STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
ALVIN NATHEL	:	DETERMINATION DTA NO. 812280
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Years 1981 through 1987.	:	

Petitioner, Alvin Nathel, 27 Craig Street, Jericho, New York 11753, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the years 1981 through 1987.

On March 23, 1994 and April 1, 1994, respectively, petitioner, represented by Leonard Kreinces, Esq., and the Division of Taxation, represented by William F. Collins, Esq. (Kenneth J. Schultz, Esq., of counsel), signed an agreement consenting to have the controversy determined on submission without a hearing, with all briefs and documents due by August 29, 1994. The Division of Taxation filed documentary evidence on April 28, 1994. Petitioner filed documents and his brief on June 16, 1994. The Division of Taxation filed a brief on August 8, 1994 and petitioner filed a reply brief on August 24, 1994. After review of all evidence submitted, Marilyn Mann Faulkner, Administrative Law Judge, renders the following determination.

ISSUE

Whether petitioner is entitled to a refund of personal income tax pursuant to the special refund authority under Tax Law § 697(d).

FINDINGS OF FACT

Petitioner, Alvin Nathel, was a shareholder of Wishnatzki & Nathel, Inc. ("Wishnatzki"), a New York corporation. From 1981 through 1990 Wishnatzki elected to be taxed as a subchapter S corporation for Federal income tax purposes, but did not make a

subchapter S corporation election for New York State income tax purposes during that same period of time.

Thus, for Federal income tax purposes for the period 1981 through 1990, Wishnatzki's income and deductions were reported on Wishnatzki's returns and were included on a pro rata basis in petitioner's Federal adjusted gross income.

Petitioner timely filed New York State personal income tax returns for that same period. In those returns, however, he did not make any modifications to take out Wishnatzki's income and deductions. Thus, Wishnatzki's income and deductions were included in petitioner's State taxable income. In addition, pursuant to Article 9-A of the Tax Law, Wishnatzki also paid New York franchise tax on its income.

Petitioner timely filed amended New York State personal income tax returns for the years 1988 through 1990 by subtracting Wishnatzki's net income. Petitioner received refunds for the overpayment of taxes for these years.

By application dated July 21, 1992, petitioner requested refunds for the years 1981 through 1987 in the following amounts:

Year	Amount of Refund Requested
1981	$ 22,903.00
1982	$ 36,247.00
1983	$ 38,106.00
1984	$ 42,276.00
1985	$ 26,310.00
1986	$ 42,858.00
1987	$ 34,959.00

In its refund request, petitioner argued that because Wishnatzki paid Federal and State tax on its subchapter S income for the period in question, petitioner, as stockholder of the subchapter S corporation, was permitted to deduct on his State income tax returns the pro rata amount of profits on which payment was made by the corporation to the State. Petitioner asserted that his failure to take such deductions for the years in question constituted mistakes of fact for which refunds are granted under Tax Law § 697(d) notwithstanding any period of limitations.

By letter dated October 16, 1992, the Division of Taxation ("Division") denied the refund stating that petitioner did not qualify under Tax Law § 697(d) for a refund for the years in question.

Thereafter, petitioner requested an Advisory Opinion. An Advisory Opinion was issued on July 15, 1993. The opinion stated that the special refund authority under section 697(d) can be implemented if there are no questions of fact or law involved and the tax was paid under a mistake of fact. In the opinion, it was opined that petitioner mistakenly paid taxes for the years in question because he did not know that he was entitled to a deduction pursuant to Tax Law § 612(c)(22); therefore, petitioner's failure to take the deductions amounted to ignorance of the law which constituted a mistake of law and not a mistake of fact.

Petitioner filed a petition dated September 28, 1993. The Division filed an answer dated January 3, 1994 affirmatively stating that the Division properly denied petitioner's claim for a refund and that petitioner bears the burden of proving by clear and convincing evidence that the refund denial was erroneous.

SUMMARY OF THE PARTIES' POSITIONS

Petitioner contends that the Division erroneously decided that his failure to make the proper income tax deductions for the years in question constituted a mistake of law rather than a mistake of fact. Petitioner also argues that the reliance in the Advisory Opinion on the courts' holdings in Mercury Machine Importing Corp. v. City of New York (3 NY2d 418, 165 NYS2d 517) and in Wendell Foundation v. Moredall Realty Corp. (176 Misc 2d 1006, 29 NYS2d 451) were inappropriate and that these cases have no bearing on the facts or law of the present case. Petitioner also contends that the Division's failure to exercise its discretion under Tax Law § 697(d) was arbitrary and capricious as evidenced by a contrary determination by the former State Tax Commission in Matter of Tompkins (May 26, 1987 [TSB-H-87-(125)-I]).

The Division argues that the Division's authority under Tax Law § 697(d) is discretionary not mandatory; that petitioner's failure to apply a provision of the Tax Law involves an erroneous application of the Tax Law, not a mistaken factual belief; and that,

therefore, the Advisory Opinion properly determined that petitioner was not entitled to a refund under Tax Law § 697(d) because his mistake was one of law rather than one of fact.

In his reply brief, petitioner argues that the cases relied on by the Division involved the payment of tax under a statute that was subsequently declared unconstitutional by the higher courts; that the facts in the present case are identical to those in Matter of Tompkins where the State Tax Commission exercised its discretion under section 697(d) in the taxpayer's favor; and that because the Division exercised its discretion in this case differently than it did under an identical fact pattern in Tompkins, its decision is arbitrary and capricious.

CONCLUSIONS OF LAW

A. Tax Law § 697(d) grants to the Commissioner of Taxation and Finance a special refund authority under the personal income tax law under certain conditions when the statute of limitations has expired with respect to a refund. This section sets forth these conditions as follows:

> "Where no questions of fact or law are involved and it appears from the records of the tax commission that any moneys have been erroneously or illegally collected from any taxpayer or other person, or paid by such taxpayer or other person under a mistake of facts, pursuant to the provisions of this article, the tax commission at any time, without regard to any period of limitations, shall have the power, upon making a record of its reasons therefor in writing, to cause such moneys so paid and being erroneously and illegally held to be refunded and to issue therefor its certificate to the comptroller" (emphasis added).

In this case there is no question of fact or law involved with respect to whether the taxpayer would have been entitled to the refund but for the statute of limitations. The Division refunded the tax mistakenly paid by petitioner for those years where he was not barred from recovery by the statute of limitations. The question in this case is whether petitioner's mistake in not deducting the subchapter S income constituted a mistake of law or of fact for the purpose of invoking the special refund authority.

In Matter of Tompkins (supra), the State Tax Commission exercised its authority under Tax Law § 697(d) to refund an overpayment of income taxes to a taxpayer who erroneously included in his tax returns the proceeds of a New York State pension in his New York adjusted gross income. The Commission granted the refund noting that the taxpayer's inclusion of the

pension proceeds was a mistake of fact. After the signature of the three commissioners to the Tompkins decision, it was noted that the decision expressed the existing audit policy of the Division.

Although decisions of the State Tax Commission[1] are not binding precedent for the Division of Tax Appeals, they are entitled to respectful consideration (Matter of Racal Corp., Tax Appeals Tribunal, May 13, 1993). Subsequent to this State Tax Commission decision, however, the Division issued an Advisory Opinion on similar facts in Hanrahan (July 15, 1993). In that Opinion, the Division reached a different result finding that the erroneous inclusion of State pension payments on a New York income tax return constituted a mistake of law, not a mistake of fact. In reaching this decision, the Division distinguished a mistake of law from a mistake of fact, citing to 54 Am Jur 2d, Mistakes, Accident or Surprise, §§ 4 and 8 and Wendell Foundation v. Moredall Realty Corp. (supra), and based on this analysis, concluded that a mistake of law was involved. The Division therefore decided that the Commissioner of Taxation and Finance could not exercise his discretionary authority under section 697(d) to issue a refund. The opinion noted that in the past the State Tax Commission allowed refunds under section 697(d) with respect to taxes erroneously paid on New York State pensions. The opinion specifically referred to the decisions in Matter of Tompkins (supra) and Matter of Zimmet (State Tax Commn., October 14, 1968) and stated that under the current analysis these cases "would now be decided differently if they were now to come before the Commissioner of Taxation and Finance for consideration."

The Tax Appeals Tribunal has addressed the special refund authority under Tax Law § 697(d) in Matter of The Estate of Mackay (Tax Appeals

Tribunal, March 23, 1989). In that case, Mr. Mackay received record royalties for the years

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[1]In 1987, an independent Division of Tax Appeals was established to replace the State Tax Commission in resolving controversies with the Department of Taxation and Finance (L 1986, ch 282).

1951 through 1979 pursuant to an agreement with Helen D. Miller, the widow of Glenn Miller. Subsequent to Helen Miller's death, a court action was brought against Mr. Mackay for return of all royalties paid. In accordance with a final decision by the New Jersey State Court, the estate of Mr. Mackay paid to the estate of Helen Miller certain sums of money based on the Court's interpretation of the royalty contract at issue. The estate of Mackay thereafter sought a refund of an overpayment of income tax based on the royalties and commissions the Mackay estate was ordered to repay to the Miller estate. The Tax Appeals Tribunal held that the refund could not be made pursuant to section 697(d) because the Mackay estate's entitlement to retain the income from the commissions and royalties was a question of law resolved by the New Jersey Court and that payments made due to the wrong construction of the terms of a contract was a mistake of law and not a mistake of fact. In reaching this decision, the Tribunal set forth the following legal standard based on the same cited sources relied on in the Advisory Opinion:

> "A mistake of fact has been defined as an understanding of the facts in a manner different than they actually are (54 Am Jur 2d Mistake, Accident or Surprise § 4; Wendell Foundation v. Moredall Realty Corp., 176 Misc. 1006, 1009). A mistake of law, on the other hand, has been defined as acquaintance with the existence or nonexistence of facts, but ignorance of the legal consequences following from the facts (54 Am Jur 2d Mistake, Accident or Surprise § 8; Wendell Foundation v. Moredall Realty Corp., supra, at 1009)."

As noted by petitioner, the facts in the present case do not involve a subsequent court finding that the controlling statute is unconstitutional (compare, Mercury Machine Importing Corp. v. City of New York, 3 NY2d 418, 165 NYS2d 517; Matter of Fiduciary Trust Co. of N.Y. v. State Tax Commn., 120 AD2d 848, 502 NYS2d 119). Moreover, "[t]he borderline between mistakes of law and mistakes of fact is often very narrow" (77 NY Jur 2d, Mistake, Accident or Surprise). However, petitioner's failure to make the appropriate deductions permitted under the Tax Law apparently resulted from either his misinterpretation of the law or his ignorance of the law and not on a mistake as to the existence or nonexistence of the underlying material facts. In either case, based on the legal standard set forth by the Tribunal in Mackay, petitioner's mistake was one of law and not one of fact (but see, Matter of Mutual Benefit Health and Accident Assoc. v. Holtz, 5 AD2d 388, 172 NYS2d 643, 645, affd 6 NY2d

954, 190 NYS2d 1014).[2] Accordingly, despite the harshness of the refund denial, the limitations period has expired under section 687(a) and the Division was not obligated to exercise its discretion to grant a refund under Tax Law § 697(d).

B. Petitioner argues that the State Tax Commission's prior decision in Matter of Tompkins should be followed in this case and that the Division's decision to reach a contrary result in this case and in its Advisory Opinion in Matter of Hanrahan is arbitrary and capricious. Contrary to petitioner's contentions, administrative agencies, like the courts, are free "to correct a prior erroneous interpretation of the law . . . by modifying or overruling a past decision" (Matter of Charles A. Field Delivery Service, Inc., 66 NY2d 516, 498 NYS2d 111, 114 [and cases cited therein]).

However, when an agency alters a "prior stated course", it must set forth reasons for such change in order to allow a reviewing court "to determine whether the agency has changed its prior interpretation of the law for valid reasons, or has simply overlooked or ignored its prior decision" (id., 498 NYS2d at 115). In this case the Division has stated valid reasons for changing its interpretation of the law since Matter of Tompkins. Thus, it has not acted in an arbitrary or capricious manner.

C. The petition of Alvin Nathel is denied.

DATED: Troy, New York
February 9, 1995

/s/ Marilyn Mann Faulkner
ADMINISTRATIVE LAW JUDGE

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[2]The majority opinion in that case restricted its holding narrowly to the facts in finding that ignorance on the part of a foreign corporation of a local law is a mistake of fact. As noted by the dissenting opinions, the majority holding turned on an assessment of how remote the taxpayer was to the local law in question. Thus, this case is not persuasive authority to support petitioner's position.