STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition

of

CUSHLIN LIMITED

for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the years 2002 through 2008.

DECISION
DTA NO. 829939

Petitioner, Cushlin Limited, filed an exception to the determination of the Administrative Law Judge issued on July 13, 2023. Petitioner appeared by Roberts and Holland LLP (Richard A. Levine, Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (David Markey, Esq., of counsel).

Petitioner filed a brief in support of its exception. The Division of Taxation filed a brief in opposition. Petitioner filed a reply brief. Oral argument was heard on May 16, 2024, in New York, New York, which date began the six-month period for issuance of this decision.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUES

I. Whether the Division of Taxation's notices of deficiency had a rational basis.

II. Whether the Division of Taxation properly disallowed petitioner's claimed deductions.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge, except that we have not restated the Administrative Law Judge's findings of fact 76 and 77 (rulings on proposed findings of fact). The Administrative Law Judge's findings of fact appear below.

1. Petitioner, Cushlin Limited, was a corporation formed under the laws of the Isle of Man.

2. Petitioner's business model was to acquire and refurbish three- and four-star hotels.

3. Petitioner owned an equity interest in the following limited liability companies (the underlying entities), each of which did business in New York during the years at issue:

(a) Central Park Hotel Associates LLC
(b) President Hotel Associates LLC
(c) Sheffield Hotel Associates LP
(d) Hampshire Hotels & Resorts LLC
(e) Consulate Hotel Associates LLC
(f) Kensington Hotel Associates LP
(g) Beverly Hotel Associates LLC
(h) Cornwall Hotel Associates LLC
(i) Dover Hotel Associates LLC
(j) Surrey Hotel Associates LLC
(k) Hampshire Hotels Manhattan LLC
(l) 310 W 52 Realty LLC (starting in 2004)
(m) 310 W 52 Holdings LLC (starting in 2004)

4. In 2008, the Division of Taxation (Division) commenced an audit of President Hotel Associates LLC (President), for the year 2005. President sold real property located in New York, but did not file a New York State partnership return, form IT-204.

5. During the audit of President, the Division learned of other underlying entities, as well as petitioner, who had an ownership interest in these entities. Because of its ownership interest, petitioner was required to report the gains and losses of such entities, including from the real

estate transaction of President. The Division commenced a limited scope field audit of petitioner in 2009.

6. The Division performed the audit of petitioner for years 2002 through 2006 (audit period 1), to determine whether the taxpayer reported the gains and losses correctly.

7. A second audit of petitioner for the same purpose was opened for the years 2007 through 2009 (audit period 2). The Division determined no additional tax was due for 2009.

8. The Division had an initial meeting with petitioner on May 13, 2009.

9. The Division met with petitioner multiple times from 2010 through 2013 and exchanged multiple phone calls. Throughout that time, petitioner repeatedly stated it was working on the returns and requested more time to prepare the returns for the underlying entities and for petitioner. Petitioner provided some draft tax returns for entities related to the underlying entities during that time.

10. In January of 2013, the auditor conducted a field visit of petitioner, where draft copies of tax returns for all entities were provided.

11. On November 29, 2013, the audit was transferred to a new auditor with the Division, Mr. Souren Das.

12. On June 24, 2014, Mr. Das received notice that petitioner had engaged Mr. Richard A. Levine of Roberts & Holland, LLP, as its representative for the audit.

13. In August of 2014, the Division met with Mr. Levine and provided him with a summary of the case history.

14. In March of 2015, petitioner began filing New York State partnership returns for the years at issue for certain of the underlying entities.

15. In April of 2015, petitioner's representative claimed that the returns for the other underlying entities would be finalized within a month and that he would send the original of petitioner's returns with a copy of the underlying entities returns at that time.

16. In September of 2015, the Division prepared an audit adjustment for taxes due from petitioner and sent it to petitioner's representative.

17. On May 4, 2016, the Division sent petitioner's representative a letter advising that an audit of petitioner's tax returns for audit period 1 had resulted in an increase to the tax liability in the amount of $45,306,458.00. The letter enclosed a consent to field audit adjustment (consent 1) reflecting the details of the proposed audit adjustments. Consent 1 listed a total tax due of $13,626,240.00 for audit period 1, plus interest and penalties.

18. On the same date, the Division sent petitioner's representative a letter advising that an audit of petitioner's tax returns for audit period 2 has resulted in an increase to the tax liability in the amount of $3,825,713.00. The letter enclosed a consent to field audit adjustment (consent 2) reflecting the details of the proposed audit adjustments. Consent 2 listed a total tax due of $1,557,414.00 for audit period 2, plus interest and penalties.

19. On or before June 15, 2016, petitioner late filed New York State general business corporation franchise tax returns (CT-3), for 2007 and 2008; general business corporation franchise tax return short forms (CT-4), for 2002 through 2006; and general business corporation MTA surcharge returns (CT-3M/4M), for all of the years at issue.

20. The forms CT-3 and CT-4 filed by petitioner showed negative capital for the years 2002 and 2003.

21. Petitioner's returns showed losses on federal form 8810, corporate passive activity loss and credit limitations, for each year at issue. The Division determined that petitioner failed to substantiate these claimed losses.

22. Petitioner deducted expenses on its federal and state tax returns that were incurred pursuant to its Management & Administrative Services Agreements with Kent Properties Limited for each year at issue. The Division determined that petitioner failed to support these expenses.

23. Petitioner retained Kent Properties Limited to assist with the refurbishment of the hotels by the underlying entities.

24. Petitioner also deducted expenses on its federal and state tax returns that were incurred in connection with the loan and guarantee agreement it entered into with Securelink Holdings Limited. The Division determined petitioner failed to support these expenses.

25. Petitioner needed the assistance of Securelink Holdings Limited to acquire funds to refurbish the hotels and to cover operating costs when cash flow was low.

26. The underlying entities deducted interest expenses each year at issue on their federal and state tax returns. The Division determined petitioner failed to support these expenses.

27. The underlying entities had to borrow funds for working capital, repairs, and capital improvements.

28. When petitioner filed the tax returns, the income reported on the returns was higher than the income amount it originally informed the Division it would be. The taxpayer also deducted larger expenses against that income.

29. After receiving petitioner's returns, and to verify the expenses reported thereon, on July 8, 2016, the Division sent petitioner's representative a letter enclosing Information

Document Request (IDR) number 1, covering both audit periods. This IDR requested that petitioner explain the source of the passive activity losses and how the losses allow the company to reduce the taxable income to zero by deducting passive losses every year. The IDR also requested that petitioner explain the decrease in its United States (U.S.) equity amount.

30. On July 29, 2016, petitioner's representative sent the Division a letter in response to IDR number 1. In response to the request for an explanation as to the source of passive activity losses, petitioner's representative stated that the taxpayer holds an interest in various limited liability companies that operate in New York. He continued that as petitioner does not materially participate in the entities within the meaning of Internal Revenue Code § 469 (h), all income and losses realized by those entities are passive activity losses which flow through to petitioner and may be used by petitioner to offset passive activity income. He explained that any net unused passive activity losses realized in one year carry forward to future years indefinitely and may be used by petitioner to offset passive activity income in the subsequent year. He enclosed a schedule setting forth the sources of the passive activity for each year and the forms 8810 from which they were derived.

When asked to explain the decrease in U.S. equity, petitioner's representative responded that the decrease each year reflects the losses that flow to the taxpayer from its interests in the LLCs. The letter stated that "U.S. equity is equivalent to corporate retained earnings."

31. On September 8, 2016, the Division sent petitioner's representative a letter acknowledging information received with a letter dated July 29, 2016, in response to the Division's IDR number 1 and enclosing IDR number 2 for both audit periods. IDR number 2

requested documentation supporting the losses claimed on form 8810 from tax year 2000 to 2008, and documentation supporting a decrease in U.S. equity.[1]

32. On November 7, 2016, petitioner's representative sent a letter to the Division in response to IDR number 2. In response to the Division's request for documentation supporting the losses claimed in form 8810 from 2000 through 2008, petitioner's representative stated that the losses reported primarily came from passive losses for the entities in which petitioner owns an interest. Petitioner received a schedule K-1 each year from those entities that set forth petitioner's aliquot share of those losses. The letter stated that petitioner had previously sent a schedule reflecting, by year, the losses that flow through to petitioner as indicated in the schedules K-1 it received. Enclosed with the letter were the schedules K-1 received by petitioner for each tax year from 2000 through 2008.

In response to the Division's request for documentation regarding a decrease in U.S. equity, the letter stated that it was primarily from the losses generated each year that flow through to petitioner. Petitioner's representative also enclosed a schedule setting forth the activity from form 1120-F, U.S. income tax return of a foreign corporation, page 5, section III, lines 4a, 4b, 4c (where applicable) and 4d (where applicable) regarding the decrease in U.S. net equity for each tax year 2000 through 2008.

33. Petitioner's responses to both IDRs included invoices and schedules but did not provide any third-party verifiable documentation or proof of payments.

34. On January 18, 2017, Mr. Das met with Mr. Levine to discuss passive losses. At that meeting, Mr. Das informed Mr. Levine that "[w]e said we want itemization of income and

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[1] The caption of IDR number 2 states that the audit years included only those ended December 31, 2002 through December 31, 2006. However, the requests within IDR number 2 involve information from both audit periods.

expenses for all entities that will tie to the loss claimed. Rep will do it as a sample for one year and if that is acceptable, they will do the rest."

35. On February 8, 2017, petitioner's representative sent the Division a letter enclosing returns for 310 W 52 Realty LLC, 310 W 52 Holdings LLC, and Central Park Hotel Associates LLC, for the years 2004 through 2011, and for Cornwall Hotel Associates LLC, Dover Hotel Associates LLC, and Sheffield Hotel Associates LP, for the years 2004 through 2011.

36. On May 2, 2017, Mr. Levine provided Mr. Das with a schedule itemizing income and expenses for petitioner and for the underlying entities for the year 2004.

37. On May 8, 2017, Mr. Das sent petitioner's representative a letter acknowledging receipt of the reconciliation and detailed breakdown by entity of petitioner's losses for 2004 and requesting the same information for every other year for the period 2000 through 2009 by June 8, 2017.

38. On June 12, 2017, Mr. Levine provided similar schedules itemizing income and expenses of the underlying entities and reconciling them to petitioner's income and loss for calendar years 2002, 2003, and 2006 through 2009. These schedules were prepared in the same manner and using the same template that were previously accepted by Mr. Das for 2004.

39. On August 9, 2017, Mr. Levine provided similar schedules itemizing income and expenses of the underlying entities and reconciling them to petitioner's income and loss for calendar years 2000 and 2001. These schedules were prepared in the same manner and using the same template that was previously accepted by Mr. Das for the year 2004. The letter stated that petitioner was not able to locate copies of the returns for all the entities, and for those entities where the return could not be located, the schedule reflected the information reported on the schedule K-1 that was provided by the entity.

40. On August 29, 2017, Mr. Das sent petitioner's representative a letter acknowledging receipt of the information he provided. The letter also advised that additional information was requested, and he enclosed IDR number 3. At that point, the audit of petitioner had been open for approximately eight years.

41. IDR number 3, dated August 29, 2017, requested the following: (i) reconciliations and detailed breakdowns by entity of petitioner's income and loss for 2005; (ii) documentation and details to support "other passive deductions" for all years under audit; (iii) loan agreements and details for the loans related to interest expenses deducted for all years under audit, including principal amount, interest paid, purpose of each loan, how loan proceeds were used, work papers used to compute the interest expense deduction; and (iv) an explanation of how ordinary income was negative for some entities in some years, with work papers showing the calculations for the negative ordinary income.

42. On October 3, 2017, petitioner's representative sent the Division a letter enclosing a schedule for tax year 2005 that showed the income or loss for each entity that flowed to petitioner.

43. On October 25, 2017, petitioner's representative sent the Division an additional response to IDR number 3, enclosing a schedule detailing the items that comprise "other passive deductions" for tax years 2001 through 2009 that was referred to in the previously provided schedules.

The letter also stated that the Division had inquired about the category "ordinary income," which for some entities was reported as a profit, and for others, a loss. This category only appeared on the schedules for 2000 and 2001 for those entities and the tax returns for those years could not be found. In the absence of tax returns, the accountants who prepared the

schedules did not have information regarding the amount of revenue and details regarding the expenses. In order to complete the schedules, the accountants used the net income or net loss shown in the tax returns of Hampshire Hotels Manhattan LLC.

44. On February 5, 2018, the Division sent petitioner's representative a letter regarding IDR number 3. The letter stated that the Division received two mailings, dated October 3, 2017, and October 25, 2017, respectively, but that these letters were incomplete and/or unsubstantiated. The letter also provided that the Division had multiple conversations with petitioner's representative, on October 30, 2017, December 21, 2017, and January 22, 2018, and that, to date, the Division had not received a complete response to IDR number 3. The letter stated that if the Division did not receive a response by February 19, 2018, it would issue an assessment based on the information it had available.

45. In further response to the Division's IDR number 3, with a letter dated February 20, 2018, petitioner's representative sent a schedule showing the details of expenses incurred by petitioner that qualified as "other passive deductions" for the tax years 2002 through 2009. Petitioner's representative explained that these expense items were shown on petitioner's financial statements under the heading "operating expenses." He also enclosed copies of petitioner's financial statements for tax years 2002 through 2009, as well as copies of invoices for the years 2002 through 2009 for the annual management fee from Kent Properties Limited, and invoices for the Loan and Guarantee fee from Securelink Holdings Limited. Petitioner also enclosed schedules showing the calculation of interest charges incurred for the loan agreements of Hampshire Hotels Manhattan LLC.

46. Because petitioner failed to meet the deadline stated in the Division's letter of February 5, 2018, the Division sent petitioner's representative a letter on March 1, 2018,

advising that an audit of petitioner's New York State tax returns for audit period 1 has resulted in an increase to the tax liability in the amount of $52,744,930.00. Enclosed with the letter was a consent to field audit adjustment (consent 3), detailing the proposed audit adjustments. The letter provided that if petitioner's representative disagreed with the findings, he should contact the auditor by March 14, 2018, and that he may submit evidence to substantiate his position.

Consent 3 listed a tax due of $13,626,240.00, plus interest and penalties. Penalties were imposed pursuant to Tax Law § 1085 (a) (1), for failure to file a return, Tax Law § 1185 (b) (1), for deficiency due to negligence, and Tax Law § 1185 (b) (2), for a subsequent deficiency due to negligence.

47. The schedule E, that forms the entire net income basis for the determination of the tax due by petitioner for audit period 1, provides the following:

Year:	2002	2003	2004	2005	2006	**Total**
President			264,946.00	40,481,937.00	8,903,651.00	**49,650,534.00**
Kensington				(4,688,113.00)	(1,179,919.00)	**(5,868,032.00)**
Surrey					(1,021,339.00)	**(1,021,339.00)**
Beverly				(1,001,660.00)	(49,829.00)	**(1,051,489.00)**
Sheffield (N/F)			(170,089.00)	49,733,469.00	1,367,030.00	**50,930,410.00**
Dover (N/F)			13,553,168.00	(295,973.00)	63,070.00	**13,320,265.00**
Cornwall (N/F)	1,862,024.00	1,653,273.00	30,692,079.00	(52,794.00)	-	**34,154,582.00**
Central Park (N/F)			82,714.00	5,141,462.00	6,077.00	**5,230,253.00**
	1,862,024.00	**1,653,273.00**	**44,422,818.00**	**89,318,328.00**	**8,088,741.00**	**145,345,184.00**

48. The schedule E for audit period 1 does not indicate the source of the figures included in the schedule. The figures on the schedule E were used as the entire net income for the years 2002 through 2006, to determine the entire net income tax base for those years. Schedule E does not show disallowances of any deductions claimed by petitioner on the returns that were filed thereafter.

49. On the same date, the Division sent petitioner's representative a letter advising that an audit of petitioner's New York State tax returns for audit period 2 has resulted in an increase of tax liability in the amount of $4,466,426.00. Enclosed with the letter was a consent to field audit adjustment (consent 4), detailing the proposed audit adjustments. The letter provided that if petitioner's representative disagreed with the findings, he should contact the auditor by March 14, 2018, and that he may submit evidence to substantiate his position.

Consent 4 listed a tax due of $1,557,414.00, plus interest and penalties. Penalties were imposed pursuant to Tax Law § 1085 (a) (1), for failure to file a return, Tax Law § 1185 (b) (1), for deficiency due to negligence, and Tax Law § 1185 (b) (2), for a subsequent deficiency due to negligence.

50. The schedule E, that forms the entire net income basis for the determination of the tax due by petitioner for audit period 2, provides the following:

Year:	2007	2008	Total
President	(10,493.00)	(14,666.00)	**(25,159.00)**
Kensington	70.00	(1,880,819.00)	**(1,880,749.00)**
Surrey	(482,499.00)	(822,268.00)	**(1,304,767.00)**
Beverly	(2,625,014.00)	1,895,901.00	**(729,113.00)**
Sheffield (N/F)	1,457,527.00	15,695,188.00	**17,152,715.00**
Dover (N/F)	(266,990.00)	(1,564,101.00)	**(1,831,091.00)**
Cornwall (N/F)	(2,003.00)	(4,321.00)	**(6,324.00)**
Central Park (N/F)	(11,634.00)	(3,471.00)	**(15,105.00)**
	(1,941,036.00)	**13,301,443.00**	**11,360,407.00**

51. The schedule E for audit period 2 does not indicate the source of the figures included in the schedule. The figures on the schedule E were used as the entire net income for the years 2007 and 2008 to determine the entire net income tax base for those years. Schedule E does not show disallowances of any deductions claimed by petitioner on the returns that were filed thereafter.

52. The capital basis the Division used for determination of capital base tax due for each year for both audit periods was $196,629,210.00. The Division verified the fair market value of

real estate for purposes of the capital base tax by reviewing real estate transfer tax returns (RETT returns) that were filed for some of the underlying entities during the periods at issue. Based on the amounts listed in the RETT returns, the auditor determined that the fair market value of petitioner's real estate holdings exceeded the amount that would result in the maximum capital tax for the years at issue. Accordingly, the Division used $196,629,210.00 for the total capital, because that amount multiplied by the tax rate resulted in the maximum capital tax allowed by statute of $350,000.00.

53. On March 12, 2018, petitioner's representative sent the Division a letter stating that petitioner disagreed with the Division's adjustments for years ended December 31, 2002 through December 31, 2006. Petitioner's representative asserted that the proposed adjustments ignored petitioner's submissions made to the Division during the audit, including the tax returns filed for tax years 2002 through 2006, and its responses to the Division's IDRs. Petitioner's representative also asserted that the proposed audit adjustment in the amount of $350,000.00 in tax for both 2002 and 2003 was based on an erroneous amount of capital, and that the actual capital for those years was negative. He also asserted that the proposed audit adjustments fail to indicate how the amount of capital, which is claimed to be the same for tax years 2002 through 2008, was determined. Petitioner's representative requested that the Division provide justification for the amount of capital asserted as the basis for its calculations. Petitioner's representative also stated that the proposed audit adjustments fail to reflect the figures used for the tax returns for the underlying entities.

54. In a second letter dated March 12, 2018, petitioner's representative sent the Division a letter stating that petitioner disagreed with petitioner's adjustments for years ended December 31, 2007 and December 31, 2008. Petitioner's representative asserted that the proposed

adjustments ignored petitioner's submissions made to the Division during the audit, including the tax returns filed for tax years 2007 and 2008, and its responses to the Division's IDRs. Petitioner's representative also asserted that the proposed audit adjustment in the amount of $350,000.00 in tax for tax year 2007 was based on an erroneous amount of capital, and that the actual capital for those years was negative. He also asserted that the proposed audit adjustments fail to indicate how the amount of capital, which is claimed to be the same for tax years 2002 through 2008, was determined. Petitioner's representative requested that the Division provide justification for the amount of capital it determined was the basis for its calculations. Petitioner's representative also asserted that the proposed audit adjustments failed to reflect the figures used for the tax returns for the underlying entities.

55. The Division sent petitioner two closing letters dated March 19, 2018, each of which included a statement of the tax due, plus interest and penalties, for the two audit periods. The amounts in the closing letters were the same as the amounts in consents 3 and 4, respectively.

56. On March 22, 2018, the Division issued a notice of deficiency, assessment ID number L-047830045, for audit period 1, asserting tax in the amount of $13,626,240.00 plus interest and penalties, and notice of deficiency, assessment ID number L-047829734, for audit period 2, asserting tax in the amount of $1,557,414.00, plus interest and penalties. The notices do not provide the relevant sections of the Tax Law upon which the assessment is based or the specific tax periods.

57. Petitioner requested a conciliation conference before the Bureau of Conciliation and Mediation Services (BCMS) protesting the notices. A conciliation conference was held on November 26, 2018.

58. On November 30, 2018, Mr. Das sent petitioner's representative a letter requesting additional documentation. The letter stated that petitioner had previously provided invoices to support management and administration fees but that the Division needed more extensive documentation substantiating those fees. The letter asked petitioner to refer to the schedule it had previously provided that broke down management and administration fees per year, and asked for the management agreements and payment schedules, with proof of payment, payees, worksheets for fee calculation, and any other relevant information related to the management and administration fees.

That letter acknowledged that petitioner had previously provided invoices to support some of the loan and guarantee fees, but also stated that the Division needed more extensive documentation to substantiate those fees. The Division requested that petitioner refer to the schedule it had previously provided that broke down the loan and guarantee fees per year, and asked for the loan agreements/contracts, payment schedules with proof of payment, payees, worksheets for fee calculation as well as any other relevant information related to these loan and guarantee fees.

The letter further asked for documentation substantiating interest expenses claimed in the schedules the petitioner had previously provided. This included loan agreements or contracts containing the principal amount, interest paid, purpose of each loan, how loan proceeds were used and work papers for interest computation as well as any other relevant information related to these interest expenses.

The letter also requested a breakdown of ordinary income (loss) with work papers showing how the negative ordinary income was calculated per the following schedule:

Year	Entity	Amount ($)
2000	Central Park Hotel Associates	(642,241)
2000	Hampshire Hotels and Resorts	(51,557)
2000	Surrey Hotel Associates	(3,073,761)
2001	Hampshire Hotels and Resorts	(1,268,699)
2001	Consulate Hotel Associates	(1,096,908)
2001	Beverly Hotel Associates	(1,805,568)

59. On March 28, 2019, petitioner's representative sent the conferee a letter as an initial response to the Division's request for documents, enclosing an intercompany payable schedule between petitioner and its parent company, two management and administrative service agreements between Kent Properties Limited and petitioner, the first effective as of January 9, 2001, and the second effective as of January 4, 2006, and copies of various notes for the claimed expenses.

60. On July 29, 2019, petitioner's representative sent the conferee a second later stating that obtaining additional documentation is challenging because the documents are more than 20 years old, the taxpayer has undergone several moves and personnel changes, and the parent company who maintained the records is located outside of the United States. Petitioner's representative also requested a detailed calculation of the tax the Division asserted is due. Enclosed with this letter, petitioner's representative provided schedules for the calculation of interest charges on some of the loans.

61. By conciliation order (CMS No. 000303328) dated February 14, 2020, the conferee sustained the statutory notices.

62. The Division did not respond to petitioner's request for a detailed calculation of the tax due.

63. Petitioner timely filed a petition with the Division of Tax Appeals on or about May 14, 2020, in protest of the conciliation order.

64. During the hearing, petitioner called Peter Allmark, an accountant in the United Kingdom whom petitioner hired as a consultant in May of 2014. As an accountant, Mr. Allmark primarily works with hotels. He testified that he reviewed petitioner's books and records as well as its financial statements for 2002 through 2008.

65. Mr. Allmark testified that petitioner did not have its own bank account. He asserted that petitioner's parent company, which he referred to as a "participation company," Simlle Limited, made payments on its behalf and charged petitioner in an intercompany accounts payable/accounts receivable. However, when asked during cross-examination whether all invoices were paid, Mr. Allmark responded that he would "presume" that they were being paid but that he did not provide proof of payment of the invoices during the audit or work with the auditors during the audit.

66. Mr. Allmark also testified that Hampshire Hotels Manhattan LLC (Hampshire) was the borrower for the loans that were arranged by Securelink, and that Hampshire was a subsidiary of petitioner.

67. During the hearing, petitioner elicited testimony from John Bartiuk, CPA, the accountant who prepared petitioner's federal and state tax returns for the periods at issue. Mr. Bartiuk testified that he prepared the returns using the financial statements for petitioner, a trial balance and financial statement for Hampshire, and K-1s. He explained that Hampshire was an entity mostly owned by petitioner through 2004 and owned entirely after 2004 as a single member limited liability company that held many of the underlying investments. Mr. Bartiuk did not look at any of the source documents to prepare the returns.

68. Mr. Bartiuk testified that the calculation of capital base that was reported on the returns included petitioner's investment in the underlying entities.

69. Mr. Das, who inherited the instant audit, did not perform a calculation of the capital base for any of the years at issue.

70. During the hearing, Mr. Das confirmed that he determined the amounts due based on the schedules E that he received from the prior auditor and that he did not use any of the information that was reported on the tax returns for the audit periods.

71. Mr. Das testified that the total tax determined to be due was based on the "pro forma" numbers that were previously provided by the petitioner to the prior auditor because those were verified by the Division using its real estate transaction database. He cited to the relevant pages in his audit file showing the prior auditors draft schedules and the pages reflecting the real estate transfers of the underlying entities.

72. Mr. Das testified that when the Division received the returns in 2016, he reviewed them and saw that the numbers, especially the income amounts reported, were higher than what the taxpayer originally said they would be pursuant to the pro forma numbers. He also found that the taxpayer had been deducting large expenses against that income. The Division wanted to confirm the high expenses that petitioner had reported, so Mr. Das issued IDRs. Mr. Das testified that initially petitioner provided explanations through invoices and schedules but no third-party verifiable documentation or any proof of payment. Petitioner gave partial responses, but no complete information backed up by supporting documents. He stated that for IDR number 3, the petitioner did not respond by the deadline given, and that the Division felt that petitioner had been given reasonable time to provide the information, so he prepared consents 3 and 4.

Mr. Das then testified that petitioner did respond after the deadline provided, but again, the documentation was limited to schedules and explanations without third-party documentation for the expenses, and proof of payments. At that time, the Division closed the audit.

73. Mr. Das testified that on the CT-3 and CT-4 returns there were some years where petitioner did not calculate the entire net income base correctly, and, for other years, where the entire net income did not apply, the capital base tax was not calculated correctly. He explained that the capital base had to be adjusted for the fair market value of real property and marketable securities and the returns did not include the calculation.

74. Mr. Das also testified that some of the documents submitted at BCMS substantiated some of the interest expenses reported on the returns but explained that they were only a small part of what petitioner deducted. He explained that for the expenses petitioner claimed, there were different categories of expenses and for some of the categories, petitioner did not substantiate what they reported at all, and for others, they only provided minimal substantiation.

75. The auditor who initially commenced the audit of petitioner did not appear or testify at the hearing.

THE DETERMINATION OF THE ADMINISTRTIVE LAW JUDGE

The Administrative Law Judge started the determination in this matter by citing the presumption of correctness that attaches to notices issued by the Division and petitioner's burden of proving, by clear and convincing evidence, that the assessments on the notices were erroneous.

The standard enunciated by the Administrative Law Judge was that an estimate of taxable income of a taxpayer by the Division requires only a rational basis to be sustained; that if a taxpayer fails to file a tax return, estimates can be used from "any information" in the possession

of the Division and, where returns are filed and there is "some factual basis" for determining that the returns do not accurately reflect income, indirect audit methods may be used by the Division to determine income.

Here, petitioner did not file tax returns for a significant portion of the of the audit; petitioner provided the Division with "pro forma" numbers during the course of the audit that were represented to be the numbers to be used when returns were eventually filed; that the Division was able to verify those numbers based upon information in its records and when returns were finally filed, petitioner failed to substantiate deductions claimed; accordingly, the Administrative Law Judge ruled that use of the pro forma numbers, verified on the Division's real estate transaction data base established the rational basis for the tax due in the notices.

The Administrative Law Judge pointed out that corporations such as petitioner were obligated to report their tax liability on the greatest of four bases, including the entire net income (ENI) base, the capital base, the minimum taxable income base and the fixed dollar minimum. After reviewing petitioner's returns, the Administrative Law Judge determined that petitioner failed, in certain years, to correctly calculate the ENI base and in instances where ENI did not apply, failed to correctly calculate the capital base tax.

Noting, with benefit of case citation that the burden of establishing entitlement to claimed deductions is upon the taxpayer and that the Division does not have a burden of establishing the disallowance of deductions, the Administrative Law Judge determined that information and documentation provided by petitioner was not "sufficient to substantiate the deductions and losses claimed in the late-filed returns." Ruling that schedules, invoices, copies of loans and management and guarantor agreements, absent source document verification, was not enough, the Administrative Law Judge determined that petitioner also failed to provide proof of payment

for the invoices it submitted. Accordingly, the Administrative Law Judge determined that petitioner failed to meet the burden of proving that the notices were not correct.

The Administrative Law Judge further rejected the argument that the Division had an obligation to "perform another audit because petitioner finally filed its returns years after they were due" and petitioner's claim that the notices were invalid because they were not based upon tax returns. Again, the Administrative Law Judge pointed to the inconsistency with information previously provided by petitioner and the insufficiency of documentation, "schedules and returns, without any source documents." The Administrative Law Judge went on to determine that documentation provided at a BCMS conference, subsequent to the audit and issuance of the notices herein, was insufficient to substantiate petitioner's claims and that the Division was "under no obligation to commence yet another audit because petitioner(s) (sic) finally produced documents to support returns that were years overdue." The Administrative Law Judge also concluded that none of the submissions by petitioner rose to the level of clear and convincing evidence necessary to overcome the presumption of correctness that attaches to notices and that petitioner had not met its burden of proving error in the Division's audit findings.

Next, the Administrative Law Judge addressed the computation methods used to arrive at the deficiencies. For three of the years of the audit, the Division determined that the capital base method, imposing a tax on the total of a taxpayer's business and investment capital allocated within New York State, would be the highest. Citing section 210 (2) of the Tax Law, the Administrative Law Judge distinguished the treatment of real property and marketable securities, which are valued at fair market value, and personal property other than marketable securities, which are valued as shown on a taxpayer's books and records (book value) in accordance with Generally Accepted Accounting Practices (GAAP), and accordingly rejected petitioner's

argument that the assets in question should be treated as personal property or valued at book value.

The Administrative Law Judge determined that petitioner did not address the imposition of penalties and therefore failed to meet its burden of showing that its failure to timely file returns for several years was a result of reasonable cause and not willful neglect. The Administrative Law Judge concluded that the resulting deficiencies were due to negligence or intentional disregard of Article 9-A of the Tax Law.

Accordingly, the Administrative Law Judge denied the petition and sustained the notices of deficiency.

ARGUMENTS ON EXCEPTION

On exception, petitioner asserts that the Administrative Law Judge erred in sustaining the finding of a tax liability under the ENI method for certain years and under the capital base method for others. Specifically, petitioner claims that the Division did not have a rational basis for the determination of tax due; that petitioner had correctly computed the ENI base; and that it had met its burden of proof to establish that the notices were erroneous.

Petitioner also takes the position that the determination of the Administrative Law Judge is not supported by the record, particularly concerning finding of fact 71, regarding testimony by the Division's witness and, consequently, petitioner objects to the conclusion that petitioner did not meet its burden. Petitioner takes issue with the findings of the Administrative Law Judge that the audit had a rational basis and that the Division's verification of the fair market valuation of real estate was not erroneous. Petitioner also disputes the determination that they calculated their tax liability incorrectly and asserts that they substantiated expenses associated with

deductions claimed on their return. As below, petitioner does not specifically take issue with the assertion of penalties in their exception or supporting briefs.

The Division takes the position that the determination of the Administrative Law Judge is correct in all respects. They assert that the Division's "limited scope field audit," based on "pro forma" numbers provided by petitioner and verified from the Division's database, fully supports the notices issued, and the underlying finding of tax due. The Division also claims that when petitioner belatedly filed the returns, the entries did not match the pro forma information previously provided by petitioner and that petitioner failed to substantiate expenses claimed on late-filed returns. With regard to the valuation of assets for the years in which the capital base computation was used, the Division contends that fair market value is the appropriate measure. The Division also argues that should this Tribunal accept petitioner's argument that book value of those assets should prevail, the tax would be calculated using the ENI method and, thus, although reduced, it would not be eliminated. Accordingly, a deficiency would continue to exist for those years.

Regarding the imposition of penalties, the Division reiterates that petitioner did not address penalties and, in any case, did not establish that their failure to file returns was due to reasonable cause and not due to willful neglect and that petitioner has not established that the deficiencies are not attributable to negligence or "an acceptable ground for reasonable cause."

OPINION

Given their significant impact, we will review the events, interactions and lengthy timeline involved in this matter.

In 2008, the Division commenced an audit of President, a New York hotel company (***see*** finding of fact 3) and found that while it sold property in the state during the audit period, it did

not file tax returns (***see*** finding of fact 5). During course of that audit, it was determined that petitioner, a corporation formed under the laws of the Isle of Man, owned an equity interest in President and twelve other hotels, each of which were limited liability companies doing business in New York. In 2009, the Division expanded the examination of petitioner and determined that petitioner was required to file tax returns, but had failed to do so. The audit initially covered the years 2002 through 2006. It also resulted in a second audit for the years 2007 through 2009.

During the audit, petitioner provided some draft returns relating to the underlying entities, but did not file tax returns for the years under audit.

The audit continued throughout 2013, 2014 and 2015. After lengthy exchanges between the Division and petitioner, petitioner did not provide the promised documentation within the time frame indicated. In September of 2015, more than six years after the audit was commenced, the Division prepared an audit adjustment for taxes due and sent it to petitioner (***see*** finding of fact 16).

On or before June 15, 2016, petitioner late filed tax returns for all of the years here at issue (2002 through 2006, 2007 and 2008). The returns reported income and expenses that were higher than the amounts petitioner had informed the Division that they would be (***see*** findings of fact 19 and 20).

At this point, the audit shifted to verification of the filed returns. On July 8, 2016, seeking verification of the entries on the returns, the Division sent a letter to petitioner's representative with an IDR (***see*** finding of fact 29). The IDR specifically requested petitioner explain the source and basis of claimed passive activity losses that resulted in reducing taxable income to zero for every year. The IDR also requested an explanation of the decrease in its U.S. equity amount. Later that month, on July 29, 2016, petitioner's representative returned a letter to

the Division claiming that petitioner holds interests in various LLCs that operate in New York and, as petitioner does not materially participate in the entities within the meaning of Internal Revenue Code (26 USC) § 469 (h), all such losses may be used to offset petitioner's passive activity income. Petitioner's representative included a schedule setting forth sources of the passive activity for each year and the forms 8810 from which they were derived. The decrease in U.S. equity was explained by petitioner to be a reflection of losses that flow to the taxpayer from its interests in the LLCs and stated that "U.S. equity is equivalent to corporate retained earnings" (***see*** findings of fact 29 and 30).

On September 8, 2016, the Division sent a second IDR requesting documentation supporting the losses claimed on forms 8810 for all years and documentation supporting a decrease in U.S. equity. In the response, petitioner's representative included a schedule 1120-F U.S. income tax return of a foreign corporation regarding the net decrease in U.S. equity for each of the years in question along with schedules K-1 for each of the years at issue. While petitioner provided invoices and schedules, it did not provide any third-party verifiable documentation or proof of payments (***see*** findings of fact 31 - 33).

On August 29, 2017, the Division acknowledged receipt of the information provided by petitioner's representative so far and accompanied the acknowledgement with a request for additional information, a third IDR. This IDR included requests for reconciliations and breakdowns by each entity of petitioner's income or loss for 2005; specific documentation and details to support "other passive deductions" for all years under audit and an explanation with workpapers and calculations of how ordinary income was negative for some entities in some years (***see*** findings of fact 40 - 42).

On February 5, 2018, the Division again sent a letter to petitioner's representative indicating that the information thus far provided was still inadequate and also that multiple conversations were had with the representative between the previous correspondence from petitioner and the issuance of the letter. In that letter, the Division indicated that if the Division did not receive a response by February 19, 2018, an assessment would be issued based on information available. The day after that deadline, petitioner's representative responded to the Division by letter with schedules showing details of expenses and asserted that they qualified as "other passive deductions" for all of the tax years in question (***see*** findings of fact 44 and 45). They also provided invoices from a management company and invoices for certain loan guarantee fees and a schedule showing interest charge calculations for loan guarantees regarding one of the hotel LLC entities.

On March 1, 2018, the Division sent two letters and two consents to petitioner indicating tax due in the same amount as indicated in the initial consents issued nearly two years earlier, with additional amounts due from accrued interest and penalty charges. The Division advised that if it disagreed with the findings, petitioner must contact the Division by March 14, 2018. On March 12, 2018, petitioner's representative so notified the Division, requesting further information regarding the computation and asserting that the computations did not take into account additional information provided or returns filed. As the correspondence did not include any further documentation from petitioner, on March 19, 2018, the Division sent two closing letters indicating the same amounts as on the Division's March 1, 2018 letter. The audit that began in 2008 finally concluded on March 22, 2018.

Next, petitioner requested a conciliation conference before BCMS. The conference was held on November 26 and November 30, 2018. The Division again requested petitioner to

provide documentation. The letter acknowledged that petitioner provided certain documents, but that more substantiation would be required. The Division requested specific substantiation, documentation and explanations of claimed management and administrative fees, loan and guarantee fees and interest expenses. For each category, the Division specified the level of detail and the nature of the substantiation requested. It also asked for a further breakdown and work papers regarding how ordinary income and losses were calculated (***see*** findings of fact 57 and 58).

On March 28, 2019, and July 29, 2019, petitioner's representative responded to the BCMS conferee regarding the Division's letter. The March 2019 letter was accompanied by intercompany payable schedules between petitioner and its parent company, two management and administrative agreements between a property management company and petitioner and copies of notes regarding claimed expenses. In the July 2019 letter, petitioner's representative included schedules for the calculation of interest on some of the loans and stated that obtaining additional documentation was challenging because some of the documents "are more than 20 years old, the taxpayer has undergone several moves and personnel changes, and the parent company who maintained records is located outside the United States" (***see*** findings of fact 59 and 60).

On February 14, 2020, the conferee issued a conciliation order sustaining the notices. Petitioner duly filed a petition on or about May 14, 2020, with the Division of Tax Appeals, in protest of the notices.

The audit began as an examination of a related company and, following the determination that petitioner had failed to file required returns, concluded a decade later. Working without returns or supporting documentation more than six years after it began, the Division used the

available information provided by petitioner, verified by other information contained in the Division's own database, to arrive at a computation of tax due from petitioner.

Had the matter ended there with the issuance of notices, the filing of a petition and exception taken against the determination that followed, the question before this Tribunal would have been whether the assessments had a rational basis or, in the alternative, whether petitioner met its burden of proving by clear and convincing evidence that, in view of the records available, the assessments lacked a rational basis. Such a determination, absent returns or substantiation by petitioner, would clearly inure to the Division.

The Division provided petitioner with multiple opportunities over several years to supply the necessary substantiation to support or refute the initial findings, however it failed to do so. Indeed, for the first several years that the audit was being conducted, petitioner did not file returns and significantly after the audit began, offered only pro forma draft returns. When returns were finally filed, the information reported therein did not conform to what petitioners had earlier indicated. Instead of closing the audit at that point, the Division provided petitioner numerous new opportunities to offer substantiation of the significantly higher income and expenses claimed on those returns. In spite of numerous requests, petitioner provided only partial responses that lacked any externally verifiable substantiation. The audit continued for several more years, with requests by the Division continually being met with partial, inconclusive responses.

A decade later when the Division finally issued notices, petitioner claimed that the complexities of its business arrangements and the passage of time prevented it from providing full responses to the Division's requests. Petitioner proceeded at the BCMS conference and at

the hearing below to assert that the Division did not fully explain the basis of its audit and to the extent that the Division did assert a basis for its findings, it was irrational. We disagree.

We conclude that the findings and results of the Division's audit have a rational basis, and that petitioner's actions and inactions left little choice but for the Division to use another method to arrive at a determination of a tax liability, if any. More than six years after the commencement of the "limited scope audit," premised on numbers provided by petitioner and verified by the Division's own database, petitioner filed returns. Even after repeated requests for additional information had been made throughout those years, the Division demonstrated a willingness to modify its findings if the radically different information provided on returns could be substantiated. The Division extended numerous opportunities to petitioner to provide external supporting evidence of the numbers used on the returns, instead of the information previously provided to the Division. Petitioner consistently failed to provide sufficient proof of the basis for the income and expense entries on their late filed returns, and thus failed to bear its burden (***see*** Tax Law § 1089 [e]).

Petitioner takes issue with a single finding of fact in the determination below and challenges the conclusion that the witness for the Division found that the total tax determined to be due was based on the "pro forma" numbers provided by petitioner to the prior auditor, because those were verified by the Division using its real estate transaction database. The Division's witness, Mr. Das, cited to the relevant pages in the audit file showing the prior auditor's draft schedules and the pages reflected in the real estate transfers of the underlying entities. The basis of the determination was the "pro forma" numbers provided by petitioner and verified by the Division using its real estate transaction database.

It appears, therefore, that the portion of that finding petitioner sees as objectionable is the characterization of the Division's database and the relevancy of the pages cited in the audit file. A decade long audit, however, consisting of thousands of pages, all of which are part of the record, points to a radically different conclusion. Additionally, while asserting the incompleteness or inaccuracy of the Division's information, petitioner's claim never rises to a level above a mere assertion. Petitioner's argument that this finding is unsupported is without merit.

Petitioner further argues that since the computation could have been different, the audit results must lack a rational basis. The law does not support petitioner's theory. A presumption of correctness attaches to notices issued by the Division (***see Matter of Greenfeld***, Tax Appeals Tribunal, March 7, 2019, citing ***Matter of Leogrande v Tax Appeals Trib.***, 187 AD2d 768 [3d Dept 1992], ***lv denied*** 81 NY2d 704 [1993]). That presumption can be overcome by a petitioner if it is established, by clear and convincing evidence, that the notices are erroneous (***see*** Tax Law 1089 [e]; ***Matter of Greenfeld***; ***see also Matter of O'Reilly***, Tax Appeals Tribunal, May 17, 2004). Here, petitioner failed to provide requested documentation for several years and after repeated requests by the Division. It is well established that estimates may be used to arrive at a taxpayer's New York tax liability (***see*** Tax Law § 1081 [a]; ***Matter of Rujak Trucking Corp.***, Tax Appeals Tribunal, April 1, 1993; ***Matter of Mountain Star Company, Inc.***, Tax Appeals Tribunal, March 13, 2008). By statute, when a taxpayer fails to file returns, the Division may estimate a taxpayer's liability from "any information in its possession" (Tax Law § 1081 [a]). When returns are filed, as ultimately occurred here, several years late, significantly after an extensive audit was underway and there is a basis for determining that the returns as filed do not

accurately reflect a taxpayer's true income, indirect audit methods can be employed to determine income (***see Matter of R & J Automotive, Inc.***, Tax Appeals Tribunal, June 15, 1989).

Likewise, when a taxpayer claims a deduction, the taxpayer has the burden of proving entitlement to that deduction. It is not the burden of the Division to establish why deductions are disallowed (***see*** Tax Law § 1089 [e]; ***Matter of Macaluso***, Tax Appeals Tribunal, September 22, 1997, ***confirmed*** 259 AD2d 795 [3d Dept 1999]).

Petitioner offered copies of loan and management and guarantor agreements to substantiate claimed expenses. It did not, however, provide proof of payment for a single invoice or agreement submitted. Throughout the audit and even during the BCMS conference process, petitioner was advised numerous times by the Division that direct, independent source documents would be needed to substantiate its claims. Just as many times petitioner failed to provide that documentation. It was petitioner, not the Division, that failed to meet its obligation to establish its claims (***see Matter of Scarpulla v State Tax Commn.***, 120 AD2d 842 [3d Dept 1986]; ***see also Matter of Titan Elevator and Lift LLC***, Tax Appeals Tribunal, September 11, 2017).

We turn now to the question of the computation of tax. The law is clear that the computation that produces the highest tax result from alternative methods is applicable (***see*** Tax Law former § 210; ***Matter of TransCanada Facility USA, Inc.***, Tax Appeals Tribunal, May 1, 2020). For some years, that was the ENI method. However, for three of those years, 2002, 2003 and 2007, the Division utilized the capital base method, which yielded a higher tax. Here, petitioner disputes the inclusion of the fair market value of partnership interests instead of the book value of those assets. Petitioner further argues that because of amendments to the law in 2007, the use of fair market value of partnership interests can be prospective only. We disagree.

The courts have ruled on provisions in the New York City Administrative Code that reflect the overall scheme of Tax Law former § 210 [1] [b] and affirmed the use of the fair market valuation of assets under the capital base method as rationally based (***see e.g. Matter of National Bulk Carriers, Inc. and Affiliates***, New York City Tax Appeals Tribunal, November 30, 2007, ***affd***, 61 AD3d 522 [1st Dept 2009], ***lv denied*** 12 NY3d 716 [2009]).

Finally, we address the matter of penalties. It is undisputed that petitioner initially failed to file returns and ultimately late-filed required returns only after the first six years of an ongoing audit, thus penalties were asserted for failure to file and for late filing pursuant to Tax Law §§ 1085 (a) and (b). In addition, the Division determined deficiencies for the years at issue, forming the basis upon which additional penalties were imposed. We agree with the Administrative Law Judge that the burden is allocated to petitioner to prove that imposition of penalties was improper (Tax Law § 1089 [e]; ***see also Matter of Ross-Viking Mdse. Corp. v Tax Appeals Trib. of State of N.Y.***, 188 AD2d 698, 699 [3d Dept 1992]). The Administrative Law Judge correctly determined that petitioner did not establish reasonable cause or even address the issue of penalties and therefore did not meet its burden of proof on the subject. Petitioner did not address the issue of penalties below. In other words, petitioner had the opportunity to offer evidence or arguments to establish that its failure to file and failure to pay the deficiencies determined was due to reasonable cause, but ultimately failed to make such arguments in the hearing below.

While finally mentioning the assertion of penalties and acknowledging the late filing of its returns in its reply brief on exception, petitioner fails to point to anything in the record that supports their argument that penalties should be abated. Instead, petitioner relies on the argument that the assessments lack a rational basis and should be dismissed, resulting in no tax

due and therefore, no penalty either. We disagree and, thus, sustain the Division's imposition of penalties for failure to file, late filing and negligence.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Cushlin Limited is denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petition of Cushlin Limited is denied; and

4. The notices of deficiency, dated March 22, 2018, are sustained.

DATED: Albany, New York
October 10, 2024

/s/ Jonathan S. Kaiman__ ___
Jonathan S. Kaiman
President

/s/ Cynthia M. Monaco
Cynthia M. Monaco
Commissioner

/s/ Kevin A. Cahill____ ___
Kevin A. Cahill
Commissioner