STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
HENRY I. LIPNER	:	DETERMINATION DTA NO. 818483
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Year 1985.	:	

Petitioner, Henry I. Lipner, 357 Mayfair Drive South, Brooklyn, New York 11234, 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 1985.

A hearing was held before Timothy J. Alston, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on February 21, 2002 at 10:00 A.M., with all briefs submitted by June 12, 2002, which date began the six-month period for the issuance of this determination. Petitioner appeared by David B. Petshaft, Esq. The Division of Taxation appeared by Barbara G. Billet, Esq. (Kevin R. Law, Esq., of counsel).

ISSUES

I. Whether petitioner's claim for refund for the 1985 tax year, filed following a Federal change in petitioner's taxable income, was filed within the limitations period provided for in Tax Law § 687(c).

II. If not, whether petitioner's refund claim should be granted pursuant to the doctrine of equitable recoupment.

FINDINGS OF FACT

1. Petitioner, Henry I. Lipner, was a limited partner in Professional Arbitrage Associates ("PAA"), a limited partnership which was audited by the Internal Revenue Service ("IRS") for the years 1983, 1984, and 1985. The IRS audit of PAA began in 1986. In 1990, the IRS issued a final partnership administrative adjustment which disallowed all losses and deductions claimed by PAA for the 1983 and 1984 tax years. In March 1991, PAA's tax matters partner filed a petition in United States Tax Court challenging the proposed adjustment.

2. In 1995, the tax matters partner reached a settlement with the IRS. The details of the settlement were outlined in a letter to petitioner dated March 29, 1995 from Kirkland & Ellis, PAA's counsel in the Tax Court matter. The issues in the dispute between PAA and the IRS involved the timing of losses and deductions. The result of the settlement was to shift such losses and deductions from tax years 1983 and 1984 to 1985. The specific results of the settlement on PAA's reported income was as follows:

Year	PAA's Reported Taxable Income (Loss)	PAA's Income (Loss) per Settlement	Adjustment
1983	$ (54,798,792.00)	$ (42,148,687.00)	$ 12,650,105.00
1984	(19,246,312.00)	33,103,583.00	52,349,895.00
1985	65,460,188.00	460,188.00	(65,000,000.00)
Total	$ (8,584,916.00)	$ (8,584,914.00)	$ 0

3. The March 29, 1995 letter further advised petitioner that other items on a particular partner's return, even if not directly related to the PAA audit, could be impacted by the settlement.

4. Petitioner accepted the proposed settlement between PAA and the IRS and, with his accountant, proceeded to process the changes to his Federal personal income tax returns in accordance with the settlement and in accordance with the procedures outlined in the March 29, 1995 letter.

5. Pursuant to the settlement between PAA and the IRS, a decision was entered in the United States Tax Court on June 1, 1995 in ***Professional Arbitrage Associates, PAA Management, Ltd., Tax Matters Partner v. Commissioner of Internal Revenue*** (Docket No. 4496-91).

6. At about the time of the PAA settlement, Kirkland & Ellis, attorneys for PAA, advised petitioner of the adjustments to his personal Federal income tax return flowing from the settlement. These adjustments were as follows: 1) 1983 income adjustment of $38,565.00; 2) 1984 income adjustment of $223,999.00; and 3) 1985 income adjustment of ($289.593.00) and long-term capital gain of $6,414.00. In its March 29, 1995 letter, Kirkland & Ellis advised that the long-term capital gain increase resulted from the income adjustments at the partnership level. At no time did petitioner dispute any of these adjustments.

7. Petitioner and his accountant reviewed the PAA adjustments and determined that, as a result of carry-back and carry-forward changes resulting from these adjustments, the tax years 1982 through 1988 would ultimately be affected.

8. Under cover letters dated July 23, 1996, the IRS transmitted Forms 4549-A (Income Tax Examination Changes) for the years 1983 through 1985. The Forms 4945-A were dated July 2, 1996 and reflected the adjustments listed above in Finding of Fact "6." The 1985 additional long-term capital gain income of $6,414.00 did not impact the computation of petitioner's 1985 taxable income because such gain was offset by short-term losses. As a result,

petitioner reported a capital loss of $3,000.00 on his Form 1040 on both his original and amended 1985 Federal returns.

9. The Form 4549-A for 1985 contained the following explanation:

> This is a final report based on the Tax Court decision for the partnership. The ordinary income has been reduced from $291,615.00 to $2,022.00, a decrease in income of $289,593.00, and there is a long-term capital gain of $6,414.00. With the long-term capital gain, the long-term capital loss carryover to 1986 is reduced to zero.
>
> The alternative minimum tax has been increased by $32,673.00. This increase releases investment credit in the same amount; therefore, an additional $32,673.00 of credit is available to carry back. The carryback adjustment is not being addressed at this time since your representative, Mr. McCafferty, indicated that amended returns were being prepared to claim the carryback.
>
> When you file your carryback claims, please attach a copy of this report.

10. An attachment to the 1985 Form 4549-A ("Schedule 1") computes petitioner's capital gains and losses for 1985. These computations indicate a 1985 short-term capital loss carryover of $92,385.00 and a long-term capital loss carryover of zero. Petitioner's amended 1985 return reported the same carryover amounts.

11. The IRS also issued a Form 4549-A dated July 2, 1996 to petitioner with respect to certain changes for 1986. This report advised petitioner of an increase to his adjusted gross and taxable income of $2,287.00, which was explained as follows:

> This report is written to make the computational change to the long-term capital loss carryover form [sic] 1985.
>
> It was determined that you had unreported capital gain income in the amount of $6,414.00 for the taxable year 1985 from the cash distribution made by Professional Arbitrage Associates to you in 1985. Consequently, the long-term capital loss available to carryover from 1985 to 1986 was decreased from $5,717.00 to zero. We are increasing your income by 40% of $5,717.00.
>
> This report was prepared without benefit of the 1986 return.

12. The cover letters accompanying the Forms 4549-A for 1983 through 1985 stated in part:

> Enclosed is Form 4549-A explaining how the adjustments made during our examination of the above return affect your individual income tax return. The Form 4549-A does not require any signatures and should not be returned to us, but should be kept for your records.
>
> If you owe additional tax, you will receive a bill for the additional tax and interest. If penalties are applicable because of the adjustments made during our examination, a separate report will be mailed to you. If you are due a refund, it will be sent to you within 6 to 8 weeks.

13. Also accompanying the Forms 4549-A was a flyer captioned "Read Me First!," page two of which stated, in part:

> We have processed the adjustments for your investment in Professional Arbitrage. In approximately 3-4 weeks you will receive computer generated notices showing these adjustments. In most cases, the 1985 year will show a credit and the 1983 & 1984 years will show a debit balance. We will offset any credit against the debits. Please allow an additional 4 weeks for processing.
>
> If a balance due remains, you will receive a corrected notice at that time. Any remaining credit will be refunded if you owe no other taxes.

14. By Notice of Deficiency dated July 29, 1996, the IRS asserted a deficiency of $961.00 in additional tax due for the year 1986. This deficiency was equal to the deficiency indicated in the Form 4549-A for 1986.

15. By Notice of Tax Due dated August 5, 1996, the IRS gave notice to petitioner of a purported assessment of $112,162.00 for the 1984 tax year, plus interest. This assessment amount was equal to the deficiency for 1984 as set forth on the Form 4549-A for 1984.

16. Petitioner filed amended Federal returns for the years 1982 through 1988 under a cover letter dated October 3, 1996.[1] In the cover letter petitioner's accountant explained that

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[1] Petitioner and his wife timely filed their original 1985 Federal return

"[b]ecause the Internal Revenue Service calculations did not take into account the effects of various income tax credit carryovers and carrybacks, which have been reflected in the attached Forms 1040X, we believe that the attached amended returns are a more accurate overall reflection of the impact of the PAA settlement on [petitioner]."

17. Petitioner's 1982, 1983 and 1984 amended returns claimed tax credit carrybacks flowing from the 1985 changes. The 1986, 1987, and 1988 amended returns showed a reduction in the amount of capital loss carryforward available as a result of the inclusion of $6,415.00 of additional capital gain in the 1985 tax year from the PAA settlement. The October 3, 1996 letter noted that there was no tax effect from the additional capital gain in 1985, 1986, or 1987 due to the existence of capital loss carryovers in excess of the 1985 adjustment. The letter further notes that the tax liability effect of the 1985 capital gain adjustment was delayed until the 1988 tax year.

18. Petitioner's amended Federal returns for the years 1983, 1984, and 1985 accept and reflect the income adjustments set forth in the Forms 4549-A for those years. In addition, the 1985 amended Federal return accepts and reflects the long-term capital gain of $6,414.00 as set forth on the Form 4549-A for that year.

19. The October 3, 1996 letter also requests that the IRS process the "income tax liability effect of the PAA settlement . . . on an overall basis and not on a year by year basis . . . due to the linkage among the various income tax years."

20. Petitioner received a "Final Notice!" dated March 17, 1997 regarding an assessment for 1984, which asserted tax, penalty and interest of $322,841.26. Petitioner's accountant responded to this notice by advising the IRS that petitioner had filed an amended return for 1984, along with amended returns for all other affected years, and had not heard from the IRS since

filing the returns. The letter also stated petitioner's understanding that the IRS was handling this matter on an overall basis. The IRS responded to the March 20, 1997 letter by a letter dated April 28, 1997 indicating that the IRS had no record of receiving petitioner's amended returns.

21. Petitioner subsequently filed his amended Federal returns for the years 1982 through 1988, for a second time, on August 14, 1997.

22. The IRS issued notices to petitioner dated December 22, 1997 with respect to the years 1982, 1983, 1984, and 1986. With respect to the years 1982 through 1984, the notices indicated that the IRS had adjusted petitioner's account in accordance with the amended returns and had given petitioner credit for the tax credits claimed on those amended returns. With respect to 1986, the December 22, 1997 notice continued to indicate an amount due. Such an amount due for 1986 was inconsistent with petitioner's filed amended 1986 Federal return.

23. By notice dated November 23, 1988, the IRS advised petitioner that, at petitioner's request, it had changed his account for the 1986 tax year to correct petitioner's investment gain or loss and minimum tax or alternative minimum tax. This change properly reflected capital loss carryforwards reported on petitioner's amended Federal Return for 1986. As a result of this change, tax and interest that the IRS had previously asserted against petitioner for 1986 was reduced to zero.

24. By letter dated July 31, 1997, the Division of Taxation ("Division") advised petitioner that New York had been notified of changes to petitioner's Federal income tax returns for the years 1983 and 1984. The Division further advised petitioner that he was required to report such changes to New York. In response, petitioner's accountant advised the Division by letter dated August 22, 1997 that amended returns for the affected years had been submitted, misplaced by the IRS, and then resubmitted by petitioner. The letter further stated petitioner's position that,

until the IRS completed its review of the amended returns, a final Federal determination had not occurred and that, therefore, petitioner was not in a position to report Federal changes to New York. The Division sent a follow-up letter to petitioner dated November 18, 1997 inquiring as to whether a final Federal determination had been made with respect to 1983 and 1984. In response, petitioner's accountant sent a FAX transmittal to the Division on December 3, 1997, advising that the IRS review of petitioner's 1983 and 1984 amended returns was not completed.

25. On January 4, 1999 the Division issued to petitioner a Notice of Additional Tax Due by which the Division asserted a New York income tax deficiency totaling $47,535.00, plus interest, for the years 1983 and 1984. The notice explained that the deficiency was based on petitioner's failure to report Federal audit changes to New York and that the Division had been notified of such changes by the IRS.

26. On February 17, 1999, petitioner and his spouse[2] jointly filed an amended 1985 New York State personal income tax return reporting the adjustments to the Division and claiming a refund in the amount of $34,067.00 for 1985 based on the Federal changes. Petitioner's amended 1985 New York return was in all material respects consistent with his amended 1985 Federal return and with the July 2, 1996 Form 4549-A for the year 1985.

27. By Notice of Disallowance dated June 11, 1999, petitioner's claim for refund of the 1985 overpayment flowing from the Federal audit changes was denied as untimely filed.

CONCLUSIONS OF LAW

A. At issue in this matter is whether petitioner's refund claim for the tax year 1985 was timely filed. As pertinent here, Tax Law § 659 provides that where a taxpayer's *Federal taxable income* is changed or corrected by the Internal Revenue Service the taxpayer must report such

[2] Although petitioner filed jointly with his wife, the petitioner filed herein lists only petitioner's name.

change or correction to the Division of Taxation within 90 days after "the final determination of such change or correction." Tax Law § 687(c) provides that a refund claim attributable to a Federal change or correction required to be reported under Tax Law § 659 must be filed within two years from the time the notice of such change or correction was required to be filed with the Division. By the combined operation of Tax Law §§ 659 and 687(c), then, petitioner had two years and ninety days from the date of the final determination by the IRS of petitioner's 1985 Federal taxable income in which to file his refund claim. The refund claim at issue, that is, petitioner's amended 1985 New York personal income tax return, was filed on February 17, 1999 (***see***, Finding of Fact "26"). The timeliness of this claim thus turns on the date of the final determination of petitioner's Federal taxable income for 1985.

B. The Form 4549-A for the 1985 tax year, dated July 2, 1996, which correctly listed the adjustments to petitioner's taxable income resulting from the PAA settlement, was the "final determination" of petitioner's "taxable income" for that year for purposes of Tax Law § 659. This document set forth the 1985 adjustments to petitioner's ordinary income of minus $289,593.00 and long term capital gain of $6,414.00 flowing from the PAA settlement and the resulting corrected taxable income for that year. Petitioner accepted and did not dispute these adjustments, which were "partnership items" under IRC § 6231(a)(3). As partnership items, these adjustments, and the resulting corrected taxable income, were "conclusive" under IRC § 6230(c)(4). These partnership item adjustments were also "computational adjustments" (***see,*** IRC § 6231[a][6]) not subject to regular income tax notice of deficiency and Tax Court petition procedures set forth in IRC § 6211 ***et seq***. (***see***, IRC § 6230[a][1]). Petitioner thus had no right to file a petition with the Tax Court in respect of the adjustments in the Form 4549-A for 1985.

Additionally, the Form 4549-A stated that it was "a final report based on the Tax Court decision for the partnership," a further indication to petitioner that the adjustments were conclusive.

C. Although the Form 4549-A bore a date of July 2, 1996, the cover letter transmitting the form to petitioner was dated July 23, 1996. Accordingly, the date of the final Federal determination of petitioner's 1985 taxable income is deemed to be July 23, 1996, the date of issuance of the Form 4549-A.

D. Petitioner's 1985 refund claim, i.e., his amended 1985 New York return, was thus filed more than two years and ninety days from the date of the final determination by the IRS of petitioner's 1985 Federal taxable income and was therefore untimely pursuant to Tax Law §§ 659 and 687(c).

E. Petitioner contended that the Form 4549-A was not the final Federal determination of his taxable income and asserted that, while the 1985 PAA income adjustment of minus $289,593.00 is properly considered a "partnership item" under IRC § 6231(a)(3), the long-term capital gain adjustment was not a partnership item and therefore was subject to normal deficiency and petition procedures. This contention is rejected. As indicated by the March 29, 1995 letter from Kirkland & Ellis advising petitioner of the settlement and subsequent information from Kirkland & Ellis advising petitioner of the settlement's impact on his tax liability (***see***, Findings of Fact "2" and "6"), the long-term capital gain increase resulted from the PAA income adjustments and was part of the PAA settlement. This adjustment is therefore properly considered a partnership item.[3]

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[3] Even if the long-term capital gain adjustment was not a partnership item, its treatment had no impact on the calculation of petitioner's taxable income for 1985. Specifically, because capital losses were available to offset this adjustment, petitioner took a $3,000.00 capital loss on his amended return. Petitioner also took a $3,000.00 loss on his original 1985 return. The disposition of this item thus does not impact the calculation of petitioner's 1985 taxable income. The Form 4549-A is therefore properly considered a final determination of petitioner's taxable income regardless of whether the long-term capital gain adjustment is a partnership item.

F. Petitioner also contended that Form 4549 was not a closing agreement under IRC § 7121, which authorizes the IRS to enter into closing agreements with taxpayers which are "final and conclusive." Accordingly, petitioner asserted, the Form 4549-A at issue was not a final determination of taxable income under Tax Law § 659. Tax Law § 659, however, refers not to a closing agreement, but to a "final determination" of a change in "Federal taxable income." Thus, while the Form 4549-A at issue may not have been a closing agreement under IRC § 7121, it was, as discussed above, a "final determination" for purposes of Tax Law § 659. Moreover, in contrast to the situation in ***Evans v. Commr.*** (77 TCM 1490), a case cited by petitioner in support of his position, the Form 4549-A for 1985 did state explicitly that it was "a final report based on the Tax Court decision for the partnership." Moreover, Tax Law § 659 does not define "final determination" and the Division's regulations make clear that a myriad of Federal determinations may trigger the reporting requirement under section 659 (***see***, 20 NYCRR 159.5). Certainly, under the circumstances of this case, the Form 4549-A is analogous to example "(c)" of the regulations which provides that a final determination includes an unpetitioned 90-day deficiency notice and a decision of a court of last resort (***see***, 20 NYCRR 159.5[c]). Similar to this example, the treatment of the computational adjustments resulting from the PAA settlement was conclusive and petitioner had no right to petition the Tax Court in respect of such adjustments.

G. Petitioner asserted that the language on the 1985 Form 4549-A stating that carryback adjustments were not being addressed because petitioner's accountant had stated that amended returns were being prepared to claim the carryback (***see***, Finding of Fact "9") indicates that the IRS did not believe that the Form 4549-A was a final adjustment. The carrybacks referred to in the 1985 Form 4549-A involve the years 1982 through 1984 (***see***, Finding of Fact "17") and

would have no impact on petitioner's taxable income for 1985, whether such claims were granted or not. The carryback adjustments are thus immaterial to the issue of whether the Form 4549-A was a final Federal determination of petitioner's 1985 taxable income.

H. Petitioner also asserted that he disputed the adjustments on the Form 4549-A. This assertion is clearly erroneous with respect to 1985, for at no time did petitioner dispute these adjustments. Indeed, petitioner's amended 1985 Federal return is entirely consistent with the 1985 Form 4549-A.

I. Petitioner asserted that the date of the final Federal determination under Tax Law § 659 was November 23, 1998. This was the date the IRS advised petitioner that, at petitioner's request, it had changed his account for the 1986 tax year to correct petitioner's investment gain or loss and minimum tax or alternative minimum tax (***see***, Finding of Fact "23"). This change reflected an acceptance by the IRS of loss carryforward amounts claimed on petitioner's 1986 amended returns. As a result of this change, tax and interest that the IRS had previously asserted against petitioner for 1986 were reduced to zero. This assertion is rejected. The November 23, 1998 notice had no impact on petitioner's 1985 taxable income which, as discussed, was conclusively determined by the 1985 Form 4549-A. Indeed, the 1985 Form 4549-A properly reflected not only petitioner's 1985 taxable income, but also the 1985 capital loss carryforward amounts. Contrary to petitioner's assertion, a final Federal determination of petitioner's 1985 taxable income was not contingent upon a resolution of petitioner's 1986 tax liability.

J. Alternatively, petitioner asserted that a final Federal determination could not have occurred until the August 13, 1997 filing date of his amended Federal returns. Petitioner asserted that the IRS could not have made a final determination with respect to changes made on the returns until it received them. This contention, too, is rejected. As noted previously, the

changes to petitioner's taxable income for 1985 as set forth in the From 4549-A were conclusive. Indeed, petitioner's 1985 amended return contains no changes from the Form 4549-A. The amended returns for the years 1982 through 1984 and 1986 through1988 were filed to reflect tax credit carrybacks and capital loss carryforwards. Such changes did not impact petitioner's 1985 taxable income.

K. Petitioner's position throughout this proceeding appears premised on the notion that a final Federal determination under Tax Law § 659 for 1985 could not occur until all issues for all years affected by the PAA audit were resolved. This premise is much broader than the language of Tax Law § 659 which simply refers to a final determination of a change to Federal taxable income. The record in this matter is clear that the Form 4549-A was such a final determination for 1985.

L. Petitioner also contended that, pursuant to the doctrine of equitable recoupment, the overpayments which are the subject of his 1985 refund claim should be offset against 1983 and 1984 New York income tax deficiencies arising from the PAA audit.

> The doctrine of equitable recoupment allows a taxpayer *against whom a deficiency is asserted* to offset against that deficiency overpayments which are time barred for claiming a refund and (1) involve the same type of tax as the deficiency; (2) were paid during the period that comprises the deficiency; and (3) involve the same transaction as is the subject of the deficiency (***National Cash Register Co. v. Joseph***, 299 NY 200, 203). (***Matter of Turbodyne Corp.***, Tax Appeals Tribunal, June 25, 1996, ***confirmed Matter of Turbodyne Corp. v. Tax Appeals Tribunal***, 245 AD2d 976, 667 NYS2d 105; emphasis added.)

In explaining the doctrine of equitable recoupment, the United States Supreme Court has stated:

> *[A] party litigating a tax claim in a timely proceeding* may, in that proceeding, seek recoupment of a related, and inconsistent, but now time-barred tax claim relating to the same transaction. (***United States v. Dalm***, 494 US 596, 608, 108 L Ed 2d 548; emphasis added.)

M. Petitioner's equitable recoupment claim must fail because there is no deficiency asserted against petitioner in the instant matter to offset the time-barred refund claim. While the record shows deficiencies against petitioner for the years 1983 and 1984 (***see***, Finding of Fact "25"), he did not file a petition in respect of such deficiencies and the Division of Tax Appeals has no jurisdiction over such years. As indicated by the Supreme Court in ***Dalm***, equitable recoupment is available in a "timely proceeding." In such a proceeding, where certain criteria are met, a time-barred refund claim may be used to offset the deficiency which is the subject of the timely proceeding. Here, petitioner seeks to use the doctrine of equitable recoupment to avoid the statute of limitations and to open an otherwise time-barred refund claim. Equitable recoupment is not available under such circumstances. Additionally, petitioner's equitable recoupment claim must fail because the overpayment and the asserted deficiencies relate to different tax years, i.e., the deficiencies involve the 1983 and 1984 tax years and the overpayment involves 1985 (***see***, ***Matter of Boyle***, Tax Appeals Tribunal, February 26, 1998).

N. Petitioner also asserted that he acted in good faith and that Tax Law §§ 659 and 687(c) should not be applied in a manner which would lead to an unreasonable or inequitable result. Petitioner points to the communication between his accountant and the Division regarding his 1983 and 1984 returns (***see***, Finding of Fact "24") as an indication of such good faith.

While there is no dispute that petitioner acted in good faith in his dealings with both the Division and the IRS, the conclusion reached herein results from the application of the relevant limitations period. Periods of limitations are "established to cut off rights, justifiable or not, that might otherwise be asserted and they must be strictly adhered to by the judiciary" (***Kavanagh v. Noble***, 332 US 535, 539; ***see also***, ***Cohen v. Pearl River Union Free School Dist.***, 70 AD2d 94,

419 NYS2d 998). Accordingly, notwithstanding petitioner's good faith efforts to resolve this matter, his claim for refund must be denied.

O. The petition of Henry I. Lipner is denied and the Notice of Disallowance dated June 11, 1999 is sustained.

DATED: Troy, New York
December 5, 2002

/s/ Timothy J. Alston
ADMINISTRATIVE LAW JUDGE