STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
ROBERT H. AND HANNA H. SABEL	:	DECISION
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Year 1981.	:	

Petitioners Robert H. Sabel and Hanna H. Sabel, c/o Iwanyshyn, Kesich & Co., 834 Ridge Avenue, Pittsburgh, Pennsylvania 15212, filed an exception[1] to the determination of the Administrative Law Judge issued on October 20, 1988 with respect to their petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the year 1981 (File No. 802535). Petitioners appeared by Epstein, Becker, Borsody & Green, Esqs., P.C. (Rona Klein, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Herbert Kamrass, Esq., of counsel).

Petitioners and the Division of Taxation each filed a brief. Oral argument was held on October 17, 1990.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUE

Whether petitioners are entitled to reduce the capital gain reported on their Federal income tax return, realized on the sale of a partnership interest, by an amount attributable to the amount of the mortgage assumed by the purchaser of the interest.

[1]The Division of Taxation also filed an exception in this matter, but this exception was dismissed as untimely (Matter of Sabel, Tax Appeals Tribunal, May 10, 1990).

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for finding of fact "2" which has been modified. The Administrative Law Judge's findings of fact and the modified finding of fact are set forth below.

Petitioners Robert H. and Hanna H. Sabel were residents of New York during the entire year 1981. They have since moved to Afton, Virginia.

We modify the Administrative Law Judge's finding of fact "2" to read as follows:

> In 1973, while a resident of Pennsylvania, Mr. Sabel invested in Village South Apartments, Ltd., a partnership. The partnership invested in real estate. Between 1973 and 1980, the partnership suffered losses in excess of $550,000.00. Most of these losses were incurred prior to 1978. These losses reduced Mr. Sabel's basis in his partnership interest for Federal income tax purposes. Petitioners claimed to have received a tax benefit from these losses on their Federal tax return. The exact nature of the losses is not indicated in the record. While petitioners filed Pennsylvania income tax returns in those years, under that state's tax law the losses from one type of income cannot be used to reduce income from other sources (see Pennsylvania Reg. Sec. 101.1). Therefore, it is assumed that petitioners obtained no benefit from these losses on any State return in those years.[2]

In 1980, petitioners changed their domicile to Bridgehampton, New York.

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[2] We modified finding of fact "2" of the Administrative Law Judge's determination to delete the following words from the second sentence of the paragraph "which, for lack of any other information, is assumed also to be in Pennsylvania."

We modified this fact to delete this assumption for which there is no support in the record.

In 1981, the partnership sold its assets to a purchaser who assumed the mortgage on the real estate and paid the remainder of the purchase price in cash. (The amount of the mortgage is not in the record.) Mr. Sabel's share of the partnership's capital gain was $873,284.00. His share of the cash received was $189,684.00. Mr. Sabel characterizes the assumption of the mortgage by the purchaser as a "phantom gain". He has calculated this phantom gain as the difference between the capital gain of $873,284.00 and certain losses from prior years of $113,535.00. Petitioner did not explain why this reduction for losses was made.

On his Federal tax return, Mr. Sabel computed a gain by reducing his share of the partnership capital gain, $873,284.00, by $113,535.00, representing the losses in tax years for which he received no tax benefit, to arrive at a figure of $759,749.00. With other gains and losses, his long-term capital gain totalled $761,295.00. He reported 40% of this, $304,518.00, as capital gain income.

On their New York returns for 1981, petitioners started with the Federal figure for income, which included capital gain income of $304,518.00, after a capital gain deduction, and then reduced said income by the sum of $208,873.00. This latter figure represented the difference between the taxable portion of the gain included in petitioner's Federal return ($761,295.00 less a 60% capital gain deduction of $456,777.00) and the taxable portion (50%) of the capital gain from the cash received from the partnership of $189,684.00 (with another small gain and small loss) which amounted to $95,645.00. This difference of $208,873.00 would appear to represent the difference between the tax on a capital gain which included the purchaser's assumption of the mortgage and the tax on a capital gain which includes only cash received.

The Notice of Deficiency, issued on August 16, 1985, is premised upon the Division's disallowance of the downward adjustment to income of $208,873.00, the finding of additional capital gain of $76,129.50 (representing the 10% difference between the Federal deduction for capital gains of 60% and the New York deduction of 50%), and the computation of a minimum tax on tax preferences based entirely on the capital gain deduction.

A further deficiency was asserted in the Division's answer in the amount of $10,237.00, arrived at by disallowing petitioners' deduction of the losses from prior years, amounting to $113,535.00, in computing their gains and losses for Federal and State purposes.

A further deficiency was asserted at the hearing in the amount of $2,256.00. This was computed as the tax on the amount of $37,600.00, representing intangible drilling costs deducted on petitioners' Federal schedule C. This is an item of tax preference for Federal purposes (see IRC § 57[a][2]) and New York purposes (Tax Law § 622[b]) which was not, however, included in the tax computation found in either the deficiency notice or the answer of the Division. Petitioner objected to this new issue and would have asked for an adjournment to prepare for it. The Division admitted it had done nothing to notify petitioner of this issue prior to the hearing and agreed to the adjournment. Such requests were denied at the hearing.

OPINION

In his determination below, the Administrative Law Judge found that the Division of Taxation (hereinafter the "Division") properly disallowed the capital gain reduction. He reasoned that since adjusted gross income for New York purposes is defined in Tax Law § 612 to be Federal adjusted gross income with modifications, and under Federal law, the amount of an assumed mortgage is included in the calculation of capital gain, and New York law does not provide for any modification, the Division was correct in disallowing the reduction. Moreover, the Administrative Law Judge allowed a deduction for the losses of prior years which the Division sought to disallow. He concluded that because the Division first raised this further deficiency in its answer, Tax Law § 689(e)(3) placed the burden of proof on the Division to prove this further deficiency, and that the Division failed to sustain its burden. Lastly, the Administrative Law Judge denied the further deficiency asserted at the hearing. He concluded that petitioners did not receive reasonable notice of the further deficiency which is required by Tax Law § 689(d)(1) and § 301.1(d) of the State Administrative Procedure Act.

On exception, petitioners only challenge the first conclusion of the Administrative Law Judge. They argue that when Mr. Sabel's partnership interest was sold, the purchaser's assumption of his mortgage on the property was not an actual cash gain, but was a "phantom gain" and, therefore, should not be included in their capital gain calculation for New York

purposes.

In response, the Division asserts that the Administrative Law Judge was correct in disallowing the reduction. Furthermore, the Division filed an exception with respect to the second and third conclusions reached by the Administrative Law Judge. Even though its exception was dismissed as untimely, the Division asserts that we have jurisdiction to review the issues raised within such exception, and it urges us to exercise our discretion in this matter.

We affirm the determination of the Administrative Law Judge.

Section 612(a) of the Tax Law provides that:

> "[t]he New York adjusted gross income of a resident individual means his federal adjusted gross income as defined in the laws of the United States for the taxable year, with the modifications specified in this section."

It is undisputed that petitioners' Federal adjusted gross income correctly included the amount that petitioners would subtract for New York purposes, i.e., the portion of the gain attributable to the assumed mortgage. Petitioners have not pointed to any modification in the New York income tax law that authorizes their subtraction. Instead, petitioners argue that it would be unfair to make them pay New York State income tax on the amount of gain reported for Federal purposes. They assert that prior to their residency in New York, which began in 1981, they were not able to deduct Mr. Sabel's partnership losses for State income tax purposes because Pennsylvania (the state where they resided) did not allow for such deductions. However, they were able to take such partnership loss deductions for Federal purposes. In 1981, Mr. Sabel sold his interest in the partnership. Because petitioners have been allowed to take loss deductions on their Federal tax returns which were not utilized on any state return, they argue that they should be treated as having a higher basis in the partnership for State purposes than for Federal purposes. In essence, petitioners argue that in all fairness, since they were never allowed to take loss deductions on a State income tax return and, thus, were deprived of this tax benefit, they should now not incur a tax on the same amount of gain at the State and Federal levels. We disagree.

There exists no authority for allowing petitioners to reduce their gain on the sale of the partnership interest by subtracting that portion of the gain attributable to the assumption of the

mortgage by the purchaser of the interest. Therefore, petitioners cannot reduce their capital gain by the amount of the assumed mortgage.

With regard to the Division's request that we consider the issues raised in the Division's untimely exception, the Tribunal's Rules of Practice and Procedure do not provide for a cross-exception, nor for any exception outside the 30 day time period, unless an extension of this period has been requested. Accordingly, we hold that since the Division failed to file an exception within the 30 day period, or make a timely extension request, the Tribunal is not required to review the Administrative Law Judge's determination in its entirety. While the Tribunal has the power to review any aspect of the Administrative Law Judge's determination (Tax Law § 2006[7]; 20 NYCRR 3000[11][e]), we decline to exercise this discretion in this case (see, Matter of Klein's Bailey Foods, Tax Appeals Tribunal, August 4, 1988).

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of petitioners Robert H. and Hanna H. Sabel is denied;

2. The determination of the Administrative Law Judge is, in all respects, affirmed;

3. The petition of Robert H. and Hanna H. Sabel is denied; and

4. The Notice of Deficiency issued August 16, 1985 is sustained.

DATED: Troy, New York
March 21, 1991

/s/John P. Dugan
John P. Dugan
President

/s/Francis R. Koenig
Francis R. Koenig
Commissioner

/s/Maria T. Jones
Maria T. Jones
Commissioner