

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
KATHLEEN KARLSBERG	:	DETERMINATION
		DTA NO. 822130
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 2003 and 2004.	:	

Petitioner, Kathleen Karlsberg, 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 2003 and 2004.

A hearing was held before Timothy J. Alston, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on September 5, 2008 at 10:30 A.M., which date began the six-month period for the issuance of this determination. Petitioner appeared by Kenneth Terrano, Esq. The Division of Taxation appeared by Daniel Smirlock, Esq. (Herbert M. Friedman, Jr., Esq., of counsel).

ISSUE

Whether gambling losses claimed as itemized deductions are properly subject to the itemized deduction limitation under Tax Law § 615(f).

FINDINGS OF FACT

1. Petitioner, Kathleen Karlsberg, timely filed her 2003 New York State Resident Income Tax Return. Petitioner reported adjusted gross income of \$253,220.00, which included

\$155,550.00 in gambling winnings. Petitioner claimed a deduction for \$155,550.00 in gambling losses among her itemized deductions. Given her reported adjusted gross income, and in accordance with the itemized deduction adjustment on the return (IT-201 ATT), petitioner reduced her total itemized deductions by 25 percent, from \$163,157.00 to \$122,368.00. Petitioner thus reported \$130,852.00 in taxable income and tax liability of \$15,375.00. After allowing for tax withheld and credits, the return reported \$7,003.00 in tax due.

2. Petitioner filed an amended return for 2003, dated November 28, 2006, on which she increased her reported itemized deduction by \$34,072.00. As a result of this change, petitioner's total tax liability for 2003 was reduced to \$9,645.00 and the amended return claimed a refund of \$5,730.00.

3. On March 20, 2007, petitioner filed a claim for refund for 2003 seeking a refund of the \$5,730.00 claimed on the amended return.

4. By Notice of Disallowance dated May 25, 2007, the Division of Taxation (Division) disallowed petitioner's refund claim for 2003.

5. Petitioner also timely filed her 2004 New York State Resident Income Tax Return. She reported adjusted gross income of \$866,903.00, which included \$817,825.00 in gambling winnings. Petitioner claimed a deduction for \$817,825.00 in gambling losses among her itemized deductions. Given her reported adjusted gross income, and in accordance with the itemized deduction adjustment on the return (IT-201 ATT), petitioner reduced her total itemized deductions by 50 percent, from \$819,642.00 to \$409,821.00. Petitioner thus reported \$457,082.00 in taxable income and tax liability of \$55,535.00. After allowing for tax withheld and credits, the return reported \$51,544.00 in tax due.

6. Petitioner did not pay the amount reported due on her 2004 return and on July 18, 2005, the Division issued to petitioner a Notice and Demand assessing tax due for 2004 in the amount of \$51,544.00, plus penalty and interest.

7. On October 10, 2006, petitioner filed an amended return for 2004, dated August 25, 2006, on which she increased her reported itemized deduction by \$409,821.00. As a result of this change, petitioner's total reported tax liability for 2004 was reduced to \$4,449.00 with reported tax due of \$521.00.

8. On November 6, 2006 petitioner filed a second amended return for 2004, dated October 23, 2006. On this second amended return petitioner increased her itemized deduction as reported on her original return by \$427,458.00. As a result of this change, petitioner's total tax liability for 2004 as reported on this second amended return was reduced to \$2,606.00 and this amended return claimed a refund of \$1,385.00.

9. On February 5, 2007, the Division issued to petitioner a Notice and Demand assessing tax due for 2004 in the amount of \$50,139.00, plus interest. This Notice and Demand replaced the July 18, 2005 Notice and Demand.

10. On March 14, 2007, petitioner filed a claim for refund for 2004 seeking \$2,910.13, the amount of payments made on her 2004 income tax assessment according to a Response to Taxpayer Inquiry dated March 12, 2007.

11. By Notice of Disallowance dated May 18, 2007, the Division disallowed petitioner's refund claim for 2004.

12. Petitioner's refund claims and amended returns for 2003 and 2004 were based on the premise that her gambling losses were not subject to the itemized deduction limitation and that, therefore, she was entitled to claim the full amount of such losses (to the extent of winnings).

13. The Division's denial of petitioner's refund claims and its refusal to accept petitioner's amended returns was based on its position that petitioner's gambling losses were subject to the itemized deduction limitation under Tax Law § 615(f) and that petitioner had properly reduced her total itemized deductions on her original returns.

14. In support of her position petitioner relies on Division Publication 140-W (FAQs: New York State Lottery Winners: What Are My Tax Responsibilities for New York State?), a publication which explains how New York State, New York City, and Yonkers income taxes apply to lottery prizes won on or after October 1, 2000. Petitioner specifically relies on the Division's answer to Question 16:

Q: Can I deduct the amount spent on non-winning lottery tickets on my income tax return?

A: If you itemize your deductions on your federal income tax return, you may be able to deduct the amount spent on lottery tickets and any other gambling losses up to the amount of your gambling winnings as miscellaneous itemized deductions. For more information regarding federal requirements, see federal Publication 529, *Miscellaneous Deductions*. To obtain Internal Revenue Service forms and publications, call toll free 1 800 829-3676. You can also obtain IRS forms and publications through the Internet at www.irs.gov.

15. Petitioner filed her returns as a single filer during the years at issue.

CONCLUSIONS OF LAW

A. New York itemized deductions are subject to limitation where a taxpayer's adjusted gross income exceeds certain levels, depending on filing status (*see* Tax Law § 615[f]; 20 NYCRR 115.5). As a single filer, petitioner was required to reduce her total itemized deductions when her New York adjusted gross income exceeded \$100,000 (*see* 20 NYCRR 115.5[b][1][i]). Pursuant to Tax Law § 615(f), all New York itemized deductions, including gambling losses to the extent of winnings, are subject to the New York itemized deduction limitation (*Matter of*

Pospischil, Tax Appeals Tribunal, June 6, 1996). Petitioner thus properly reduced her New York itemized deductions on her original returns filed for the years at issue and her refund claims must be denied.

B. As noted in *Pospischil*, Tax Law § 615(f) contains no language exempting or otherwise removing gambling losses, or indeed, any category of deduction, from the reduction calculations. In contrast, the analogous federal provision, Internal Revenue Code § 68 (Overall Limitation on Itemized Deductions), specifically excepts certain categories of deductions, including gambling losses to the extent of winnings, from the reduction calculations (*see* IRC § 68[c]).

Petitioner contends that, as indicated by its answer to Question 16 in Publication 140-W (*see* Finding of Fact 14), the Division has adopted the federal position noted above and that therefore her deductions for gambling losses should be allowed in full.

More specifically, petitioner notes that the Division is authorized to communicate tax policy and interpretations to taxpayers by various methods including publications and notices (*see* 20 NYCRR 2375.1[1][a]; 2375.9[a]) and that Publication 140-W is the Division's only publication that specifically discusses gambling losses. Petitioner further notes that of the 18 questions and answers that make up Publication 140-W, only the answer to Question 16 makes a specific reference to federal law. Petitioner asserts that by this answer to Question 16, and the notable lack of any reference to Tax Law § 615(f), the Division has adopted the federal position on gambling loss deductions. That is, that gambling losses are not subject to reduction based on adjusted gross income.

As further support for her contention that the Division has adopted the federal position, petitioner asserts that the Division has reviewed both the federal law and the laws of other states

which follow the federal position, and, as indicated by Publication 140-W, adopted the federal position consistent with Tax Law § 171(13).

Petitioner's contention is rejected. Although they "serve an essential role in expeditiously conveying pertinent information to taxpayers," publications such as Publication 140-W, "in themselves do not have any legal effect" (20 NYCRR 2375.9[c]). Accordingly, even if as petitioner contends, Publication 140-W clearly adopted the federal position on gambling loss deductions, Tax Law § 615(f) is controlling and, as discussed, that section subjects gambling losses to reduction. As to petitioner's contention regarding Tax Law § 171(13), that section directs the Commissioner to "recommend to the legislature" measures that "will bring about "uniformity of methods, harmony and cooperation between the different states." Section 171(13) does not authorize the Division to unilaterally adopt a position which, as noted above, is contrary to statute.

Even if the regulations did not expressly deny Publication 140-W any legal effect, petitioner's contention would nonetheless fail because the answer to Question 16 cannot reasonably be interpreted as an adoption of the federal position as petitioner contends. While the answer to Question 16 may be incomplete given the lack of any reference to Tax Law § 615(f), the answer couches the right to deduct gambling losses in conditional language ("you may be able to deduct"), thereby indicating not an adoption of the federal policy, but a possible restriction on the deduction. At best, the answer is ambiguous; it does not clearly adopt the federal rule.

C. Petitioner also contends that Tax Law § 615(f) as applied in this instance, i.e., the reduction of her gambling losses, violates her equal protection rights in that such an application results in a significantly greater tax liability for her as compared to similarly situated taxpayers.

As an example, petitioner notes that, after the reduction modification, she was required to pay tax on approximately \$409,000.00 of her gambling winnings in 2004, even though all of her winnings were offset by gambling losses in during that year. In contrast, petitioner notes that a taxpayer who won and lost only about \$95,000.00 would not be subject to the itemized deduction limitation and would thus not pay any tax on their gambling winnings (*see* 20 NYCRR 115.5[b][1][i]). Petitioner notes that both she and the hypothetical taxpayer are in the same position economically, both having zero net gain from gambling. As a result of the application of Tax Law § 615(f), however, petitioner, unlike the hypothetical taxpayer in the example, faces a significant income tax liability.

Petitioner's equal protection claim must be rejected.

Legislatures possess the greatest freedom in matters of taxation, and the resolution of equal protection claims is not achieved by demonstrating that a particular tax statute or regulation results in even flagrant unevenness (*Matter of Long Is. Light Co. v. State Tax Commn.*, 45 NY2d 529, 535, 410 NYS2d 561, 564 [1978]). The proper standard of review is a rational basis test, under which a statute will be upheld absent a showing that the different treatment of different persons is so unrelated to the achievement of a legitimate purpose that it becomes readily apparent that the Legislature's actions were irrational (*Vance v. Bradley*, 440 US 93, 97, 59 L Ed 2d 171, 176 [1979]). (*Greco Bros. Amusement Co. v. Chu*, 113 AD2d 622, 497 NYS2d 206, 209 [1986].)

While the statute in question may occasionally yield harsh results, particularly in the case of a problem or compulsive gambler, such inequities are insufficient to find an equal protection violation where a rational purpose may be seen in the broad legislative goal of raising revenue through a system of progressive taxation. Such systems are "unquestionably constitutional" (*Matter of Brady v. State of New York*, 80 NY2d 596, 602, 592 NYS2d 955, 958 [1992], *cert denied* 509 US 905, 125 L Ed 2d 692 [1993]).

D. Petitioner also argues that the application of Tax Law § 615(f) in this instance violates Article I (§ 1) of the New York State constitution by denying petitioner her rights. Inasmuch as

the Tax Law does not provide petitioner with the right she claims, i.e., the right to deduct the full amount of her gambling losses to the extent of winnings without limitation, there can be no violation of Article I (§ 1).

E. The petition of Kathleen Karlsberg is denied, and the Division's notices of disallowance dated May 18, 2007 and May 25, 2007 are sustained.

DATED: Troy, New York
December 18, 2008

/s/ Timothy J. Alston
ADMINISTRATIVE LAW JUDGE