STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
ALAIN E. AND BRIGITTE WERTHEIMER	:	DECISION DTA No. 808770
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law and the Administrative Code of the City of New York for the Year 1986.	:	

Petitioners Alain E. and Brigitte Wertheimer, 1060 Fifth Avenue, Apt. 12B, New York, New York 10128, filed an exception to the determination on remand of the Administrative Law Judge issued on May 18, 1995. Petitioners appeared by Willkie, Farr & Gallagher (Peter W. Schmidt, Esq., of counsel). The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Michael J. Glannon, Esq., of counsel).

Petitioners filed a brief in support of their exception, the Division of Taxation filed a brief in opposition and petitioners filed a reply brief on September 18, 1995, which date began the six-month period for the issuance of this decision. Oral argument was not requested.

The Tax Appeals Tribunal renders the following decision per curiam.

ISSUE

Whether the Court of Appeals decision in Matter of McNulty v. New York State Tax Commn. (70 NY2d 788, 522 NYS2d 103) can be applied retroactively to the income tax return filed by petitioners for 1986.

FINDINGS OF FACT

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

The parties entered into a Stipulation of Facts, dated June 29, 1993, which has been incorporated into the Findings of Facts below.

Alain E. Wertheimer and Brigitte Wertheimer, his wife, ("petitioners") were residents of the State of Connecticut for the period beginning January 1, 1986 through September 30, 1986.

Petitioners became residents of the State of New York on October 1, 1986 and remained residents of this State for the period through and including December 31, 1986.

Petitioner Alain E. Wertheimer was a limited partner in various partnerships. Petitioners' sole source of income was their distributive share of earnings of New York partnerships. During calendar year 1986, income and losses were allocated to him, and cash distributions were made to him from these partnerships as follows:

NAME OF PARTNERSHIP	EIN #	CASH ALLOCATED DISTRIBUTIONS	INCOME/(LOSS)
Eagle 82 Bravo	73-1165526	$6,068.00	$ 4,381.00
Openheimer East Point Assoc.	13-3014211	$ -0-	$ 68,092.00
Buchanan 82 Drilling Program	74-2248314	$1,932.00	$ 509.00
Texoma Partners	23-2242495	$2,204.00	$ (14,146.00)
R & D Ltd. Partnership	06-1102454	$6,000.00	$ 79,526.00
Banyon Club Assoc., Ltd.	59-2454066	$ -0-	$ (179,289.00)
VV Associates-No.4 Twin Towers Assoc.	11-2600367	$ -0-	$ (97,790.00)
Ltd. Partnership of Albany	06-1076586	$ -0-	$ (860,873.00)
New Community Manor Associates Ltd.	22-2472107	$ -0-	$ (116,906.00)
Normandie Ltd. Partnership No. 35	54-1280147	$ -0-	$ (36,530.00)
Normandie Ltd. Partnership No. 39	54-1280149	$ -0-	$ (36,530.00)
Normandie Ltd. Partnership No. 46	62-1280153	$ -0-	$ (36,530.00)
Normandie Ltd. Partnership No. 48	62-1239579	$ -0-	$ (36,530.00)
Fairway Shores Assoc. Limited Partnership	59-2416816	$ -0-	$ (15,758.00)
1626 New York Assoc. Ltd.	04-2808184	$ -0-	$ (139,425.00)
1626 New York Assoc. Limited Partnership	04-2808184	$ -0-	$ (125,105.00)

TOTAL NET PARTNERSHIP LOSSES			$(1,542,904.00)
M. Wythenhove Inc.-Sub S	13-3220707	$ -0-	$ 40,706.00
TOTAL LOSSES PER TAX RETURN			$(1,502,198.00)

Each of the above-referenced partnerships used the calendar year as their tax year for Federal and State income tax purposes, i.e., the tax year of each partnership ended December 31, 1986.

Petitioners timely filed a New York State and City of New York Resident Income Tax Return and a New York State Nonresident Income Tax and City of New York Nonresident Earnings Tax Return for the year 1986, both filed under the status "married filing joint return." The resident income tax return filed by petitioners was for the period beginning October 1, 1986 through December 31, 1986 and all of the income and losses allocated by the partnerships to petitioner Alain Wertheimer were reported on this resident return.

The Court of Appeals decision in McNulty (supra) was issued on October 15, 1987. Petitioners' tax returns for 1986 were in-date stamped as received by the Division of Taxation ("Division") on October 15, 1987.

The Division issued a Statement of Audit Changes to petitioners on August 17, 1988. This statement advised petitioners that their tax was being recomputed as a result of errors on their 1986 income tax returns, and that additional income tax was being asserted in the amount of $169,988.00, plus interest. The statement explained further that petitioners were required to prorate their partnership losses and appropriate New York additions to and subtractions from income because their 1986 income tax return covered less than a full year. The statement stated that the proration (set forth in the statement) was based on the number of months that petitioners were residents of New York State in 1986, i.e., three months.

Petitioners disputed the proposed assessment by letter dated September 8, 1988. The Division's letter in response, dated December 9, 1988, supplemented the explanation contained in

the Statement of Audit Changes by stating that the 1987 Court of Appeals decision in McNulty v. New York State Tax Commn. (supra) required that:

> "When a part-year New York resident return is filed due to a change of residence and the taxpayer is a member of a partnership or a shareholder of a New York S Corporation and [sic] distributive share should be prorated by months, over the entire tax year of the taxpayers . . . .
>
> "Your partnership (losses) and New York modifications have been prorated on an 3/12 basis. In the nonresident period New York nonresident partnership (loss) were not included as income.
>
> "New York State Regulation 148.6 is in the process of being revised." (Emphasis added.)

At the time this letter was written, the amendment to former regulation section 148.6 had not yet been finalized.

The Division issued a Notice of Deficiency to petitioners, dated March 16, 1989, asserting a tax deficiency of $169,988.00, plus interest, for a total amount of $193,229.59.

OPINION

In his first determination on this matter, the Administrative Law Judge held that Matter of McNulty v. New York State Tax Commn. (70 NY2d 788, 522 NYS2d 103) did not mandate proration of partnership distributions between a partner's New York resident and nonresident return and, therefore, that McNulty did not invalidate the method of reporting used by petitioners on their 1986 tax return. Given this conclusion, the Administrative Law Judge deemed it unnecessary to decide whether the holding in McNulty could be applied retroactively.

We reversed the Administrative Law Judge's determination, concluding that "the holding of McNulty is that where a partner's distributive share of income is reported without regard to actual receipt, the only possible method of allocation under section 654 is on a proportionate basis throughout the year" (Matter of Wertheimer, Tax Appeals Tribunal, January 12, 1995). We remanded the case to the Administrative Law Judge to issue a determination on whether McNulty could be applied retroactively.

In his determination on remand, the Administrative Law Judge concluded that the Court of Appeals decision in McNulty could be applied to the income tax return filed by petitioners for 1986. The Administrative Law Judge based this conclusion on several alternative grounds. First, he reasoned that it was for the Court of Appeals to limit the effect of its decision and because it did not, the decision should be given both prospective and retroactive application. The Administrative Law Judge also opined that the application of McNulty to petitioners' 1986 tax return did not constitute a retroactive application because this tax year was still open. Finally, the Administrative Law Judge concluded that even if he were to determine whether McNulty should be given retroactive effect, by applying the criteria of Chevron Oil Co. v. Huson (404 US 97), it would not change the result he reached because, he concluded, "there was no new principle of law adopted in McNulty overruling a long line of cases" and "while applying the McNulty holding to petitioners' 1986 return will result in their paying additional tax, there has been no showing that the application of the McNulty decision to petitioners would result in inequity, injustice or hardship to petitioners or to taxpayers generally" (Determination, Conclusion of Law "I"). In a footnote, the Administrative Law Judge explained his reasoning with respect to the third criteria of Chevron as follows: "[t]he third criteria of Chevron dealt with whether retroactive application of the court's decision would tend to further the legislative purpose of the statute. That consideration is moot since section 654 was repealed effective January 1, 1988 (L 1987, ch 28, § 88)" (Determination, footnote "3").

On exception, petitioners argue that the Court of Appeals decision in McNulty cannot be applied to them based on the three-factor test applied by the Supreme Court in Chevron, which was adopted by the Court of Appeals in Gager v. White (53 NY2d 475, 442 NYS2d 463, cert denied 454 US 1086) and by this Tribunal in Matter of NewChannels Corp. & Upstate Community Antenna (Tax Appeals Tribunal, September 23, 1993).

We affirm the conclusion of the Administrative Law Judge that the McNulty decision applies to petitioners' 1986 tax return, but we do so for the reasons stated below.

In NewChannels, the issue before us was whether our ruling in Matter of Capitol Cablevision Systems (Tax Appeals Tribunal, June 9, 1988), that cable television companies were subject to tax under Article 9-A, rather than Article 9, of the Tax Law, applied to taxable periods ending prior to the issuance of our decision in Capitol Cablevision. In other words, whether our decision in Capitol Cablevision was retroactive.[1] In NewChannels, we concluded that in Gager v. White (supra) the Court of Appeals had adopted the Chevron analysis to decide retroactivity questions and that this result was not affected by the Supreme Court's decision in Harper v. Virginia Dept. of Taxation (___ US ___, 125 L Ed 2d 74) because Harper was limited to questions of Federal law. While we believe that we followed the correct analysis in NewChannels, we believe that this analysis leads to a different conclusion in this case.

Our analysis of the present issue must begin with a discussion of the context in which our deliberation takes place. The Tribunal is not a court, but is an administrative agency (New York State Dept. of Taxation & Fin. v. Tax Appeals Tribunal, 151 Misc 2d 326, 573 NYS2d 140); however, it is an administrative agency that performs exclusively a quasi-judicial function. Our status and function create conflicting pressures when deciding a question of retroactivity: as an administrative agency it is preferable that our action be prospective (Matter of Howard Johnson Co. v. State Tax Commn., 65 NY2d 726, 492 NYS2d 11; Matter of Friesch-Groningsche Hypotheekbank Realty Credit Corp. v. Tax Appeals Tribunal, 185 AD2d 466, 585 NYS2d 867, lv denied 80 NY2d 761, 592 NYS2d 670), but in the judicial function decisional law is traditionally applied retroactively (Gager v. White, supra). In our view, these conflicting pressures have different weights depending on the history of the issue before us. Specifically, in NewChannels the issue before us had not been previously addressed by any other judicial body. Thus, our decision was whether as an administrative agency we should apply our own decision

[1]The Administrative Law Judge cited no authority, and we have found none, for his conclusion that a decision is not retroactive so long as it is being applied to an open tax year.

retroactively.[2] In this case, the issue has already been addressed by the Court of Appeals and the issue is whether in performing our judicial function we should apply the rule identified by the Court of Appeals in McNulty. It is in this context that we apply the three factors identified by the Supreme Court in Chevron.

"First, the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied [citation omitted] or by deciding an issue of first impression whose resolution was not clearly foreshadowed" (Chevron Oil Co. v. Huson (supra, at 106). In Gurnee v. Aetna Life & Cas. Co. (55 NY2d 184, 448 NYS2d 145, cert denied 459 US 837), the Court of Appeals applied this factor in circumstances very analogous to ours. The Court of Appeals had previously ruled, in Matter of Kurcsics v. Merchants Mut. Ins. Co. (49 NY2d 451, 426 NYS2d 454), that a regulation of the Insurance Department was an incorrect interpretation of section 671 of the Insurance Law. In Gurnee, the Court was required to decide whether its decision in Kurcsics should be applied retroactively to a claim that arose before Kurcsics was decided. By overturning the Insurance Department regulation, the Court held that Kurcsics had not established a new principle of law because "[a] judicial decision construing the words of a statute . . . does not constitute the creation of a new legal principle. Additionally, the definitional language of section 671 itself foreshadowed the conclusion this court first had the opportunity to express in Kurcsics" (Gurnee v. Aetna Life & Cas. Co., supra, 448 NYS2d 145, 147). The clear rule of Gurnee is that a Court of Appeals decision, in this case McNulty, declaring an administrative regulation invalid, here 20 NYCRR 148.6, does not create a new principle of law.

The next Chevron factor is whether retroactive operation of the rule in issue "will further or retard its operation" (Chevron Oil Co. v. Huson, supra, at 107). In McNulty, the Court stated that:

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[2]This is the same situation that was before the Appellate Division, First Department in Matter of Hilton Hotels Corp. v. Commissioner of Fin. of New York (___ AD2d ___, 632 NYS2d 56).

> "[s]ection 654 of the Tax Law, which establishes specialized reporting requirements for taxpayers who change resident status during the tax year, evinces a clear legislative intent that most forms of income, as well as exemptions and standard deductions, be allocated between the taxpayer's resident and nonresident returns in a manner that either reflects the actual date of receipt and expenditure or encompasses an annual amount distributed on a proportionate basis" (Matter of McNulty v. New York State Tax Commn., supra, 522 NYS2d 103, 104).

The Court found rule 148.6 inconsistent with this legislative intent because it required that "annual partnership distributions be reported in their entirety on 1 of the 2 returns without regard either to when such distributions are received or to proration" (Matter of McNulty v. New York State Tax Commn., supra, 522 NYS2d 103, 104). Therefore, to deny retroactive effect to the rule stated in McNulty would be directly contrary to the legislative design identified by the Court in McNulty and would retard the operation of the rule.

With respect to this second factor, petitioners argue "McNulty could only retroactively apply to two tax years (1986 and 1987) [footnote omitted] and thus retroactive application would not further any meaningful tax policy of the Division" (Petitioners' brief on exception, p. 4). As petitioners suggest, the section at issue in McNulty, section 654, was repealed effective January 1, 1988 (L 1987, ch 28, § 88). This repeal was part of a major revision of Article 22 which altered the manner in which all nonresidents and all taxpayers who changed their resident status during the tax year calculated their New York income tax. Thus, the change was not aimed only at partners who changed their resident status and was not intended simply to overrule the result of McNulty. Consequently, we do not see what bearing the repeal of section 654, as part of this overall revision, has on the retroactive application of McNulty. In our view, McNulty identified the legislative policy that was intended to apply to the year 1986 and that is the meaningful policy reason for applying McNulty to 1986.

Next, petitioners argue that retroactive application of McNulty would seriously undermine confidence in the Tribunal because it "'would send an ominous signal to all taxpayers concerning their ability to rely on . . . established rules'" (Petitioners' brief on exception, p. 5). To the

contrary, we believe that we are following the established rules of judicial decision making by deciding this case in accord with the direct, binding precedent articulated by the Court of Appeals in McNulty.

The last factor applied by the Supreme Court in Chevron requires the weighing of the inequities imposed by retroactive application. Petitioners argue that retroactive application would impose great economic hardship on them because they "relied on an established regulation that the Division had consistently enforced for over 20 years [footnote omitted] and they could not have anticipated that this established regulation would be changed in any way. It is fundamentally unfair to now expose Petitioners to an unexpected and substantial tax liability" (Petitioners' brief on exception, p. 5). It is undisputed that the application of McNulty will require petitioners to pay more tax for 1986 than they reported on their return; however, it is not obvious to us that a taxpayer has a substantial equitable right to pay less tax than a rule announced by the Court of Appeals would require. Petitioners would have a stronger equitable argument if they could identify specific actions they took in reliance on rule 148.6 which now work to their detriment under the retroactive application of McNulty.[3] Petitioners' claim that they relied on the regulation when they filed their return would be pertinent if the Division had assessed penalty. However, the Division did not assert penalty and without penalty we do not see that petitioners were prejudiced by their reliance on the regulation. Thus, we see little weight to the equitable burden imposed on petitioners by the retroactive application of McNulty.

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[3]Specific detrimental reliance on the old agency rule does not always prevent a retroactive enforcement of a rule change. In both Retail, Wholesale & Dept. Store Union v. National Labor Relations Board (466 F2d 380 [DC Cir 1972]) and in National Labor Relations Board v. Laidlaw Corp. (414 F2d 99 [7th Cir 1969], cert denied 397 US 920), a Court of Appeals found that the employer had specifically tailored its behavior to conform with an explicit National Labor Relations Board ("NLRB") rule which was subsequently changed by the NLRB. Nonetheless, in Laidlaw, the Court of Appeals for the Seventh Circuit held that the rule could be applied retroactively to impose a back pay award on the employer. The Circuit Court for the District of Columbia in Retail, Wholesale held it could not.

In sum, our application of the three Chevron factors indicates that the circumstances in this case do not warrant a departure from the normal rule that "a change in the decisional law usually will be applied retrospectively to all cases still in the normal litigating process" (Gager v. White, supra, 442 NYS2d 463, 466). Therefore, we conclude that McNulty does apply to petitioners' 1986 tax return.

Accordingly it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Alain E. and Brigitte Wertheimer is denied;

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

3. The petition of Alain E. and Brigitte Wertheimer is denied; and

4. The Notice of Deficiency dated March 16, 1989 is sustained.

DATED: Troy, New York
March 14, 1996

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

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

/s/Donald C. DeWitt
Donald C. DeWitt
Commissioner