

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :
of :
STEVE KANNEY : DETERMINATION
for Redetermination of a Deficiency or for Refund of New : DTA NO. 826159
York State Personal Income Tax under Article 22 of the :
Tax Law for the Year 2010. :

Petitioner, Steve Kanney, filed a petition for redetermination of a deficiency or for refund of New York State personal income tax under Article 22 of the Tax Law for the year 2010.

On December 2, 2014 and December 5, 2014, respectively, petitioner, appearing pro se, and the Division of Taxation, by Amanda Hiller, Esq. (Leo Gabovich, of counsel), waived a hearing and agreed to submit this matter for a determination based on documents and briefs submitted by April 20, 2015, which date began the six-month period for the issuance of this determination. After review of the evidence and arguments presented, Herbert M. Friedman, Jr., Administrative Law Judge, renders the following determination.

ISSUE

Whether, for purposes of the add-back to federal adjusted gross income under Tax Law § 612(b)(1), interest income paid on bonds by states other than New York, which are federally tax-exempt but taxable in New York, equals gross income paid on the bonds or whether such interest income equals such gross interest less amortized bond premiums allocable to the tax year.

FINDINGS OF FACT

1. For the year 2010, petitioner, Steve Kanney, was a resident of New York State and filed

a 2010 New York resident income tax return (Form IT-201).

2. For periods prior to and including 2010, petitioner bought and held federally tax-exempt obligations issued by state and local governments other than New York (the municipal bonds). There is no evidence that petitioner bought the municipal bonds as part of his trade or business.

3. Often these federally tax-exempt municipal bonds were purchased at a premium. For example, if a bond carried a stated interest rate that was in excess of current market rates, petitioner paid a premium to acquire the bond.

4. In preparing his 2010 Form IT-201, petitioner reported a federal adjusted gross income (federal AGI) of \$20,709.00. He also separately reported, as a New York addition, interest income of \$13,854.00 from the municipal bonds at line 20. Petitioner computed this amount by reducing the municipal bond gross interest he received in 2010 by that year's amortized portion of the bond premiums he paid to acquire the bonds.

5. Petitioner did not include any of the interest income he received in 2010 from the municipal bonds in his federal AGI for that year.

6. The record does not contain a full copy of petitioner's 2010 federal tax return. Therefore, it is unclear, based on the record presented, whether petitioner itemized his deductions or chose the standard deduction on his 2010 federal tax return.

7. Petitioner did not itemize his deductions on his 2010 Form IT-201. Instead, he chose the standard deduction of \$7,500.00.

8. The Division of Taxation (Division) audited petitioner's 2010 Form IT-201 and determined that it was appropriate to increase the municipal bond interest income reported at line 20. Based on information provided by petitioner's payers pursuant to Tax Law § 658, the

Division increased petitioner's municipal bond interest income from \$13,854.00 to \$17,717.00. The adjustment was an increase of \$3,863.00, which represented inclusion of the 2010 portion of the amortized bond premiums petitioner offset against the gross interest income from the municipal bonds.¹

9. On February 20, 2014, based on its audit determination, the Division issued to petitioner a Notice of Deficiency, which asserted a total of \$204.00 in additional income tax due, plus interest, for the year 2010.

SUMMARY OF THE PARTIES' POSITIONS

10. Petitioner maintains that the municipal bonds at issue were purchased at premiums and, as a result, according to the Internal Revenue Code (IRC), these premiums are to be amortized against income, lowering the total amount of taxable income. Consequently, petitioner states that the federal definition of income, which allows for the amortization of premiums, must be implemented by New York under principles of conformity. He adds that he must be afforded the right to amortize the bond premiums on his 2010 Form IT-201, regardless of the fact that he claimed the standard deduction.

11. The Division asserts that petitioner underreported his income derived from non-New York State municipal bonds and that, under the Tax Law, he cannot claim an offset for amortized premiums on the bonds or a separate itemized deduction when claiming the standard deduction.

CONCLUSIONS OF LAW

A. As a New York resident, petitioner's New York taxable income is his New York adjusted gross income (New York AGI), less New York deductions and New York exemptions

¹Petitioner states in his brief that, upon review, the correct interest income should be \$17,670.00 and the amortized premiums were \$4,284.56, resulting in a corrected income for line 20 of \$13,385.44. There is no evidence that petitioner amended his 2010 Form IT-201, however, and these figures are not supported by the record.

(Tax Law § 611[a]). Petitioner's New York AGI equals his federal AGI with specific modifications both increasing and decreasing federal AGI (Tax Law § 612[a]).

B. Included among the modifications increasing federal AGI for purposes of computing New York AGI is interest income on bonds of states other than New York (including political subdivisions of such other states) to the extent not properly includible in federal AGI (Tax Law § 612[b][1]). There is no dispute in the present matter that interest income on petitioner's federally exempt municipal bonds was excluded from his federal AGI but subject to New York income tax under this add-back modification. The question here is whether the amortized bond premiums allocable to the year at issue may be either 1) offset against gross interest payments in an above-the-line adjustment in calculating petitioner's interest income for purposes of the add-back modification of Tax Law § 612(b)(1) or 2) deducted in a below-the-line adjustment.

C. It is well settled that interest income on bonds, as discussed in Tax Law § 612(b)(1), constitutes gross interest income and not income net of allocable bond premiums (*see Matter of Solomon*, Tax Appeals Tribunal, June 2, 2011). The Tax Law treats bond premiums such as those in the instant case as a below-the-line deduction (*see* Tax Law § 615[d][3]). This deduction, however, is only available to a taxpayer who itemizes his or her deductions (*see* Tax Law § 615[a]). Here, petitioner chose the benefit of the standard deduction pursuant to Tax Law § 613. Hence, as he chose the standard deduction, he is unable to also randomly itemize deductions, including the one for bond premiums.²

D. Petitioner, however, asserts that pursuant to Tax Law § 607(a), principles of federal conformity require that interest income from the bonds is properly determined by reference to the

²From the record presented, it appears that petitioner wisely chose the standard deduction for his 2010 Form IT-201. Given the amount of premiums for the year at issue in the record (\$3,863.00), and without any evidence of other potential deductions, petitioner clearly benefitted by claiming the standard deduction of \$7,500.00.

IRC and its regulations, which provide that, generally, with respect to a taxable bond, a bondholder offsets interest payments on a bond for an accrual period with the bond premium allocable to that period (*see* IRC § 171[e]; Treas Reg § 1.171-2). Petitioner maintains, therefore, that New York taxpayers should likewise be entitled to report as interest income payments of interest net of the allocable bond premiums.

Petitioner's argument lacks support under the facts and law. Federal conformity does not extend to circumstances "[w]here a different meaning is clearly required" and is "subject to the exceptions or modifications prescribed by Article 22 or by statute" (*see* Tax Law § 607[a]; *see also Matter of Pospischil*, Tax Appeals Tribunal, June 6, 1996). Initially, it must be noted that this matter deals with income that is federally tax-exempt. Despite petitioner's insistence to the contrary, the Tax Appeals Tribunal has addressed the instant issue in *Matter of Solomon*, where it refuted the same claim that federal conformity required that New York treat the premiums paid on federally-exempt municipal bonds in the same manner as the IRC. In doing so, the Tribunal stated that:

"We note that the federal conformity principle does not affect this matter because the Code does address the subject matter (Tax Law § 607[a]). This is not a case where the Tax Law specifically references terms from the Code (*see e.g. Matter of Brookfield Power Corp.*, Tax Appeals Tribunal, November 10, 2010). Rather, Tax Law § 612(b)(1) calls for the treatment of interest income that is not included within the Federal adjusted gross income and must be added back at the state level. We find that the New York scheme for addressing this income, generated from bonds issued by states other than New York, differs from the Code because the latter exempts such income from taxation while the former imposes tax, clearly requiring a different result (*c.f. Matter of Webster v. Tully*, 56 NY2d 532 [1982]). Accordingly, we hold that it is inappropriate to look to Federal law for guidance on federally tax-exempt municipal bonds because the Code is silent on such income."

Pursuant to *Matter of Solomon*, federally tax-exempt interest income for purposes of the Tax Law § 612(b)(1) add-back means gross interest payments and not interest payments net of amortized bond premiums. Meanwhile, amortized bond premiums may be deducted from New

York AGI pursuant to Tax Law § 615(d)(3), an option petitioner elected to forego.

E. Petitioner attempts to distinguish *Matter of Solomon* by arguing that the case solely applies to those, unlike petitioner, who itemize their deductions. He adds that the Tribunal did not address those that claim the standard deduction. As a result, petitioner asserts, the improper application of *Matter of Solomon* prohibits those who claim the standard deduction from gaining the tax benefit of premiums.

On the contrary, pursuant to *Matter of Solomon*, the Tribunal emphasized that a taxpayer may benefit from the payment of premiums by claiming an itemized deduction. There are situations, however, such as petitioner's, where claiming the standard deduction provides a greater benefit than itemization. The principle of *Matter of Solomon*, that the Tax Law imposes a different statutory scheme than the IRC for addressing income generated from bonds issued by states other than New York and related bond premiums, is applicable in the instant case, regardless of petitioner's election of the standard deduction (*see also Matter of Pospischil* [deductibility of gambling losses treated differently under IRC and the Tax Law]).

F. In sum, the Tribunal has refused to accept petitioner's definition of interest income under the Tax Law as the net of gross income less allocable bond premiums. Instead, Tax Law § 615(d)(3) allows for a below-the-line deduction for bond premiums, an option petitioner abandoned when he claimed the standard deduction. As the Tribunal also noted was the case in *Matter of Solomon*, petitioner's argument appears to be with the New York statutory scheme, an objection more appropriately directed to the Legislature.

G. The petition of Steve Kanney is denied and the Notice of Deficiency dated February 20, 2014 is sustained.

DATED: Albany, New York
September 3, 2015

/s/ Herbert M. Friedman, Jr.
ADMINISTRATIVE LAW JUDGE