STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
TIMOTHY W. AND KATHLEEN A. JAY	:	
for Redetermination of a Deficiency or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law for the Years 2001 and 2002.	:	DETERMINATION DTA NO. 821911

Petitioners, Timothy W. and Kathleen A. Jay,[1] filed a petition for redetermination of a deficiency or for refund of New York State personal income tax under Article 22 of the Tax Law for the years 2001 and 2002.

On December 8, 2008 and December 31, 2008, respectively, petitioners, appearing by Sushil Sadh, CPA, and the Division of Taxation, appearing by Daniel Smirlock, Esq. (Peter B. Ostwald, Esq., of counsel), waived a hearing and submitted the matter for determination based on documents and briefs to be submitted by May 11, 2009, which date commenced the six-month period for issuance of this determination. After due consideration of the documents and arguments submitted, Brian L. Friedman, Administrative Law Judge, renders the following determination.

ISSUE

I. Whether the Division of Taxation properly determined petitioners' nonresident allocation percentages for the years 2001 and 2002.

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[1] Kathleen A. Jay's name is included by virtue of having filed joint income tax returns with Timothy W. Jay. For purposes of this determination, references to "petitioner" shall mean Timothy W. Jay, while "petitioners" shall mean Timothy W. Jay and Kathleen A. Jay.

II. Whether, for the year 2001, the Division of Taxation properly denied petitioners' subtraction of income as a foreign exclusion.

III. Whether penalties assessed for the years at issue should be abated.

FINDINGS OF FACT

1. This audit commenced in March 2004. The audit concentrated on verifying petitioner's allocated income and determining whether his subtraction of $197,971.00 of income as a foreign exclusion for 2001 was proper.

2. At the initial meeting with petitioners' previous representative, the auditor was informed that Mr. Jay was the head of the bond trading department for Lehman Brothers, Inc., and that he was a New York State resident until 1998 when he was sent on foreign assignment to the United Kingdom. Upon his return to the United States in 1999, petitioner sold his New York State house and purchased a house in Connecticut.

3. On June 12, 2006 and June 13, 2006, respectively, petitioners and the Division of Taxation (Division) executed a Consent Extending Period of Limitation for Assessment of Income Taxes under Articles 22, 30, 30A and 30B of the Tax Law whereby it was agreed that taxes due for the period January 1, 2001 through December 31, 2002 could be determined or assessed at any time on or before August 16, 2007.

4. Despite numerous requests therefor, the Division did not receive any documentation to verify petitioner's allocation for the years 2001 and 2002 until January 2007. At that time, date logs were provided to the auditor from which New York State allocation percentages for the years at issue were calculated. When the auditor's calculations were presented to petitioners' previous representative, he disagreed with such calculations.

Since the information provided to the auditor was not complete (a breakdown of wages as to source, year paid, etc., was sought by the auditor), additional requests for such information were made, but when no documentation was provided and petitioners' representative refused to sign a consent further extending the period of limitation for assessment, the case was closed as disagreed.

The Tax Field Audit Record includes a notation made by the auditor for January 12, 2007, after meeting with petitioners' previous representative, Attorney Robert W. Taylor, which states in relevant part: "The taxpayer was affected by the events of 9/11 which would explain the unusual nature in his work history between 9/11/01 and 03/02. I left a list of additional info. for the rep to provide."

5. For the year 2001, according to the auditor's workpapers contained within the audit file, petitioner's nonworking days were determined to be 118, consisting of 104 weekend days, 10 holidays and 4 vacation days, thereby leaving 247 workdays (365 days - 118 nonworking days). Per petitioner's calendar, it was determined that his non-New York workdays totaled 89.50; New York workdays were, therefore, 157.50 (247 workdays - 89.50 non-New York workdays). Petitioner's New York State allocation percentage for 2001 was, therefore, calculated to be 63.77% (157.50 New York State workdays/247 total workdays).

The auditor determined, from petitioners' 2001 federal income tax returns, that total wages in the amount of $7,439,408.00 were paid by Mr. Jay's employer, Lehman Brothers, Inc., during the year. Applying the allocation percentage of 63.77% resulted in an audited New York State allocation of $4,744,110.00. Petitioners on their 2001 New York State nonresident return reported a New York State amount of wages as $3,869,700.00 and their New York adjusted gross income as $3,671,729.00. From an examination of the return, it is unclear as to the manner in

which petitioners calculated their New York State wage amount for 2001 since the attachment to the form IT-203, which provides for allocating wage and salary income to New York, was not fully completed.

As a result of the auditor's application of the 63.77% wage allocation percentage, it was determined that petitioners had additional New York State income of $874,410.00 for 2001. In addition, on their 2001 federal return, petitioners had claimed a foreign earned income exclusion in the amount of $197,971.00 as a result of having earned income in the United Kingdom. On their New York State nonresident return for 2001, petitioners deducted the $197,971.00 as a "2555 Exclusion" on the line provided for "Total federal adjustments to income." The auditor disallowed this adjustment.

Petitioners' New York adjusted gross income, per their 2001 nonresident return, was listed as $3,671,729.00. The auditor added the $874,410.00 resulting from the allocation adjustment and the $197,971.00 for the 2555 exclusion, which resulted in New York adjusted gross income of $4,744,110.00. The tax liability per audit was determined to be $323,821.00. When tax previously paid ($226,480.00) was subtracted, the additional tax liability was $97,341.00 for the 2001 tax year.

On the Consent to Field Audit Adjustment (form AU-251) issued to petitioners by the Division on June 22, 2007, the auditor listed the allocation percentage as 61.16% rather than the 63.77% referred to above. The 61.16% is, in fact, the New York adjusted gross income per audit, $4,744,110.00, divided by $7,756,973.00, the federal adjusted gross income per audit which was computed by subtracting New York State modifications per audit ($114,799.00) from petitioners' federal adjusted gross income per their return ($7,871,772.00).

6. For the 2002 tax year, petitioner received two W-2 forms from Lehman Brothers, Inc., one for New York State, which indicated that he had received wages in the amount of $6,192,427.20 (with New York State income tax withheld of $454,366.76), and one for New Jersey, which indicated that he had received wages in the amount of $1,072,578.69 (with New Jersey income tax withheld of $74,543.43). Only the amount set forth on the W-2 for New York State was allocated by the auditor.

From petitioner's records, the auditor determined that he worked in the New York office from April 29, 2002 through the end of the year (December 31, 2002), a total of 245 days. Nonworking days were determined to be 95, consisting of 70 weekend days, 21 vacation days, 3 holidays and 1 "other non-working day," thereby leaving 150 workdays (245 days - 95 nonworking days). Per petitioner's calendar, it was determined that his non-New York workdays totaled 24.50; New York workdays were, therefore, 125.50 (150 workdays - 24.50 non-New York workdays). Petitioner's New York State allocation percentage for 2002 was, therefore, calculated to be 83.67% (125.50 New York workdays/ 150 total workdays).

The auditor then applied this allocation percentage to petitioner's New York wages of $6,192,427.00, resulting in an audited New York State allocation of $5,181,018.00. Petitioners had reported, on their 2002 New York State nonresident return, New York adjusted gross income of $4,628,839.00, thereby resulting in additional New York State income of $552,179.00. The tax due thereon was determined to be $37,306.00.

As was the case for the 2001 tax year, the auditor, on the Consent to Field Audit Adjustment (form AU-251) issued to petitioners by the Division on June 22, 2007, set forth an allocation percentage of 70.22% rather than the 83.67% referred to above. This 70.22% is, in fact, the New York adjusted gross income per audit, $5,181,018.00 (New York adjusted gross

income per return plus $552,179.00 additional New York State income determined on audit) divided by $7,377,889.00, the federal adjusted gross income per audit which was computed by subtracting New York State modifications per audit ($33,790.00) from petitioners' federal adjusted gross income per their return ($7,411,679.00).

7. On July 16, 2007, the Division issued a Notice of Deficiency to petitioners which asserted as follows:

Period Ended	Tax Amount	Interest Amount	Penalty Amount	Total
12-31-01	$97,341.00	$43,038.70	$26,213.85	$166,593.55
12-31-02	$37,306.00	$13,361.58	$8,483.29	$59,150.87
TOTAL	$134,647.00	$56,400.28	$34,697.14	$225,744.42

SUMMARY OF THE PARTIES' POSITIONS

8. In their brief, petitioners submitted copies of the auditor's workpapers prepared in March 2007 and contained within the audit file, and admit that the Division correctly calculated the 2001 income allocation. However, as to the 2002 year, petitioners maintain that pursuant to the instructions for the preparation of form IT-203 (the New York State nonresident return), the auditor erred in the income allocation computation by failing to use the number 365 (for total days in the year) as the starting point for determining the denominator. In the present matter, despite the fact that petitioner worked one job for one employer during the 2002 tax year, the auditor used 245 calendar days as the starting point and allocated only that portion of the W-2 wage income for which New York State income tax was withheld. Petitioners assert that the correct allocation of income should include both W-2s issued for the entire year, and accordingly, the starting point for determining total work days should be the entire year, or 365 days. By

using petitioners' method, the denominator of the fraction would be larger and the resulting percentage would, therefore, be smaller.

In addition, petitioners maintain that penalties imposed should be abated. They state that the issue is complicated and as evidence of that fact, petitioners point out that the auditor improperly calculated the allocation percentage.

9. The Division states that petitioners submitted no proof of days worked in versus days worked outside of New York and, accordingly, failed to prove, by clear and convincing evidence, their claimed day counts and resulting allocation percentages. The Division further states that petitioners' brief improperly relies on "draft" audit workpapers as the basis for their allocation percentage calculations and that these "non-final" calculations were revised during the course of the audit.

Finally, the Division contends that petitioners failed to establish reasonable cause for the abatement of penalties. In support of this position, the Division states that as an individual employed in the financial industry, petitioner should be aware of the filing requirements of the Tax Law and, in addition, petitioners failed to cooperate during the audit by not providing documentation when requested to do so.

CONCLUSIONS OF LAW

A. New York State imposes personal income tax on the income of nonresident individuals to the extent that their income is derived from or connected to New York sources (Tax Law § 601[e]). Included in such income is that which is attributable to a business, trade, profession or occupation carried on in New York State (Tax Law § 631[b][1][B]). If a taxpayer's business, trade, profession or occupation is carried on partly within and partly without this state, as determined under regulations of the Commissioner of Taxation, the items of income, gain, loss

and deduction derived from or connected with New York sources shall be determined by apportionment and allocation under such regulations.

B. The New York adjusted gross income of a nonresident individual, such as petitioner, rendering personal services as an employee, includes the compensation for personal services entering into his federal adjusted gross income, but only if and to the extent that such services were rendered within New York State (20 NYCRR 132.4[b]). Where such personal services are performed within and without New York State, the portion of the compensation attributable to the services performed within New York State must be determined in accordance with 20 NYCRR 132.15 through 20 NYCRR 132.18. An allocation of such personal service income on the basis of the number of working days employed in New York State in relation to the total number of working days employed both within and without New York State is set forth in 20 NYCRR 132.18(a).

C. 20 NYCRR 132.18(a) provides, in pertinent part, as follows:

> If a nonresident employee (including corporate officers, but excluding employees provided for in section 132.17 of this Part) performs services for his employer both within and without New York State, his income derived from New York State sources includes that proportion of his total compensation for services rendered as an employee which the total number of working days employed within New York State bears to the total number of working days employed both within and without New York State. . . . In making the allocation provided for in this section, no account is taken of nonworking days, including Saturdays, Sundays, holidays, days of absence because of illness or personal injury, vacation, or leave with or without pay.

D. As noted in Finding of Fact 5, the auditor computed petitioner's allocation percentage for the 2001 tax year pursuant to 20 NYCRR 132.18 and petitioners, in their brief, acknowledged their agreement with this computation. In their brief, petitioners stated no objection to the Division's disallowance of the foreign earned income exclusion claimed on their federal return

for 2001. Such exclusion, in the amount of $197,971.00, was deducted on the federal return in computing petitioners' federal adjusted gross income which is the starting point for computing New York State adjusted gross income (***see*** Tax Law § 612[a]). There is no provision in the Tax Law for the further subtraction of the amount of the foreign earned income previously excluded from the computation of federal adjusted gross income. Accordingly, it is hereby found that the Division's calculation of petitioners' 2001 audited New York adjusted gross income, their New York allocation percentage and the resulting amount of additional tax due thereon ($97,341.00) was proper.

E. As to the 2002 tax year, petitioners object to the Division's computation of their New York allocation percentage. Petitioners point to the fact that the auditor, in computing the allocation percentage, included only the period April 29 through December 31, 2002, or 245 days, despite the fact that petitioner worked for the same employer, Lehman Brothers, Inc., for the entire year. While it is true that the employer issued two W-2 forms to petitioner for the year (***see*** Finding of Fact 6), petitioners maintain that there was no apparent reason for doing so, other than that it was "clearly an internal bookkeeping function of the employer, and in no way indicates two employers or two jobs that should be allocated separately." In support of their position, petitioners have offered into evidence a copy of the Division's instructions for computation of the amount of wages of a nonresident to be allocated to New York. The instructions state: "Enter the total number of days you were employed at this job during the year while you were a nonresident. If you were employed at the same job from January 1 through December 31, you would enter 365 (except in leap years)."

In their brief, petitioners provided the following allocation percentage calculation for 2002:

Total calendar days: 365

Weekends: 104

Holidays 10 (same number of holidays used by auditor in computing the 2001 allocation percentage)

Vacation days 21 (same number as in auditor's computation)

Total nonworking days: 135

Total working days: 230

Total NYS work days per auditor's calculation: 125

NYS Allocation percentage: 125/230 = .54347

Total wages paid from employer: ($6,192,427.20 + $1,072,578.69 = $7,265,006.00

NYS Income Allocation: ($7,265,006.00 x .54347) = $3,948,313.00

Allocation shown on return: $4,628,839.00

Overreported NYS income: $680,526.00[2]

As a result, petitioners assert, while the agreed-upon understatement of income for 2001 was $874,410.00, by virtue of having overstated their income for 2002 in the amount of $680,526.00, the net understatement of income is $193,884.00 which is additional income upon which tax should be assessed for the 2001 tax year. Petitioners' assertion is without merit.

F. As noted in Finding of Fact 4, the auditor made a specific notation in the Tax Field Audit Record that petitioner had been affected by events of September 11, 2001 "which would explain the unusual nature in his work history between 9/11/01 and 03/02." This notation

[2] In petitioner's brief, a mathematical error was made when computing "over reported" NYS income for the year. Petitioners brief states that the amount was $680,467.00 when, in fact, the correct amount is $680,526.00.

provides a reasonable explanation for why petitioner's employer, Lehman Brothers, Inc., issued two W-2 forms to petitioner for 2002.

20 NYCRR 132.18(b) provides as follows:

> Where a nonresident employee (including corporate officers, but excluding employees provided for in section 132.17 of this Part) performs services both within and without New York State for only part of a taxable year, his income derived from New York State sources during that period includes only that portion of compensation received during the period he performs services both within and without New York State, multiplied by a fraction the numerator of which is the number of days he worked within New York State and the denominator of which is the number of days he worked both within and without New York State *during the period he was required to perform services both within and without New York State*. (Emphasis added.)

Section 132.18(c) then provides an example which appears to be quite similar to the employment situation of petitioner.

> *Example:* E, a resident of New Jersey for the entire taxable year, was employed by T Corporation for the entire taxable year. During the period from January 1st through June 30th he worked at the company's Philadelphia, Pa. office. Since E did not perform any services within New York State during this period, none of the compensation received for such period would be includible in computing his New York adjusted gross income. On July 1st, E was transferred to the company's New York City office where he was required to perform services both within and without New York State. The New York adjusted gross income of E includes the total compensation received from T Corporation during the period from July 1st through December 31st, multiplied by a fraction the numerator of which is the number of days worked within New York State during the period from July 1st through December 31st and the denominator of which is the total number of days worked both within and without New York State during this same period.

G. While petitioners, in their brief, assert that the issuance of two W-2 forms to petitioner for 2002 was an internal bookkeeping function of the employer, such assertion is without any corroborating evidence. One of the W-2s issued by the New Jersey based employer indicated

wages of $1,073,579.69 and withheld New Jersey income taxes; the other W-2 for wages in the amount of $6,192,427.20 withheld New York income taxes.

Petitioners had numerous opportunities, both during the duration of the audit which lasted from March 2004 until the case was closed in July 2007 and from the time that the parties agreed to submit the matter for determination in December 2008 until they were required to submit their documentation in March 2009, to provide evidence from Lehman Brothers, Inc., to show that petitioner was required to perform services both within and without New York State for the entire 2002 year. As correctly noted by the Division in its brief, where, as here, the Division properly issued a Notice of Deficiency to a taxpayer, a presumption of correctness attaches to such notice (***see Matter of O 'Reilly***, Tax Appeals Tribunal, May 17, 2004; ***Matter of Land Transport Corporation***, Tax Appeals Tribunal, June 29, 2000; ***Matter of Atlantic & Hudson Ltd. Partnership***, Tax Appeals Tribunal, January 30, 1992). In proceedings for review of a properly issued notice of deficiency, the burden of proof is on the taxpayer to demonstrate that the deficiency is erroneous (Tax Law § 689[e]). Other than a general allegation that the reason for issuance of two W-2s by petitioner's employer in 2002 was "an internal bookkeeping function," petitioner has not shown that for the entire 2002 year he was required to perform services for such employer both within and without the State of New York. Therefore, it is hereby found that the auditor's calculation of a wage allocation for petitioner's wage income for the 2002 tax year was proper and, as such, tax due thereon is sustained.

H. Petitioners, in their brief, "vigorously oppose" the imposition of penalties herein. However, while they agree that there was an understatement for 2001, they maintain that "[t]his is a complicated matter that the agent, trained and experienced in such matter, miscalculated himself." As shown in Conclusion of Law G, the agent (auditor) did not miscalculate the

allocation percentage; rather it was petitioners who failed to compute the percentage pursuant to the applicable regulation, to wit, 20 NYCRR 132.18(b). Petitioners' failure to provide documentation when requested to do so and their failure to properly calculate an allocation percentage for both of the years at issue cannot be found to have been the result of a complicated statute and regulations. It is well settled that ignorance of the law is not a valid excuse or defense. (***Genesee Brewing Co. v. Village of Sodus Point,*** 126 Misc2d 827, 834, 482 NYS2d 693, 700 [1984], ***affd*** 115 AD2d 313, 496 NYS2d 720 [1985]; ***accord Matter of Nathel v. Commissioner of Taxation and Fin.***, 232 AD2d 836, 649 NYS2d 196 [1996] [ignorance of the law is no excuse and a taxpayer is charged with knowledge of the law, including subsequent judicial interpretation thereof].) Penalties are, therefore, sustained.

I. The petition of Timothy and Kathleen Jay is denied, and the Notice of Deficiency issued on July 16, 2007 is sustained.

DATED: Troy, New York
November 5, 2009

/s/ Brian L. Friedman
ADMINISTRATIVE LAW JUDGE