STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
JAMES R. SHORTER, JR.	:	DECISION DTA No. 813571
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law and the New York City Administrative Code for the Year 1991.	:	

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on August 22, 1996 with respect to the petition of James R. Shorter, Jr., c/o Thacher Proffitt & Wood, 2 World Trade Center, 39th Floor, New York, New York 10048. Petitioner appeared pro se. The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Susan Hutchison, Esq., of counsel).

The Division of Taxation filed a brief in support of its exception and a reply brief. Petitioner filed a brief in opposition. Oral argument was not requested.

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

ISSUE

Whether petitioner properly computed the amount of his Federal deduction for State and local income taxes where petitioner was subject to the Federal overall limitation on itemized deductions.

FINDINGS OF FACT

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

Petitioner, James R. Shorter, Jr., filed a New York State and City of New York Resident Income Tax Return, Form IT-201, for the year 1991. Petitioner computed his state, local and foreign income taxes for purposes of line 40 of Form IT-201 as follows:

INCOME TAXES & OTHER SUBTRACTION ADJUSTMENTS (LINE 40 - IT - 201)

FEDERAL AGI	165,849

FEDERAL WORKSHEET

1. FED ITEM DED (PRE SEC. 68 LIMIT)	62,980
2. INVESTMENT INTEREST, MEDICAL & CASUALTY AND THEFT LOSSES	(2,440)
3. FED ITEM DED SUBJECT TO LIMIT	60,540
4. FED ITEM DED SUBJ TO LIMIT X 80%	48,432
5. FEDERAL AGI	165,849
6. $100,000 LIMIT	100,000
7. LINE 5 LESS LINE 6 (NOT < 0)	65,849
8. 3% X LINE 7	1,975
9. REDUCTION OF ITEM DED (MIN 4 OR 8)	1,975
10. FED ITEM DED (POST SEC. 68 LIMIT)	61,005
REDUCTION %	3.26%

LINE 40 ADJUSTMENTS
NY WORKSHEET (PAGE 14 OF INSTRUCTIONS)

1. FED ITEM DED SUBJECT TO LIMIT		60,540
2. INC TAXES & SUBTRACTION ADJUSTMENTS		19,885
3. LINE 1 LESS LINE 2		40,655
4. FED ITEM DED WKSHT LINE 9		1,975
5. LINE 3 X 80%		32,524
IS LINE 5 > LINE 4?	YES	
6. LINE 4 LESS LINE 5		0
7. LINE 2 LESS LINE 6		19,885
TAXES PLUS SUBTRACTION ADJUSTMENTS		19,885
APPLY FEDERAL REDUCTION TO TAXES		19,236

In making his computation of total itemized deductions (line 39 of Form IT-201) and the state, local and foreign taxes (line 40 of Form IT-201), petitioner determined that the Federal overall limitation on certain itemized deductions under Internal Revenue Code ("IRC") § 68 is applied pro rata to all Federal itemized deductions, including the deduction for income taxes paid to a state, local or foreign jurisdiction, that are reduced under Section 68. For purposes of the

New York subtraction modification, the amount of the Federal deduction for such taxes is determined after the application of the percentage reduction computed for Federal income tax purposes.

After audit, the Division of Taxation ("Division") claimed that petitioner made the following errors in his computation of New York itemized deductions:

a. petitioner incorrectly carried over the amount on line 26 of his Internal Revenue Service Form 1040, Schedule A, to line 39 of his Form IT-201;[1] and

b. petitioner incorrectly reported state, local and foreign income taxes from line 5 Form 1040, Schedule A to line 40 of Form IT-201.

According to the Division, since petitioner's Federal adjusted gross income exceeded $100,000.00, he was subject to an overall limitation on certain of his claimed itemized deductions, pursuant to IRC § 68 (i.e., 3% of the taxpayer's adjusted gross income in excess of $100,000.00, however, limited in that total otherwise allowable itemized deductions may not be reduced by more than 80%). Section 68 of the IRC reduces certain itemized deductions in excess of the above-described limit from the total otherwise allowable itemized deductions. Section 68 does not specifically reduce the certain itemized deductions by a pro rata amount. In effect, on petitioner's resident income tax return, Form IT-201, Federal itemized deductions are reported after the Federal limitation is applied.

On September 26, 1994, the Division issued to petitioner a Statement of Proposed Audit Changes which decreased petitioner's itemized deductions as shown on his 1991 New York State resident income tax return. The Division arrived at the adjustment of $1,968.00 to petitioner's New York taxable income by decreasing the amount of total itemized deductions that appeared on line 39 of petitioner's income tax return, Form IT-201, and increasing the amount of state, local and foreign income taxes that appeared on line 40 of petitioner's income tax return, Form IT-201. The resulting increase to taxable income caused a tax increase of $242.39. The

[1]Petitioner conceded in his brief that he incorrectly carried over the amount in line 26 of IRS Form 1040, Schedule A to line 39 of Form IT-201.

Statement of Proposed Audit Changes indicated that interest and penalties were imposed pursuant to sections 684(a) and 685(b)(1) and (2) of the Tax Law.

On November 7, 1994, the Division issued to petitioner a Notice of Deficiency for the year 1991 indicating total amount of tax, penalty and interest due of $317.19. However, petitioner made payment of $211.15 leaving tax, penalty and interest due of $106.04.

OPINION

In computing his Federal itemized deductions, petitioner was subject to the limitations imposed by IRC § 68. That is, petitioner was not allowed to deduct the full dollar amount of his Federal itemized deductions but rather was required to reduce his reported Federal itemized deductions to a lesser allowable amount in accordance with IRC § 68. Stated differently, petitioner did not receive the benefit of being able to deduct all of his otherwise allowable Federal itemized deductions. At issue in this proceeding is how petitioner, in determining his New York itemized deductions, must compute the Tax Law § 615(c)(1) subtraction modification for State and local income taxes in light of the reduction to Federal itemized deductions imposed by IRC § 68.

Tax Law § 615(a) provides that the New York itemized deduction of a resident individual is:

> "the total amount of his deductions from federal adjusted gross income, other than federal deductions for personal exemptions . . . with the modifications specified in this section . . . ."

As relevant to this proceeding, Tax Law § 615(c) provides that:

> "[t]he total amount of deductions from federal adjusted gross income shall be reduced by the amount of such federal deductions for:
>
> "(1) income taxes imposed by this state or any other taxing jurisdiction . . . ."

Prior to the enactment of IRC § 68, which became effective for tax years beginning after December 31, 1990, there existed little or no confusion as to how a resident individual computed

the Tax Law § 615(c)(1) modification reducing Federal itemized deductions for State and local income taxes. Generally,[2] the amount of the deduction for State and local income taxes, which was shown on Federal Schedule A - Itemized Deductions, was the amount of the Tax Law § 615(c)(1) subtraction modification. However, with the enactment of IRC § 68, taxpayers, such as petitioner, whose Federal adjusted gross income exceeded a certain dollar amount were required to reduce their otherwise allowable itemized deductions. Petitioner's otherwise allowable itemized deductions before application of the IRC § 68 overall limitation totalled $62,980.00, which amount included a $19,885.00 deduction for State and local income taxes. After application of IRC § 68, petitioner's otherwise allowable itemized deductions were reduced by $1,975.00, from $62,980.00 to $61,005.00. The question to be addressed here is how the $1,975.00 reduction in Federal itemized deductions occasioned by IRC § 68 affected the $19,885.00 deduction claimed for State and local income taxes. To the extent such reduction affected petitioner's deduction for State and local income taxes, it follows that the amount of petitioner's Tax Law § 615(c)(1) subtraction modification would likewise be reduced by such allocable amount.

In the determination below, the Administrative Law Judge concluded that the $1,975.00 reduction in petitioner's Federal itemized deductions as the result of IRC § 68 should be allocated pro rata among all the itemized deductions that were subject to this overall limitation. The Administrative Law Judge noted that since IRC § 68 does not provide for an allocation of the $1,975.00 reduction to specific itemized deductions, and since Tax Law § 615(c)(1) does not specify a method for determining the amount of the Federal deduction for State and local income taxes, a pro rata allocation was appropriate and reasonable. The Administrative Law Judge found support for a pro rata allocation in Matter of Golden v. State Tax Commn. (90 AD2d 941, 457 NYS2d 905) where the Court held that for purposes of computing the subtraction

[2]An exception to the modification exists for a portion of the New York City earnings tax on nonresidents. However, this exception is not at issue in this proceeding.

modification pursuant to Tax Law § 615(c)(3), investment expenses should be allocated to exempt income in the same proportion as the exempt income bears to total income.

Next, the Administrative Law Judge addressed regulation 20 NYCRR 115.2(g)[3] which provided for an assumption that the IRC § 68 overall limitation applied first to the Federal itemized deductions which were not subject to the Tax Law § 615(c) subtraction modifications. The Administrative Law Judge determined that the "ordering convention" established by 20 NYCRR 115.2(g) failed "to apply the more generally accepted pro rata method of allocation" (Determination, conclusion of law "D"). Furthermore, the Administrative Law Judge found that the regulation produced a result which disallowed a portion of the deduction for State and local income taxes twice; a result which "goes beyond the policy that such taxes are not deductible for New York income tax purposes" (Determination, conclusion of law "E"). Although the Administrative Law Judge found that the regulation was constitutionally enacted, he, at least implicitly, concluded that the regulation was invalid, unreasonable and inconsistent with the statute.

The Administrative Law Judge also concluded that the Federal policy concerning the tax treatment of State tax refunds is not applicable since said policy was adopted to prevent taxpayers from obtaining a windfall where taxes are overpaid in one year and refunded in a subsequent year, a situation not at issue in the instant dispute. The Administrative Law Judge noted that Tax Law § 615(c)(1) is not concerned with the same policy that the Federal tax benefit rules address.

Finally, the Administrative Law Judge cancelled the negligence penalty on the basis that petitioner made an honest mistake in carrying over the amount of Federal itemized deductions to the New York return and there existed a bona fide dispute between petitioner and the Division as to the computation of the Tax Law § 615(c)(1) subtraction modification.

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[3]For 1991, the regulation was then current § 117.11(g), renumbered § 115.2(g).

On exception, the Division argues that the Administrative Law Judge incorrectly determined that the IRC § 68 reduction to petitioner's otherwise allowable itemized deduction must be allocated pro rata among the itemized deductions subject to the IRC § 68 limitation. The Division maintains that the Administrative Law Judge failed to apply 20 NYCRR 115.2(g) correctly, that the regulation is a valid and rational interpretation of Tax Law § 615(c)(1) and that, pursuant to said regulation, petitioner's Tax Law § 615(c)(1) subtraction modification for State and local income taxes is $19,885.00, the full amount shown on petitioner's Federal tax return before application of the IRC § 68 limitation. The Division also asserts that 20 NYCRR 115.2(g) conforms to the Federal tax benefit rules and that the computation of petitioner's State and local income tax deduction as the result of the regulation is consistent with the manner in which the Internal Revenue Service would compute the same item under Rev. Rul. 93-75, 1993-2 C.B. 63. Finally, the Division contends that petitioner failed to show entitlement to the abatement of the negligence penalty.

Petitioner, in opposition to the Division's exception, asserts that the Administrative Law Judge correctly concluded that the IRC § 68 limitation on otherwise allowable itemized deductions is allocable on a pro rata basis and that the Division's application of the Federal tax benefit rule and reliance on Rev. Rul. 93-75, 1993-2 C.B. 63 is inappropriate since same were adopted for a totally different purpose and, thus, are not used in a comparable context as contemplated by Tax Law § 607. Finally, petitioner maintains that he has presented a meritorious challenge to the Division's position, thus warranting waiver of the negligence penalty as well as abatement of interest.

We affirm the determination of the Administrative Law Judge. It is an axiom of statutory construction that legislative intent is to be ascertained from the language used and, that where the words of a statute are clear and unambiguous, they should be literally construed (McKinney's Cons Laws of NY, Book 1, Statutes §§ 76, 94; People v. Munoz, 207 AD2d 418, 615 NYS2d 730, lv denied 84 NY2d 938, 621 NYS2d 535). As previously noted, Tax Law § 615(a) defines a

resident individual's New York itemized deduction to be the total amount of his itemized deductions from Federal adjusted gross income with certain modifications. The specific modification at issue here, Tax Law § 615(c)(1), provides that a taxpayer's itemized deductions from Federal adjusted gross income are reduced by the amount of such Federal deductions for State and local income taxes. Thus, the legislative intent is clear; when computing the New York itemized deduction, a taxpayer must reduce the amount of Federal itemized deductions which were actually deducted from Federal adjusted gross income by the amount of State and local income taxes included in such amount actually deducted.

Petitioner's otherwise allowable Federal itemized deductions were $62,980.00 before application of IRC § 68 and $61,005.00 after the IRC § 68 limitation. Accordingly, it is the $61,005.00 amount which was actually deducted by petitioner from his Federal adjusted gross income. The controversy here is how to determine or compute the amount of State and local taxes included in the $61,005.00 of Federal itemized deductions which were actually deducted from Federal adjusted gross income. It is clear that petitioner included a deduction of $19,885.00 for State and local income taxes when computing his pre-IRC § 68 total itemized deduction figure of $62,980.00. What is not clear is the dollar amount of the deduction for State and local income taxes included in the post-IRC § 68 Federal itemized deduction figure of $61,005.00.

Pursuant to IRC § 68, the itemized deductions for medical expenses, casualty and theft losses and investment interest are specifically excluded from the limitation imposed by IRC § 68(a). Since certain itemized deductions are excluded from the IRC § 68 limitation, an affirmative inference is warranted, under the maxim of expressio unius est exclusio alterius (i.e., expression of one thing is the exclusion of another), that Congress intended the remaining itemized deductions, not so specifically excluded, to be included in and subject to the limitation. Since the Federal itemized deduction for State and local income taxes is not specifically excluded from the limitation, it follows that said deduction was intended to be included among those remaining itemized deductions subject to and affected by the IRC § 68 limitation.

Having concluded that Tax Law § 615(c)(3) is clear and unambiguous and that the IRC § 68 limitation includes the deduction for State and local income taxes, we now turn our attention to how taxpayers are to compute the amount of a Tax Law § 615(c)(1) subtraction modification when their Federal itemized deduction for State and local income taxes is subject to the IRC § 68 limitation. The Division's regulation at 20 NYCRR 115.2(g), effective June 12, 1991, provides for a cap on the Tax Law § 615(c)(1) subtraction modification "assuming that the Federal overall limitation applies first to those Federal itemized deductions which are not subject to such modifications" (20 NYCRR 115.2[g][1][i]). Said regulation goes on to provide that:

> "[t]his rule follows the Federal method applying the tax benefit rule and provides an ordering of the itemized deductions subject to the Federal overall limitation such that the limitation is first applied to those itemized deductions for which a New York subtraction modification is not required. Under this ordering convention, a taxpayer will, in most cases, recognize a full Federal tax benefit of the itemized deductions for which New York subtraction modifications are required and such taxpayer accordingly will be required to subtract the full amount of the subtraction modifications" (20 NYCRR 115.2[g][1][ii]).

Thus, it can be readily seen that if the regulation is found to be a valid and reasonable interpretation of Tax Law § 615(c)(3), then the Division's assessment would be correct and the petition dismissed. We conclude, however, that regulation 20 NYCRR 115.2(g) is invalid to the extent that it requires the IRC § 68 overall limitation to be applied first to those Federal itemized deductions not subject to the subtraction modifications contained in Tax Law § 615(c).

It is well established that regulations adopted by an administrative agency have the same force and effect of law if reasonable (Molina v. Games Mgt. Servs., 58 NY2d 523, 462 NYS2d 615). However, an administrative agency must promulgate rules consistent with the statute and when addressing an interpretive regulation the Court noted that:

> "[w]here the interpretation of a statute or its application involves knowledge and understanding of underlying operational practices or entails an evaluation of factual data and inferences to be drawn therefrom, the courts regularly defer to the governmental agency charged with the responsibility for administration of the statute. If its interpretation is not irrational or unreasonable, it will be upheld [citations omitted]. Where, however, the question is one of pure statutory reading and analysis, dependent only on accurate apprehension of legislative intent, there is little basis to rely on any special competence or expertise of the administrative agency and its interpretive regulations are therefore to be accorded much less weight. And, of course, if the regulation runs counter to the clear wording of a statutory provision, it should not be accorded any weight [citation omitted]" (Kurcsics v. Merchants Mut. Ins. Co., 49 NY2d 451, 426 NYS2d 454, 458).

An administrative agency cannot adopt a regulation which adds a requirement that does not exist under the statute and furthermore:

> "it is elementary that '[a]dministrative agencies can only promulgate rules to further the implementation of the law as it exists; they have no authority to create a rule out of harmony with the statute'" (Matter of McNulty v. New York State Tax Commn., 70 NY2d 788, 522 NYS2d 103, 104, quoting Finger Lakes Racing Assn. v. New York State Racing & Wagering Bd., 45 NY2d 471, 410 NYS2d 268).

In our view, regulation 20 NYCRR 115.2(g) is not in harmony with the statute. Said regulation assumes that the IRC § 68 limitation applies first to those itemized deductions not subject to the subtraction modifications of Tax Law § 615(c). No such assumption exists in the statute. Tax Law § 615(c)(1) simply requires a taxpayer, in computing the New York itemized deduction, to reduce Federal itemized deductions actually deducted from Federal adjusted gross income, i.e., the post-IRC § 68 amount, by the amount of State and local income taxes included in such amount actually deducted. As previously noted, our review of IRC § 68 leads us to the conclusion that Congress intended the deduction for State and local taxes to be included in and affected by the limitation imposed by IRC § 68 and, thus, it is irrational and unreasonable for the Division to promulgate a regulation which assumes that the IRC § 68 limitation applies first to those itemized deductions not subject to the Tax Law § 615(c) subtraction modifications and, thus, does not affect those itemized deductions.

The Division argues that New York's statutory scheme is to disallow the deduction for any amount of State and local income taxes and that the regulation at issue is a valid and rational interpretation of the statute. We disagree. Tax Law § 615(c)(1) is clear and unambiguous. It does not disallow the deduction for any amount of State and local income taxes, but rather, only the amount of State and local income taxes included in Federal itemized deductions which are deducted from Federal adjusted gross income. The Administrative Law Judge correctly noted in his determination that:

> "failure to allocate the IRC § 68 Federal overall limitation to all itemized deductions, including income taxes, before determining the New York subtraction adjustment, goes beyond disallowance of deductibility of income taxes. In effect, the itemized deduction for income taxes that already was reduced, based on a pro rata allocation of the IRC § 68 reduction (the starting point for determining the New York itemized deductions) is again reduced by the same amount under the New York subtraction adjustment using the Division's ordering convention. Consequently, the portion of the income tax deduction is disallowed twice. Surely, this goes beyond the policy that such taxes are not deductible for New York income tax purposes. To prevent such double disallowance, the IRC § 68 reduction should be applied to taxes using the pro rata rule discussed above" (Determination, conclusion of law "E").

In light of our conclusion that regulation 20 NYCRR 115.2(g) is invalid and unreasonable for purposes of determining the amount of the Tax Law § 615(c)(1) subtraction modification for State and local income taxes, the IRC § 68 reduction should be allocated on a pro rata basis. The pro rata basis of allocation results in a reasonable, simple and easily applied method for determining the amount of the Tax Law § 615(c)(1) subtraction modification and, in our view, is the only reasonable interpretation of the statute. Furthermore, a pro rata allocation has been previously endorsed in Golden v. State Tax Commn. (supra), a case which, although not directly on point, is sufficiently analogous to provide guidance. The issue in the Golden matter involved the proper method to be used to allocate the Tax Law § 615(c)(3) subtraction modification. In Golden, the Court held that the Division properly allocated the Tax Law § 615(c)(3) subtraction modification for expenses relating to both exempt and taxable income in the same proportion that

exempt Treasury income bore to total income. The regulations in effect for the year at issue in Golden, i.e., 20 NYCRR former 117.11(c), 116.2(e) and 116.3(j), provided that if an expense was attributable to both taxable and exempt income, a reasonable portion of said expense, determined in light of all the facts and circumstances, should be allocated to each class of income. The Court found the Division's method of allocation rational and that petitioner had not shown that his alternative method of allocation was a more reasonable method.

We also find support for our conclusion in Matter of Friedsam v. State Tax Commn. (64 NY2d 76, 484 NYS2d 807) and Matter of Lunding v. Tax Appeals Tribunal (89 NY2d 283, 653 NYS2d 62, cert granted ___US___). Both cases involve alimony deductions taken by nonresident taxpayers. Pursuant to the Tax Reform Act of 1976 (Pub L 94-455), Congress changed the manner in which taxpayers claimed a deduction for alimony payments on their Federal tax returns. The act changed the alimony deduction from an itemized deduction to a deduction from gross income in determining Federal adjusted gross income so that all taxpayers, whether they took the standard deduction or claimed itemized deductions, would receive a tax benefit from alimony payments. Although resident taxpayers automatically received the benefit of the change in the law, the Division took the position that nonresident taxpayers could not claim the alimony deduction since it was not a deduction attributable to a profession carried on in New York. In Friedsam, the Court stated that:

> "[t]here was no State legislative response to this liberalized Federal policy and the Legislature gave no indication whatsoever that either New York's historical policy of following Federal tax policy, or its long-standing treatment of alimony vis-a-vis nonresidents was to be changed in any respect" (Matter of Friedsam v. State Tax Commn., supra, 484 NYS2d, at 809).

In response to the Court's decision in Friedsam, the Legislature added Tax Law § 631(b)(6) (L 1987, ch 28, § 78) which provided express statutory authority to deny the alimony deduction to nonresidents. This specific legislative change denying the alimony deduction to nonresidents was upheld by the Court of Appeals as constitutionally valid in Lunding. Both the controversy

here and the one in Friedsam were the result of a change in Federal law which, because of the manner in which the Division chose to interpret and/or implement said changes, had an adverse effect on New York taxpayers. Here, as in Friedsam, there was no legislative response to the enactment of IRC § 68 nor was there any indication from the Legislature that it intended to change the manner in which nonresidents were to compute the Tax Law § 615(c)(1) subtraction modification. It took direct action by the Legislature, specifically, the enactment of Tax Law § 631(b)(6) which had the effect of overriding Friedsam, to clarify legislative intent with respect to alimony deductions for nonresidents. Given the clear and unambiguous wording and intent of Tax Law § 615(c)(1), we believe such direct legislative action would be required here in order to arrive at the result advocated by the Division. This point is further emphasized when one considers that the Legislature has, prior to the enactment of IRC § 68, imposed limitations on the amount of New York itemized deduction which can be claimed by upper income taxpayers (see, Tax Law § 615[f]). While we are cognizant that IRC § 68 and Tax Law § 615(f) imposed separate and distinct limitations on itemized deductions (see, Matter of Karash, Tax Appeals Tribunal, March 13, 1997), we believe the fact that the Legislature has already imposed a limit on the New York itemized deductions of upper income taxpayers lends strong support to our conclusion that the Legislature never intended to further reduce a taxpayer's New York itemized deduction as suggested by the Division in regulation 20 NYCRR 115.2(g).

We will also briefly address additional arguments raised by the Division on exception. The Division maintains that the Federal conformity provisions of the New York Tax Law, specifically Tax Law § 607, apply and that the Federal tax benefit rule and Rev. Rul. 93-75, 1993-2 C.B. 63 provide support for regulation 20 NYCRR 115.2(g). Tax Law § 607 provides that terms used in New York income tax law "shall have the same meaning as when used in a comparable context" in Federal income tax law. We agree with petitioner that the Federal tax

benefit rule in the case of tax refunds and Rev. Rul. 93-75, 1993-2 C.B. 63[4] are not used in comparable context as applied to Tax Law § 615(c)(1) and, therefore, do not lend support to the Division's argument that regulation 20 NYCRR 115.2(g) is rational.

The Division has also provided several pages of computational examples which, at first blush, suggest that the full amount of State and local income taxes do in fact provide petitioner with a "tax benefit." Once again, we agree with petitioner that the examples simply prove the obvious. That is, if one assumes that the IRC § 68 reduction applies first to itemized deductions not subject to the Tax Law § 615(c)(1) subtraction modification, then the deduction for State and local taxes will always appear under the Division's computational theory to produce a "tax benefit." If, however, the assumption was that the IRC § 68 reduction applies first to the deduction for State and local taxes, then the opposite result would occur. Thus, the Division's computational examples only illustrate that the "tax benefit" arises solely as a result of the assumption as to which itemized deductions first absorb the IRC § 68 reduction and, as such, they do not justify the assumption.

As a result of the decision reached herein, the issue concerning whether the Administrative Law Judge properly waived penalty is rendered moot.

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 James R. Shorter, Jr. is granted; and

[4]We note that prior to Rev. Rul. 93-75, 1993-2 C.B. 63, the Internal Revenue Service applied the same pro rata allocation as petitioner seeks. It is curious that the Division's regulation 20 NYCRR 115.2(g), promulgated in 1991, was not in conformity with Federal policy as it existed in 1991 when the regulation was promulgated.

4. The unpaid and contested portion of the Notice of Deficiency, dated November 7, 1994, is cancelled.

DATED: Troy, New York
July 31, 1997

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

/s/Carroll R. Jenkins
Carroll R. Jenkins
Commissioner

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