STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	DETERMINATION DTA NO. 824218
CRAIG A. OLSHEIM:		
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Year 2005.	:	

Petitioner, Craig A. Olsheim, 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 2005.

On June 21, 2012 and June 25, 2012, respectively, the Division of Taxation, appearing by Amanda Hiller, Esq. (Marvis A. Warren, Esq., of counsel), and petitioner, appearing by Gary Richards, CPA, waived a hearing and submitted this matter for determination based on documents and briefs to be submitted by November 30, 2012, which date commenced the six-month period for issuance of this determination (Tax Law § 2010[3]). After due consideration of the documents and arguments submitted, Thomas C. Sacca, Administrative Law Judge, renders the following determination.

ISSUE

Whether petitioner, a nonresident, may allocate to New York State a capital loss arising from the disposition of a partnership interest in the year 2005.

FINDINGS OF FACT

1. Petitioner, Craig A. Olsheim, was a resident of Colorado in the year 2005. He filed a New York State nonresident and part-year resident personal income tax return claiming, among

other items, a long-term capital loss in the amount of $234,674.00 from Fifth Avenue Building Associates, LLC (Fifth Avenue).[1] It is the validity of this claimed loss that is at issue in this matter.

2. Petitioner was a limited partner in Fifth Avenue. He inherited his interest in the partnership on January 12, 2004 as a 50% beneficiary of a trust established by his father. Fifth Avenue was a New York partnership with one asset, an office building located in New York City. In 2005, the partnership sold the office building creating an Internal Revenue Code (IRC) section 1231 gain. Petitioner was allocated his portion of the gain ($234,674.00) through receipt of a Partner's Share of Income, Deductions, Credits, Etc., form K-1. Petitioner properly reported the gain from the sale of the office building on his 2005 New York State personal income tax return.

3. On the date petitioner inherited his interest in the partnership, he received a step-up in basis to the fair market value of the partnership interest,[2] referred to as "outside basis." Petitioner assumed his pro rata share of the partnership's adjusted basis in the office building, referred to as "inside basis." Since the partnership did not allow petitioner to make an election to adjust his inside tax basis related to this inherited interest pursuant to IRC § 754 in 2004, petitioner's outside basis of his partnership interest exceeded his inside basis in the partnership property. Upon the sale of its only asset, Fifth Avenue was completely dissolved. As he did at the federal level, petitioner offset on his 2005 New York State return, as a deduction, a capital loss resulting

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[1] Although a limited liability company (LLC), Fifth Avenue was treated as a partnership and its members as partners for purposes of New York State income tax, pursuant to Tax Law § 601(f). All references to Fifth Avenue and its members herein will be as a "partnership" and its "partners."

[2] Internal Revenue Code § 1014(a)(1).

from the difference between his outside tax basis and his inside tax basis in Fifth Avenue against the gain realized on the sale of the office building.

4. Following an audit of petitioner's 2005 income tax return, the Division of Taxation (Division) sent a letter, dated December 5, 2008, to petitioner's representative explaining its reasons for disallowing the claimed loss resulting from the dissolution of Fifth Avenue. Referring to Technical Services Bureau Memorandum, TSB-M-92-(2)I, the letter stated that:

> a gain or loss from the sale of an interest in a New York partnership does not constitute gain or loss derived from or connected with New York sources and is not includible in the New York source income. Therefore, the capital loss relating to the disposition of the interest in Fifth Avenue Building Associates cannot be allocated to New York State. Furthermore, the gain relating to the sale of the Fifth Avenue Building Associates' property is considered New York source income and should be allocated to New York State.

5. On April 6, 2009, the Division issued to petitioner a Notice of Deficiency of personal income tax due in the amount of $12,058.00, plus interest.

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]).

B. The New York source income of a nonresident individual includes the sum of the net amount of items of income, gain, loss and deduction entering into the individual's federal adjusted gross income "derived from or connected with New York sources, including: (A) his distributive share of partnership income, gain, loss and deduction, determined under [Tax Law] section six hundred thirty-two . . ." (Tax Law § 631[a][1]). The New York source income of a nonresident partner includes his distributive share of all items of partnership income, gain, loss

and deduction entering into his federal adjusted gross income to the extent such items are derived from or connected with New York sources (Tax Law § 632[a][1]).

C. The disposition of petitioner's partnership interest and resulting loss is deemed to be a loss from the sale or exchange of the partnership interest. Internal Revenue Code (IRC) § 731(a)(2) provides for the recognition of loss by the distributee partner on the distribution in liquidation of his interest in a partnership where no property other than money or unrealized receivables and inventory is distributed to the partner. Section 731(a)(2) further provides that the gain or loss recognized in the subsection is to be considered gain or loss from the sale or exchange of the partnership interest.

D. As petitioner's loss was considered to be a loss from the sale or exchange of his partnership interest, the Division applied TSB-M-92-(2)I, and disallowed the claimed loss resulting from the dissolution of Fifth Avenue. Prior to the issuance of TSB-M-92-(2)I, it had been the position of the Division that an interest in a New York partnership constituted an interest in real or tangible personal property in New York State, or represented an intangible employed in a business, trade, profession or occupation carried on in the state. Accordingly, any gain or loss realized upon the sale of the New York partnership interest was treated as a gain or loss derived from or connected with New York sources pursuant to Tax Law §§ 631(b)(1) and (2).

However, in TSB-M-92-(2)I, the Division revised its position and decided that a gain or loss from the sale of an interest in a New York partnership did not constitute gain or loss derived from or connected with New York sources and was therefore not includible in the New York source income of a nonresident individual.

E. Petitioner claims that the Division's interpretation in TSB-M-92-(2)I runs contrary to the definition of the New York source income of a nonresident individual contained in Tax Law § 631(a)(1) as well as to the amendment to Tax Law § 631(b)(1)(A) (L 2009, ch 57, pt F-1, § 1) that added a new clause (1) that defined the ownership of any interest in real or tangible personal property located in New York to include an interest in a partnership.

F. Contrary to petitioner's argument, this is not a situation where the Division is interpreting the Tax Law and applying its memorandum in a way that is contrary to the statute or discriminates against nonresidents of New York. Although TSB-M-92(2)I is dated August 21, 1992, it reflects a long-established line of cases that hold that the income of a nonresident from an intangible arising from the sale of an interest in New York is not subject to New York State personal income tax because the intangible was not used in a business, trade, profession or occupation carried on in New York State (***see Matter of Pastor v. State Tax Commn.***, 115 AD2d 144; 495 NYS2d 515 [1985]; ***Matter of Delmhorst v. State Tax Commn.***, 92 AD2d 981, 461 NYS2d 499 [1983], ***affd*** 60 NY2d 628, 467 NYS2d 352 [1983]; ***Matter of Epstein v. State Tax Commn.***, 89 AD2d 256, 456 NYS2d 454 [1982]). The promulgation of TSB-M-92(2)I represented an acquiescence in the then existing case law rather than a change in the law. As TSB-M-92(2)I accurately reflected the law as it existed in 2005, it is concluded that the Division properly determined that petitioner could not allocate to New York the capital loss resulting from the disposition of petitioner's interest in the Fifth Avenue partnership.

G. Furthermore, the fact that such was the state of the law was acknowledged by the Legislature when it added Tax Law § 631(b)(1)(A)(1) to require nonresidents to include as a source of income the gain or loss resulting from the sale of a partnership interest.

Unfortunately for petitioner, the legislation that added Tax Law § 631(b)(1)(A)(1) specifically provided that it would "take effect immediately [April 7, 2009] and shall apply to sales or exchanges of entity interests that occur thirty or more days after the date this act becomes law" (L 2009, ch 57, pt F-1, § 2). As the act was approved on April 7, 2009, and the sale of Fifth Avenue's only asset and its dissolution occurred in 2005, Tax Law § 631(b)(1)(A)(1) is inapplicable to this matter.

H. The petition of Craig A. Olsheim is denied and the Notice of Deficiency dated April 6, 2009 is hereby sustained.

DATED: Albany, New York
May 9, 2013

/s/ Thomas C. Sacca
ADMINISTRATIVE LAW JUDGE