STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
TIMOTHY W. AND ALICE K. JAY	:	DETERMINATION DTA NO. 822613
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Years 2004 and 2005.	:	

Petitioners, Timothy W. and Alice K. Jay,[1] 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 2004 and 2005.

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 August 27, 2009 at 10:30 A.M., with all briefs submitted by January 29, 2010, which date began the six-month period for the issuance of this determination. Petitioner appeared by Robert W. Taylor, Esq. The Division of Taxation appeared by Daniel Smirlock, Esq. (Kevin R. Law, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation properly determined petitioners' nonresident allocation percentages for the years 2004 and 2005.

II. Whether the Division properly disallowed petitioners' subtraction of foreign wages from their total New York income for the year 2005.

[1]Alice K. 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 Alice K. Jay.

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

FINDINGS OF FACT

1. Petitioners, Timothy W. and Alice K. Jay, were domiciliaries of the State of Connecticut and the United States of America during the years 2004 and 2005 (the audit period).

2. The Division of Taxation (Division) commenced an audit of petitioners in October of 2007 with the mailing of an appointment letter, power of attorney form and a nonresident questionnaire. A power of attorney was received but the auditor was unsuccessful in his attempts to meet with the representative until May 1, 2008, at which time he was informed that the taxpayers had not supplied the representative with any information.

3. The Division requested a waiver of the period of limitations on assessment, but petitioners refused to sign it, and a decision was made to close the audit, calculate the additional tax due and issue a notice of deficiency.

4. The auditor's review of the 2004 and 2005 nonresident tax returns filed by petitioners indicated that they claimed 120 and 205 days worked outside of New York State in those years, respectively. The Division requested documentation to substantiate those day counts but were provided with none.

5. All of the allocations reported on petitioners' returns for the years in issue were disallowed because no substantiating documentation was submitted prior to assessment. Further, for the year 2004, petitioners listed Lehman Brothers wages on the allocation schedule as $8,874,436.00 while the W-2 listed wages as $12,200,808.00, with no explanation of the discrepancy offered. As a result, the $12,200,808.00 figure was utilized by the Division in calculating petitioners' 2004 tax liability. For the year 2005, the Division disallowed and added back to New York income the $337,557.00 subtracted by petitioners as foreign wages.

6. As a result of the adjustments made to petitioners' returns, there was additional tax due of $522,508.00 for 2004 and $563,728.00 for 2005. Penalties for negligence pursuant to Tax Law § 685(b)(1) and (2) and penalties for failure to provide information pursuant to Tax Law § 685(i) were assessed as well.

7. On August 11, 2008, the Division issued to petitioners a Notice of Deficiency, which set forth additional income tax due for the years 2004 and 2005 of $1,086,236.00, plus penalty and interest, for a total amount due of $1,569,788.29.

8. After issue was joined in this matter and prehearing conferences held, petitioners submitted documentation of employee expenses incurred by Mr. Jay in the course of his employment with Lehman Brothers for the purpose of establishing days worked in and out of New York during the years in issue. The documentation consisted of hundreds of pages of expense reports and bills with no summary sheets attached.

9. Prior to the hearing in this matter, the auditor reviewed the documentation submitted and created a spreadsheet that indicated days worked in and out of New York during the years 2004 and 2005.

10. The documentation submitted by petitioner prior to the hearing demonstrated 71.5 days worked outside of New York during 2004 and 7.5 days worked outside of New York in 2005. After allowing for weekend and vacation days reported, the auditor determined that there were 271 total workdays in 2004, 71.5 of which were days worked outside of New York. This yielded an allocation percentage of 73.62%, which, when applied to the W-2 wage income of $12,200,808.00 produced audited New York wages of $8,981,776.00. After crediting petitioners for the wages reported of $3,929,600.00, additional New York State wages were $5,052,176.00.

Audited tax on this income was $690,342.00, which, after credit for tax paid in the sum of $415,294.00, resulted in additional tax due of $275,048.00.

For the year 2005, petitioners' documentation established that 7.5 days were worked outside of New York and 55.5 within, yielding an allocation percentage of 88.10%, where the entire fiscal year was January 1 through March 31, 2005 (63 days). The March 31, 2005 date was provided to the auditor by petitioners' representative, who stated to him that this date was petitioner's last day at Lehman Brothers. Applying 88.10% to petitioner's W-2 wages of $8,826,636.00 resulted in audited New York State wages of $7,775,846.00. After allowing for the $1,866,834.00 in wages petitioners reported, the auditor found additional New York State wages were $5,909,012.00. In addition to the New York State wage income determined on audit, the Division added back $337,557.00 to New York State income that had been subtracted as foreign wages on petitioners' return.[2] The result was an allocation percentage of 89.38% and a tax liability per the audit of $597,526.00.

For the year 2005, petitioners had withheld tax of $680,049.00 and overpaid tax with their return. Ultimately, they were owed $114,555.00. After credit for this amount was applied to the audited tax liability, it was determined that petitioners owed $482,971.00.

11. After hearing, petitioner submitted three exhibits that contained Lehman Brothers expense reports for the years in issue that are indistinguishable from those submitted to the Division prior to hearing. Petitioners did not offer any arguments based on this documentation that the number of days worked outside of New York was any less than the days determined by the Division based on petitioners' prior submission.

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[2]After hearing, the Division conceded that Mr. Jay's employment ended on March 19, 2005 and agreed to adjust its computations. Therefore, total days worked was 56: 7.5 outside of New York and 48.5 in New York. The allocation percentage would have been 48.5/56, or 86.61%.

12. Petitioner established that he terminated his employment from Lehman Brothers on March 19, 2005.

13. Petitioners did not submit any proof that Mr. Jay lived and worked in the United Kingdom during the years in issue, other than brief stays suggested by the Lehman Brothers expense reports submitted.

SUMMARY OF THE PARTIES' POSITIONS

14. In their brief, petitioners raise several arguments. They believe that the Division has not determined an accurate number of days worked in and out of New York for the years in issue. They contend that the Division erred in not allowing the deduction of foreign wages paid to petitioner while he was working and living in London, and that by doing so it violated a treaty between the United States and the United Kingdom and the United States Constitution.

Petitioners also argue that the Division has asserted a de facto fraud penalty because they were unable to produce records when requested.

15. The Division states that petitioners' proof of days worked in and out of New York established, by clear and convincing evidence, the day counts and resulting allocation percentages it determined, albeit after the assessment was issued and merely months before the hearing. The Division further argues that petitioners have not indicated where its determination is in error even though it produced a spread sheet for all days of each of the years in issue.

The Division argues that petitioner Timothy Jay did not establish that he ever lived in the United Kingdom, and therefore petitioners' reliance on violation of a treaty between the countries is moot.

Finally, the Division contends that petitioners failed to establish reasonable cause for the abatement of penalties asserted pursuant to Tax Law § 685(b)(1), (2) and (i).

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 and Finance, 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. (***Matter of Schibuk v. Tax Appeals Tribunal***, 289 AD2d 718, 733 NYS2d 801 [2001] ***lv dismissed*** 98 NY2d 720, 748 NYS2d 900.)

B. The New York adjusted gross income of a nonresident individual, such as Mr. Jay, 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 10, the auditor computed petitioner's allocation percentage for the 2004 tax year pursuant to 20 NYCRR 132.18 and petitioners neither raised any credible arguments nor submitted any additional documentation to refute this computation. Based upon the allocation percentage discerned by the Division from the documentation submitted, 73.62%, the resulting additional tax due was determined to be $275,048.00.

For the year 2005, the auditor followed the same procedure to determine additional tax due, as more fully described in Finding of Fact 10. Based on petitioners' records, an allocation percentage of 89.38% was computed and resulted in additional tax due of $482,971.00. However, in calculating the tax due for 2005, it was also necessary for the Division to add back the deduction to income for foreign wages in the sum of $337,557.00.

Petitioners' objection to the Division's disallowance of their subtraction of foreign wages in 2005 is without merit. The wages were deducted on the federal returns for 2004 and 2005 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]). [3] 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

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[3]It is noted that petitioners subtracted foreign wages from their federal income in 2004 in the sum of $2,423,353.00, which was incorporated into their federal adjusted gross income and used for the New York starting point, with no additional subtraction from the New York amount.

that the Division's calculation of petitioners' 2005 audited New York adjusted gross income, their New York allocation percentage and the resulting amount of additional tax due thereon was proper.

Petitioners' argument that taxation of Mr. Jay's income is somehow prohibited by a tax treaty or the United States Constitution is without merit. Mr. Jay is being taxed as a nonresident on wages he earned for work performed in New York, determined in accordance with an accepted allocation formula and well documented by his expense reports from Lehman Brothers.

In addition, petitioner offered no evidence of ever living in the United Kingdom or receiving wages from an employer there. Mr. Jay only offered his W-2 from Lehman Brothers, which indicated a New Jersey address and a multitude of expense documentation that indicated Mr. Jay's office address located at 745 Seventh Avenue in New York City.

E. As the Division noted 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]). Petitioner has not introduced documentary or testimonial evidence to challenge the findings of the auditor, which were based on an analysis of petitioners' own records. In fact, the day counts determined by the auditor were more favorable to petitioners than those suggested in their post hearing submissions. Therefore, it is found that petitioners have not met their burden of proof.

However, as noted in the footnote to Finding of Fact 10, a further adjustment will be necessary to accommodate the Division's concession that Mr. Jay's employment ended on March 19, 2005. This shortens the total days in the denominator and the Division is directed to make that modification. In addition, since the Notice of Deficiency issued in this matter allocated all the income to New York, the Division is directed to modify the notice to the extent it has conceded to do so, and make it consistent with the auditor's review of the documentation submitted, the computations performed and the revised tax determined to be due.

F. The Division imposed penalties pursuant to Tax Law § 685(b)(1), (2); and (i). Tax Law § 685(b)(1) and (2) provide for the imposition of penalties if any part of a deficiency is due to negligence or intentional disregard of Article 22 of the Tax Law or the regulations promulgated thereunder and an addition based on the interest on the underpayment. Tax Law § 685(i) provides for a penalty for failing to supply information and carries a $1,000.00 penalty for each year of the audit.

Although petitioners argue that they should not be held liable for the penalties asserted, there can be no dispute that it was petitioners who failed to properly compute the allocation percentage pursuant to the applicable regulation, 20 NYCRR 132.18, which resulted in the gross underpayment of the tax due, and who provided the incorrect wage information for 2004. Petitioners also subtracted "foreign wages" from their New York income, with no legal basis for doing so and failed to provide documentation when requested to do so.

Petitioners have advanced no reasonable cause for their failures, and the penalties are sustained. The fact that petitioners were unable to retrieve records from Lehman Brothers in a timely fashion does not relieve them of their duty to personally maintain records to substantiate the accuracy of the entries on their tax returns.

In addition, petitioners' argument that the Division asserted fraud penalties has no basis in the record, and their attempt to characterize the penalties asserted as fraud penalties so as to shift the burden of proof is rejected.

G. The petition of Timothy W. and Alice K. Jay is granted consistent with and to the extent set forth in Finding of Fact 10 and conclusions of Law D and E, but in all other respects is denied and the Notice of Deficiency, dated August 11, 2008, as modified is sustained.

DATED: Troy, New York
July 22, 2010

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