STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition of **WILLIAM AND IPEK TECHAR** for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Year 2019.	ORDER DTA NOS. 830479 AND 830481
In the Matter of the Petition of **ANTHONY AND JENNIFER FRASCELLA** for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Year 2019.	

Petitioners, William and Ipek Techar and Anthony and Jennifer Frascella, filed petitions for redetermination of deficiencies or for refund of personal income tax under article 22 of the Tax Law for the year 2017. These two matters have been consolidated.

On January 14, 2022, petitioners, by Hodgson Russ LLP (K. Craig Reilly, Esq., of counsel), filed a motion seeking summary determination in the above-captioned matters pursuant to sections 3000.5 and 3000.9 (b) of the Rules of Practice and Procedure of the Tax Appeals

Tribunal. The Division of Taxation appearing by Amanda Hiller, Esq. (Linda A. Farrington, Esq., of counsel), timely responded on March 28, 2022, after being granted an extension of time by which to file a response, which date commenced the 90-day period for issuance of this order. Based upon the motion papers and all pleadings and documents submitted in connection with this matter, Jessica DiFiore, Administrative Law Judge, renders the following order.

ISSUE

Whether the Division of Taxation properly allocated New York source income.

FINDINGS OF FACT

1. In 2017, petitioners Anthony Frascella and William Techar were nonresident partners of Aristeia Holdings, LP (Aristeia), which was treated as a partnership for federal and state income tax purposes. [1]

2. In 2017, Aristeia recognized nonqualified deferred compensation in the amount of $126,208,261.00 (the NDC). The NDC flowed through as proportionate shares of partnership income to petitioners. Petitioners then reported their proportionate shares of the NDC on their 2017 personal income tax returns filed with the Internal Revenue Service and with the Division of Taxation (Division).

3. In exchange for providing investment management services and in accordance with its Investment Management Agreements, Aristeia received both (i) annual management fees based on the total net assets of Aristeia International Limited (Aristeia International) and (ii) annual

---

[1] While Ipek Techar and Jennifer Frascella are petitioners in this matter, only William Techar and Anthony Frascella were partners in Aristeia, the entity that generated the income at issue. Mrs. Techar and Mrs. Frascella are petitioners in this matter solely because they filed joint forms IT-203, nonresident and part-year resident income tax returns with their spouses. Accordingly, unless otherwise indicated, all references to "petitioners" shall refer to Mr. Frascella and Mr. Techar.

performance fees based on any increase in the net asset value per share of any shareholder of Aristeia International.

4. Aristeia International is a company incorporated in the Cayman Islands in accordance with the Companies Law.

5. For the years ending December 31, 1998, December 31, 1999, December 31, 2000, December 31, 2001, December 31, 2002, and December 31, 2003, Aristeia made irrevocable elections to defer certain percentages of the management and performance fees it received (Deferred Fees).

6. The combined value of the Deferred Fees at the time of payment in 2017 totaled $29,013,693.00.

7. At the time of payment, the appreciation on the combined value of the Deferred Fees totaled $97,194,568.00 (Appreciation).

8. Aristeia reported the full $126,208,261.00 value of the Deferred Fees and Appreciation (collectively, the NDC) on its 2017 tax returns, including its form IT-204, partnership return.

9. Prior to 2015, Aristeia was based in New York City, with a satellite office located in Connecticut.

10. In 2015, Aristeia relocated its principal office to Greenwich, Connecticut, while maintaining an additional office in New York City.

11. In 2017, Aristeia maintained 42.2668 percent of its real and tangible personal property within New York State.

12. In 2017, Aristeia maintained 56.4762 percent of its payroll within New York State.

13. In 2017, Aristeia sourced 88.0713 percent of its receipts within New York State. This calculation included adding all NDC as receipts sourced within New York State when determining its gross income percentage for 2017. Specifically, Aristeia included the full value of the NDC ($126,208,261.00) in the numerator and the denominator.

14. On April 6, 2018, the Division published Technical Memorandum TSB-M-18(2)C, 3(I), *New York State Tax Treatment of Nonqualified Deferred Compensation* (the 2018 Technical Memorandum). The 2018 Technical Memorandum states that for services performed before January 1, 2009, where the business, trade, profession, or occupation was carried on only in New York State in the year the services were performed, the entire amount of nonqualified deferred compensation must be included in New York source income. The 2018 Technical Memorandum also provides that if the business, trade, profession, or occupation was carried on partly in and partly outside of New York State during the tax year the services were performed, the amount of nonqualified deferred compensation included in New York source income is determined using the rules described for a partnership.

15. The Division performed audits of Aristeia and petitioners' personal income tax returns for the tax year January 1, 2017 through December 31, 2017 (audit period).

16. During the audit, the Division determined that Aristeia failed to properly source deferred compensation it was required to report in 2017.

17. The Division removed the NDC from the numerator and denominator of Aristeia's gross income factor of its business allocation percentage (BAP) for 2017. The Division separately allocated all of the NDC, both the Deferred Fees and the Appreciation, to New York State.

18. During the audit, the Division issued petitioners each a letter dated January 15, 2021, advising that an audit of their returns for the relevant tax period had resulted in an increase of tax liability. Enclosed with the letters were documents entitled Consent to Field Audit Adjustment. In the Consent to Field Audit Adjustment issued to petitioners Anthony and Jennifer Frascella, the additional tax due was $1,258,375.00 plus interest and penalties. In the Remarks section of this document, it stated as follows:

> "The audit adjustment reflects the sourcing of income related to nonqualified deferred compensation as defined under IRS 457A following Technical Memorandum TSB-M-18(2)C, (3)I [sic] which addresses the treatment of nonqualified deferred compensation by nonresident individuals. The deferred income has been allocated to New York State utilizing the business allocation percentage for each of the tax years the services were performed as described in 20 NYCRR 132.15."

The last few pages of the document showed the reallocation of the NDC by removing it from the gross income percentage piece of the BAP for tax year 2017 and finding that it was separately fully taxable as New York State income. The letter of the same date and the enclosed Consent to Field Audit Adjustment issued to William and Ipek Techar mimicked the letter to Mr. and Mrs. Frascella, except that their additional tax due was $402,715.00 plus interest and penalties according to their proportionate share of Aristeia.

19. On April 13, 2021, following the audit, the Division issued petitioners Anthony and Jennifer Frascella notice of deficiency L-053133059, which asserted additional tax due for the tax year 2017 of $1,258,375.00 plus penalty and interest. On the same date, the Division issued petitioners William and Ipek Techar notice of deficiency L-053133062, which asserted additional tax due for the year 2017 of $402,715.00 plus interest and penalty.

20. On May 28, 2021, petitioners each timely filed petitions asserting that the Division erred in issuing the assessments because the notices of deficiency were based on a nonbinding

Technical Memorandum that was not consistent with the New York State Tax Law and the Division's own regulations. Petitioners also alleged that the Division's assessment of penalties against the petitioners was improper as any delinquency was due to reasonable cause and not negligent, intentional disregard, or willful neglect within the meaning of Tax Law §§ 685 (b), (p).

CONCLUSIONS OF LAW

A. Petitioners bring a motion for summary determination under section 3000.9 (b) of the Rules of Practice and Procedure of the Tax Appeals Tribunal. A motion for summary determination "shall be granted if, upon all the papers and proof submitted, the administrative law judge finds that it has been established sufficiently that no material and triable issue of fact is presented" (20 NYCRR 3000.9 [b]). A motion for summary determination is subject to the same provisions as a motion for summary judgment pursuant to CPLR 3212 (***see*** 20 NYCRR 3000.9 [c]). It is well established that, as the procedural equivalent of a trial, summary judgment is a drastic remedy that should be denied if there is any doubt as to the existence of a triable issue or where a material fact is arguable (***see Glick & Dolleck v Tri-Pac Export Corp.***, 22 NY2d 439, 441 [1968]; ***Museums at Stony Brook v Village of Patchogue Fire Dept.***, 146 AD2d 572 [2d Dept 1989]). Consistent with this principle, the party bringing such a motion bears the following burden:

> "The proponent of a summary judgment motion must make a prima facie showing of entitlement to judgment as a matter of law, tendering sufficient evidence to eliminate any material issues of fact from the case (***see Zuckerman v City of New York***, 49 NY2d 557, 562 [1980]; ***Sillman v. Twentieth Century-Fox Film Corp.***, 3 NY2d 395, 404 [1957]). Failure to make such showing requires denial of the motion, regardless of the sufficiency of the opposing papers (***Matter of Redemption Church of Christ v Williams***, 84 AD2d 648, 649 [1981]; ***Greenberg v Manlon Realty***, 43 AD2d 968, 969 [1974])" (***Winegrad v New York Univ. Med. Ctr.***, 63 NY2d 851, 853 [1985]).

B. Internal Revenue Code (IRC) (26 USC) § 457A (a) provides that "[a]ny compensation which is deferred under a nonqualified deferred compensation plan of a nonqualified entity shall be includible in gross income when there is no substantial risk of forfeiture of the rights to such compensation." Section 457A was added to the IRC by section 801 (a) of the Tax Extenders and Alternative Minimum Tax Relief Act of 2008, (Pub. L. No. 110-343 [Div. C], 122 Stat. 3929 [2008] [TEAMTRA]). Section 801 (d) (1) of TEAMTRA provides that "the amendment made by this section shall apply to the amounts deferred which are attributable to services performed after December 1, 2008." Section 801 (d) (2) provides a transition rule where nonqualified deferred compensation for services performed before 2009 must be includible in gross income in the later of the last taxable year beginning before 2018 or the taxable year of vesting. It is undisputed that in the instant matter, the compensation was deferred under a nonqualified deferred compensation plan for a nonqualified entity, and that it was included in gross income in 2017, the last taxable year before 2018. The issue here is whether the NDC should be allocated as New York income when determining the gross income percentage and ultimately the BAP for 2017, as petitioners determined it in their respective returns, or allocated separately as income based on where the partnership conducted business in the years the services earning the compensation were performed.

C. New York State imposes personal income tax on the income of nonresident individuals that is derived from or connected to New York sources (Tax Law § 601 [e]; ***Brady v State***, 172 AD2d 17, 23 [3d Dept 1991], ***affd*** 80 NY2d 596 [1992], ***cert. denied*** 509 US 905 [1992]). Tax Law § 632 (a) (1) limits New York taxes to that portion of the partner's gross income that is derived from or connected with New York sources. The New York source income of a nonresident partner includes his distributive share of all items of partnership income, gain,

loss, and deduction entering into his federal adjusted gross income to the extent such items are derived from or connected with New York sources (Tax Law § 632 [a] [1]). This portion is determined "under the regulations of the tax commission consistent with the applicable rules of section six hundred thirty-one of this part" (***id.***).

D. Tax Law § 631, like Tax Law § 632, provides that the New York source income of a nonresident individual shall be the sum of the net amount of income, gain, loss, and deduction entered into federal adjusted gross income for the taxable year, derived from or connected with New York sources. Tax Law § 631 (b) (1) (F) provides that income, gain, loss, and deduction derived from New York sources includes as follows:

> "income received by nonresidents related to a business, trade, profession or occupation previously carried on in this state, whether or not as an employee . . . Income received by nonresidents related to a business, trade, profession or occupation previously carried on partly within and partly without the state shall be allocated in accordance with the provisions of subsection (c) of this section."

Subsection (c) of Tax Law § 631 provides that where a business is carried on partly within and partly without New York State, the income, gain, loss, and deduction derived from New York sources shall be determined by apportionment and allocation under such regulations. The relevant portion of the applicable regulation provides that the income, gain, loss, and deduction attributable to the activities of a business carried on within and without New York State shall be determined by multiplying the net amount of income, gain, loss, and deduction of the business by the average of the property percentage, the payroll percentage, and the gross income percentage (collectively the BAP) as described therein (20 NYCRR 132.15).

Here, the Division found that the first sentence of Tax Law § 631 (b) (1) (F) directed that the NDC sourced to New York State as part of ordinary income on the partnership's return, and ultimately, the petitioners' returns, should be sourced based on business done in New York at the

time the services were performed generating the income, not included with other income from the tax year it was claimed. In reaching the determined amount due, the Division found that all of the income from the NDC should be allocated to New York.

E. Petitioners argue that the regulations require that the NDC included in Aristeia's income for 2017 be allocated to New York by adding the income to the gross income percentage piece of the BAP used to determine the portion of income that should be sourced to New York for 2017. However, petitioners' methodology would potentially ignore the plain language of the first sentence of Tax Law § 631 (b) (1) (F), which states that New York source income is income derived from a nonresident's business, trade, profession or occupation that was previously carried on in this state. If the services were performed when the income of Aristeia was earned solely from New York sources, there would be no reason to resort to the second sentence of that subsection and ultimately to the regulations, which only apply when income was earned within and without New York State. The effect of doing that would be that less income would be sourced to New York than what was derived from New York sources if the services generating the NDC were performed at a time when all of the business of the partnership was done in New York.

Additionally, even if the NDC was for services from years business was performed within and without New York State, using the property percentage, payroll percentage and the gross income percentage for 2017 with the NDC included in the numerator and denominator of the gross income percentage, instead of using the same percentages separately for the year the services were performed, would not result in an accurate amount of income derived from New York sources. New York source income is income derived from New York sources (***see*** Tax Law § 631 [a]). To determine the correct amount of income derived from New York sources and

comply with the Tax Law, the statute supports looking either at all the income earned if the services generating the income was done wholly within New York during that same year, or to the property percentage, payroll percentage and gross income percentage creating the BAP from the same year the services were rendered as directed by 20 NYCRR 132.15. To interpret otherwise would result in New York receiving more or less income than what was derived from New York sources, which is in direct contradiction of the applicable statutes (***see*** Tax Law §§ 601; 631; 632).

F. Despite alleging that there were issues of fact not fully developed in the record, the Division failed to identify what those issues were. Nevertheless, an issue of fact exists as to whether the Division's allocation of the NDC to New York in full was proper. It is not in the record whether Aristeia earned income within and without New York in the years the services earning the Deferred Fees were performed. Accordingly, petitioners' motion for summary determination must be denied.

G. Petitioners assert that the Division's creation of and reliance on a Technical Memorandum (TSB-M) for the authority for the Division's audit methodology was struck down previously in ***Matter of Stuckless***, Tax Appeals Tribunal, August 17, 2006, and that like in ***Stuckless***, the Tax Law and regulations do not support the Division's sourcing of income in the present matter. However, the facts and law in ***Stuckless*** are distinguishable from the instant case.

In ***Stuckless***, the Division determined that the gain from petitioner's stock options that was secured or earned through his New York employment was properly considered New York source income even though the petitioner exercised the stock options and sold stock thereafter while he was a nonresident of New York. The Division then apportioned the gain realized on the

exercise of the stock options to New York, using the number of New York working days from the option grant date to the exercise date, which was several years later, compared to the total number of days worked both in and out of New York for the same period. This resulted in the Division issuing a notice of deficiency for the years during which the stock was exercised. In making its determination, the Division relied on a TSB-M, which set forth the Division's audit methodology. The Division argued that in issuing the relevant TSB-M, its method therein was authorized pursuant to a catchall provision in 20 NYCRR 132.24 and caselaw. This provision provided that where allocation and apportionment of a nonresident's income was not done in a fair and equitable manner under the express methods provided in the regulations, the Division was allowed to require a taxpayer to apportion and allocate those items under an alternative method as long as it resulted in a "fair and equitable apportionment and allocation."

The Tax Appeals Tribunal cancelled the notices of deficiency, finding that the Division's use of a multiple year allocation method based on a day count ratio over the years from the grant to the exercise of stock options was not supported either by existing caselaw or the Tax Law and regulations. The Tribunal held that the issue in that case was one of statutory interpretation that did not require agency deference and reliance on the Division's TSB-M. The Tribunal also interpreted 20 NYCRR 132.24 to only be applicable on a case-by-case basis, where the general rules of the regulations would produce an unfair or inequitable result. The Tribunal found this provision did not grant the Division the authority to issue a TSB-M that articulated rules for general application.

Like ***Stuckless***, the issue here is one of statutory interpretation that does not require deference to the Division's TSB-M. However, unlike ***Stuckless***, the Tax Law and regulations

expressly authorize the method used by the Division to determine the tax amount due (***see*** Tax Law §§ 601 [e]; 631 [a], [b] [1] [F]).

H. Petitioners also assert that the Division's application of the 2018 Technical Memorandum to nonresident partners violates the New York State Constitution and the State Administrative Procedure Act (SAPA). The New York Constitution provides that in order for a rule or regulation to have legal effect such rule or regulation must be formally promulgated in accordance with the procedures established by the Legislature (NY Const Art IV, § 8). SAPA provides for uniform procedures for the promulgation of rules and regulations of administrative bodies, requires publication of proposed rules in the State Register and a period of public comment and hearings before the rules may be imposed (SAPA § 202). As the actions of the Division here and as directed in the 2018 Technical Memorandum are explanatory and have no legal effect, are provided for by the existing Tax Law and corresponding regulations and no new rules were created, they do not violate the New York Constitution or SAPA and neither are applicable here (***see Matter of Friesch–Groningsche Hypotheekbank Realty Credit Corporation v Tax Appeals Tribunal***, 185 AD2d 867 [3d Dept 1992]).

I. Additionally, as neither party addressed the penalties imposed despite the fact that petitioners alleged in their petitions that they should be abated, an issue of fact exists as to whether there was reasonable cause to abate the penalties (***see*** Tax Law §§ 685 [b], [p]; ***Rubin v Tax Appeals Trib. of State of New York***, 29 AD3d 1089, 1091 [3d Dept 2006]; ***Matter of Barker***, Tax Appeals Tribunal [2012]).

J. Petitioners' motion for summary determination is denied and a hearing will be scheduled in due course.

DATED: Albany, New York
June 23, 2022

/s/ Jessica DiFiore
ADMINISTRATIVE LAW JUDGE