STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
MARC S. SZNAJDERMAN AND JEANNETTE SZNAJDERMAN	:	ORDER
	:	DTA NO. 824235
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law and the New York City Administrative Code for the Year 2001.	:	

Petitioners, Marc S. Sznajderman and Jeannette Sznajderman,[1] filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law and the New York City Administrative Code for the year 2001.

Petitioners, by their representative, Stuart A. Smith, Esq., brought a motion, dated June 7, 2011, seeking summary determination in the above-captioned matter pursuant to Tax Law § 3000.9(b). The Division of Taxation, appeared in opposition to the motion by its representative, Mark F. Volk, Esq. (Kathleen D. O'Connell, Esq., of counsel). The parties completed their submissions by October 25, 2011, which date began the 90-day period for issuance of this order. Upon notice to the parties, this period was extended to six months pursuant to 20 NYCRR 3000.5(d).

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[1]The parties executed a Stipulation (petitioners on October 25, 2010 and the Division of Taxation (Division) on October 27, 2010) which provided that the resolution in this matter would apply to five other matters pending before the Division of Tax Appeals (DTA numbers 823196, 823197, 823198, 823199 and 823200), where resolution was defined to mean the final holding of the Division of Tax Appeals and any subsequent appeals, administrative or judicial, determining the tax liability of Marc S. and Jeanette Sznajderman.

After due consideration of petitioners' motion, the Memorandum in Support of the motion and exhibits annexed thereto, the Division of Taxation's Memorandum of Law in Opposition and the exhibits submitted therewith, petitioners' Reply Memorandum with attached exhibits and all the pleadings and proceedings had herein, Joseph W. Pinto, Jr., Administrative Law Judge, renders the following order.

ISSUE

Whether petitioners have demonstrated that they are entitled to summary determination as a matter of law because the notice of deficiency was barred by the statute of limitations or that the notice of deficiency was invalid for failing to inform petitioners of the basis of the asserted deficiency.

FINDINGS OF FACT

1. Petitioners, Marc S. and Jeannette Sznajderman, were New York residents and filed a personal income tax return for the year 2001 (year in issue) pursuant to an extension, on June 19, 2002.

2. As part of an ongoing investigation by the Division's Tax Shelter Unit, the Division identified more than 100 oil and gas partnerships with over 1,000 partners who had claimed intangible drilling cost deductions and who shared a common tax preparer.

3. Between January 2007 and March 2008, the Division worked with the Internal Revenue Service on respective audits of oil and gas partnerships, which included partnerships promoted by Richard Siegal, specifically Belle Island Drilling, of which petitioners were partners. The Division learned that the Internal Revenue Service was involved with audit projects concerning the same oil and gas ventures and that two of the ventures were involved with the same tax return preparer and the same promoter, Richard Siegal.

4. In examining the returns filed by the same tax return preparer, the Tax Shelter Unit noted that most had the same federal industry classification code, identifying the taxpayer as an oil and gas extraction venture.

5. Prior to issuing a notice of deficiency to petitioners herein, the Division obtained from the Internal Revenue Service transcripts of interviews conducted by the latter with principals of, and investors in, oil and gas ventures promoted by Richard Siegal. Richard Siegal passed away on February 9, 2010, before either the Division or the Internal Revenue Service was able to interview him.

6. On January 3, 2008, the Division sent a request for information to Belle Island Drilling Company, but never received a response. It also sent a request for information to petitioners on January 15, 2008, and, once again, received no response. The information requested included, in part, an explanation and computation, including supporting documentation, regarding participation in the Belle Island Drilling Company and the loss generated by Belle Island; copies of the offering memorandum, prospectus and subscription agreement; the partnership agreement; copies of cancelled checks used to pay the cash portion of the investment; copies of the demand notes or loan agreements between petitioners and the partnership; and any other documents provided by any party that promoted, solicited or recommended participation in the partnership.

The January 15, 2008 letter to petitioners explained what information was needed and the purpose therefor. The first paragraph of that letter stated:

> We are reviewing the above listed partnership [Belle Island Drilling Company], along with your New York State tax return for the tax year(s) indicated [2001]. This is part of the department's continuing effort to review returns containing large deductions and offsets to income. Additional information is required to complete our review.

The letter also advised petitioners that Tax Law § 683(c)(11) provided that the tax may be assessed at any time within six years after the return was filed if the deficiency was attributable to an abusive tax avoidance transaction. Further, the letter asked that the requested information be submitted within 15 days.

7. On March 14, 2008, the Division issued a Notice of Deficiency to petitioners asserting additional income tax due for the year 2001 in the sum of $78,427.36, plus penalties and interest, including a penalty for failure to participate in the voluntary compliance initiative, for a total amount due of $193,613.15.

8. The Notice of Deficiency stated in pertinent part as follows:

> Your 2001 New York State tax return was selected for review. The recomputation of your return has resulted in an additional . . . tax due.
>
> You failed to provide the requested documentation regarding your basis in Belle Island Drilling Company EIN 13-4199995. Therefore we are disallowing the loss you claimed on Federal Schedule E in the amount of $751,076. This amount is based upon available information.

9. The Division served petitioners with a subpoena on March 25, 2008, seeking the same information included in the January 15, 2008 letter. Petitioners were to appear with the materials on April 7, 2008 at the Division's office in New York City, but petitioners did not appear, instead appearing by counsel who informed the Division that they would not be complying with the subpoena.

10. A second subpoena was served on petitioners on August 6, 2008. Petitioners and other similarly situated individuals brought an Article 78 proceeding challenging the validity of the subpoena, but the challenge was ultimately unsuccessful and denied by Order of the New York Supreme Court, Albany County, on December 30, 2008.

11. Despite the order to comply with the subpoena and several requests by the Division, petitioners did not supply a copy of the Investment Proposal to the Division until October 19, 2010. A similar document had surfaced in the audits of several other Richard Siegal oil and gas partnerships and its relevance and materiality was considered important by the Division in coming to its conclusion that the Belle Island partnership was an abusive tax avoidance transaction.

12. The Investment Proposal for Belle Island, used to attract investors, began with the subsection "Introduction and Problem," which cited a 50 percent tax rate resulting from the Revenue Reconciliation Act of 1993 as the problem to be addressed for "taxpayers who are not yet possessed of vast net worth, but who are now creating personal wealth through high earnings." The Investment Proposal suggested that the solution to these "confiscatory" tax rates was a redeployment of "upper bracket tax dollars into certain investments," creating income and cash flow rather than paying the same money to federal, state and municipal governments. Investment in oil and gas leases was the suggested vehicle to attain these goals.

13. The Division examined the financial projections and expectations set out in the Investment Proposal and the Partnership Agreement for Belle Island and concluded that, without the tax savings, no reasonable investor would invest in the partnership. The Division's analysis, using the numbers provided in the above-mentioned documents, revealed a yearly total revenue of $15,000.00 and yearly expense of $14,400.00, or a $600.00 profit. This equated to less than 1% rate of return on the investment, before payments on the recourse notes given for the purchase of the partnership interest. The Division calculated that, using only the yearly profit, it would take 300 years to repay the note, while the life expectancy of the wells was 10 to 12 years.

14. Petitioners purchased a partnership interest in Belle Island in December 2001. They contributed $300,000.00 in cash and signed a full recourse promissory note to the partnership for the balance in the amount of $540,000.00. The note was secured by petitioners' interest in the partnership and their rights to profits from the partnership. Further, some part of petitioners' share of net revenues was withheld to purchase financial instruments with a value at maturity (not later than that of the promissory note) equal to a substantial portion of the promissory note.

15. The partnership entered into a Prospect Agreement with Palace Exploration Company, acquiring working interests in certain designated oil and gas leases. On or about the same day, Belle Island entered into a turnkey contract with SS&T Drilling Co., Inc., a drilling contractor, to drill oil and gas wells and to turn over to the partnership completed operating wells. The partnership paid the driller for a portion of the drilling services upon execution of the contract, consisting of the cash contributions of the partners and the drilling promissory note, which had the same maturity date and interest rate as petitioners' note to the partnership. The drilling promissory note was secured by the partnership assets, including the unpaid balance of the partners' promissory notes. In accordance with the terms of petitioners' promissory note, petitioners also assumed personal liability for their pro rata share of the partnership's obligation under the drilling promissory note, to the extent of the unpaid balance of their promissory note. All of the entities with which the partnership contracted were related through Mr. Seigal and/or his associates.

16. On Schedule E of their 2001 federal income tax return, petitioners claimed an intangible drilling cost deduction of $751,076.00, the net amount of which was reported on their New York State resident income tax return, all as derived from the Schedule K-1 issued to

petitioners by the partnership. It was this deduction that was disallowed by the Division, resulting in the additional tax asserted in the Notice of Deficiency at issue herein.

17. On June 1, 2008, petitioners protested the Notice of Deficiency and chose to have the case submitted to the Bureau of Conciliation and Mediation Services (BCMS). Thereafter, on January 29, 2009, petitioners elected to participate in the Department's Voluntary Compliance Initiative (VCI), while reserving their appeal rights. Payment of $98,035.00 was submitted with the Form DTF-672. On April 30, 2009, petitioners withdrew their request for conference in BCMS, conditioned on acceptance in the VCI.

18. Petitioners were accepted into the VCI for the year 2001 and subsequently filed a petition with the Division of Tax Appeals on July 28, 2009. On July 26, 2010, petitioners filed a motion for summary determination that was denied by Order, dated January 6, 2011, for lack of subject matter jurisdiction because petitioners had not filed a claim for refund of the tax paid.

19. In response to the Order, petitioners filed a second amended return, which constituted a claim for refund. Said refund claim was denied by the Division by letter, dated January 18, 2011. Thereafter, petitioners filed a petition protesting the refund denial creating the instant matter before this forum.

20. The Internal Revenue Service had examined many of the Siegal partnerships for several years. A letter from an IRS appeals officer, dated September 14, 2011, indicated that the IRS was considering a compromise granting investors a deduction limited to their cash investment, exclusive of any notes or debt obligations, and a ten percent penalty on the deficiency resulting from the adjustment. The letter specifically referenced Hurricane Drilling Company, one of the Siegal partnerships, and also referred to as "Great Neck" Oil and Gas Partnership.

21. The IRS issued several "No Adjustments Letters" to various drilling companies in June 2005, all with the address 475 Northern Blvd., Great Neck, NY 11021. Belle Island Drilling Company's address was 55 Babylon Turnpike, Freeport, NY 11520.

CONCLUSIONS OF LAW

A. A motion for summary determination shall be granted:

> if, upon all the papers and proof submitted, the administrative law judge finds that it has been established sufficiently that no material and triable issue of fact is presented and that the administrative law judge can, therefore, as a matter of law, issue a determination in favor of any party (20 NYCRR 3000.9[b][1]).

B. Section 3000.9(c) of the Rules of Practice and Procedure of the Tax Appeals Tribunal provides that a motion for summary determination is subject to the same provisions as a motion for summary judgment pursuant to CPLR 3212. "The proponent of a summary judgment motion must make a prima facie showing of entitlement to judgment as a matter of law, tendering sufficient evidence to eliminate any material issues of fact from the case" (***Winegrad v. New York Univ. Med. Ctr.***, 64 NY2d 851, 853, 487 NYS2d 316, 317-318 [1985], ***citing Zuckerman v. City of New York***, 49 NY2d 557, 427 NYS2d 595 [1980]). Inasmuch as summary judgment is the procedural equivalent of a trial, it should be denied if there is any doubt as to the existence of a triable issue or where the material issue of fact is "arguable" (***Glick & Dolleck v. Tri-Pac Export Corp.***, 22 NY2d 439, 293 NYS2d 93 [1968]; ***Museums at Stony Brook v. Village of Patchogue Fire Dept.***, 146 AD2d 572, 536 NYS2d 177 [1989]). If material facts are in dispute, or if contrary inferences may be drawn reasonably from undisputed facts, then a full trial is warranted and the case should not be decided on a motion (***Gerard v. Inglese***, 11 AD2d 381, 382, 206 NYS2d 879, 881 [1960]).

"To defeat a motion for summary judgment, the opponent must also produce 'evidentiary proof in admissible form sufficient to require a trial of material questions of fact on which he rests his claim' and 'mere conclusions, expressions of hope or unsubstantiated allegations or assertions are insufficient'" (***Whelan v. GTE Sylvania***, 182 AD2d 446, 449, 582 NYS2d 170, 173 [1992], ***citing Zuckerman*** at 562).

C. From the evidence presented on the motion, petitioners have not proffered sufficient evidence to eliminate material issues of fact that would enable a trier of fact to rule in their favor as a matter of law.

Petitioners contend that the Notice of Deficiency issued to them is barred by the statute of limitations, noting that Tax Law § 683(a) provides for assessment of additional personal income tax within three years from the due date of the return or the date it was filed, whichever is later. Here, petitioners filed their 2001 return on April 15, 2002, meaning the Division could assess a deficiency at any time on or before April 15, 2005. Since there is no dispute that the Notice of Deficiency was issued on March 14, 2008, it was issued beyond the three-year statute of limitations and petitioners contend it was time-barred. Although there are several exceptions to the three-year statute of limitations set forth in Tax Law § 683(c) and Tax Law § 683(d)(1), only one is applicable herein.

Tax Law § 683(c)(11)(B) provides that tax may be assessed at any time within six years after the return was filed if the deficiency was attributable to an abusive tax avoidance transaction. For purposes of Tax Law § 683(c)(11)(B), an abusive tax avoidance transaction is defined as "a plan or arrangement devised for the principal purpose of avoiding tax. Abusive tax avoidance transactions include, but are not limited to, listed transactions described in paragraph

five of subsection (p-1) of section six hundred eighty-five of this article" (Tax Law § 683[c][11][C]).

Tax Law § 685(p-1)(5) provides that the terms "reportable transaction" and "listed transaction" have the meanings given to them in Tax Law § 25 and the term "listed transaction" includes any transaction designated as a tax avoidance transaction pursuant to that section. A New York reportable transaction is a transaction that has the potential to be a tax avoidance transaction as determined by the commissioner (Tax Law § 25[a][2]) and may be prescribed by regulation (Tax Law § 25[a][3]). The commissioner has the authority to designate specific transactions that are the same as, or substantially similar to, transactions the commissioner has determined to be tax avoidance transactions (Tax Law § 25[a][4]).

The regulation at 20 NYCRR 2500.3 further defines the term "New York reportable transaction" as follows:

> (a) General. A New York reportable transaction is a transaction that has the potential to be a tax avoidance transaction under article . . . 22 . . . of the Tax Law. The term transaction includes all of the factual elements relevant to the expected tax treatment of any investment, entity, plan, or arrangement, and includes any series of steps carried out as part of a plan. There are three categories of New York reportable transactions: New York listed transactions, New York confidential transactions, and New York transactions with contractual protection.

The term "New York listed transaction" is defined in the regulations as follows:

> A New York listed transaction is a transaction that is the same as or substantially similar to one of the types of transactions that the commissioner has determined to be a tax avoidance transaction and identified by notice or other form of published guidance as a New York listed transaction. For purposes of identifying a New York listed transaction, the determination that a type of transaction is a tax avoidance transaction shall be based upon a finding by the commissioner that:
>
> [1] the transaction is not done for a valid business purpose, that is, one or more business purposes, other than obtaining tax benefits, that alone or in combination constitute the primary motivation for the transaction;
> [2] the transaction does not have economic substance apart from its tax benefits; or

> [3] the tax treatment of the transaction is based upon an elevation of form over substance. (20 NYCRR 2500.3[b].)

In fact, the Department did issue Taxpayer Services Bureau memoranda, TSB-M-05(2)C and TSB-M-05(4)I, that further explained the reporting requirements with respect to the disclosure of information relating to transactions that presented the potential for tax avoidance.

D. Regardless of the listed transactions referred to in Tax Law § 685(p-1)(5), it remains that "abusive tax avoidance transactions include, *but are not limited to*, listed transactions described in paragraph five of subsection (p-1) of section six hundred eighty-five of this article" (Tax Law § 683[c][11][C]; emphasis added). This critical language indicates that other transactions, in the commissioner's discretion, may constitute abusive tax avoidance transactions within the context of 20 NYCRR 2500.3(b), specifically whether there was a valid business purpose other than the obtaining of tax benefits that alone constitute the primary motivation for the transaction. Therefore, petitioners' arguments based on the instant transaction being a reportable or listed transaction are rejected.

E. The burden of proof with regard to the issue of whether the subject transaction was an abusive tax avoidance transaction rests with petitioners. (***Matter of Sholly***, Tax Appeals Tribunal, January 11, 1990 [where a six-year statute of limitations was applicable pursuant to Tax Law § 1083(d) with respect to an omission from gross income of an amount in excess of 25 percent of the amount stated on the franchise tax report].) In ***Matter of Sholly***, the Tribunal relied on Tax Law § 689(e) and § 1084(e), which expressly place the burden of proof on the petitioner, subject to certain exceptions inapplicable here. In view of that express statutory directive, the Tribunal rejected federal case law placing the burden of proof on the Internal

Revenue Service, saying it was not controlling and that the taxpayer bears the burden of showing that the six-year limitations period does not apply.

F. Petitioners' motion for summary determination raises triable issues of fact or, at a minimum, facts from which contrary inferences may be drawn, necessitating a hearing. Petitioners argue that the Appeals Office of the Internal Revenue Service had examined a number of similar partnerships sponsored by Richard Siegal for the tax years 2003 and 2004, and that the inquiry had ended and a settlement proposal offered. Those facts were based on a letter from an appeals officer, dated September 14, 2011, which proposed granting investors a deduction limited to their cash investment, exclusive of any notes or debt obligations, and a ten percent penalty on the deficiency resulting from the adjustment. Nothing further was offered by petitioners to elaborate on the terms of the offer or if petitioners were included in the targeted partnerships. Certainly, the proposed settlement indicated in the September 14, 2011 letter from the Appeals Office did not rise to a flat rejection of the Division's contention that the Belle Island venture was an abusive tax avoidance transaction, as urged by petitioners.

Even though some samples of partnership agreements and the other contracts and drilling documents were submitted, it cannot be said with certainty that Belle Island was in some way unique and distinct from those other partnerships or that petitioners were in the same position as the investors to whom "no change" letters were sent by the IRS. Only the unsubstantiated allegations of petitioners' representative draw conclusive correlations between what otherwise are "unconnected dots."

It may well be that petitioners' characterization of the settlement terms indicates what petitioners contend, but based on the record before this forum this conclusion cannot be reached. Perhaps this was best stated by petitioners in the Reply Brief when they described the settlement

proposal as a compromise reached to resolve a lengthy examination. Such a compromise proposal, without more, is not dispositive of whether the Division's allegation of an abusive tax avoidance transaction is valid. Petitioners did not adequately address the Investment Proposal for Belle Island, which appears to be focused on tax avoidance as the primary motivation or the fact that the Division's computational analysis of the investment demonstrates a profit that would be incapable of supporting the payment of the subscription note, notwithstanding the purchase of financial vehicles/annuities to insure performance by the investor.

Finally, the Division has demonstrated that the companies and individuals that participated in the Siegal partnerships were interrelated and managed in many instances by persons without the knowledge, skills or abilities normally expected in those positions. Such factors add to the many questions the prudent trier of fact must consider in determining if the transaction is or is not an abusive tax avoidance transaction. There is insufficient evidence before this forum to make that determination.

G. With respect to petitioners' argument that the Notice of Deficiency is invalid because it failed to inform petitioners of the basis of the deficiency, it is determined that the notice was legally sufficient and valid. After examination of a taxpayer's tax return, the Division may determine whether there is a deficiency of income tax and may issue a notice of deficiency to the taxpayer (Tax Law § 681[a]). Unlike notices of determination that assess sales tax, there are no statutory requirements concerning the content of the notice of deficiency (Tax Law § 1138[a][2]).

Based upon its examination of the Belle Island partnership and the personal income tax return filed by petitioners for the year 2001, the Division requested information to substantiate the deduction taken thereon for intangible drilling costs incurred by Belle Island. This request was made by letter, dated January 15, 2008, receipt of which was conceded in petitioners' brief.

The letter explained what information was needed and the purpose therefor and further advised petitioners that Tax Law § 683(c)(11) provided that the tax may be assessed at any time within six years after the return was filed if the deficiency was attributable to an abusive tax avoidance transaction. Further, the letter informed petitioners that the requested information had to be submitted within 15 days.

Having received no response to the letter, on March 14, 2008, the Division issued a Notice of Deficiency to petitioners that indicated additional tax due for the following reason:

> You failed to provide the requested documentation regarding your basis in Belle Island Drilling company EIN 13-4199995. Therefore we are disallowing the loss you claimed on Federal Schedule E in the amount of $751,076. This amount is based on available information.

Petitioners' contention that the Division did not perform an examination of their return is without merit; the problem was caused by their failure to provide the documentation requested. Since the Notice of Deficiency clearly indicated the period under review, and the basis of the asserted deficiency, it satisfied the requirements of Tax Law § 681(a) and the presumption of correctness attached. Hence, the Notice of Deficiency was valid. Petitioners now bear the burden of establishing entitlement to the claimed deductible expenses at issue (***see Matter of Fazal Ahmad, P.C.***, Tax Appeals Tribunal, August 8, 1991).

H. Petitioners' Motion for Summary Determination is denied. The matter will be scheduled for hearing in due course.

DATED: Albany, New York
April 12, 2012

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