

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :
of :
DIAN WOODNER : ORDER
for Redetermination of a Deficiency or for Refund of : DTA NO. 827879
New York State and New York City Personal Income Tax :
under Article 22 of the Tax Law and the Administrative :
Code of the City of New York for the Year 2009. :
:

Petitioner, Dian Woodner, filed a petition for redetermination of a deficiency or for refund of New York State and New York City personal income tax under article 22 of the Tax Law and the Administrative Code of the City of New York for the year 2009.

The Division of Taxation, appearing by Amanda Hiller, Esq. (Charles Fishbaum, Esq. of counsel), filed a motion, dated November 27, 2017, seeking an order, pursuant to 20 NYCRR 3000.6 (a) (4), precluding petitioner from presenting evidence at hearing with respect to all items for which defective or inadequate particulars were provided. In opposition to the motion, petitioner, appearing by Katten Muchin Rosenman LLP (Michael M. Rosensaft, Esq., of counsel), filed a response to the Division's motion, dated December 26, 2017, and annexed exhibits. The 90-day period for issuance of this order commenced on December 27, 2017. Based upon the pleadings, motion papers and other documents filed by the parties, James P. Connolly, Administrative Law Judge, renders the following order.

ISSUE

Whether the Division of Taxation's motion seeking an order of preclusion should be granted.

FINDINGS OF FACT

1. Petitioner commenced this proceeding by filing a petition on October 6, 2016 with the Division of Tax Appeals in protest of a notice of deficiency, dated March 7, 2014, which asserted additional New York State and City personal income tax due, plus penalty and interest, for the year 2009.

2. The basis for the asserted deficiency is the audit determination of the Division of Taxation (Division) that petitioner, on her 2009 New York State and New York City personal income tax return, failed to properly report a gain from a transaction in 2009 (2009 Transaction). In that transaction, petitioner transferred her 50% membership interest in Avenue All Stars LLC (AAS) in return for AAS's transfer to her of its interest in 21 East 67th St. Associates LLC (ESA). The Division maintains that, as part of that transaction, AAS assumed all of petitioner's liabilities and obligations in connection with her membership interest in AAS. At the time of the 2009 Transaction, ESA owned a building in New York City (the Property).

3. Paragraphs four through six of the petition describe the 2009 Transaction and certain circumstances leading up to and surrounding that transaction, as detailed below.

4. The Division filed its answer to the petition on December 15, 2016, and filed an amended answer on or about December 27, 2016. With the permission of the administrative law judge, the Division filed a second amended answer on August 22, 2017. Paragraph 17 of the second amended answer asserted that AAS's assumption of all liabilities and obligations in

connection with petitioner's 50% membership interest in AAS "was a constructive distribution of cash to Petitioner."

5. Petitioner filed a reply to the Division's second amended answer on September 18, 2017 (Reply).

6. On or about September 27, 2017, the Division served a demand for a bill of particulars on petitioner (Demand). Petitioner filed a response to the Demand on or about October 25, 2017. On November 27, 2017, the Division filed the instant motion, which claims that petitioner's responses to the Demand were inadequate to amplify the proceedings. The particularization requests made by the Demand and petitioner's responses thereto are described below.

7. The first paragraph of the Demand requires petitioner to specify "the substantial business purpose" referred to in paragraph 6 of the Reply. Paragraph 6 in the Reply asserted that "any constructive distribution referred to in paragraph 17 of the [second amended answer] . . . had a substantial business purpose." Petitioner responded to the Demand in relation to this paragraph as follows:

"Petitioner's business purpose in redeeming her membership interest in [AAS] is axiomatic — to cease having any ownership of [AAS], as Petitioner no longer wished to continue as a partner in the partnership. Petitioner's acceptance of real property in lieu of cash was a wholly appropriate exchange for her membership interest."

8. The second paragraph in the Demand asks petitioner to specify the substantial business purpose of the "transactions or events" described in paragraphs four through six and ten through twelve of the petition. Below is set forth (a) each of the specified paragraphs in the petition that is the subject of the Demand; and (b) petitioner's response to the Division's demand for particularization of the transactions or events described therein.

Petition, paragraph 4:

“The property distributed to Petitioner in [2009] . . . is a building located in New York City. [AAS] purchased the Property in 2007 for \$15 million.”

Petitioner’s particularization of the paragraph:

“This paragraph notes that [AAS] purchased the ‘Property’ (as defined in the Petition) in 2007 for \$15 million. [AAS] is a Delaware limited liability company formed in 2006 to own and make real estate investments (including an interest in the Evening Star building) and its business purpose in purchasing the Property was as an investment.”

Petition, paragraph 5:

“Petitioner contributed cash to [AAS] in the amount of \$14.388 million in 2007 (after [AAS] purchased the Property), and \$455,000 in 2008.”

Petitioner’s particularization of that paragraph:

“This paragraph notes that Petitioner made a capital contribution to [AAS] in 2007. The business purpose of this contribution was the fact that [AAS] required capital in order to fund its purchase of the Property and another building.”

Petition, paragraph 6:

“[AAS] owned the Property (through a 100% owned limited liability company) at all times from the date of purchase until the Property was distributed to Petitioner. [AAS] included the income and deductions from the Property in determining its taxable income for the period that [AAS] owned the Property. [AAS] earned the income from and paid the expenses of owning and operating the Property. [AAS] had all the benefits and burdens of owning and operating the Property while [AAS] owned the Property. The Property was one of several real estate investments owned by [AAS].”

Petitioner’s particularization of that paragraph:

“This paragraph states that [AAS] owned the Property and that it was one of several real estate investments. Again, [AAS] was formed as an investment vehicle for real estate and its business purpose in owning the Property was as an investment.”

Petition, paragraph 10:

“Petitioner did not contribute cash to [AAS] in [2009]. Petitioner did not own the Property before it was transferred to her in complete liquidation of her membership interest.”

Petitioner’s particularization of that paragraph:

“This paragraph states that Petitioner did not contribute money to [AAS] in 2009. To the extent one can describe inaction as having a ‘business purpose,’ there simply was no need to contribute capital to the partnership in that year.”

Petition, paragraphs 11, 12:

“[AAS]’s tax basis in the Property in [2009] (prior to its distribution to Petitioner) was approximately \$15.02 million. Petitioner’s initial tax basis in the Property immediately following its distribution to her was approximately \$4.2 million. When distributed to Petitioner, the Property was subject to a non-recourse debt of approximately \$200,000.

Petitioner’s tax basis in her membership interest in [AAS] immediately prior to her withdrawal was approximately \$20.9 million, of which approximately \$16.9 million represented Petitioner’s allocable share of [AAS]’s aggregate non-recourse debt. When she withdrew from [AAS], Petitioner received a ‘constructive’ cash distribution (only for income tax purposes) of approximately \$16.7 million, calculated as her pre-withdrawal share of [AAS]’s non-recourse debt (approximately \$16.9 million) less the \$200,000 non-recourse debt on the Property when distributed to her. The amount of the constructive distribution to Petitioner was less than her tax basis in her interest in [AAS] immediately prior to her withdrawal. As a result, Petitioner recognized no taxable gain when she withdrew from [AAS], but the tax basis of the Property in her hands was reduced to the amount of her remaining tax basis in her interest in [AAS] after the constructive distribution (approximately \$4.2 million).”

Petitioner’s particularization of those paragraphs:

“These paragraphs merely describe the tax calculations concerning Petitioner’s redemption of her membership interests in [AAS]. These paragraphs therefore are simply a legal analysis, and the Division’s question asking about the business purpose of that

analysis does not make sense. To the extent the Division is asking about Petitioner's legal authority for these calculations, Petitioner directs the Division to Sections 731(a)(1), 752(b) and 732(b) of the Internal Revenue Code of 1986, as amended."

CONCLUSIONS OF LAW

A. The Tax Appeals Tribunal Rules of Practice and Procedure (Rules) permit the use of a bill of particulars in proceedings in the Division of Tax Appeals "to prevent surprise at the hearing and to limit the scope of the proof" (20 NYCRR 3000.6 [a] [1]). The Rules provide as follows:

"Where a bill of particulars is regarded as defective by the party upon whom it is served, the administrative law judge designated by the tribunal may, upon notice, make an order of preclusion or direct the service of a further bill."

B. A wealth of case law has been created under section 3041 of the New York Civil Practice Law and Rules (CPLR), "Bill of Particulars in Any Case," and it is appropriate to refer to that section for guidance in matters before the Division of Tax Appeals (*see* 20 NYCRR 3000.5 [a]).

C. The purpose of a demand for a bill of particulars is to enable the party demanding the particulars to know definitively the claims to be defended against (*see Johnson, Drake and Piper v State of New York*, 43 Misc 2d 513 [Ct of Claims 1964]) or to crystallize the issues that will be raised at hearing (*see e.g. Bassett v Bando Sangsa Co., Ltd.*, 94 AD2d 358 [1st Dept 1983], *appeal dismissed* 60 NY2d 962 [1983]). However, a demand for a bill of particulars may not be used to probe into an adversary's legal interpretations or to obtain disclosure of evidence. While drawing a line between a demand for a bill of particulars that seeks evidence versus one that seeks only to crystallize the issues is an inherently difficult task (*see* Practice Commentary CPLR 3041, C3041:2 [Bills of Particular, Defined]), it is especially important to make that

distinction in this forum, where an administrative law judge may not entertain a motion for discovery (*see* 20 NYCRR 3000.5 [a]). Moreover, a party may not be required to particularize a claim on which it does not have the burden of proof (*see Hydromatics, Inc. v Count Nat. Bank*, 23 AD2d 576 [2d Dept 1965]).

D. The remedy for failure to serve a bill of particulars or for service of an inadequate bill of particulars is an order precluding the party from giving evidence at the hearing of items of which particulars have not been delivered (*see* 20 NYCRR 3000.6 [a] [3]), or a conditional order of preclusion that becomes effective unless a proper bill is served within a specified time frame (*see* 20 NYCRR 3000.6 [a] [5]).

E. Petitioner argues that its bill of particulars satisfactorily amplified its pleadings herein and that, therefore, the Division is not entitled to a preclusion order. The Demand seeks to have petitioner identify the “substantial business purpose” referred to in paragraph 6 of the Reply and with respect to the “transactions or events” in six paragraphs of the petition. With regard to paragraphs 11 and 12 of the petition, the Demand is not appropriate because those paragraphs do not recount “transactions or events”; rather, those paragraphs make certain assertions about petitioner’s gain in regard to the 2009 Transaction and her basis in the asset she acquired as a result of that transaction. Therefore, the Division is not entitled to any preclusion order in regard to petitioner’s response to the Demand in connection with those paragraphs.

Furthermore, petitioner’s response to the Demand with regard to the substantial business purpose for the transactions or events relevant to paragraph 6 of the Reply and paragraphs 4, 5, 6, and 10 of the petition was in essence that the transactions or events described in those paragraphs were investment decisions taken in the ordinary course of business. If the Division believes that the proffered business purpose is not sufficient as a matter of law, that is an issue it

can raise at hearing, but it is not a basis for obtaining an order of preclusion. To require petitioner to provide further details regarding the investment rationale for each such transaction would be inappropriate, given that it is not the function of a demand for bill of particulars to seek the evidentiary detail for an assertion in a pleading (*see Frequency Elecs., Inc. v We're Assocs. Co.*, 90 AD2d 822 [2d Dept 1982]). Therefore, the “drastic sanction” of an order of preclusion is not appropriate here (*Kleinberg Elec., Inc. v City of New York*, 255 AD2d 248, 249 [1ST Dept 1988]). At hearing, the parties will have an opportunity to flesh out whether these transactions had a substantial business purpose.

F. Petitioner also argues that the Division is not entitled to an order of preclusion here because the Demand is inappropriate, as it seeks particularization on issues on which the Division bears the burden of proof. In this regard, petitioner points out that the Demand requests particularization of the “substantial business purpose” for a number of the transactions set forth in the petition. According to petitioner, “substantial business purpose” is relevant to a number of the justifications for the issuance of the notice of deficiency raised in the second amended answer on which the Division has the burden of proof, including that pleading’s reliance on the so-called “anti-abuse” rules of Treas. Reg. [26 CFR] § 1.701.2 and its “disguised sale” claim under the Internal Revenue Code [26 USC] § 707. In petitioner’s view, this means that the Division has the burden of proof with regard to those justifications for the notice of deficiency and, therefore, also has the burden of proof on the issue of the substantial business purpose with regard to the transactions at issue. This argument is unavailing. In proceedings before the Division of Tax Appeals, a presumption of correctness attaches to a notice of deficiency and petitioner bears the burden of overcoming that presumption (*see e.g. Matter of Estate of Gucci*, Tax Appeals Tribunal, July 10, 1997, citing *Matter of Atlantic & Hudson*, Tax

Appeals Tribunal, January 30, 1992). Moreover, in cases involving personal income tax, such as here, the burden of proof is upon petitioner, with the following exceptions:

- “(1) whether the petitioner has been guilty of fraud with intent to evade tax;
- (2) whether the petitioner is liable as the transferee of property of a taxpayer, but not to show that the taxpayer was liable for the tax;
- (3) whether the petitioner is liable for any increase in a deficiency where such increase is asserted initially after the mailing of a notice of deficiency and a petition filed . . .; and
- (4) whether any person is liable for a penalty under [Tax Law § 685 (q) or (r)]”

(*see* Tax Law § 689 [e]). Petitioner has not shown that the Division’s disguised sale or anti-abuse arguments triggers any of the above exceptions to the usual allocation of the burden of proof under section 689 (e). Moreover, petitioner has not established that “fundamental fairness” requires that the Division bear the burden of proof with regard to disguised sale or anti-abuse arguments (*cf.*, ***Matter of Ilter Sener***, Tax Appeals Tribunal, May 5, 1988 [burden of proof shifts to the Division where a late-payment penalty is asserted for the first time by the Division in its answer as an alternative to the fraud penalty]). Accordingly, petitioner’s argument is rejected.

G. Finally, petitioner also argues that the Demand improperly seeks information pertinent to transactions that took place in 2007, which, petitioner claims, is a closed year for statute of limitations purposes. This argument lacks merit for a number of reasons. First, petitioner has not established that 2007 is a closed year. Second, even if it is a closed year, events occurring in earlier years may cast light on events occurring in the year assessed (*see H.J. Heinz Co. & Subsidiaries v United States*, 76 Fed. Cl. 570 [2007], *appeal dismissed* 331 F. App’x 727 [Fed. Cir. 2009] [in determining whether a corporation’s purchase of its own stock from a subsidiary

in 1995 should be considered a redemption of stock, and applying the step transaction and economic substance doctrines, the Court of Claims considered the circumstances surrounding the subsidiary's acquisition of the stock in 1994, the subsidiary's formation in 1985, and its operations since then]; *G.D. Parker, Inc. v Commissioner*, 104 T.C.M. 627 [T.C. 2012] [in determining whether to allow a capital loss claimed by petitioner from the sale of stock in 2004, and applying the step transaction doctrine, the Tax Court considered the interest petitioner's indirect owner expressed in selling the stock in 2001]). Thus, information about events occurring in years prior to the year for which the notice of deficiency was issued may be the subject of a demand for a bill of particulars if necessary to clarify a pleading.

H. Accordingly, the Division's motion for preclusion is denied.

DATED: Albany, New York
March 22, 2018

/s/ James P. Connolly
ADMINISTRATIVE LAW JUDGE