STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
IRA SPANIERMAN	:	DECISION DTA No. 808685
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law and Title T of the Administrative Code of the City of New York for the Year 1985.	:	

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on April 23, 1992 with respect to the petition of Ira Spanierman, c/o Spanierman Gallery, 50 East 78th Street, New York, New York 10021, for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law and Title T of the Administrative Code of the City of New York for the year 1985. Petitioner appeared by Steven Glaser, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Michael J. Glannon, Esq., of counsel).

The Division of Taxation filed a brief in support of its exception. Petitioner filed a brief in response. Oral argument was heard on November 12, 1992 and began the Tax Appeals Tribunal's six month time period to issue this decision.

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

ISSUES

I. Whether petitioner filed a valid application for extension of time to file his 1985 personal income tax return.

II. Whether, if petitioner filed a valid application, the Division of Taxation properly imposed penalties for failure to file a timely income tax return.

III. Whether, if penalties were properly imposed, petitioner has shown reasonable cause to support the abatement of penalties.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

Petitioner, Ira Spanierman, is a dealer in fine art. From 1969 until 1985, petitioner was the sole shareholder of Ira Spanierman, Inc., (the "corporation") a corporation which owned and operated an art gallery in New York City. Prior to 1985, petitioner, acting under the advice of his accountants, determined to dissolve the corporation and begin operating the gallery and art dealership as a sole proprietor. In order to accomplish this goal, the assets of the corporation, consisting almost entirely of works of art, were transferred to petitioner as a liquidating distribution. Petitioner understood that as a result of this transaction he would have to pay Federal and State income taxes in 1985 based on his capital gain from the distribution.

In order to calculate his 1985 tax liability, it was necessary for petitioner to determine the fair market value of the artwork. In the absence of actual sales of the artwork, petitioner believed that appraisal was the only appropriate method of estimating fair market value. Early in 1986 petitioner hired Mary M. Walsh, an independent appraiser, to value approximately 700 works of art transferred to him by the corporation and to prepare a written appraisal of the collection. The performance of the appraisal was delayed because of an illness in Ms. Walsh's family. As a result, the appraisal was not submitted to petitioner and his accountants until September 25, 1986.

Because the appraisal was not completed before April 15, 1986, petitioner was not able to accurately determine the full amount of his New York State and New York City personal income tax liability for 1985 by the prescribed date for filing. Petitioner's accountant, Paul Brieloff, prepared and timely filed on petitioner's behalf an application for an automatic extension of time to file State and City personal income tax returns for 1985. In his application, petitioner

estimated a total State and City tax liability of $7,500.00. This amount was somewhat greater than petitioner's 1984 State and City personal income tax liability.

The form (IT-370) filed by petitioner states on its face: "This is not an extension of time for payment of tax. You must pay any tax due with this form. There is a penalty for paying the tax late." That portion of the form that asks the taxpayer to enter the amount of the taxpayer's tax liability states: "you may estimate this amount". As material here, the reverse side of the form states:

> "File Form IT-370 on or before the due date of the return to get an automatic 4 month extension of time to file [New York State and New York City personal income tax returns].
>
> * * *
>
> "The extension will be granted if you complete this form properly, file it on time, and pay with it the amount of tax shown on line 12." (Emphasis added.)
>
> "Late payment penalty -- If you do not pay your tax liability when due, you will have to pay a penalty of 1/2 of 1% of the unpaid amount for each month or part of a month it is not paid. The penalty will not be charged if you can show reasonable cause for paying late. This penalty is in addition to the interest charged for late payments.
>
> * * *
>
> "Late filing penalty -- If you file your [personal income tax return] late, or if you do not file Form IT-370 on time and pay your tax liability with it, you will have to pay a penalty of from 5 to 25% of the tax due. If a return is not filed within 60 days (including extensions) of the time prescribed for filing a return, the penalty may not be less than the lesser of $100 or 100% of the amount required to be shown as tax on the return. The penalty will not be charged if you can show reasonable cause for filing late."

Petitioner made total estimated tax payments of $12,802.00 for 1985, and an additional $1,248.00 was withheld from his wages. It was his understanding, based on advice from his accountant, that he would be required to pay interest on the balance of his tax liability for 1985 but that no penalty would be imposed because he had timely and properly filed a form IT-370. Petitioner was not told that he was required to estimate his tax liability on the basis of an estimate of the value of the artwork he received.

As the appraisal of the art work was not completed by August 15, 1986, petitioner's accountant filed an application for an additional extension until October 15, 1986 to file petitioner's 1985 returns. This application was approved by the Division of Taxation (hereinafter the "Division") on August 21, 1986.

Petitioner filed a 1985 New York State and City Resident Income Tax Return on or about October 15, 1986. The return showed a capital gain of $2,211,067.00 and a total State and City tax liability of $501,045.00. Petitioner made a payment with the return of $521,280.00. With amounts already paid, petitioner's tax payments totalled $535,330.00.

The Division issued a Notice and Demand, dated August 6, 1987, to petitioner asserting a penalty of $129,053.76. The notice contained the following explanation:

> "Your extension of time is invalid because the total payments received by the due date were less than 90% of the tax due. Penalty and interest for late filing and late payment are imposed."

Petitioner paid the full amount of penalty and interest imposed by the Division and made a timely claim for refund of the penalty plus all interest paid on it. The Division denied the refund by letter dated April 30, 1990 which stated in material part: "You have failed to establish reasonable cause to abate the penalty for late payment and/or late filing."

Petitioner has no training or experience in law or accounting. His educational background is in liberal arts. He engaged the accounting services of Paul Brieloff for many years before the liquidation of the corporation took place. Petitioner was never assessed additional tax, penalty or interest until the instant assessment occurred.

In order to ensure that the liquidation of the corporation was being handled correctly, petitioner engaged the services of a law firm, in part to oversee the work done by Mr. Brieloff. In September 1986, an accountant working with the law firm informed petitioner that he might be subject to a penalty for late payment of tax because of his failure to estimate his 1985 tax liability

accurately. Because of this, petitioner lost confidence in his old accountant and hired a law firm to oversee his work in the future.

Pursuant to State Administrative Procedure Act § 306(4), official notice is taken of the following fact:

Form IT-370 for the years 1986 through 1988 contained the following instruction:

> "You must indicate the properly estimated amount of tax liability. Taxes are deemed properly estimated if you pay at least 90 percent of the taxes as finally determined. Taxes as finally determined are the total amount of taxes which the return shows to be due or would have shown to be due but for mathematical errors. To obtain a valid extension of time to file, where the taxes as finally determined are $1,000 or more, Form IT-370 must be accompanied by a full remittance of the properly estimated amount of taxes due as of April 15, 1988."

OPINION

The Administrative Law Judge determined that 20 NYCRR former Part 151 did not provide for the invalidation of an extension of time to file because the taxpayer failed to pay at least 90% of the tax due at the time the application for extension was filed. The Administrative Law Judge offered several reasons in support of this conclusion. First, the Administrative Law Judge noted that the Notice and Demand received by petitioner states that the extension to file is invalid because total payments made on the filing due date were less than 90% of the total tax due. The Administrative Law Judge found that this language refers to the Division's 1986 regulation, since the 1985 regulation did not address invalidation of the extension on this basis. The Administrative Law Judge disregarded TSB-M-83-(5)-I in part because she concluded that the TSB-M is in conflict with the 1985 regulation to the extent the TSB-M indicates that the Division followed the less than 90% rule as a basis for invalidating an extension in 1985. The Administrative Law Judge also disregarded the TSB-M because if the 1985 regulation were consistent with the TSB-M, the 1986 amendment of the regulation would have been unnecessary. The Administrative Law Judge found that this analysis is further supported by the Notice of Adoption which accompanied the 1986 regulation which stated that one reason for the

amendments to the 1985 regulation was to increase conformity between the income tax and corporation tax rules. Since the corporation tax rules contained a 90% rule, the Administrative Law Judge concluded that this was one aim of the 1986 amendments and that, therefore, the 1985 regulations lacked such a provision.

The second reason the Administrative Law Judge offered for disregarding the 1985 regulation was that it is in direct conflict with the Tax Law as pointed out in the Notice of Adoption related to the 1986 amendments to former Part 151.

Third, the Administrative Law Judge was unable to find support in either the 1985 regulation or the 1985 Form IT-370 for the Division's assertion that an extension would be considered invalid if payment of the total amount of tax due was not made at the time the application for extension of time to file was made.

The final basis for the conclusion of the Administrative Law Judge was the 1990 amendments to 20 NYCRR 151.2, which the Administrative Law Judge considered to be a partial return to the 1985 regulation.

The Administrative Law Judge determined that petitioner had not established reasonable cause for late payment of tax due because, despite petitioner knowing that his 1985 tax liability would greatly exceed his 1984 liability, petitioner made no effort to accurately determine his tax liability.

On exception, the Division states that petitioner did not meet the requirements of 20 NYCRR former 151.2(a)(3) and, thus, did not have a valid filing extension pursuant to 20 NYCRR former 151.2(a)(4). The Division goes on to state that the use of the term "estimated" in 20 NYCRR former 151.2(a)(3)(i) is of no benefit to petitioner, as the regulation requires the estimate to be the full amount of tax due. The Division asserts that the Administrative Law Judge erred in several respects. First, the Division contends that the regulations are clear on their face, not confusing as the Administrative Law Judge found. Second, the Division submits that the Administrative Law Judge's conclusion that petitioner's 1985 estimated tax liability was

based on petitioner's 1984 liability is without basis in the record. Third, the Division maintains that the Administrative Law Judge improperly disregarded the income tax regulations in favor of the corporation tax regulations. Finally, the Division claims that the Administrative Law Judge was wrong to rely on the 1990 regulations for the resolution of a matter concerning the 1985 regulations. The Division asserts that petitioner has not demonstrated reasonable cause and is, therefore, not entitled to the abatement of the late filing penalty. The Division bases its position on 20 NYCRR former 151.8 and TSB-M-83-(5)-I. Further, the Division asserts that the TSB-M is consistent with both 20 NYCRR former 151.2 and 20 NYCRR former 151.8.

In response, petitioner relies on the analysis and conclusions of the Administrative Law Judge regarding the validity of the filing extension and the propriety of imposing a late filing penalty. Further, petitioner argues that, regardless of how 20 NYCRR former 151.2 is ultimately resolved, reasonable cause for late filing has been shown under 20 NYCRR former 151.8. Petitioner asserts that reasonable cause exists when a taxpayer has relied in good faith on the advice of a tax professional, and that the present matter is clearly addressed by this principle. Petitioner further asserts that his history of tax compliance also supports a finding of reasonable cause.

We affirm the determination of the Administrative Law Judge for the reasons set forth below.

Application for Extension of Time to File a Return

Tax Law § 685[1] addresses additions to tax and civil penalties, stating:

> "(a)(1) Failure to file tax return.--
>
> "(A) In case of failure to file a tax return under [Article 22] on or before the prescribed date (determined with regard to any extension of time for filing), unless it is shown that such failure is

[1]The personal income tax imposed by Title T of the Administrative Code of the City of New York refers to Article 22 of the Tax Law and contains corresponding provisions which are essentially the same as those in Article 22. Therefore, all references in this decision to provisions of the Tax Law shall be deemed references, although uncited, to the corresponding provisions of Title T.

> due to reasonable cause and not due to willful neglect, there shall be added to the amount required to be shown as tax . . .
>
> * * *
>
> "(2) Failure to pay tax shown on return.--In case of failure to pay the amounts shown as tax on any return required to be filed under [Article 22] on or before the prescribed date (determined with regard to any extension of time for payment), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount shown as tax . . ." (Tax Law §§ 685[a][1][A] and 685[a][2]).

20 NYCRR former 151 sets forth the rules concerning extensions of time for filing and for the payment of tax. The relevant portions of former Part 151 provide:

> "**151.2 Application for automatic four-month extension of time for filing New York State income tax returns.** (a) Requirement to file New York State application form. An individual, fiduciary or partnership who is required to file a New York State income tax return for any taxable year and who anticipates having an amount of New York State personal income tax and City of New York tax remaining unpaid as of the date prescribed for the filing of such return, will be allowed an automatic four-month extension of time to file such return after the date prescribed for the filing of such return only if the requirements contained in paragraphs (1) through (3) of this subdivision are met.
>
> "(1) An application must be prepared on form IT-370, New York State Application for Automatic Extension of Time to File, and must be signed by the taxpayer or other person duly authorized by the taxpayer to request such extension.
>
> "(2) The application must be completed and filed with New York State Income Tax, The State Campus, Albany, NY 12227, on or before the date prescribed for the filing of the New York State income tax return of the individual, fiduciary or partnership.
>
> "(3) (i) In the case of an individual or a fiduciary, the application must indicate thereon the full amount of the New York State personal income tax liability and the full amount of the City of New York tax liability for such taxable year. The full amount of the New York State personal income tax liability and the full amount of the City of New York tax liability for the taxable year may be estimated by such individual or fiduciary.
>
> "(ii) The application must be accompanied by a full remittance of the amount of New York State personal income tax and City of New York tax remaining unpaid as of the date prescribed for the filing of the New York State income tax return.

"(iii) For purposes of this Part, the New York State personal income tax liability means the amount of New York State personal income tax imposed under article 22 of the Tax Law, and the City of New York tax means the City of New York personal income tax imposed under title T of the Administrative Code of the City of New York and the City of New York nonresident earnings tax imposed under title U of the Administrative Code of the City of New York.

"(4) Upon the timely filing of form IT-370, properly prepared and accompanied by remittance of the full amount of the unpaid New York State personal income tax and City of New York tax liabilities, the four-month extension will be considered as allowed. Except in undue hardship cases, no extension of time for filing a New York State income tax return will be granted until the provisions of this section have been met.

"(5) Any automatic extension of time for filing a New York State income tax return granted under this subdivision will not operate to extend the time for the payment of any New York State personal income tax or City of New York tax due on such return . . . .

* * *

"**151.8 Interest and Penalties.** (a) Interest. Interest, at the rate prescribed by the Tax Commission pursuant to section 697 of the Tax Law (see Part 603 of this Title), accrues on any balance of New York State personal income tax and City of New York tax due from the due date of the New York State personal income tax return (determined without regard to any extension of time to file), to the date of payment.

"(b) Penalties. (1) Late payment and late filing penalties may be imposed on any balance of New York State personal income tax and City of New York tax remaining unpaid after the due date of the return, determined without regard to any extension of time to file, unless there can be shown reasonable cause for such late payment or late filing.

"(2) A showing of reasonable cause will be presumed, and late payment and late filing penalties will not be imposed, if:

"(i) the excess of the amount of the New York State personal income tax and City of New York tax shown on a New York State personal income tax return over the amount of New York State personal income tax and City of New York tax paid on or before the due date of the New York State personal income tax return (determined without regard to any extension of time to file) by virtue of taxes withheld by the employer, payments pursuant to a declaration of estimated income tax and the payment in full of

> estimated tax liabilities pursuant to the provisions of section 151.2(a)(3) of this Part, is no greater than 10 percent of the amount of the New York State personal income tax and City of New York tax as finally determined on the New York State personal income tax return; and
>
> "(ii) any balance due shown on the New York State personal income tax return is paid with such return.
>
> "(3) In determining reasonable cause, consideration will be given to all the facts and circumstances of the taxpayer's financial situation; however, mere failure of the taxpayer to have sufficient funds under his possession or control with which to pay the tax due does not constitute reasonable cause" (20 NYCRR former 151.2 and 151.8, emphasis in original).

We find nothing in the language of the regulations which establishes the amount of tax that must be paid in order to obtain a valid extension.[2]

The Division asserts that the proper measure is whether the full amount of tax has been remitted with the application (see, 20 NYCRR former 151.2[a][3][i]). However, this language is contradicted by other language in former Part 151. First, 20 NYCRR former 151.2(a)(3)(i), though stating that the full amount of tax due must be remitted, also provides that "the full amount . . . may be estimated . . ." (emphasis added). In our opinion, the allowance of an estimation of tax due is inconsistent with requiring remittance of the full amount.

Second, 20 NYCRR former 151.2(a)(5) states that an extension of time to file a return does not extend the time for payment of the tax due on the return. This provision would be unnecessary if the full amount of tax was due when the application for extension of time was filed because in that situation either (i) a valid extension would exist, meaning that no tax was due because it had been paid with the extension application or (ii) a valid extension would not exist because all of the tax had not been paid. Likewise, 20 NYCRR former 151.8(b)(1), which discusses late payment penalties determined without regard to filing extensions, would also be unnecessary if the full amount of tax was due at the time the application for extension was filed.

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[2]In contrast, the regulations were amended in 1986 to provide that "[t]he amount of the New York State personal income tax liability . . . will be deemed properly estimated . . . if the combined amounts indicated thereon are not less than 90 percent of the taxes as finally determined" (20 NYCRR former 151.2[a][3][i]).

Given these conflicting requirements, we find that 20 NYCRR former Part 151 does not set forth a standard for determining the validity of an extension to file a tax return based upon the amount of tax remitted with the application for extension. Without a standard in the regulation to evaluate petitioner's estimate of his taxes, we conclude that his estimate must be deemed to satisfy the regulation and that petitioner obtained a valid extension.

The Division argues that our decision in Matter of Grace & Co. (Tax Appeals Tribunal, September 13, 1990) established a single rule for evaluating the validity of an extension request, i.e., that the taxpayer must prove that he made a good faith effort to reasonably estimate his tax liability. Because petitioner has not made such a showing, the Division asserts that he should lose. We disagree.

Our decision in Grace & Co. was based upon specific statutory provisions of Article 9-A of the Tax Law, sections 211(1) and 213(1). We concluded that these statutory provisions established safe harbor payment amounts for a taxpayer filing an extension request, but did not preclude a reasonable estimate. There is nothing in Grace & Co. to suggest that where, as here, the statute and regulations fail to set forth a standard for estimating tax, that a reasonable estimate standard will apply.

Having determined that petitioner had a valid extension, the next question before us is the application of 20 NYCRR former 151.8(b). On its face, the regulation would impose the late filing penalty on petitioner's underpayment without regard to the extension of time to file.

Pursuant to section 657 of the Tax Law, the Division has the authority to establish the terms and conditions of any extension of time to file. However, when the taxpayer has followed the procedure and obtained an extension to file, Tax Law § 685(a)(1)(A) requires that the due date of the return be determined with regard to the extension and that the late filing penalty be imposed accordingly. As the Division itself noted in its Notice of Adoption for the 1986 amendments to 20 NYCRR Part 151, 20 NYCRR former 151.8(b) was in conflict with the statute to the extent that the regulation attempted to impose the late filing penalty without regard to

whether an extension of time to file had been obtained (Exhibit "17"). A regulation that is in conflict with a statute is invalid (Matter of Trump-Equit. Fifth Ave. Co. v. Gliedman, 57 NY2d 588, 457 NYS2d 466; Matter of Codata Corp. v. Commissioner of Taxation & Fin., 163 AD2d 755, 558 NYS2d 723; Matter of Velez v. Division of Taxation of the Dept. of Taxation & Fin., 152 AD2d 87, 547 NYS2d 444). Therefore, the late filing penalty asserted by the Division during the period for which petitioner had an extension of time to file must be cancelled.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petition of Ira Spanierman is granted with regard to the late filing penalties, but is denied with regard to the late payment penalties; and

4. Petitioner's request for a refund is granted to the extent indicated in paragraph "3" above, but is otherwise denied.

DATED: Troy, New York
May 6, 1993

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

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

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