STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
ROBERT AND NAOMI REINER	:	DETERMINATION DTA NO. 820266
for Redetermination of a Deficiency or for Refund of New York State and New York City Personal Income Taxes under Article 22 of the Tax Law and the New York City Administrative Code for the Year 1997.	: : :	

Petitioners, Robert and Naomi Reiner, P.O. Box 2029, Jupiter, Florida 33468 , filed a petition for redetermination of a deficiency or for refund of New York State and New York City personal income taxes under Article 22 of the Tax Law and the New York City Administrative Code for the year 1997.

A hearing was held before Dennis M. Galliher, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on July 14, 2005 at 10:30 A.M., with all briefs to be submitted by January 24, 2006, which date commenced the six-month period for the issuance of this determination. Petitioners appeared by Hodgson Russ, LLP (Timothy P. Noonan, Esq., and Christopher L. Doyle, Esq., of counsel). The Division of Taxation appeared by Christopher C. O'Brien, Esq. (Kevin R. Law, Esq., of counsel).

ISSUE

Whether the Division of Taxation ("Division") may require petitioner Robert Reiner to allocate his capital gain income derived from the sale of substantially all of the assets of a subchapter S corporation of which he was a principal owner on a proportionate basis between his

1997 New York State resident and nonresident periods rather than upon the basis of his status as a nonresident at the time of the close of the S corporation's fiscal year.

FINDINGS OF FACT[1]

1. For many years prior to September 1997 petitioners, Robert and Naomi Reiner, husband and wife, were domiciled and had lived in Port Jefferson, Long Island, New York. Commencing in approximately 1964, and continuing thereafter into 1996, petitioner Robert Reiner ran the family business known as Sunshine Quality Products ("SQP").[2] SQP was engaged in the manufacture and sale of household cleaning products. SQP was headquartered in Frackville, Pennsylvania, did not have any significant assets or holdings in New York State, and was taxable as an "S" corporation for Federal, New York and Pennsylvania purposes. SQP reported taxes based on a fiscal year spanning October 1 through September 30. During the fiscal year ended September 30, 1997, petitioner owned 65.67% of SQP's shares, and thus was its majority shareholder.

2. Selling SQP had never been petitioner's long-term goal. Instead, petitioner's son Richard Reiner, who had worked at SQP during summers and then commenced full-time work at SQP after graduating from college in the early 1990s, was interested in succeeding his father and continuing to run SQP. Consistent with this interest, petitioner exposed his son to every aspect of SQP's operations such that, upon petitioner's retirement, Richard Reiner would be prepared to take over operating the company. However, in the mid-1990s, petitioner began to think seriously

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[1] The parties executed a Stipulation of Facts, dated July 12, 2005, setting forth some 12 separately numbered and agreed to facts in this matter. In addition, petitioners included in their brief Proposed Findings of Fact numbered "1" through "22". The Division has raised no objection to any of the proposed findings of fact, and careful review reveals that the same are supported by the evidence in the record. Accordingly, the Stipulated Facts and the Proposed Facts are incorporated in the Findings of Fact set forth herein.

[2] Petitioner Naomi Reiner's name appears herein by virtue of the fact that she and petitioner Robert Reiner filed a joint personal income tax return for the year 1997. References to "petitioner," in the singular tense, shall mean petitioner Robert Reiner, unless otherwise specified or required by context.

about selling SQP. This change was brought about by petitioner's own health considerations, involving severe heart problems including arrhythmia, and by his wife's health problems, including multiple sclerosis. Petitioner recognized that he needed to cut back, or even withdraw entirely from the business.

3. For many years, petitioner had been approached by the Sherwin-Williams Company about the acquisition of SQP. Petitioner had always rejected these offers because of his intent to transition the business to his son Richard Reiner when he retired. For his part, Richard Reiner recognized the negative effects that running the business was having on his father, advised petitioner to do what was best for his health, including selling the business, and was entirely supportive of petitioner's consideration of and ultimate decision to sell SQP.

4. In late 1994, petitioner began more substantive and serious discussions with Sherwin-Williams about a potential sale. At a meeting on February 6, 1995, the potential for an asset purchase was discussed. Later, in the summer of 1995, Sherwin-Williams made an initial proposal to buy SQP, and petitioner and his business, legal and tax advisors began evaluating the offer. This initial offer was rejected, and there was no significant action for several months thereafter. However, in April 1996, Sherwin-Williams increased its offer and formally proposed to purchase SQP for $16,000,000.00. Although there was still a considerable amount of work to be completed, petitioner decided that it made sense to pursue this offer and move the deal forward.

5. Over the next several months, the due diligence process of the sale continued. Throughout this process, the parties negotiated various aspects of the deal, including the particular assets to be purchased and obligations to be assumed. During one particularly busy period, several Sherwin-Williams representatives spent five or six weeks at petitioner's office.

6. On October 18, 1996, SQP sold substantially all of its assets to Sherwin-Williams Diversified Brands, Inc. After the sale, SQP changed its name to SQP Transition Corporation.

7. In evaluating the proposals from Sherwin-Williams, petitioner was intently focused on the "bottom line," specifically on the dollar amount he would take from the sale after satisfaction of all obligations and taxes. During the course of the negotiations, petitioner received numerous spreadsheets analyzing the different projections of income and after-tax yield under various proposals. Petitioner's notes and testimony bear out his focus on the after-tax yield from the transaction, driven in large part by his recognition that this would be his retirement result upon which he and his wife would live. Petitioner's position was clear that if the after-tax numbers did not reach an acceptable level for his future financial needs, the sale would not have occurred. Given this consideration, from the earliest stages of the negotiations petitioner discussed the tax implications and consequences associated with the sale of SQP with his advisors, including most specifically Timothy Mulcahy, who was a tax partner in the accounting firm utilized by both SQP and by petitioner for over 15 years, and also Leslie Levine, the attorney who represented petitioner on the SQP sale.

8. A frequent topic of discussion between petitioner and Mr. Mulcahy related to the timing of petitioners' planned move to Florida, and how this could affect his New York tax liability. Mr. Mulcahy was aware that petitioners planned to move to Florida upon retirement and that because SQP had no New York assets, there existed a significant planning opportunity to reduce potential New York tax on the gain from the sale of SQP. Discussions on this topic occurred as early as August 1995, when Sherwin-Williams' first purchase offer was submitted, and continued throughout the pendency of the deal, in both face-to-face meetings and over the telephone. Mr. Mulcahy's handwritten notes (his "to do" list) reflect the reminder to "Discuss move from NY" with petitioner. In addition, Mr. Levine noted that tax costs were a frequent matter of discussion during meetings and conference calls with petitioner and his accountants, including: New York taxes, the issue of whether New York could impose tax, and when, in connection therewith,

petitioners had to move to Florida in order to minimize the New York tax impact resulting from the sale of SQP.

9. The content of the discussions between petitioner and Mr. Mulcahy focused on the date of petitioners' planned move to Florida. In this regard, Mr. Mulcahy's research revealed a then-existing regulation (20 NYCRR 154.6) stating that the tax on S corporation shareholders like petitioner would be determined based on the shareholder's residency status at the end of the S corporation's fiscal year (the "year-end rule"). Mr. Mulcahy concluded that since SQP had a fiscal year that ended September 30, petitioner would be required to report his distributive share of SQP's income for the tax year ending September 30, 1997 entirely in his 1997 nonresident period as long as he established that he was a resident of Florida prior to September 30, 1997.

10. Mr. Mulcahy explained this allocation rule to petitioner early on in the SQP sale negotiations, pointing out that he was completely confident in the accuracy of his advice. In this regard, Mr. Mulcahy stated that "there was no reason to think this wasn't a proper planning. . . . There were published rules." He explained his high level of confidence on the issue was due in part to prior client experience with the "year-end" issue, including a similar situation with a client to whom he had given the same specific advice and with respect to whom no change was made upon a residency and allocation audit by the Division.

11. Mr. Mulcahy advised petitioner, based on his research and experience as detailed above, that little or no New York tax would be imposed on his distributive share of SQP's 1997 income as long as petitioners moved out of New York State before the September 30, 1997 close of SQP's fiscal year. This specific advice was given to petitioner in the spring and summer of 1996, prior to the SQP closing. Mr. Mulcahy testified that had he known that 20 NYCRR 154.6 was going to be declared invalid and that a "prorate" rule would apply, he would have advised petitioners that they needed to move out of New York State before the SQP transaction closed.

12. Petitioner completely relied on the advice of his accountants and was comfortable basing his personal and business decisions on their advice. Thus, petitioners did not move to Florida in 1996. Instead, petitioners took a cruise and traveled for several weeks in Europe to, in petitioner's words, "[catch] my breath and enjoy things." Petitioner explained that if Mr. Mulcahy had informed him during the Sherwin-Williams negotiation process of the need to move out of New York before the transaction closed (or prior to the end of 1996), he could and would have immediately moved to Florida. In this regard, petitioner told Mr. Mulcahy "I'm going anyway. You just tell me when I have to be gone by." Petitioner had researched the Florida housing market for the area to which he intended to move and knew that the housing market at that time was wide open such that a purchaser had a large selection of houses available to purchase.

13. In June and July of 1997 (i.e., after the October 18, 1996 sale of SQP's assets and after the cruise and European vacation period), petitioners listed their New York house for sale and began looking for a home to purchase in Florida, specifically in the Admiral's Cove area. Petitioners found a place in Jupiter, Florida within a matter of weeks. They contracted for the purchase of the house at the end of July 1997, and closed five weeks later on September 4, 1997. On September 12, 1997, petitioners moved their belongings from New York into their new Florida home. The parties to this proceeding specifically agree that on September 12, 1997, petitioners changed their domicile and residence to Jupiter, Florida.

14. On or about October 14, 1998, petitioners timely filed (pursuant to extensions of time granted) a Nonresident and Part-Year Resident Income Tax Return (Form IT-203) for the year 1997. On their return, petitioners reported their change of resident status from New York to Florida effective September 12, 1997. During 1996 and 1997, petitioner was a 65.67% shareholder of SQP. As an "S" corporation, SQP's items of corporate income, gain, loss and deduction were passed through to petitioner individually in proportion to his stock ownership.

SQP reported taxes on a fiscal year spanning October 1 through September 30. In reliance upon his accountant's advice and consistent with 20 NYCRR former 154.6 petitioner, on his 1997 Form IT-203, reported his distributive share of SQP's income for the SQP fiscal year ended September 30, 1997 entirely in his 1997 nonresident period because he was a nonresident of New York on September 30, 1997.

15. Petitioners filed a Pennsylvania Income Tax Return (Form PA-40) for the year 1997 and paid the tax shown as due thereon.

16. In December 2000, over three years after petitioners moved and changed their domicile to Florida, 20 NYCRR former 154.6 was repealed in the wake of the Tax Appeals Tribunal's decision in ***Matter of Greig*** (Tax Appeals Tribunal, September 16, 1999). In its Technical Services Bureau Memorandum TSB-M-00(1) I, dated February 23, 2000, the Division of Taxation set forth the rule that the amounts of a part-year resident's S corporation items of income, gain, loss and deduction for the year in which a change of residence occurs are to be prorated between the shareholder's resident and nonresident periods. Thus, under this "prorate rule," the shareholders' resident status on the last day of their S corporation's tax year was no longer a factor in the calculation of their New York tax liability. Instead, the determining factor was the number of days a shareholder was a resident during the year in which the change of residence occurred.

17. The Division audited petitioner's return for the year 1997, and applied the prorate rule. As a result, approximately 70% of petitioner's S corporation income was allocated to petitioner's resident period in 1997 and was thus fully subjected to New York taxation because petitioner was a resident of New York for approximately 70% of the year. The approximately 30% of remaining S corporation income was allocated to petitioner's nonresident period and was taxed only to the extent of SQP's business allocation percentage. Petitioner questioned this allocation of his

income and the underlying application of the prorate rule at the time of the audit, arguing that the same should not apply to him in view of his reliance upon regulation 20 NYCRR former 154.6 in his tax planning. He was advised that the Division would handle all the cases in the same manner in applying the ***Greig*** decision and that no exception would be made for petitioner.

18. On September 25, 2003, based on the foregoing audit and application of the prorate rule, the Division issued to petitioners, Robert and Naomi Reiner, a Notice of Deficiency asserting additional personal income tax due for the year 1997 in the amount of $245,991.23, plus interest.

19. The parties have agreed that the issue in this matter is whether petitioners can be required to allocate their pro rata share of the capital gain income resulting from the sale of SQP's assets on a proportionate basis between their 1997 New York resident and nonresident periods. The parties have also agreed that if such allocation cannot be required of petitioners, then the Notice of Deficiency should be cancelled. The parties have further agreed that if such allocation may be required of petitioners, then the Notice of Deficiency should be sustained, subject to the allowance of a New York State resident tax credit for the taxes petitioners paid to Pennsylvania for 1997. The parties have agreed that the allowance of such a resident credit would serve to reduce the amount of tax asserted in the Notice of Deficiency to $137,351.00, plus interest.

CONCLUSIONS OF LAW

A. Petitioners, Robert and Naomi Reiner, were residents of New York for a portion of the year 1997, specifically until September 12, 1997, and thereafter were nonresidents of New York. With regard to such part-year residents, Tax Law § 601(e) imposes New York personal income tax to the extent that an individual's taxable income for the period of nonresidence is derived from or connected with New York sources. For the year in issue, 1997, New York's taxation of the Reiner's income was governed specifically by Tax Law § 638(a), pursuant to which part-year residents such as the Reiners were required to split their tax year into a resident period and a

nonresident period. Section 638(a) provides that the New York source income of a part-year resident shall be the sum of the taxpayer's:

> (1) New York adjusted gross income for the period of residence, determined in accordance with Part II of [Article 22] as if the taxpayer's taxable year for federal income tax purposes were limited to the period of residence, and
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> (2) New York source income for the period of nonresidence, determined in accordance with section six hundred thirty-one as if the taxpayer's taxable year for federal income tax purposes were limited to the period of nonresidence.

Neither Tax Law § 638, nor any other New York statutory provision instructed part-year residents as to how to allocate specific items of income including, as is relevant here, income from S corporations, between the resident and the nonresident periods. Rather, guidance was provided by the Division's regulations.

B. Prior to 1987, Tax Law former § 654 governed the taxation of part-year residents. The relevant regulation then in effect with regard to the allocation of specific items of income was 20 NYCRR former 148.6. This regulation provided a "year-end" rule whereby items of partnership income, gain, loss and deduction were to be allocated according to the taxpayer's resident status on the last day of the partnership's tax year, as opposed to an allocation based on either the particular date of the receipt or expenditure of each item or on the annual amounts of such items distributed on a proportionate basis. In 1986, the Court of Appeals issued its decision in ***McNulty v. State Tax Commn.*** (70 NY2d 788, 522 NYS2d 103), in which the Court invalidated 20 NYCRR former 148.6 because it was inconsistent with the Legislature's preference for a proration under Tax Law former § 654. Thus, the Court in ***McNulty*** held that Tax Law former § 654 required taxpayers to utilize a "prorate" rule, so as to allocate their items of partnership distribution based on a proration of such items across the taxpayer's resident and nonresident periods "in a manner that either reflects the actual date of receipt or expenditure or encompasses

an annual amount distributed on a proportionate basis." (***McNulty v. State Tax Commn.***, ***supra.***, 70 NY2d at 791, 522 NYS2d at 104.) In response to the decision in ***McNulty***, the Division began retroactively applying the prorate rule in its audits, including those involving tax years prior to the issuance of the Court's decision.

C. The Legislature made significant substantive changes to the Tax Law in 1987 with passage of the Tax Reform and Reduction Act of 1987 (chapter 28 of the Laws of 1987). Included within this Act was the repeal of Tax Law former § 654, and the enactment of a new Tax Law § 638 to address part-year resident taxation (L 1987, ch 28, § 28; ***see***, Conclusion of Law "A"). In turn, the Division repealed regulation 20 NYCRR former 148.6, which had provided a year-end based allocation rule but, as above, had been held invalid under Tax Law § 654 by the Court in ***McNulty***. At the same time, the Division enacted another regulation, to wit, 20 NYCRR former 154.6 (20 NYCRR 148.6, amendment filed August 30, 1988, eff. September 14, 1988, renum as 20 NYCRR 154.6). This regulation, in reliance upon the change of law concerning part-year residents which occurred with the enactment of Tax Law § 638, reinstituted the year-end allocation rule of 20 NYCRR former 148.6.[3] In this regard, the New York State Register for May 16, 1990 provided, in relevant part, as follows:

> These amendments reflect a reconsideration of the Court of Appeals decision in ***McNulty v. State Tax Commission***, 70 NY2d 788, in light of legislative changes with regard to the taxation of part-year residents enacted by the Tax Reform and Reduction Act of 1987 (Chapter 28 of the Laws of 1987). Specifically, prior to the Tax Reform and Reduction Act of 1987, where there was a change of residence, two separate returns computing taxable income applicable to the resident and nonresident periods were required, and certain prorations between the two returns were also required. The Court of Appeals decision in ***McNulty*** (decided in 1987 and involving the taxpayer's 1979 taxable year) allowed the taxpayer to also prorate such taxpayer's partnership items. Accordingly, section 148.6 of the Personal Income Tax

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[3] 20 NYCRR former 154.6, unlike 20 NYCRR former 148.6, made specific note of Subchapter S corporations as well as partnerships.

> Regulations was amended to take into account the ***McNulty*** decision and provided that where a partner changes resident status during the taxable year, the distributive share of partnership items attributable to such partner are to be prorated between the resident and nonresident periods with the portion of such item prorated to the nonresident period being limited to the extent such items are derived from or connected with New York State sources. Such amendments also included the provisions relating to shareholders of S corporations.
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> With the enactment of the Tax Reform and Reduction Act of 1987, where there is a change of residence, a single return for the taxable year is required, thus obviating prorations between returns. Therefore, where there is a change of residence, the amount of partnership items to be included in the numerator of the New York source fraction under section 601(e) of the Tax Law should be determined according to the status of the taxpayer as a resident or a nonresident at the time the taxable year of the partnership ends. This conforms with the federal principle contained in section 706 of the Internal Revenue Code that partnership items are recognized by a partner at the time the partnership taxable year ends.

D. The validity of the year-end rule espoused in 20 NYCRR former 154.6 was challenged by Robert Greig, a partner in an international law firm who had moved into New York in the middle of 1992. On his 1992 tax return, Mr. Greig applied the prorate rule rather than the year-end rule then in force under 20 NYCRR former 154.6 to determine the portion of his 1992 partnership income subject to New York taxation. On audit, the Division assessed additional tax, interest *and penalties* against Mr. Greig based upon his failure to allocate according to the year-end rule of 20 NYCRR former 154.6. On appeal, the Division argued that the prorate rule set forth by the Court of Appeals in ***McNulty*** was no longer applicable because of the repeal of Tax Law former § 654. However, the Tax Appeals Tribunal disagreed, citing to ***McNulty***, and held that 20 NYCRR former 154.6 and its year-end rule was invalid, and that the partnership income should be allocated pursuant to the prorate rule (***Matter of Greig***, Tax Appeals Tribunal, September 16, 1999). Following the Tribunal's decision in ***Greig***, the Division issued a Technical Services Bureau Memorandum (TSB-M-00[1]I), dated February 23, 2000, announcing that part-

year resident partners and shareholders of New York S corporations would be required to use the prorate rule in calculating tax on flow-through income, and also stated that "[t]he rules discussed in this memorandum are effective for tax years beginning in 1999 and thereafter. They also apply to any prior tax year for which the statute of limitations is still open." It is upon the Tribunal's ***Greig*** decision and the noted memorandum that the Division employed the prorate rule in its redetermination of petitioners' tax liability for the year 1997.

E. Petitioners do not argue that the Division is precluded from correcting its prior mistakes, and thus can never apply the prorate rule, retroactively. In fact, the Division's retroactive application of the prorate rule initially determined to be appropriate in ***McNulty***, and again upheld as appropriate in ***Greig*** notwithstanding the change in the law and the Division's specific enactment of a new regulation reinstituting the year-end rule in light of such change of law, has been specifically upheld in ***Matter of Wertheimer*** (Tax Appeals Tribunal, March 14, 1996) and in ***Montgomerie v. Tax Appeals Tribunal*** (291 AD2d 129, 740 NYS2d 141). Petitioners, however, distinguish their situation from the ***Wertheimer*** and ***Montgomerie*** cases by the absence of any claim or evidence that the taxpayers in those cases engaged in any particular actions in reliance upon the Division's regulation, but rather simply filed their tax returns based on their respective situations after having physically moved into New York (as in ***Wertheimer***) or out of New York (as in ***Montgomerie***). Accordingly, rather than focusing the dispute on the general propriety of retroactively applying the prorate rule, petitioners argue most directly that under the particular circumstances of this case, wherein they specifically relied to their detriment upon the regulation at 20 NYCRR former 154.6 and its mandated use of the year-end rule, the Division should be estopped from applying the prorate rule.

F. As a general proposition, unless there are exceptional facts which require its application to avoid a manifest injustice, the doctrine of estoppel does not apply to governmental acts (***Matter of Consolidated Rail Corp.***, Tax Appeals Tribunal, August 24, 1995, ***confirmed*** 231 AD2d 140, 660 NYS2d 549, ***appeal dismissed*** 91 NY2d 848, 667 NYS2d 683; ***Matter of Harry's Exxon Service Station***, Tax Appeals Tribunal, December 6, 1988). This proposition is considered especially strong where a taxing authority is involved, since public policy supports the enforcement of the Tax Law (***Matter of Glover Bottled Gas Corp.***, Tax Appeals Tribunal, September 27, 1990). The Tax Appeals Tribunal has developed a three-part test in order to determine whether to invoke an estoppel, to wit, (i) whether there was a right to rely on a representation made by the Division, (ii) whether there was such reliance and (iii) whether the reliance was to the detriment of the party who relied upon the representation (***see, Matter of Consolidated Rail Corp., supra.; Matter of Harry's Exxon Service Station, supra***).

G. Several matters relevant to this case are not in dispute. First, the Division admits that taxpayers are entitled to rely upon the written guidance of the Division in matters of tax planning and in the filing of their returns **(*see, e.g., Matter of Bolkema Fuel Co., Inc.***, Tax Appeals Tribunal, March 4, 1993). This is, of course, especially true when such written guidance is in the form of a regulation specifically adopted to address the circumstances of taxpayers such as petitioners who were part-year residents of New York. Second, the Division admits that petitioners in fact relied upon the Division's regulation in forming and carrying out their course of conduct. That is, petitioners tailored their conduct as to the point in time they chose to abandon their New York domicile and move to Florida so as to achieve a particular tax result in clear reliance on the Division's regulation at 20 NYCRR former 154.6. In this regard, a review of the record provides detailed proof that petitioners had extensive discussions with their tax and legal

advisors, were explicitly advised of the Division's regulation and its implications on their tax liability for the year in issue, and made their decision as to when to move on the basis of this information and guidance. There is no dispute that petitioners could, and would, have moved at any prior point in time necessary to effectuate the result they sought, and the fact that they did not move at an earlier point in time was due to the clear advice they received in reliance upon the Division's regulation (***see***, Findings of Fact "11" and "12"). Given that the relevant regulation (20 NYCRR former 154.6) was specifically adopted by the Division to "resurrect" and reinstitute the year-end rule (***see***, Conclusion of Law "C"), and that petitioner's tax accountant had prior audit experience wherein the use of the year-end rule was specifically examined and "passed muster" on audit (***see***, Finding of Fact "10"), it is not surprising that petitioners received advice that they could take the steps they took to achieve the tax planning result they sought, or that such advice could be given by their advisors with confidence.[4] Petitioner's tax accountant tellingly offered his view that his failure to have advised his clients of the potential tax planning advantage available by tailoring a course of conduct to come within the explicit terms of a regulation might be considered malpractice. It is also significant to note that the Division imposed penalties in enforcing the year-end rule set forth in 20 NYCRR former 154.6 on audit against a taxpayer who chose not to follow the regulation and instead utilized the prorate rule (***Matter of Greig, supra.***) In contrast, petitioners clearly undertook their course of action in the timing of their move out of New York in direct reliance upon the Division's regulation then in effect, and thereafter filed their tax return in compliance with such regulation.

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[4] Clearly, the fact that a particular item or action is not contested in a given audit is not binding upon the Division in other audits. Nonetheless, in the context of this matter, such a direct prior audit experience involving petitioners' tax accountant certainly must be viewed as strengthening the confidence level of that accountant in providing the advice given and, in turn, strengthening the reasonableness of the taxpayers in relying and acting upon such advice.

H. In view of the foregoing, petitioners have established both a right to rely, as well as actual reliance, upon the Division's regulation. Thus, this case devolves to the third element necessary to determine whether to invoke an estoppel, to wit, whether petitioner's reliance upon the Division's representation (regulation) was to their detriment. In turn, under the unique facts and circumstances of this case, it is clear that petitioners' reliance was to their detriment. Accordingly, all three necessary elements of an estoppel are present and it is appropriate to grant such remedy. Petitioners directly, specifically and consequentially structured their course of conduct in reliance upon the Division's published guidance. Without such reliance, petitioners would not have suffered the fiscal detriment they now face, but rather could, and clearly would, have avoided the same by the simple expedient of altering their course of conduct and moving out of New York at an earlier point in time. This was a choice which petitioners clearly were aware of and possessed the wherewithal and willingness to accomplish, if the same had been presented as necessary. Instead, however, petitioners asked and were specifically advised that, under the regulation, they could move at any point in time up to September 29, 1997 (***see***, Findings of Fact "9", "11" and "12").

In the ***Wertheimer, Greig,*** and ***Montgomerie*** cases, there was no evidence or even any claim that the conduct or timing of the taxpayers in making their respective moves was undertaken in reliance on the regulation. Here, in stark contrast, petitioners have claimed, and supported by direct evidence, that they sought specific advice, relied reasonably thereon and acted accordingly by postponing or delaying their move, the result of which was that they incurred a tax liability which was entirely avoidable. While it is true that the fiscal measure of petitioners' detriment is simply increased tax liability, it is also clear that there is no specific quantity or dollar amount of detriment which must be suffered by a taxpayer in order for an estoppel to be invoked and to apply (***see, Matter of Consolidated Rail Corporation, supra.; Matter of Harry's Exxon Service***

Station, supra.) That is, the size of the deficiency is not necessarily determinative in order to qualify for estoppel. Thus, the Division's allegation that petitioners will not be "plunged into bankruptcy or suffer any severe hardship much less interfere with the standard of living that they are accustomed to if the deficiency is sustained" is not only unsupported by any facts but is largely irrelevant to the determination of whether an estoppel should be invoked. In this case, an increased personal income tax liability of nearly a quarter of a million dollars, which was avoidable but for petitioners' reliance, is obviously sufficient fiscal detriment to support estoppel.

I. The Division asserts that the prorate rule set forth in ***Greig*** must be applied retroactively and that estoppel may not be invoked in this case because such remedy is not available to correct a mistake of law. Thus, the Division maintains that it is essentially "forced" to apply the prorate rule and that the deficiency must simply be sustained. Petitioner, as noted earlier, has focused his argument most directly on the appropriateness of invoking estoppel under the specific facts of this case (***see***, Conclusion of Law "E"). At the same time, however, petitioner does challenge the Division's positions that estoppel may not be applied to correct an error of law, and that the Division must apply the prorate rule against petitioner retroactively, per ***Greig***. In this regard, petitioner asserts that retroactive application of a decisional change in the law is not mandated in all cases, especially where the decisional change establishes "a new principle of law, either by overruling clear past precedent on which litigants may have relied or by deciding an issue of first impression whose resolution was not clearly foreshadowed," citing ***Chevron Oil Co. v. Hudson*** (404 US 97,106) and ***Matter of NewChannels Corp.*** (Tax Appeals Tribunal, September 23, 1993). Petitioner notes in this context that each of the prior cases addressing the year-end versus prorate allocation issue (i.e., ***McNulty, Wertheimer, Greig*** and ***Montgomerie***) involved part-year resident *partners* and their items of *partnership* income, gain, loss and deduction, whereas the instant matter involves a part-year resident *shareholder* in an *S corporation*. Thus, petitioner posits that

since the issue of retroactive application of the prorate rule has never before been addressed judicially in the specific context of an S corporation and its shareholder, the issue is one of first impression and militates in favor of prospective application (***see, Chevron Oil Co. v. Hudson, supra.***; ***Matter of NewChannels Corp., supra.***)

J. With regard to the basic question of whether estoppel is an available remedy in this case, it is particularly noteworthy that the Tribunal stated in ***Wertheimer***, that "petitioners would have a stronger equitable argument if they could identify specific actions they took in reliance on [the year-end rule] which now work to their detriment under the retroactive application of ***McNulty*** [and its prorate rule]." This statement clearly indicates that estoppel would be an available and appropriate remedy in a proper case, to wit, where the evidence establishes that there was reliance upon a regulation in choosing and following a specific course of action with resulting detriment. The fact that this statement was made by the Tribunal in a case directly involving the same prorate versus year-end rule question as is at issue herein, clearly supports the proposition that estoppel may be applied in this matter, undermines the Division's argument that estoppel can never be available and applied to correct a mistake of law, and that the Division is thus simply "forced" under ***Greig*** to apply the prorate rule against petitioners (***Matter of Wertheimer, supra.; Matter of Bolkema Fuel Co., Inc., supra., citing Schuster v. Commissioner***, 312 F2d 311, 317 [we regard this proposition (that estoppel is generally inapplicable to correct a mistake of law) as one of general application, not as embracing the concept that the Commissioner might always (retroactively) correct a legal mistake regardless of the injustice which will result]). In fact, and of particular note, since no penalties were asserted in ***Wertheimer***, it follows that the only "equitable argument" the Tribunal was addressing would concern an estoppel against retroactively applying the prorate rule based upon the taxpayer's reliance in undertaking specific actions. As described,

the evidence in ***Wertheimer*** did not support any such "specific actions" undertaken in "reliance on" the Division's regulation. Here, however, the evidence does show that specific actions were undertaken in reliance, and thus estoppel is appropriate.

Turning to petitioner's "new principle of law" argument, it is true that the prior cases cited by petitioner dealt with partners and partnerships rather than S corporations and their shareholders. However, the impact of petitioners' argument is lessened by the substantial similarities in the manner in which partners of partnerships and shareholders of S corporations are taxed on their distributive or flow-through items of income, loss, gain and deduction. In this regard, petitioner has not specified or identified any particular distinctions between the two situations (partners versus S corporation shareholders) which might have a determining impact on the subject allocation method issue. Indeed, the regulation at 20 NYCRR former 154.6 as well as the Division's Technical Services Bureau Memorandum (TSB-M-00[1]I) essentially provide for the allocation rule applicable to a part-year resident partner to be likewise applicable to a part-year resident S corporation shareholder (***see***, 20 NYCRR former 154.6[a][3][i]; 154.6[b][1]; TSB-M-00[1]I). At least by implication, then, while ***Greig*** spoke directly to the regulation's impact on the allocation of a part-year resident *partner's* income, it can also reasonably be expected that the analysis and result would apply to a part-year resident S corporation shareholder's income so as to treat the two in identical fashion for allocation purposes.

K. In sum, the evidence in this case specifically demonstrates and supports the fact that petitioners were aware of the need to move in order to minimize the tax impact of the SQP sale, had the ability and willingness to move at any time, and fashioned their course of conduct to achieve their desired result in direct reliance on the Division's regulation. Given the clarity of petitioner's focus in the sale of SQP on his "bottom line" result, and the direct impact of the tax at issue thereon, it is abundantly clear that, but for such reliance on the regulation, petitioners could and would have made

their move out of New York at a different time, i.e., prior to 1997, so as to achieve the result they sought in mitigation of the tax impact of the sale of SQP. This is a simple matter of legitimate tax planning that petitioners were unquestionably permitted to pursue, but are being effectively deprived of after the fact under the imposition of the tax deficiency herein asserted against them (***see, Matter of Consolidated Rail Corporation, supra***.) Simply put, petitioners' reasonable and specific reliance upon the Division's regulation in choosing the time of their move out of New York gave rise to the detriment of the unexpected and entirely avoidable economic impact of the deficiency they are now being asked to pay. Petitioners structured their course of conduct to arrive at the selling price and after-tax "take" from the SQP sale bearing in mind that this would form the basis for their retirement income (***see***, Finding of Fact "7"). This is far different than simply effecting a course of conduct and thereafter filing a tax return and applying a rule which arrives (at least initially) at a fortuitous tax result, as in ***Wertheimer*** and ***Montgomerie***, or by effecting a course of conduct and then choosing not to apply the existing rule but rather to challenge the same by filing in a manner inconsistent with such rule, as in ***Greig***. Petitioners have established that they did, in fact, act in reasonable and specific reliance upon the Division's written guidance to their detriment. Accordingly, the Division is estopped from applying the prorate rule against petitioners and the deficiency in question based thereon must be cancelled.

L. The petition of Robert and Naomi Reiner is hereby granted and the Notice of Deficiency dated September 25, 2003 is cancelled.

DATED: Troy, New York
July 13, 2006

/s/ Dennis M. Galliher
ADMINISTRATIVE LAW JUDGE