STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions	:	
of	:	
ALDEN SAYRES AND BARBARA SAYRES	:	
for Redetermination of Deficiencies or for Refund of New York State and New York City Income Taxes under Article 22 of the Tax Law and Title 11, Chapter 17 of the Administrative Code of the City of New York for the year 1985.	:	DETERMINATION DTA NOS. 819049 AND 819050

Petitioners, Alden Sayres and Barbara Sayres, 113 Crest Drive, Summit, New Jersey 07901, filed petitions for redetermination of deficiencies or for refund of New York State and New York City income taxes under Article 22 of the Tax Law and the Administrative Code of the City of New York for the year 1985.

A hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on April 28, 2003 at 10:30 A.M., with all briefs to be submitted by August 11, 2003, which date began the six-month period for the issuance of this determination. Petitioner appeared by Jerrold Garson, CPA. The Division of Taxation appeared by Mark F. Volk, Esq. (Kevin R. Law, Esq., of counsel).

ISSUES

I. Whether petitioners can apply an unliquidated loss to a capital gain realized several years earlier, where the loss and gain arose out of the same transaction.

II. Whether petitioners in 1988 had any recourse to recoup taxes paid on the gain realized in 1985.

FINDINGS OF FACT

1. During the year in issue, 1985, petitioners, Alden[1] and Barbara Sayres, were domiciliaries of New York State and New York City. On or about June 23, 1987, petitioners changed their domicile from Brooklyn, New York to Summit, New Jersey.

2. On July 16, 1985, Alden Sayres entered into a stock purchase agreement whereby he sold his 13.933 % interest in Princeton Gamma-Tech, Inc. ("Princeton") to Outokumpu (U.S.A.), Inc. ("Outokumpu") for $3.80 per share.[2] Since the stock purchase agreement set forth a total consideration for the shares of $5,155,517.00, petitioner's portion, although not revealed in the record, would have been approximately $718,318.00.

3. As a result of realizing this gain and possibly others, Alden Sayres ("petitioner") entered a capital gain on his 1985 New York State Resident Income Tax Return (filed under the status of married filing separately on one return) in the sum of $211,459.00 in the "Federal Amount" column, and $201,017.00 and $10,442.00 in columns "A" and "B", respectively, reflecting New York capital gain for Alden and Barbara Sayres. However, neither the 1985 Federal income tax return nor the Federal schedule D was entered into evidence, and it was not possible to discern the source of these figures.

4. The Division of Taxation issued to petitioners a Statement of Audit Changes, dated June 7, 1988, in which it informed them that they had failed to accurately account for an item of

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[1]Alden Sayres passed away on December 29, 2002. Petitioner Barbara Sayres was named executrix of his estate on January 16, 2003 and executed a power of attorney appointing Jerrold Garson, CPA as the estate's representative in this matter.

[2]Neither the stock purchase agreement nor any other document in the record indicated that Barbara Sayres held or sold stock in Princeton Gamma-Tech, Inc.

tax preference on their return, to wit: the remaining 60% of the net long-term capital gains which was set forth on their Federal return at line 22. By failing to account for this item of tax preference, petitioners had failed to include additional minimum income tax due of $24,359.53. Although petitioners attached a computation of minimum income tax on forms IT-220 and attached them to their return, albeit with mathematical errors, they failed to transcribe the amounts due to the summary of credits and taxes, form IT-201-ATT, and the IT-201.

5. The Division of Taxation demanded payment by notice sent by the Tax Compliance Division on January 27, 1989, seeking a total sum of $24,359.33 plus interest. When no payment was received it issued two notices of deficiency dated March 16, 1989. The first was issued to Alden Sayres seeking additional income tax due for the year 1985 in the sum of $23,547.55 plus interest and the second to Barbara Sayres, seeking additional income tax for the year 1985 in the sum of $811.78 plus interest. Both notices referred to the previously issued statement of audit adjustment for an explanation of the additional tax.

6. Petitioners filed a claim for refund with the Internal Revenue Service for the year 1985 which was disallowed in full on June 27, 1990. The letter to petitioners from the Internal Revenue Service stated, in pertinent part, as follows:

> Since the proceeds from the sale of Princeton Gamma-Tech, Inc. stock were received under a claim of right and without restriction, they were taxable in 1985 the year received and the Schedule D gain as reported on your original return is unchanged. Repayments of items previously included in income under the claim of right doctrine would be deductible in the year made as provided in Code Section 1341.

On July 6, 1990, petitioners filed form 2297, waiving their right to statutory notification of claim disallowance, and the Internal Revenue Service's case was closed for the year 1985.

7. Petitioners filed a form IT-201-X, Amended New York Resident Income Tax Return, for 1985, dated July 5, 1988, in which they reflected a reduction in the capital gain claimed on the original return due to a "pending claim by the State of New Jersey Department of Environmental Protection." A handwritten note at the end of the return stated that, because petitioner Alden Sayre had issued an indemnification, the capital gain originally reported was now a loss in the sum of $201,018.00. As a result, petitioners claimed a refund due in the sum of $31,720.00.

8. The stock purchase agreement entered into by Alden Sayres contained indemnification provisions whereby petitioner agreed to hold the purchaser harmless from and against liabilities arising from failure to comply with applicable rules and regulations of the Environmental Protection Agency, the New Jersey Department of Environmental Protection and any other environmental agency; to effect any clean-up plans required by said agencies with respect to any environmental conditions existing on or before the closing date (July 16, 1985) of the agreement; or to pay any fines, assessments or damages asserted against Princeton Gamma-Tech, Inc. by said agencies with respect to environmental violations occurring prior to the closing date.

9. On February 20, 1987, Outokumpu notified the sellers that certain claims were going to be made pursuant to the indemnification provisions in the contract. Specifically, Outokumpu was seeking indemnification for a shortfall in net operating losses, costs incurred with respect to unspecified environmental issues, unpaid franchise taxes and legal and accounting costs. The total indemnification sought was estimated to be $90,000.00. However, the last paragraph of the letter stated:

> This letter is being provided to you as a matter of record and in order to preserve our rights under the Agreement. A request for payment of indemnification amounts will

be made within a reasonable time after all matters pending before the New Jersey Department of Environmental Protection are finally resolved.

10. On March 24, 1988, all shareholders of Princeton Gamma-Tech, Inc., including petitioner Alden Sayres, received a memorandum from their counsel, Dewey, Ballantine, Bushby & Wood, informing them of their potential liability for environmental problems stemming from ground water contamination at two superfund sites designated by the Federal Environmental Protection Agency. The memorandum stated that $500,000.00 of the purchase price had been placed in escrow for such a contingency and that the sellers would be liable for any excess to the extent of the proceeds received by the sellers. Therefore, Alden Sayres' liability was limited to the value of his 13.933% share of the proceeds.

SUMMARY OF PETITIONERS' POSITION

11. Petitioners argue that since they moved out of New York State in June of 1987, they converted from cash to accrual basis taxpayers and should be permitted to accrue their entire loss on the sale of the Princeton Gamma-Tech, Inc. stock for the year 1985 by virtue of the indemnity provisions in the stock purchase agreement.

CONCLUSIONS OF LAW

A. First, the petition of Barbara Sayres is denied because she has not demonstrated that she ever owned shares of Princeton Gamma-Tech, Inc. Her name does not appear on the stock purchase agreement or any other documents pertaining to that transaction which have been submitted into the record. Since the relief claimed is directly related to the loss incurred in the Princeton Gamma-Tech transaction only, petitioner Barbara Sayres has not carried her burden of proof in this matter and is not entitled to the relief sought. (Tax Law § 689[e].)

B. Petitioners' theory for relief is that they became nonresidents in 1987 at which time all items of income, gain, loss, deduction, and items of tax preference accrued. Petitioners rely on the provisions of Tax Law former § 654(c),[3] which stated, in pertinent part, as follows:

> Special accruals. (1) If an individual changes his status from resident to nonresident, he shall, regardless of his method of accounting, accrue for the portion of the taxable year prior to such change of status any items of income, gain, loss or deduction accruing prior to the change of status, if not otherwise properly includible (whether or not because of an election to report on an installment basis) or allowable for New York income tax purposes for such portion of the taxable year or for a prior taxable year.

The same provision was provided for in the regulations at 20 NYCRR former 148.10(a).

However, petitioners' theory is flawed. When they changed from resident to nonresident status in 1987, any item of loss necessarily accrued to the portion of 1987 immediately prior to their change of status, pursuant to the statute. Even if petitioners realized the loss they contend they incurred as a result of the indemnification provisions in the stock purchase agreement in 1987, they were not entitled to apply it against the gain they properly reported in 1985. They realized a gain and properly reported it in 1985, and the Federal adjusted gross income upon which the New York State and City tax is calculated, including the Schedule D gain, has never changed. Therefore, petitioners' New York adjusted gross income for 1985 has never changed. (***See,*** Tax Law § 612[a].)

Petitioners' application for refund of Federal income tax for 1985 based on the same alleged loss was denied because " the proceeds from the sale of Princeton Gamma-Tech, Inc. stock were received under a claim of right and without restriction, [hence] they were taxable in 1985 the year received and the Schedule D gain as reported on your original return [was] unchanged." However, under the "claim of right" doctrine found in Internal Revenue Code §

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[3]The New York City Administrative Code contained identical language.

1341, petitioners were afforded the opportunity to deduct any repayments in the year they were actually made. New York State offered similarly situated petitioners no such recourse until 1997, when Tax Law § 662 was enacted to conform New York law to IRC § 1341.

Petitioners' attempt to amend their 1985 New York resident tax return to reflect a loss in the sum of $201,018.00 based upon the alleged losses suffered as a result of the indemnification provisions in the stock purchase agreement is indistinguishable from the Court of Appeals decision in ***Matter of Kreiss v. New York State Tax Comm*** (61 NY2d 916, 474 NYS2d 717, ***revg*** 92 AD2d 1048, 461 NYS2d 544). In ***Kreiss***, petitioner reported a capital gain in 1974, resulting from the sale of his ownership interest in certain taxicab medallions. Litigation concerning that interest was resolved in 1977 with petitioner's agreement to pay $19,000.00. Petitioner filed amended 1974 Federal and State tax returns claiming a refund on the ground that the 1974 gain had been incorrectly reported and should be reduced. The Internal Revenue Service disallowed the amendment of adjusted gross income on the basis that the income had been correctly reported, but then allowed a refund under the "claim of right" doctrine (IRC § 1341). Petitioner's New York amendment also was disallowed on the ground that the Federal adjusted gross income was correctly reported, but the refund was denied because New York had no corresponding "claim of right" doctrine. The Court of Appeals held that the receipt of a refund under the Federal statute did not mandate a State refund where there was no State counterpart to the claim of right provision contained in IRC § 1341.

Similarly, petitioners herein have no recourse to recoup the taxes paid on the gain realized in 1985.

C. The plain language of Tax Law former § 654(c) required the accrual of items of loss only for the portion of the taxable year prior to the change of residence status and reportable on

the last resident return. In this case, that would have meant accruing any loss sustained in 1987 and reporting it on the 1987 return. Petitioners filed an amended 1985 resident income tax return in an effort to do what the New York Tax Law did not permit at that time, i.e., receive a refund for tax paid on income received under a claim of right and without restriction.

Further, even if there were a "claim of right" doctrine, petitioners' assumption that the mere presence of indemnification provisions in the stock purchase agreement constituted a "loss" for the purposes of Tax Law former § 654(c) was flawed.

Internal Revenue Code § 165 provides that a deduction will be allowed for any losses including capital losses on the sale of capital assets. (IRC § 165[a], [f].) But a bona fide loss is allowed only in the year in which the loss is sustained and is evidenced by identifiable events occurring during the taxable year. (Treas Reg §§ 1.165-1[b]; 1.165-1[d][1].)[4]

In this case petitioners have not demonstrated that they had incurred any loss in 1987 connected with the 1985 stock purchase agreement. The only evidence they submitted which can be related to 1987 is the notice from Outokumpu which set forth areas in the contract pursuant to which it was anticipating seeking compensation. However, the February 20, 1987 letter clearly informed petitioners that no request for payment would be made pursuant to the indemnification provisions until all matters pending before the New Jersey Department of Environmental Protection had been resolved. Therefore, no losses, as that term is defined and used in IRC § 165, were incurred in 1987, and petitioners' claim that they could accrue losses to that portion of 1987 for which they were residents of New York State and City and apply it to 1985 must fail.

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[4]Tax Law § 607(a) provides that terms used in Article 22 have the same meaning as those used in a comparable context in the Internal Revenue Code.

Likewise, petitioners' reliance on ***Blanco v. Commissioner of Taxation and Finance*** (282 AD2d 896, 723 NYS2d 558, ***lv denied*** 96 NY2d 719, 733 NYS2d 371) and ***Baker v. Commissioner of Taxation and Finance*** (304 AD2d 1046, 758 NYS2d 210) was misplaced. In those cases, lottery winnings were held to have a fixed value upon which a bond or tax could be calculated for special accrual purposes when residents became nonresidents. Here, there was no fixed loss to accrue and, assuming arguendo there was a loss, petitioners' attempt to apply it to 1985 was in error.

D. The petitions of Alden Sayres and Barbara Sayres are denied and the two notices of deficiency, dated March 16, 1989, are sustained.

DATED: Troy, New York
December 18, 2003

/s/ Joseph W. Pinto, Jr.
ADMINISTRATIVE LAW JUDGE