STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
NICHOLAS F. ALBANESE, JR. AND DAILE A. ALBANESE	:	DECISION DTA No. 813032
for Redetermination of a Deficiency or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law for the Years 1987 through 1989.	:	

Petitioners Nicholas F. Albanese, Jr. and Daile A. Albanese, 255 River Drive, Tequesta, Florida 33469, filed an exception to the determination of the Administrative Law Judge issued on February 15, 1996. Petitioners appeared by Wofsey, Rosen, Kweskin & Kuriansky (Joseph Brachfeld, Esq., of counsel). The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Craig Gallagher, Esq., of counsel).

Petitioners did not file a brief in support of their exception. The Division of Taxation filed a brief in opposition. Petitioners filed a reply brief. Oral argument was not requested.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision. Commissioner Jenkins took no part in the consideration of this decision.

ISSUES ON EXCEPTION

I. Whether petitioners were residents of the State of New York for the years 1987 and 1988.

II. Whether certain items of income generated by a covenant not to compete were correctly characterized as New York source income by the Division of Taxation in calculating petitioners' tax liability for the years 1987, 1988 and 1989.

III. Whether petitioners' motion to reopen the record was properly denied by the Administrative Law Judge.

FINDINGS OF FACT

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

Petitioners, Nicholas F. Albanese, Jr. and Daile A. Albanese, filed a petition with the Division of Tax Appeals on July 20, 1994, which requested a redetermination of a deficiency of New York State personal income taxes for the years 1987 through 1989 in the amount of $112,676.40.

The petition alleges that petitioners were not domiciliaries of New York State during 1987 and 1988. It also alleges that even if petitioners are found to be nonresidents of New York State for tax years 1987 and/or 1988, the lump-sum retirement plan distribution in tax year 1987 and income from consulting fees and a covenant not to compete in both tax years should not be treated as New York source income in those tax years. For tax year 1989, the petition alleges that the income from consulting fees and a covenant not to compete were not New York source income. The petition also alleges that the Division of Taxation ("Division") "errs in not granting Petitioners' request for a refund of tax, penalty and interest for the tax years at issue."

Petitioners state in their petition that they do not contest the characterization of rental income as New York source income.

Petitioners filed Federal personal income tax returns (Form 1040) for the years 1987 through 1989. However, they did not file any New York State tax returns for those years.

The Division's Exhibit "D" is a copy of petitioners' 1987 joint Form 1040, with schedules attached, which lists their address as "1016 Ocean Drive West, Juno Beach FL 33408". Petitioners claimed a total of six exemptions, four of which were for dependent children. Petitioners reported $236,824.00 as "other income" on line 21 of the Form 1040. The "other income" was broken down on the "STATEMENT OF MISCELLANEOUS INCOME" as follows:

"T[1]	COVENANT NOT TO COMPETE - WESTFAIR [sic]	$ 80,000
T	WESTFAIR [sic] CONSULTING FEE	156,824
	TOTALS	236,824."

The Schedule E Supplemental Income Schedule (From rents, royalties, partnerships, estates, trusts, REMICs, etc.) ("Schedule E"), attached to this return, reported net rental income for a one-half interest in an office building located at 182 Brady Avenue, Hawthorne, NY, in the amount of $5,971.00.

Petitioners reported on line 38 of the Form 1040 additional taxes from Form 4972 in the amount of $128,705.00. Attached to this return were two Form 4972's, Tax on Lump-Sum Distributions, the first in the name of Nicholas F. Albanese, Jr., and the second in the name of Daile A. Albanese.

Part 1 of Form 4972 contains a series of questions which a taxpayer must answer in order to see if he qualifies to use Form 4972. The Part 1 questions and petitioners' respective responses follow:

	Nicholas Albanese	Daile Albanese
1. Did you rollover any part of the distribution?	No	No
2. Were you age 50 or over on January 1, 1986?	Yes	Yes
3. Was this a lump-sum distribution from a qualifying pension, profit-sharing or stock bonus plan?	Yes	Yes
4. Was the participant a member of the plan for at least 5 years preceding the year of the distribution?	Yes	Yes
5. Is this distribution paid to a beneficiary of an employee who died?	No	No
6. Did you quit, retire, get laid off, or get fired from your job before receiving the distribution?	Yes	Yes
7. Were you self-employed or an owner-employee and became disabled?	No	No
8. Were you 59½ or over at the time of the		

[1] It appears that "T" refers to petitioner Nicholas F. Albanese, Jr.

distribution? Yes No

The instructions at the end of Part 1 state: "[I]f you qualify to use this form, you may elect to use Part II, Part III, or Part IV; or elect to use Part II and Part III, or Part II and Part IV". Both petitioners elected to use Part II and Part IV. Form 4972 Part II contains a box which, if checked, allows a taxpayer to elect to treat part of his distribution from "pre-74" participation as capital gain. Both petitioners made the election by checking the box. Petitioners reported the following amount on Lines 1 and 2 of Part II:

	Nicholas Albanese	Daile Albanese
"1. Capital gain part from box 2 of Form 1099-R.	119,378	57,393
2. Multiply line 1 by 20% (.20) and enter here.	23,876	11,479"

Part IV of Form 4972 is used "to elect the 10-year averaging method". Line 1 of Part IV of Form 4972 reported "Ordinary income from box 3 of Form 1099-R", while line 23 of Part IV contained the "Tax on lump-sum distribution", which was the sum of Part II, line 2 and Part IV, line 22. Petitioners reported the following amounts on their respective lines 1 and 23:

Nicholas Albanese, Jr.	line 1	$308,394	
	line 23		93,056
Daile A. Albanese	line 1		$148,266
	line 23	35,649.	

Petitioners' 1988 Form 1040 (Division's Exhibit "E") lists their address as "1016 Ocean Drive West, Juno Beach FL 33408". Only two exemptions were claimed on this return. Petitioners, on their Schedule E, determined the net income for their one-half interest in the Hawthorne, New York office building to be $8,965.00. They reported "other income" on line 22 of the Form 1040 to be $543,538.00. The "other income" was broken down on the "STATEMENT OF MISCELLANEOUS INCOME" as follows:

"T COVENANT NOT TO COMPETE - WESTFAIR [sic]	240,000
T WESTFAIR [sic] CONSULTING FEE	303,538

	TOTALS	543,538."

Petitioners' 1989 Form 1040 (Division's Exhibit "F") contains the same Juno Beach, Florida address as was contained on both the 1987 and 1988 Forms 1040. As was the case in tax year 1988, petitioners claimed only two exemptions on the 1989 return. According to the Schedule E attached to the Form 1040, petitioners' share of the net rental income from the Hawthorne, New York office building was $9,749.00. "Other income" on line 22 of the Form 1040 totaled $150,000.00, which was broken down as follows on the "STATEMENT OF MISCELLANEOUS INCOME":

"T	COVENANT NOT TO COMPETE - WESTFAIR [sic]	80,000
T	WESTFAIR [sic] CONSULTING FEE	70,000
	TOTALS	150,000."

Petitioners employed Caporizzo, Dylewsky, Trantanella & Associates of Stamford, Connecticut to prepare their Federal personal income tax returns for tax years 1987, 1988 and 1989.

On or about June 1, 1992, the Division commenced a field audit of petitioner, Nicholas F. Albanese, Jr., which was assigned to Joseph Tanzillo. The audit was precipitated by a prior audit of West-Fair Electric, a company of which Mr. Albanese was an original principal owner. The audit indicated that large sums of money were being paid to Mr. Albanese but no returns were being filed by him.

As a result of the search he conducted to determine whether the Albaneses had filed as New York residents in the past, Mr. Tanzillo "found that through 1986 they had been filing as residents and after 1986 they stopped filing" (tr., p. 15).

The Division's Exhibit "G" is the contact sheets entitled "Tax Field Audit Record and "Contacts and Comments of All Audit Actions" which contained all of the auditor's contacts and comments concerning this audit. According to the contact sheets, the auditor met with petitioners' former representative, Mr. Caporizzo, on June 12, 1992, and discussed the issues of domicile, residency, as well as the taxability of the rental, restrictive covenant and contractor

income. At that meeting, the former representative provided the auditor with petitioners' Federal returns for tax years 1986 through 1991, and petitioners' 1986 New York State personal income tax return. In addition, the auditor received a summary statement of Nicholas Albanese's connection with his former employer, West-Fair Electric. The notes indicate that the auditor requested additional information at that time.

On the same day, June 12, 1992, the auditor made a field visit to petitioners' Armonk, New York home. According to the auditor, the Armonk, New York address appeared on the New York State income tax returns filed by petitioners prior to the years in issue.

The auditor's next meeting with petitioners' former representative took place on September 21, 1992. According to the contact sheets, the former representative made various records pertaining to the issue of domicile available to the auditor. The notes indicate that petitioners did not provide all of the information requested at the June 12, 1992 meeting.

As a result of the September 21, 1992 meeting, the auditor prepared two documents which summarized the evidence submitted on the issue of domicile. The first document, Division's Exhibit "I", is a single page which summarizes the evidence provided by petitioners to support their position that they became Florida domiciliaries in 1987. The second document, Division's Exhibit "J", summarized the evidence submitted which showed that petitioners continued to be New York State domiciliaries from "1987 to 1992". This document consisted of two summary pages, the first of which was prepared on September 21, 1992, while the second was prepared on November 16, 1992 based upon additional evidence obtained subsequent to September 21, 1992, and attachments.

According to the contact sheets, the auditor met with petitioner's former representative on October 8, 1992 at which time the auditor reviewed "days in/out records" supplied by the representative. During that meeting, Mr. Tanzillo prepared a list of additional information which he requested be provided to him by November 15, 1992.

Petitioners provided additional information which the auditor reviewed at meetings with the former representative on November 12 and 16, 1992.

At the conclusion of the audit, the auditor prepared a Form AU-241.26 Income Tax Report of Audit ('audit report") which summarized his audit conclusions. The audit report "Comments" section contained the following:

> "This is a residency/allocation case with a source code of 34. It resulted from an earlier withholding one in which it was found the taxpayers were receiving large 1099 payments and not filing personal New York State Income Tax Returns. The payments were made by the taxpayer husband's prior owned New York State corporation. Upon examination of the nature of the payments and the taxpayers' New York State residency status, it was determined a tax liability exists. The taxpayers were found to be New York State domiciliarys [sic] for 1987 and 1988 and to have had allocable New York income in 1989. Since no returns were filed for these years, there are no relevant statute dates.
>
> "The circumstances in this case are as follows. In 1986, Mr. Albanese sold all his shares in his New York corporation and claimed to have changed his residency from New York State to Florida. Previously, the Albaneses filed yearly, personal, resident New York State Income Tax Returns. For 1986, they filed their last resident return and properly accounted for the sale of their New York business. As a result of contractual agreements with his former company in its sale, Mr. Albanese was to receive large payments in subsequent years for assisting his former company with collections of A/R, consulting on various jobs and for a restrictive covenant. The Albaneses also, continued holding a rental property interest in the building where the company is located. Large payments were made to the taxpayers for these items in 1987, 1988 & 1989. No New York returns were filed after 1986.
>
> "The department found all of the aforementioned payments allocable to New York. Although for 1987 and 1988, the taxpayers were also found to be New York domiciliarys [sic], these items are taxable by themselves, thus the 1989 adjustment. This position is supported by applicable regulations and case law, which are contained in the workpapers. In 1987, Mr. Albanese received an allocable lump sum [sic] distribution. This too, is taxable to New York regardless of the taxpayers' residency status and was included in the adjustment. The workpapers contain information for this, too.
>
> "In deciding to hold the taxpayers' domiciliarys [sic] in 1987 and 1988, the following facts were considered:
>
> "The taxpayers retained the same New York home they held as their primary residence prior to their claimed change in residence until 1992. They spent 159 days there in 1987 and 119 days in 1988. After their claimed move, the taxpayers had children attending high school

> and college and living there at their primary residence. Nothing substantial was moved from their New York home to the Florida one.
>
> "1099's issued to the taxpayers for 1987 thru 1989 show the taxpayers' address in equal numbers as New York and Florida.
>
> "The taxpayers maintained resident membership status in an exclusive country club near their New York home. Their membership was changed from resident to non resident [sic] at the end of 1988.
>
> "Medical substantiation submitted for 1987 and 1988 shows Mr. & Mrs. Albanese using only New York doctors.
>
> "The taxpayers maintained two checking accounts in 1987 at New York banks with branches near their New York home, one being the Bank of New York and the other the Putnam Trust Company. The Putnam Trust Company account continued being maintained through at least 1991. Both accounts' sample statements and checks show the taxpayers' address as their New York home. Both accounts also had active use.
>
> "All of the above adjustments were addressed with the taxpayers' representative. No agreement was reached. The taxpayers and their representative are taking the stance that all of the proposed adjustments are wrong. Several meetings were held, including one with supervisory staff to try to reach an agreement.
>
> "The case was closed as completely disagreed. Delinquency and negligence penalties were imposed. Case referred to appeals." (Division's Exhibit "L".)

The following handwritten notation appeared at the bottom of the audit report: "Note: [s]ubsequent to preparation of audit report, t/ps made full payment of assessment, but still disagreed."

According to the audit report, the closing conference took place on December 7, 1992. According to the contact sheets, the former representative was provided with copies of the auditor's workpapers at that conference. Notations in the contact sheets indicate that petitioners' former representative requested additional time to enable petitioner Nicholas Albanese and him to make a decision on how to proceed.

The notations in the contact sheets reveal that on December 21, 1992 the former representative "requested citations backing up the department's stance". The auditor provided copies of the case law and the Division's regulations to the former representative. Furthermore,

the notes indicate that the auditor had an in-depth discussion with the former representative at that time as well.

According to the March 16, 1993 notation in the contact sheets, petitioners and their representative did not agree with any of the Division's stances and they decided that the case should go to appeals.[2] The auditor's last entry for March 16, 1993 was "[C]ase closed disagreed".

The auditor's notes in the contact sheets indicate that, on May 14, 1993, he had a second conference with taxpayers' new representative.

On June 14, 1993, the Division issued three statements of personal income tax audit changes to Nicholas Jr. and Daile Albanese in the amounts of $56,120.11, $45,993.90 and $10,562.39, plus penalty and interest, for the years 1987, 1988 and 1989, respectively.

The statement for 1987 contained the following remarks:

> "AS A RESULT OF AUDIT, YOU HAVE BEEN FOUND TO BE A DOMICILIARY OF NEW YORK STATE FOR 1987 AND 1988. THEREFORE, ALL OF YOUR FEDERAL INCOME IS ALLOCABLE TO NEW YORK FOR INCOME TAX PURPOSES. INADDITION [sic], CERTAIN INCOME ITEMS WOULD HAVE BEEN ALLOCABLE TO NEW YORK STATE REGARDLESS OF RESIDENCY STATUS. THESE INCLUDE NEW YORK DERIVED RENTAL INCOME, INCOME DERIVED FROM SERVICES TO YOUR FORMER NEW YORK COMPANY AS AN INDEPENDENT CONTRACTOR, RESTRICTIVE COVENANT INCOME RESULTING FROM AN AGREEMENT WITH YOUR FORMER COMPANY UPON ITS SALE BY YOU AND INCOME FROM A LUMP SUM DISTRIBUTION. SINCE YOU WERE NOT FOUND TO BE A N.Y.S. RESIDENT FOR 1989, YOU WERE TAXED FOR THIS PERIODON [sic] THESE APPLICABLE ITEMS."

These remarks were referred to on the statements for 1988 and 1989 as well.

On June 24, 1993, petitioners' new representative, Anthony R. Lorenzo, Esq., tendered petitioners' check in the amount of $223,655.46. According to the cover letter which accompanied the check, the payment was in full payment of the additional taxes, penalties and interest which were proposed for assessment by the Division's "Final Audit Report". Mr. Lorenzo wrote, in pertinent part:

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[2]It is unclear from the record whether this entry refers to the former representative or the new representative.

> "Please be informed that the taxpayers' [sic] do not consent to the findings detailed in your report and have engaged our firm to represent them in presenting their protest before the administrative and judicial tribunals officially authorized to hear and decide upon such taxpayer appeals. The primary reason for their making payment at this time is to stop the accruing of interest while this matter is being contested."

The breakdown of additional taxes, interest and penalties by tax year follows:

"1987	$116,912.00
1988	88,358.56
1989	18,384.90
	$223,655.46"

The Division issued a Notice of Deficiency (Notice No. L-007698392-1), dated August 2, 1993, for personal income taxes due pursuant to Article 22 of the Tax Law for 1987, 1988 and 1989. In that notice, petitioners were assessed (1) a deficiency for 1987 State income tax in the amount of $56,120.11, plus a penalty of $31,487.99 and $29,303.90 in interest; (2) a deficiency for 1988 State income tax in the amount of $45,993.90, plus a penalty of $23,320.33 and $19,044.33 in interest; and (3) a deficiency for 1989 State income tax in the amount of $10,562.39, plus a penalty of $4,719.98 and $3,102.53 in interest.

The computation section of the notice contained the following explanation: "Field audit of your records disclosed additional tax due."

Petitioners timely requested a conciliation conference which was held on March 30, 1994. After the conciliation conference, the conferee issued a Conciliation Order (CMS No. 133372) dated April 22, 1994, sustaining the statutory notice.

The Division's Exhibit "A" is the Notice of Hearing ("hearing notice") issued in this matter by the Division of Tax Appeals to petitioners, their representative and the Division's representative. This hearing notice contained the following statement:

> "Except as otherwise provided by law, the petitioner has the burden of proof and must establish the facts necessary to show that there is no deficiency or that a refund is due. Such proof may be made by sworn testimony of the petitioner's witnesses or by documentary or other evidence introduced during the course of the hearing."

At the hearing held in this matter, petitioners were represented by Brian Bandler, Esq.; however, they were not present.

At the beginning of the hearing, Judge Jenkins made the following statement:

> "Bear in mind that all witnesses are subject to cross-examination and any evidence you may have put in in earlier proceedings, if you want me to consider it in my decision, you have to put it in here" (tr., p. 2).

At the outset of the hearing, petitioners' representative conceded that the rental income was New York source and should have been included in income (tr., p. 7).

The Division presented only one witness, the auditor, Joseph Tanzillo.

During the hearing, the auditor proffered the following information concerning petitioners' usage of the Armonk, New York home:

> "Through the course of the audit, information was obtained that the taxpayer spent a substantial amount of time there; that they had children in high school and in college still living there, and that they had all there [sic] original possessions that they had obtained over the years while living there still there and had not moved any to Florida" (tr., pp. 26-27).

Petitioners have nine children. The record is silent as to the ages of the children during the relevant period. Although the auditor requested their specific ages, he never received that information. The only information supplied "was that at the time before the audit years, the children ranged in the age from high school age through college" (tr., p. 27).

When asked whether he knew how many children were still living in the Armonk home, the auditor responded: "I believe nine, and it's in the statement that the representative provided to me" (tr., p. 27).

Petitioners' representative informed Mr. Tanzillo that none of petitioners' original possessions were moved to Florida and that the Armonk home was kept intact.

One of the attachments to the Division's Exhibit "J" is an Internal Revenue Service ("IRS") computer printout entitled "SELECTED IRMF RECORDS", dated June 11, 1992, which listed the addresses at which petitioners received 1099 payments during 1987 through 1989 (tr., p. 53). Review of this printout indicates that in each year an equal number of form 1099's were issued to petitioners at both the Armonk, New York and the Juno Beach, Florida addresses, to wit: 5 each in 1987; 2 each in 1988 and 2 each in 1989.

The auditor did an in-depth analysis of petitioners' days in and days out of New York State. Based on the evidence submitted to the auditor, petitioners were in New York 159 days in 1987; 119 days in 1988 and "in the low 70's" in 1989 (tr., p. 31).

The auditor determined that by 1989, petitioners were no longer New York domiciliaries. He based his determination on a number of factors which included among others: (1) the substantial drop in the amount of time petitioners spent in New York; (2) at the end of 1988, petitioners "changed their membership in a very exclusive, expensive country club in New York from residents to nonresidents"; and (3) "in 1988 the taxpayers obtained a receipt for the Homestead Exemption in Florida" (tr., p. 32). The auditor also noted that the records provided for tax years 1987 and 1988 indicated that petitioners only used New York doctors. No records were provided for tax year 1989 concerning petitioners' visits to health care professionals.

The auditor asked petitioners' representative whether petitioners ever filed Florida intangible tax returns. The record does not state what response was given to that question. The auditor was never provided with copies of any Florida intangible tax returns that may have been filed, nor were any Florida intangible tax returns submitted into the hearing record.

The auditor was asked why, for tax year 1987, the covenant not to compete income was picked up by him as being a New York source income item. His response was:

> "Well, for a series of reasons which we took into account in its entirety. West-Fair Electric has offices in New York, and from our interview, my interview, with the taxpayer representatives, it was the case that the taxpayer predominantly worked in New York and the regulations, as well as case law, indicate that in the case of a covenant not to compete, that that is New York source income and -- including in the case of a nonresident and in a case where he sells his business and that's one of the sources of income for the sale of the business" (tr., p. 17).

According to the auditor, whether or not petitioner was a resident or nonresident the covenant not to compete income would be deemed New York source income.

The auditor was asked about the consulting fee income which he picked up as New York source income for tax year 1987. He stated that although he "attempted to obtain information on the nature of the consulting fee income", very little information was provided about it (tr., p.

18). The auditor testified that he obtained "a contract saying that Mr. Albanese would be available to collect for accounts receivable and that that work would be done in New York, and on that basis we presumed it was New York income" (tr., p. 18).

For tax year 1987, the Division included the lump-sum distribution as New York source income. The auditor explained that since petitioner had elected for Federal tax purposes, on Form 4972, to compute the tax on the lump-sum distribution separately from the tax on the remainder of his income, "the New York State law works simply that the taxpayer has to do the same with New York State" (tr., p. 19).

The Division's Exhibit "H" is the 1987 Form IT-230 entitled "Separate Tax on Lump-Sum Distributions" which the auditor used to calculate the amount of the separate tax due on the lump sum distribution. Review of Form IT-230 reveals that although there were two Form 4972's - one for each petitioner, the auditor used the figures from Nicholas Albanese's Form 4972 only to compute the separate tax due for New York State purposes on the lump-sum distribution. The following computations appeared on the Form IT-230: the auditor multiplied $119,378.00, which Mr. Albanese elected to treat as capital gain, by 5.4 % (.054) to determine a tax of $6,446.00 on that portion of the distribution. The auditor determined the tax on the Form 4972 Part IV line 1 ordinary income of $308,394.00 to be $27,480.00. The total separate tax on the lump-sum distribution was determined to be $33,926.00 ($6,446.00 plus $27,480.00) by the auditor.

For tax years 1988 and 1989, the auditor included the rental income, covenant not to compete income and the consulting fees as New York source income.

As its Exhibits "M" and "N" respectively, the Division submitted the filing instructions for New York State nonresident income tax returns for tax years 1987 and 1988 through 1991. These instructions contain the requirements for filing.

The auditor testified that he took these instructions into account when he determined whether or not penalties should be assessed.

Penalties were assessed by the auditor for all three tax years in issue. According to the auditor, penalties were assessed for tax year 1987 because even if petitioners were determined to be nonresidents, they were required to file a New York State nonresident return based on the fact that: (1) they had rental income from New York real property; and (2) Mr. Albanese was "subject to lump sum [sic] distributions derived from or connected with New York State sources" (tr., pp. 35-36). For tax years 1988 and 1989, the penalties were assessed because even if petitioners were nonresidents,they were required to file a return to report the rental income from the New York real property.

Petitioners' representative asked Mr. Tanzillo the basis for his determination that Mr. Albanese had provided services in New York to his former employer. His response was:

> "Well, in part, it was, for lack of a better word, from my standpoint circumstantial. His business was located in New York and when I went to the business originally to conduct the first audit, I saw many people coming and going and I reviewed records that indicated there was a lot of New York jobs but in addition his representative said such and also put it into writing" (tr., p. 37).

The Division's Exhibit "O" is the "STOCK REDEMPTION AGREEMENT" ("agreement"), entered into on November 20, 1986, "by and among West-Fair Electric Contractors, a New York Corporation (the 'Corporation'), and Nicholas F. Albanese, Jr. and Daile Albanese ('Albanese')". According to the terms of this agreement, the Albaneses agreed to sell all of their interest in the company, 95 shares, and the Corporation agreed to purchase same from the Albaneses. Paragraph 2(A) of the agreement set forth the purchase price as follows:

> "(i) $800,000.00 in cash or certified check to be paid on or before November 26, 1986 which amount includes Albanese's share of the accounts receivable set forth in Attachment A hereto.
>
> "(ii) Sum of $483,000 in consideration of a Restrictive Covenant Not To Compete in a form as attached hereto and made hereof as Attachment B which payments shall be payable as follows: $80,500 on April 1, 1987; $80,500 on January 2, 1988; $80,500 on July 1, 1988; $80,500 on January 2, 1989; $80,500 on July 1, 1989; $80,500 on January 2, 1990."

Attached to the agreement is "ATTACHMENT B" entitled "Restrictive Covenant" ("covenant

not to compete") which stated that:

> "Nicholas F. Albanese Jr. covenants and agrees that he will not establish, re-establish, open, re-open, own, manage, operate, joint control, be engaged in or participate in the ownership, management, operation or control of or be connected in any manner whatsoever with any business directly or indirectly, either as employee, as owner, as partner, as agent or stockholder, director or officer of a corporation or otherwise of any firm or entity engaged in any business of a nature similar to or competitive with the business of West-Fair Electric Contractors, Inc. within the County of Westchester and States of New York and Connecticut for a term of five years from the date hereof."

Petitioner Nicholas F. Albanese Jr. executed this covenant not to compete on November 20, 1986. His signature was witnessed by Kevin Plunkett, Esq., the Corporation's counsel.

The following colloquy took place between Administrative Law Judge Jenkins and petitioners' representative:

> "ALJ Jenkins: You have no witnesses today?"
>
> "Mr. Bandler: That's correct, your Honor."
>
> "ALJ Jenkins: How do you wish to proceed?"
>
> "Mr. Bandler: I would be glad to make reference to the factual background of this case which I believe is part of the State's information provided in their submissions."
>
> "ALJ Jenkins: At this point it's your turn to put on your evidence. They put on theirs. If you have exhibits, I'd be happy to take them. You don't have any witnesses to present. Do you have any exhibits you would like to present?"
>
> "Mr. Bandler: No, I do not, your Honor."
>
> "ALJ Jenkins: Okay. In that case, do you intend to file a brief?"
>
> "Mr. Bandler: I believe we would then."
>
> "Ms. Gardiner: Yes." (Tr., pp. 56-57.)

At that point in the proceedings, Judge Jenkins set the briefing schedule in this matter. He then identified the responsibilities of both parties. Judge Jenkins asked the representatives for both sides whether they wished to make closing statements or "hold it for the brief" (tr., p. 58). The representatives for both sides responded that they wished to hold it for their respective briefs. Judge Jenkins then stated "[t]his matter is concluded. Thank you."

Petitioners timely filed their brief in this matter on June 27, 1995. Attached to their brief were five appendices which contained the following documents:

(A) Condominium records; (B) Homestead Exemption; (C) Connecticut bank statements; (D) Realtor's letter; (E) Monthly logs and expenses; (F) Florida bank statements.

Petitioners' request to reopen the record was contained in their reply brief along with the arguments in support of their motion. Petitioners did not submit any affidavits in support of this motion. In their motion, petitioners "request that the Administrative Law Judge exercise his discretion and consider the Appendices, either by considering the Appendices as submitted by the Petitioners or by convening another hearing for the purpose of resubmitting Petitioners' evidence, in order to liberally construe the Tax Appeals Tribunal Rules of Practice and Procedure to render justice in this case" (Petitioners' reply brief, p. 2). They contended that, in order to render a just decision on the issue of domicile, the appendices must be considered by the administrative law judge. Petitioners averred that the appendices bore directly on the issue of their change of domicile and were clearly relevant to that issue.

Petitioners argued that the purpose of the appendices was to complete the Division of Tax Appeals' record and to refute the testimony of the auditor at the hearing. They contended that the Division's exhibits "make reference to a factual background based upon, in part, the information provided in the Appendices" (Petitioners' reply brief, p. 3). They maintained that it was always their "intention that the Appendices form a part of the Department's Division of Tax Appeals record" (Petitioners' reply brief, p. 3). Petitioners asserted that Administrative Law Judge Jenkins'

> "language 'put it in here' was understood to mean that Petitioners would be permitted to provide evidence to the Administrative Law Judge for consideration at any point within the entire proceeding, including at the time the Petitioners' briefs were submitted, because nothing within the Tax Appeals Tribunal Rules of Practice and Procedure precludes or restricts the submission of evidence in a brief" (Petitioners' reply brief, p. 4).

Furthermore, they argued that their "attorney stated that although no exhibits or witnesses would be presented at the Hearing, a brief would be filed and closing statements would be set forth in the brief" (Petitioners' reply brief, p. 3).

Petitioners also argued that:

> "[t]he audit investigation and the informal and formal hearings within the Department are all part of an on-going and continuous administrative proceeding. The Hearing should not be treated as the equivalent of a trial de novo. All the facts and evidence set forth in Petitioners' brief (including the Appendices) have been previously submitted to the Department. Accordingly, Respondent would most assuredly not be disadvantaged in any way by Petitioners' 'failure' to resubmit all of the evidentiary materials previously furnished to the Department" (Petitioners' reply brief, p. 5).

Lastly, they asserted that even if there was no automatic right to present evidence to an administrative law judge outside of a hearing, "as long as a petitioner requests that the record be reopened while the matter is still pending in the Department's Division of Tax Appeals, the discretion remains with the Administrative Law Judge to reopen the record" (Petitioners' reply brief, pp. 7-8). They maintained that "the equities in this case demand that the Appendices be taken into consideration by the Administrative Law Judge so that a decision on the merits can be properly made" (Petitioners' reply brief, p. 8).

The Division's responses to petitioners' submission of the appendices, along with their brief, were contained in its brief. It argued that since the record in this matter was closed at the conclusion of the hearing held on April 27, 1995, the additional documents attached to petitioners' brief should be rejected, and not considered by the administrative law judge in his determination. Citing relevant case law, the Division asserted that "the Tax Appeals Tribunal has consistently rejected similar attempts to introduce additional documents after the record has been closed" (Division's brief, p.6). It argued that Judge Jenkins, at the outset of the hearing, apprised petitioners' representative that:

> "any evidence you may have put in in earlier proceedings, if you want me to consider it in my decision, you have to put it in here." (Division's brief, p. 6, citing tr., p. 2.)

Furthermore, the Division contended that, after it had presented its case, "Administrative Law Judge Jenkins asked petitioners' representative whether he was planning on introducing any exhibits at the formal hearing to which Mr. Bandler responded that he was not introducing any evidence" (Division's brief, p. 7).

On September 15, 1995, both parties' representatives were notified by Andrew F. Marchese, Chief Administrative Law Judge, Division of Tax Appeals, that this matter had been reassigned to Administrative Law Judge Winifred Maloney.

The Division submitted five proposed findings of fact. In accordance with State Administrative Procedure Act § 307(1), all the proposed findings of fact have been incorporated into the findings of fact herein except numbers three and four which are conclusory in nature.

OPINION

The critical issue to be decided in this matter is whether the Administrative Law Judge properly denied petitioners' motion to reopen the record. In her conclusions of law, the Administrative Law Judge summarized petitioners' arguments in support of their motion, to wit: that the appendices were submitted to the auditor during the audit and relate directly to both the domicile issue and the evidence submitted by the Division at the hearing; that it was always their intent that the appendices be part of the record; and that they believed that they would be able to submit evidence to the Administrative Law Judge at any point in the proceeding up to and including the time for submission of their brief. On appeal before us, petitioners have raised the argument that the Administrative Law Judge breached the Tax Appeals Tribunal's Rules of Practice and Procedure, 20 NYCRR 3000.0(c), which requires that such rules "be liberally construed to secure the just . . . determination of every controversy . . . ." Petitioners contend that there is no rule barring the Administrative Law Judge from considering evidence presented with a brief after a hearing, and the failure of the Administrative Law Judge to consider the additional evidence deprived petitioners of justice and denied them their constitutional due process.

The Administrative Law Judge held that petitioners did not demonstrate any extraordinary circumstances to warrant reopening the record. The Administrative Law Judge noted that the evidence was available at the time of the hearing; that petitioners knew their burden of proof at that time, as stated in the Notice of Hearing; that the Administrative Law Judge at the hearing informed the parties that any evidence previously submitted in earlier proceedings must be submitted at the hearing in order for it to be considered; that petitioners' representative stated on the record that he had neither witnesses nor exhibits to offer into evidence; and that the record was closed by the Administrative Law Judge at the conclusion of the hearing.

We agree with the Administrative Law Judge. As we stated in Matter of Schoonover (Tax Appeals Tribunal, August 15, 1991):

> "[i]n order to maintain a fair and efficient hearing system, it is essential that the hearing process be both defined and final. If the parties are able to submit additional evidence after the record is closed, there is neither definition nor finality to the hearing. Further, the submission of evidence after the closing of the record denies the adversary the right to question the evidence on the record. For these reasons we must follow our policy of not allowing the submission of evidence after the closing of the record."

In Matter of Anzilotti (Tax Appeals Tribunal, February 22, 1996), the petitioner submitted additional evidence with a reply brief. We noted that the record had been closed by the Administrative Law Judge at the conclusion of the hearing after the Administrative Law Judge had given the parties a last opportunity to submit testimonial or documentary evidence. The petitioner objected to the rejection of the additional evidence but we upheld the Administrative Law Judge, citing the reasoning in Schoonover and the fact that the evidence had been submitted long after the record had been closed at hearing. It made no difference that the evidence submitted referred to something in the record.

In the instant matter, the Administrative Law Judge clearly informed petitioners' representative of his opportunity to produce witnesses or submit exhibits into evidence. The representative stated he had no witnesses or exhibits. After setting briefing dates, the Administrative Law Judge closed the hearing on April 27, 1995. Petitioners submitted an

extensive set of exhibits with their brief on June 27, 1995, long after the record had been closed. As in the Anzilotti matter, the exhibits were properly rejected. Although petitioners argue that the evidence submitted with the brief related to prior submissions, there was no provision in the record for any further submissions, regardless of relevance or whether it related to material previously submitted.

In the determination below, the Administrative Law Judge found that petitioners did not carry their burden of proof with regard to the issue of domicile for the years 1987 and 1988, having submitted no testimony or documentary evidence. Without any proof, petitioners failed to show that the assessment was erroneous and the Administrative Law Judge found that the Notice of Deficiency was, therefore, presumed valid.

As we held in Matter of Atlantic & Hudson Ltd. Partnership (Tax Appeals Tribunal, January 30, 1992):

> "[a]lthough a determination of tax must have a rational basis in order to be sustained upon review (see, Matter of Grecian Sq. v. New York State Tax Commn., 119 AD2d 948, 501 NYS2d 219), the presumption of correctness raised by the issuance of the assessment, in itself, provides the rational basis, so long as no evidence is introduced challenging the assessment (see, Matter of Tavolacci v. State Tax Commn., 77 AD2d 759, 431 NYS2d 174; Matter of Leogrande, Tax Appeals Tribunal, July 18, 1991, confirmed Matter of Leogrande v. Tax Appeals Tribunal, 187 AD2d 768, 589 NYS2d 383, lv denied 81 NY2d 704, 595 NYS2d 398)."

Petitioners have presented us with no arguments that they did not present to the Administrative Law Judge. We conclude that the Administrative Law Judge fully and adequately addressed each argument made by petitioners and affirm her on this issue.

For the year 1989, petitioners were nonresidents of New York State. For that period, they declared income from two sources, which the Division allocated to New York pursuant to Tax Law § 631 as derived from or connected with New York sources. Specifically, the items were

consulting fees received by petitioner Nicholas Albanese and income received pursuant to a restrictive covenant not to compete.[3]

With regard to the $70,000.00 in income received for consulting services from West-Fair in 1989, the Administrative Law Judge determined that said fees were properly New York source income. The Administrative Law Judge noted that the burden of proof was on petitioners to show that the fees were non-New York source income and they failed to carry their burden. The record indicated that West-Fair was located in New York and that Mr. Albanese received consulting fees from it during each of the years in issue. Although petitioners made allegations in their brief concerning the nature and location of the consulting services, none of the claims were substantiated by testimony or documentation.

Once again, the failure of petitioners to submit any evidence at hearing proved fatal to their claims. The Administrative Law Judge noted that petitioners' failure to establish what the consulting fees represented was an adequate basis for sustaining the Division's characterization of the fees as New York source income.

We agree with the determination of the Administrative Law Judge on this issue and find that she fully and adequately dealt with the issue below. The only argument petitioners raised with respect to this issue was that the Division was mistaken to rely on the terms of the contract with West-Fair since it did not specifically state that the work would be done in New York. However, as the Administrative Law Judge said, it was incumbent upon petitioners to resolve any confusion or lack of clarity with regard to what the fees represented and they submitted no evidence to support their position. Petitioners believe that the case of Matter of Linsley v. Gallman (38 AD2d 367, 329 NYS2d 486, affd 33 NY2d 863, 352 NYS2d 199) is analogous to their situation, but the Administrative Law Judge correctly distinguished Linsley due to the fact that the court there had specific facts upon which to make a finding that no work was done in

[3]The lump-sum distribution received in 1987, the income received pursuant to the covenant not to compete in 1987 and 1988, and the consulting fees received in 1987 and 1988 were properly taxed by the Division given our decision on the residency issue, i.e., that petitioners were New York State residents in 1987 and 1988. A fourth issue regarding rental income from New York real property was conceded by petitioners below.

New York and other facts which clearly explained the circumstances surrounding the payment of moneys to a former employee after his retirement. Additionally, petitioners continue to rely on the case of Matter of Donahue v. Chu (104 AD2d 523, 479 NYS2d 889 [wherein the court held that future rights in regard to consultative fees and regular salary were not taxable by New York State after the petitioner and his company moved to Connecticut and that it was incumbent upon the Division to produce substantial evidence in support of its rational basis for the determination that money paid was for services performed in New York]) to support their argument that the Division has the burden to produce substantial evidence that the consulting fees were for services performed in New York. However, the Division submitted testimony of the auditor, subject to cross-examination, which demonstrated that on field audit he saw a contract which called for services to be rendered in

New York. Although more information was requested to better understand the consulting services and fees, petitioners provided nothing. Petitioners are mistaken in their belief that the burden of proof has shifted herein because they were no longer domiciled in New York in 1989 and their reliance on Donahue is misplaced. Unlike the facts in Donahue, where that petitioner and his company moved to Connecticut, diminishing the likelihood that consulting fees would be performed in New York, West-Fair remained a New York company with a New York location and the contract reviewed by the auditor called for services to be rendered in New York. It was absolutely incumbent upon petitioners to clarify and elaborate on this uncontroverted evidence. Even if petitioners had not been determined to be domiciliaries of New York, the uncontroverted evidence proffered by the Division established that the services were to be rendered in New York.

The last income issue before us is the income received in 1989 pursuant to the restrictive covenant not to compete. The Administrative Law Judge determined that the covenant not to compete restricted petitioner Nicholas Albanese from engaging in certain business activities in New York and Connecticut for a period of five years. Mr. Albanese received amounts in each year of the audit pursuant to the covenant. The Administrative Law Judge decided that since

petitioners failed to show what portion of the income was allocable to Connecticut, the Division was correct in apportioning all of the income from the covenant to New York.

The Division argues that the source of a covenant not to compete is the place where the promisor forfeits his right to act (citing Korfund Co. v. Commissioner, 1 TC 1180), and that abstinence of performance is sourced for tax purposes in the place that the performance would have occurred and that such income is taxable for New York State personal income tax purposes (20 NYCRR 131.4[d][1]).

This Tribunal has recently held that the income received pursuant to a covenant not to compete was not attributable to a business, trade, profession or occupation carried on in New York where the agreement provided that the nonresident recipient would not compete with the employer, either directly or indirectly, for a period of five years as a specialist broker on the New York Stock Exchange in specific securities (Matter of Haas, Tax Appeals Tribunal, April 17, 1997). In another case, we decided that payments received by a taxpayer pursuant to a covenant not to compete were in lieu of future employment which was unconnected with a New York source (Matter of Penchuk, Tax Appeals Tribunal, April 24, 1997). In Penchuk, the petitioner gave up his right in the future to be self-employed or to be employed by a competitor of the corporation and, given the national and international nature of the business, there was no basis to assume that the competitive business would be located in New York. Further, even if Mr. Penchuk had engaged in a competitive business located outside New York State, the amount received under the covenant could not be construed as being from New York sources on the mere speculation that the petitioner could have located a competitive business in New York State as well as outside the State.

In the instant matter, there is no basis to hold that petitioner would engage in a competitive business located in New York as opposed to Connecticut. Based upon the reasoning in Haas and Penchuk, the amount received under the covenant for the year 1989 was not derived from or connected with New York sources and was, therefore, not New York source

income of a nonresident (Tax Law § 631[a]). For the years 1987 and 1988, however, the income was properly taxed as income to a resident, as established above.

Relative to the issue of the lump-sum payment received in 1987, it is noted that since petitioner was found to be a New York State resident for the tax year 1987, the full amount of the payment to him is taxable.

Finally, petitioners did not specifically challenge the penalties imposed pursuant to the Administrative Law Judge's determination, except to mention in their reply brief that they "challenge the imposition of penalties as they relate to the items of income contested" (Petitioners' reply brief, p. 2). It must be held that petitioners did not preserve their right to pursue this issue and we will not disturb the determination of the Administrative Law Judge which held petitioners liable for the penalties asserted pursuant to Tax Law § 685(a)(1)(A) and (b) (see, Matter of Friendly Motors, Tax Appeals Tribunal, March 20, 1997). Even if the assertion in their reply brief could be construed to have preserved the issue, petitioners submitted no evidence on the issue of penalty before the Administrative Law Judge and we would affirm her determination on the issue nonetheless (Matter of Hull, Tax Appeals Tribunal, December 8, 1994; Matter of Etheredge, Tax Appeals Tribunal, July 26, 1990).

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Nicholas F. Albanese, Jr. and Daile A. Albanese is granted with regard to the issue of the payment received pursuant to the restrictive covenant for the year 1989, but in all other respects is denied;

2. The determination of the Administrative Law Judge is modified as specified in paragraph "1" above, but is otherwise affirmed;

3. The petition of Nicholas F. Albanese, Jr. and Daile A. Albanese is granted consistent with paragraph "1" above, but in all other respects is denied; and

4. The Notice of Deficiency, dated August 2, 1993, is modified consistent with paragraph "1" above, but in all other respects is sustained.

DATED: Troy, New York
July 17, 1997

/s/Donald C. DeWitt
Donald C. DeWitt
President

/s/Joseph W. Pinto, Jr.
Joseph W. Pinto, Jr.
Commissioner