STATE OF NEW YORK

DIVISION OF TAX APPEALS

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

Petitioners, Robert H. Sabel and Hanna H. Sabel, c/o Iwanyshyn, Kesich & Co., 834 Ridge Avenue, Pittsburgh, Pennsylvania 15212, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the year 1981 (File No. 802535).

A hearing was held before Nigel G. Wright, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York on March 22, 1988 at 1:15 P.M., with briefs to be submitted by August 19, 1988. Petitioners appeared by Epstein, Becker, Borsody & Green, P.C. (Rona Klein, Esq., of counsel). The Audit Division appeared by William F. Collins, Esq. (Herbert Kamrass, Esq., of counsel).

ISSUES

I. Whether petitioner Robert H. Sabel can reduce his capital gain by an amount which represents the portion of the Federal capital gain realized by a partnership, of which petitioner was a partner, on the sale of property because of the purchaser's assumption of a mortgage on that property.

II. Whether a taxpayer who (as a member of a partnership) sells a depreciated asset which he had owned prior to becoming a New York resident can deduct from the realized gain the losses which the asset had incurred in earlier years.

III. Whether, in these circumstances, the Division of Taxation can assert a further deficiency under Tax Law § 689(d)(1) at the hearing when it had not previously notified petitioners of its intent to do so.

FINDINGS OF FACT

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

2. In 1973 while a resident of Pennsylvania, Mr. Sabel invested in Village South Apartments, Ltd., a partnership. The partnership invested in real estate which, for lack of any other information, is assumed also to be in Pennsylvania. Between 1973 and 1980, the partnership suffered losses in excess of $550,000.00. Most of these losses were incurred prior to 1978. These losses reduced Mr. Sabel's basis in his partnership interest for Federal incometax purposes. Petitioners claimed to have received a tax benefit from these losses on their Federal

tax return. The exact nature of the losses is not indicated in the record. While petitioners filed Pennsylvania income tax returns in those years, under that state's tax law the losses from one type of income cannot be used to reduce income from other sources (see Pennsylvania Reg. Sec. 101.1). Therefore, it is assumed that petitioners obtained no benefit from these losses on any State return in those years.

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

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

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

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

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

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

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

hearing.

CONCLUSIONS OF LAW

A. The Audit Division properly disallowed the modification to New York income of $208,873.00. Adjusted gross income for New York purposes is defined in Tax Law § 612 to be Federal adjusted gross income with modifications. Under Federal law computation of capital gain includes the amount representing the purchaser's assumption of a mortgage (see, Crane v. Commissioner, 331 US 1). New York, therefore, does the same. There is no modification stated in the Tax Law for such a reduction.

B. The reduction in capital gain for the losses of prior years ($113,535.00) can be granted. The burden of proof on this issue is on the Division of Taxation since the issue was raised for the first time as a further deficiency in the answer (Tax Law § 689[e][3]). The nature of those losses is not known. They may have been allowable on the Federal return as capital loss carryovers or net operating loss carryovers. If so allowed for Federal purposes, New York would do the same (20 NYCRR 148.7, 148.8). The Audit Division has failed to show why the losses should be disallowed.

C. The further deficiency asserted at the hearing is denied. Section 689(d)(1) of the Tax Law allowing assertion of a further deficiency must be interpreted consistently with section 301.1(d) of the State Administrative Procedure Act which requires that a party be given reasonable notice of a hearing and that such notice include a short and plain statement of matters asserted. The Division of Taxation in this case gave no such notice of this further deficiency. (In any event, section 689[d][1] is discretionary. See, C.I.R. v. Long's Estate, 304 F2d 136, interpreting the comparable section of the Internal Revenue Code, § 6214[a].) The denial of any adjournment is justified because of the relatively small amount involved and the possibility that such late amendments could be used to obtain adjournments and cause unwarranted delays.

D. The petition is denied, and the Notice of Deficiency of August 16, 1985 is sustained. The further deficiencies asserted in the answer and at the hearing are found erroneous.

DATED: Albany, New York

October 20, 1988

/s/ Nigel G. Wright
ADMINISTRATIVE LAW JUDGE