden. Petitioner was required to report the gains and losses from the transactions of the underlying entities. For years, petitioner continually promised the Division that it was about to file returns and sent the Division numbers that it claimed would eventually be reported on the returns. Finally, in 2016, seven years after the Division initiated its audit of petitioner, it late-filed its returns.

To verify petitioner's claimed expenses, the Division issued several IDRs. However, in response to the IDRs, petitioner provided invoices and their own schedules. Finally, during BCMS, petitioner offered copies of loans as well as management and guarantor agreements. However, they were not sufficient to substantiate the deductions and losses claimed in the late-filed returns. Petitioner also failed to provide proof of payment for any of the invoices submitted. Schedules without any source documents verifying the payment are not enough. Petitioner failed to meet its burden that the notices of deficiency at issue herein were not proper.

Petitioner repeatedly argues, without citing to any caselaw or statutory support for its position, that because Mr. Das did not use information from the returns in his assessment and did not explain the basis for the audit adjustments, the notices are invalid. This argument is without merit. The Division began the audit of petitioner in 2009, after waiting several years, the Division reviewed the records that were available to it, including numbers that were previously provided by petitioner and information from its real estate transaction database, to determine the tax due. The Division was not under an obligation to perform another audit because petitioner finally filed its returns years after they were due. Additionally, when the Division asked for the documentation in support of what was filed in the returns, which notably, did not match the information previously conveyed to the Division, the only items petitioner produced for years were schedules and returns, without any source documents.

Petitioner repeatedly asserts that the Division did not explain its basis of the audit adjustments yet fails to substantiate the information it reported on the returns. Finally, at BCMS, petitioner produced some source documentation to substantiate some of its claimed deductions. However, this alone was insufficient, and the Division was again under no obligation to commence yet another audit because petitioner finally produced documents to support returns that were years overdue. The submissions petitioner made in response to the IDRs and the Division's document request at BCMS do not rise to the level of clear and convincing evidence necessary to overcome the presumption of correctness that attaches to a notice of deficiency and petitioner has not meet its burden of proving error in the Division's audit findings.

D. For the years 2002, 2003, and 2007, the auditor determined that the tax computed using the capital base method would be higher than the other three bases. The capital base imposes a tax upon the total of a taxpayer's business and investment capital allocated within

New York (***see*** Tax Law former § 210 [1] [b]). Tax Law § 210 (2) provides rules for the valuation of investment capital and business capital for the purpose of computing the tax under the capital base and states, in relevant part, the following:

> "The amount of investment capital and business capital shall be determined by taking the average value of the assets included therein . . . *For purposes of this subdivision, real property and marketable securities shall be valued at fair market value and the value of personal property other than marketable securities shall be the value thereof shown on the books and records of the taxpayer in accordance with generally accepted accounting principles*" (emphasis added).

The issue here is whether the petitioner's partnership interest constitutes "personal property" valued at book value in accordance with GAAP for purposes of computing the franchise tax liability under the capital base. Petitioner cites to the Administrative Law Judge determination, ***Matter of Arcade Broadway Plaza Rentals, Inc.*** (Division of Tax Appeals, December 31, 1998) for the proposition that prior to 2007, the value of a partnership interest owned by a taxpayer was based on the book value of the partnership interest and is not based on the fair market value of the assets owned by the partnership. This argument is rejected.

Determinations issued by administrative law judges "shall not be cited," and "shall not be considered as precedent" (Tax Law § 2010 [5]; ***Matter of Flair Beverages Corp.*** [Tax Appeals Tribunal, December 2, 2021]). Moreover, the Division properly determined petitioner's business capital utilizing the fair market value of its partnership assets, here, the underlying entities real property (***see*** Tax Law § 210 [2]; ***Matter of National Bulk Carriers, Inc.***, NYC Tax Appeals Trib., November 30, 2007, ***confirmed National Bulk Carriers, Inc. v New York City Tax Appeals Trib.***, 61 AD3d 522 [1st Dept 2009], ***lv denied*** 12 NY3d 716 [2009]).

In ***National Bulk Carriers, Inc.***, in interpreting a New York City Administrative Code § 11-604.2, a statutory provision identical to Tax Law § 210 (2), the New York City Tax Appeals Tribunal (City Tribunal) affirmed the City Administrative Law Judge's determination holding

that for purposes of computing petitioner's business capital under the capital base method, petitioner was required to include its ratable share of the partnerships' property in its business capital valued at the fair market value (***see id.***). The Appellate Division, First Department, confirmed the City Tribunal's decision, finding it to be "rationally based and supported by substantial evidence" (***National Bulk Carriers, Inc.***, 61 AD3d 522). Accordingly, the Division properly verified the fair market value of the real estate in determining the capital base and, ultimately, the capital base tax.

E. The Division imposed penalties on petitioner for failure to timely file returns pursuant to Tax Law § 1085 (a) (1) and for a deficiency due to negligence or intentional disregard pursuant to Tax Law §§ 1085 (b) (1) and 1085 (b) (2). Petitioner bears the burden of proving that penalties were improperly assessed (***see Matter of Ross-Viking Mdse. Corp. v. Tax Appeals Trib. of State of N.Y.***, 188 AD2d 698, 699 [3d Dept 1992]). Penalties for untimely filing may be abated upon the showing of reasonable cause and a lack of willful neglect (***see*** Tax Law § 1085 [a] [1]). Penalties pursuant to Tax Law §§ 1085 (b) (1) and 1085 (b) (2) may be waived if it is determined that the deficiency was not due to negligence or intentional disregard of the article 9-A rules and regulations. Petitioner did not address these penalties and, as such, has failed to meet its burden of showing that its failure to timely file was due to reasonable cause and not willful neglect and has failed to meet its burden that the deficiency was not due to negligence or intentional disregard of article 9-A.

F. The petition of Cushlin Limited is denied and notices of deficiency, assessment numbers L-047830045 and L-047829734, dated March 22, 2018, are sustained.

DATED: Albany, New York
July 13, 2023

/s/ Jessica DiFiore
ADMINISTRATIVE LAW JUDGE