STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
LYNDA JURIST	:	DETERMINATION DTA NO. 806488
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law and of New York City Personal Income Tax under Chapter 46, Title T of the New York City Administrative Code for the Years 1983 and 1984.	:	

Petitioner Lynda Jurist, 1050 Park Avenue, New York, New York 10020 filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law and of New York City personal income tax under Chapter 46, Title T of the New York City Administrative Code for the years 1983 and 1984.

On February 24, 1992 and March 2, 1992, respectively, petitioner by her representative, Richard DeMarco, CPA, and the Division of Taxation by William F. Collins, Esq. (Herbert Kamrass, Esq., of counsel) waived a hearing and agreed to submit this case for determination. Documents and briefs were to be submitted by the parties by July 23, 1992. The Division of Taxation submitted its documents on March 30, 1992. Petitioner submitted her documents and a letter brief on April 28, 1992. The Division of Taxation submitted its answering letter brief on June 24, 1992. Petitioner then submitted a reply brief and additional documents on July 13, 1992, and the Division of Taxation responded by submitting an additional letter brief on July 23, 1992. Based on all of the documents in evidence, Frank W. Barrie, Administrative Law Judge, renders the following determination.

ISSUES

I. Whether the Division of Taxation properly disallowed small business corporation losses deducted on petitioner's New York State/City personal income tax returns for 1983 and 1984.

II. Whether, if it is determined that the Division of Taxation properly disallowed small business corporation losses deducted on petitioner's tax returns, petitioner should be allowed a credit for taxes paid on small business corporation capital gains included on her 1984 tax return.

FINDINGS OF FACT

The Division of Taxation ("Division") issued a Statement of Personal Income Tax Audit Changes dated April 9, 1987 against petitioner, Lynda Jurist, asserting additional New York State/City personal income taxes for 1983 and 1984 as follows:

	1983		1984			
	NYS	NYC	NYS	NYC		
Reliance Capital Advisors, Inc.			$53,212.00	$53,212.00	$ 2,031.00	$ 2,031.00
Net Adjustment			53,212.00	53,212.00	2,031.00	2,031.00
Taxable Income Previously Stated			16,055.00	16,055.00	239,436.00	239,436.00
Corrected Taxable Income			$69,267.00	$69,267.00	$241,467.00	$241,467.00
Tax on Above						
Max Tax if Applicable			$ 8,257.38		$ 32,365.38	
Add: New York City				$ 2,578.48		$ 9,983.08
New York City Surcharge				257.85		499.15
Min Tax				0.00	9,883.90	4,118.29
Min Tax Surcharge City				0.00		205.91
Corrected Tax Due			$ 8,257.38	$ 2,836.33	$ 42,249.28	$ 14,806.43
Tax Previously Computed/Adjusted			966.00	389.00	41,982.00	14,721.54
Additional Tax Due			$ 7,291.38	$ 2,447.33	$ 267.28	$ 84.89

Total Additional Tax Due: $10,090.88

Penalties for negligence under Tax Law § 685(a)(2) equal to five percent of the additional tax due plus interest were added to the additional tax asserted as due.

The following explanation was provided for the audit changes:

> "Reliance Capital Advisors, Inc. has not elected sub-chapter [S] status with NY State."

The Division then issued a Notice of Deficiency dated July 3, 1987 against petitioner for

1983 and 1984 asserting additional personal income tax due of $10,090.88, plus penalties and interest.

Petitioner alleged in her petition that the Division erroneously disallowed her distributive share of the income and loss of Reliance Capital Advisors, Inc. (hereinafter "Reliance Capital"), which was a Delaware subchapter S corporation. According to petitioner, because Reliance Capital was not required to pay Article 9-A tax since it conducted no business activities in New York, she was required to report her share of the income or loss of Reliance Capital, a subchapter S corporation, on her New York State/City tax returns.

In particular, the Division denied knowledge and information of the following allegations included in the petition:

> "Reliance Capital Advisors, Inc. is a Delaware Subchapter S corporation which engages in trading for its own account on the Philadelphia Stock Exchange and owns a seat on the New York Mercantile Exchange (but has not engaged in any trading therein). Reliance Capital Advisors, Inc. is not doing business, employing capital, owning or leasing property in a corporate or organized capacity nor maintaining an office in New York State and is not subject to the tax imposed under Article 9-A of the New York State Tax Law."

By a letter dated April 24, 1992, petitioner submitted the following documents in support of her position that Reliance Capital is not subject to tax under Article 9-A because it was not doing business in New York during the years at issue:

(i) Petitioner submitted a Form CT-245, "Maintenance Fee and Activities Report of Foreign Corporations Disclaiming Tax Liability", for 1984,[1] which showed the address of Reliance Capital as 4 Penn Center Plaza, Philadelphia, Pennsylvania. Its principal business activity was described as "trading on Philadelphia Stock Exchange." This report also disclosed that Reliance Capital, a Delaware corporation, was incorporated on January 11, 1979 and

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[1]The photocopy of this document is poor, and the date this report was signed by Reliance Capital's vice-president, whose signature is also not readable, was some date in June of 1987. According to the letter brief dated July 23, 1992 of the Division, petitioner previously filed "New York corporate franchise tax reports indicating that [Reliance Capital] had activities in New York and was subject to New York taxation." However, these returns were not submitted for review.

became "authorized to do business in New York State" on September 21, 1979. The activities report on the Form CT-245 showed that it actually began trading on the Philadelphia Stock Exchange on September 20, 1983. The 15 questions included in the activities report, which are posed to detect any business activities in New York, were all answered in the negative except for "9(g)" which asked whether officers or employees of the corporation "perform other activities in New York State." Petitioner responded: "mailed requests required by government regulating bodies . . . ."[2]

(ii) Petitioner submitted one page only of Reliance Capital's Pennsylvania corporate tax return, "Settlement Computation", for 1983, which showed a minimum tax of $75.00.

(iii) Petitioner also submitted Reliance Capital's Pennsylvania corporate tax report for 1984 which listed Pennsylvania taxable income of 0 and showed tax of $75.00.

(iv) An excerpt from a "statement of financial condition" of Reliance Capital prepared by the certified public accountants, Touche Ross & Co., described Reliance Capital as follows:

> "[Reliance] was incorporated in 1979 and was dormant until its capitalization on July 13, 1983. The Company registered in 1983 as a broker-dealer under the Securities Exchange Act of 1934. The Company is a member of the Philadelphia Stock Exchange and commenced activities in November 1983 as a registered market maker in securities options. As a market maker, the Company operates under Subsection (a)(6) of Rule 15c3-1.
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> "Revenues result principally from options transactions with other brokers which are cleared on a fully disclosed basis with a clearing broker. The Company does not carry customer accounts and introduces customer transactions to another clearing broker. Accordingly, the Company is not subject to the Securities and Exchange Commission's customer protection rule (SEC Rule 15c3-3) under exemptive provision (k)(2)(B)."

Two months after petitioner's submission, the Division, by a letter dated June 24, 1992, submitted additional documents including a complete copy of Reliance Capital's Pennsylvania corporate tax return settlement computation for 1983. The "Notice of Settlement", which was a part of such computation, showed a "revenue code" used by Pennsylvania of "foreign franchise"

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[2]Reliance Capital's ownership of a seat on the New York Mercantile Exchange, which was mentioned in petitioner's letter brief dated April 24, 1992, was not noted in the Form CT-245.

for Reliance Capital and a resulting tax balance of $75.00. In addition, the Division submitted a copy of Reliance Capital's 1983 Pennsylvania corporate tax return which showed Reliance Capital's principal office as Park Avenue Plaza in New York City. A review of this return also showed that Reliance Capital reported as a foreign corporation to Pennsylvania, with no income or loss. Reliance Capital checked the following box on the 1983 Pennsylvania return:

> "This Foreign Corporation, chartered under the laws of a state other than Pennsylvania, did not conduct any business, own property, or exercise any corporate rights or privileges of any kind within the Commonwealth of Pennsylvania during the tax year ended 12/31/83 [emphasis in original]."

The same box was checked off by Reliance Capital on its 1984 Pennsylvania return which was also submitted by the Division on June 24, 1992. Petitioner had submitted only the front page of Reliance Capital's 1984 Pennsylvania return.

In its submission dated June 24, 1992, the Division argued:

> "Nothing has been submitted in evidence to show that Reliance was a subchapter S corporation for federal tax purposes. Therefore, the petitioner is barred from taking such loss on her New York return and the adjustments adding back the losses to her New York income should be sustained."

In response, petitioner, by a letter dated July 13, 1992, submitted a copy of Reliance Capital's Form 1120S, "U.S. Income Tax Return for an S Corporation" for 1983 which showed an ordinary loss of $1,520,335.00. Petitioner also submitted a copy of a Schedule K-1, "Shareholders Share of Income, Credits, Deductions, etc.", for petitioner which showed her distributive share of Reliance Capital's ordinary loss as $53,212.00. Copies of Form 1120S and a Schedule K-1 for petitioner were also submitted for 1984. The 1984 Schedule K-1 showed petitioner's distributive share of Reliance Capital's ordinary loss for 1984 as $2,301.00. It also showed her share of Reliance Capital's net short-term capital gain and net long-term capital gain as $18,046.00 and $27,068.00, respectively. A copy of a Federal Form 2553, "Election by a Small Business Corporation" dated December 30, 1983 showed the election to be treated as an "S corporation" was to be effective for the tax year beginning November 7, 1983. It is observed that on all of the returns and schedules described in Finding of Fact "7" the address provided for Reliance Capital was either 55 East 52nd Street or Park Avenue Plaza in New York City.

SUMMARY OF THE PARTIES' POSITIONS

Petitioner contends:

> "Reliance's state tax returns were filed by the Philadelphia tax department of Reliance Insurance Company. The tax department was unaware that Reliance had elected Subchapter S corporation status and was in-fact [sic] active. The Philadelphia tax department erroneously filed 1983 and 1984 New York Corporation Franchise Tax Reports Form CT-4. Since Reliance was not subject to tax under Article 9-A . . . these filings were all subsequently amended and the proper Form CT-245 . . . were filed and accepted by New York State.
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> " . . . The Division has based their conclusions on the Pennsylvania returns, which are erroneous and contrary to the facts, rather than on the Federal Form 1120S and related Schedule K-1's that were filed with the Internal Revenue Service for the years 1983 and 1984."

The Division counters that petitioner failed to prove that no business was done in New York by Reliance Capital:

> "The only acceptable proof would have been for Reliance to submit its books and records for audit . . . as was requested at the BCMS Conference. This Reliance failed to do."

CONCLUSIONS OF LAW

A. Tax Law § 209(former [8]),[3] as in effect during the period in question, permitted shareholders of a corporation that had made an election under subchapter S of the Internal Revenue Code to elect to be taxed on the corporation's items of income, loss, gain, deduction, etc. under the New York State Personal Income Tax Law (Article 22), with the corporation thereby becoming exempt from the corporation franchise tax as imposed under Tax Law Article 9-A. This provision pertained to corporate tax years beginning on or after January 1, 1981, and required that every shareholder of the corporation make the election to be taxed under Article 22.

B. Tax Law § 612(b)(former [19]), as in effect for the years at issue, provided that in computing the New York adjusted gross income of a resident individual, who was also a

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[3]The New York City personal income tax imposed by Chapter 46, Title T of the Administrative Code is, by its own terms, tied into and contains essentially the same provisions as Article 22 of the Tax Law.

shareholder of a corporation that had elected small business corporation status under the Federal Income Tax Law and had not done so under section 660 of the New York State Tax Law, it would be necessary to add back to that individual's Federal adjusted gross income an amount equal to his or her proportionate share of the net operating loss of the corporation to the extent that it had been deducted in determining Federal adjusted gross income.

C. If a Federal S corporation does not do business in New York State, it would not be subject to tax under Article 9-A. Therefore, the S corporation's shareholders would not have to elect with New York State to be taxed on the S corporation's items of income, loss, gain, deduction, etc. Under Tax Law § 612(a), the New York adjusted gross income of a resident individual means "his federal adjusted gross income . . . with the modifications specified in this section." As a result, when a taxpayer is a New York resident and a shareholder of a Federal S corporation not subject to tax under Article 9-A because it does not do business in New York, the taxpayer would, in effect, still be accorded the right to be taxed on the S corporation's items of income, loss, gain, deduction, etc. The starting point for computing New York adjusted gross income is Federal adjusted gross income, and the taxpayer's Federal adjusted gross income would reflect such treatment of the S corporation's items of income, loss, gain, deduction, etc. In sum, the modifications contained in Tax Law § 612, which are required to be made when a corporation has not made the election under Tax Law § 660, would not apply because no such election was required of the S corporation which did not do business in New York State. (It is observed that the Division issued an Advisory Opinion in accordance with this reasoning in Condon [TSB-A-88(12)I].)

D. The analysis therefore turns to the issue of whether Reliance Capital, the subchapter S corporation herein, conducted business in New York. It is observed that even a small amount of New York business activity subjects a foreign corporation to tax in New York (see, Tax Law § 209.1; 20 NYCRR 1-3.2[b]; see also, Matter of Hugo Bosca Company, Tax Appeals Tribunal, October 17, 1991). The record on submission is inadequate for purposes of determining the extent of business activities conducted by Reliance Capital in New York. In particular,

petitioner submitted partial copies of documents as noted in the Findings of Fact which tended to confuse the fact-finding process. As a result, since petitioner bears the burden of proof under Tax Law § 689(e), the inadequacy of the record results in her disadvantage. Petitioner may not be taxed on Reliance Capital's items of loss.

E. Nonetheless, it is observed that there is sufficient evidence in the record to support a conclusion that included in petitioner's New York adjusted gross income for 1984 is her share of Reliance Capital's net short-term capital gain and net long-term capital gain of $18,046.00 and $27,068.00, respectively. Under Tax Law § 612(c)(22) these amounts should be subtracted from petitioner's Federal adjusted gross income for 1984. This partial relief is properly allowed under Tax Law § 687(f) and (g).

F. The petition of Lynda Jurist is granted to the extent indicated in

Conclusion of Law "E", but, in all other respects, is denied, and the Notice of Deficiency dated July 3, 1987, as modified, is sustained.

DATED: Troy, New York
December 31, 1992

/s/ Frank W. Barrie
ADMINISTRATIVE LAW JUDGE