STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
BRUCE AND DANIELLE LIFTON	:	DETERMINATION DTA NO. 827854
For Redetermination of a Deficiency of Personal Income Tax under Article 22 of the Tax Law for the Year 2011.	:	

Petitioners, Bruce and Danielle Lifton, filed a petition for redetermination of a deficiency of New York State personal income tax under article 22 of the Tax Law for the year 2011.

On August 8, 2018, petitioners, Bruce and Danielle Lifton, appearing by Roberts & Holland LLP (Ellen S. Brody, Esq., of counsel), and the Division of Taxation, appearing by Amanda Hiller, Esq. (Michelle W. Milavec, Esq., of counsel), waived a hearing and submitted the matter for determination based on documents and briefs to be submitted by December 18, 2018, which date began the six-month period for issuance of this determination. After due consideration of the documents and arguments submitted, James P. Connolly, Administrative Law Judge, renders the following determination.

ISSUE

Whether petitioners were entitled to deduct $1,458,158.00 in investment interest expense on their 2011 New York State nonresident income tax return.

FINDINGS OF FACT

Petitioners, Bruce and Danielle Lifton, and the Division of Taxation (Division) entered into a joint stipulation of facts. These facts, as relevant, are included in the facts set forth below.[1]

1. Petitioners were residents of Florida in tax year 2011 and were not residents of New York for any part of that year.

2. From 2006 to 2011, petitioner Bruce Lifton, through a single member limited liability company, Lifton Homes LLC, owned a 50% membership interest in Meadow Lane Development, LLC (MLD), a New York limited liability company taxable as a partnership for Federal and New York State income tax purposes.

3. MLD owned real property subject to a mortgage (the Meadow Lane Property), on which it paid interest. For the years 2006 through 2010, MLD reported to Bruce Lifton his share of the interest expense, as shown in the following table:

2006	2007	2008	2009	2010	Total
$279,684.00	$218,384.00	$274,615.00	$409,965.00	$465,452.00	$1,648,100.00

4. For the years 2006 through 2010, under Internal Revenue Code (IRC) § 163 (d), petitioners did not have sufficient net investment income to deduct Bruce Lifton's share of the MLD interest expense, and so petitioners carried the interest expense forward.

5. Article 22 of the Tax Law does not have a rule comparable to IRC § 163 (d), but rather calculates New York adjusted gross income (New York AGI) based on federal adjusted gross

[1] Petitioners submitted 16 proposed findings of fact pursuant to section 3000.15 (d) (6) of the Rules of Practice and Procedure of the Tax Appeals Tribunal. All of the proposed findings of fact have been accepted and incorporated within the findings herein except for proposed findings of fact 14 through 16, which set forth undisputed procedural matters whose recitation is unnecessary for the resolution of this matter.

income, with certain modifications. Thus, petitioners did not deduct the MLD interest expense in calculating their New York AGI for the years 2006 through 2010.

6. In 2011, Bruce Lifton's share of the MLD interest expense was $362,292.00.

7. The Meadow Lane Property was sold in 2011.

8. Bruce Lifton's share of the gain from the sale of the Meadow Lane Property in 2011 was $1,440,391.00.

9. On line 14 of their schedule A on their 2011 federal form 1040, U.S. individual income tax return, petitioners deducted investment interest in the amount of $1,458,158.00. Of this amount, $1,067,286.00 was attributable to "disallowed investment interest prior years" that had been suspended under IRC § 163 (d).

10. On their 2011 New York non-resident income tax return (form IT-203), petitioners reported a federal AGI of $1,446,157.00. On that return, petitioners reported New York itemized deductions restricted to 50% of their charitable contributions, or $2,426.00. On line 29 of their return, petitioners took a subtraction modification of $1,458,158.00, which was the same amount as the investment interest deduction on their federal form 1040, schedule A, line 14. Petitioners reported the interest deduction as a subtraction on their form IT-203 because the form did not allow for additional itemized deductions.

11. On audit of petitioners' form IT-203, the Division accepted petitioners' federal adjusted gross income of $1,446,157.00. However, the Division adjusted petitioners' calculation of their New York AGI by disallowing petitioners' subtraction modification for their investment interest deduction of $1,458,158.00, granting them only a New York subtraction modification of $4,331.00 for interest from a federal government bond. This resulted in a New York AGI of

$1,441,826.00. In calculating petitioners' New York taxable income, the Division determined that petitioners were entitled to itemize their deductions because they had done so on their federal return, but that they were subject to the cap on itemized deductions imposed by Tax Law § 615 (g) because their New York adjusted gross income was in excess of $1,000,000.00. This resulted in their New York itemized deductions being limited to 50% of their charitable deduction of $4,852.00, or $2,426.00. Because the latter amount was less than New York's standard deduction, the Division applied the standard deduction amount of $15,000.00. After granting petitioners an exemption of $1,000.00 for their child under Tax Law § 616, the Division computed a New York taxable income of $1,425,826.00 and a tax base of $127,897.00. The Division accepted petitioners' return's source fraction of 98.52% pursuant to Tax Law § 601 (e) (3). Applying that source fraction to petitioners' tax base of $127,897.00, the Division computed tax due in the amount of $126,004.00.

12. Based on that audit, the Division issued to petitioners a notice of deficiency, assessment identification number L-043441618, dated July 31, 2015 (notice), for tax year 2011, asserting tax due of $126,004.00, interest due of $35,263.88, and a penalty of $23,931.94. The Division asserted that, because petitioners' New York AGI for 2011 was greater than $1 million, under Tax Law § 615 (g), petitioners' itemized deductions for 2011 were limited to 50% of charitable contributions made, and that no deduction was allowable for interest expense.

CONCLUSIONS OF LAW

A. On their joint form IT-203, petitioners took a subtraction modification of $1,458,158.00 for their investment interest expense deduction. On audit, the Division disallowed petitioners' subtraction modification on the ground that article 22 of the Tax Law does not permit any subtraction modification for investment interest expense. Petitioners do not disagree with that audit adjustment, but contend that they should have been allowed an itemized deduction for the investment interest expense amount, whereas the Division, applying the cap on itemized deductions in Tax Law § 615 (g), restricted their itemized deductions to 50% of their charitable contribution or $2,426.00. Petitioners do not dispute that, if the deduction cap applies to their 2011 return, the tax imposed by the notice is correct. Thus, the main issue in this matter is the applicability of Tax Law § 615 (g), which provides, as pertinent to 2011:

> "With respect to an individual whose New York adjusted gross income is over one million dollars and no more than ten million dollars, the New York itemized deduction shall be an amount equal to fifty percent of any charitable contribution deduction allowed under section one hundred seventy of the internal revenue code."

The Division argues that the provision applies to resident and nonresident taxpayers alike. Petitioners claim that § 615 (g) only applies to residents, and thus does not apply to them because they are nonresidents. Petitioners bear a heavy burden in regard to this statutory construction issue. A deduction is a type of tax exemption and, therefore, the rules of construction pertaining to exemptions are applicable (***see Matter of Grace v New York State Tax Commn.***, 37 NY2d 193, 197 [1975], ***rearg denied*** 37 NY2d 816 [1975], ***lv denied*** 338 NE2d 330 [1975]). Specifically, deduction and exemption statutes must be strictly construed against the taxpayer (***see e.g. Matter of 677 New Loudon Corp. v State of N.Y. Tax Appeals Trib.***, 19 NY3d 1058 [2012], ***rearg denied*** 20 NY3d 1024 [2013], ***cert denied*** 134 S Ct 422 [2013]). "An exemption [or deduction] from taxation 'must clearly appear, and the party claiming it must be able to point to some provision of law plainly giving the exemption"' (***Matter of Grace***, 37 NY2d at 196, quoting ***People ex rel. Savings Bank of New London v Coleman***, 135 NY 231 [1892]; ***see also***

Matter of Impath, Inc., Tax Appeals Tribunal, January 8, 2004). Moreover, petitioners must prove that the Division's interpretation herein is irrational and that their interpretation of the statute is the only reasonable construction (***see Matter of Brooklyn Navy Yard Cogeneration Partners, L.P. v Tax Appeals Trib. of State of N.Y.***, 46 AD3d 1247 [3d Dept 2007], ***lv denied*** 10 NY3d 706 [2008]; ***Matter of Refco Properties, Inc.***, Tax Appeals Tribunal, July 11, 1996). Nevertheless, construction of a deduction statute should not be so narrow as to defeat the provision's settled purpose (***see Matter of Grace***).

B. The Division's position that the deductibility cap in Tax Law § 615 (g) applies to nonresidents turns on Tax Law § 601 (e), which provides as follows:

> "Nonresidents and part-year residents. (1) General. There is hereby imposed for each taxable year on the taxable income which is derived from sources in this state of every nonresident and part-year resident individual and trust and every nonresident estate a tax which shall be equal to the tax base multiplied by the New York source fraction.
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> (2) Tax base. The tax base is the tax computed under subsections (a) through (d) of this section, as the case may be, reduced by the credits permitted under subsections (b), (c), (d) and (m) of section six hundred six, as if such nonresident or part-year resident individual, estate or trust were a resident subject to the provisions of part II of this article.
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> (3) New York source fraction. The New York source fraction is a fraction the numerator of which is such individual's, estate's or trust's New York source income determined in accordance with part III of this article and the denominator of which is such individual's New York adjusted gross income determined in accordance with part II of this article or such estate's or trust's New York adjusted gross income determined under paragraph four of this subsection."

Thus, the Division maintains that, under Tax Law § 615 (e), to calculate their tax, nonresidents are required to calculate their tax base under Tax Law § 601 (e) (2) and then multiply the product by a source fraction under Tax Law § 601 (e) (3). Crucially, however, to calculate their tax base under Tax Law § 601 (e) (2), nonresidents are required to calculate their tax under subsections

(a) through (d) of Tax Law § 601 "as if such nonresident . . . were a resident subject to the provisions of part II of this article." Part II of article 22 covers Tax Law §§ 611 to 630-F, including Tax Law § 615. As discussed above, subsection (g) of Tax Law § 615 imposes a cap on the itemized deductions of taxpayers with a New York AGI more than one million dollars and less than ten million dollars. The cap is equal to 50% of any charitable contribution deduction allowed under IRC § 170. Because petitioners' New York adjusted gross income for 2011 was in excess of $1,000,000.00, the Division limited petitioners' New York itemized deductions to $2,426.00, one-half of their itemized deduction for charitable contributions.

In arguing that the itemized deduction cap in Tax Law § 615 (g) does not apply to them because they are nonresidents, petitioners focus on the exact wording of that provision, pointing out that it does not expressly refer to nonresident individuals, while subsection (a) of Tax Law § 615 refers to a "resident individual":

> "(a) General. If federal taxable income of *a resident individual* is determined by itemizing deductions from his federal adjusted gross income, he may elect to deduct his New York itemized deduction in lieu of his New York standard deduction. The New York itemized deduction of *a resident individual* means the total amount of his deductions from federal adjusted gross income, other than federal deductions for personal exemptions, as provided in the laws of the United States for the taxable year, with the modifications specified in this section, except as provided for under subsections (f) and (g) of this section" (emphasis added).

Petitioners urge that, in light of the reference to "a resident individual," in Tax Law § 615 (a), subsection (g) of section 615 should also be interpreted to refer only to New York residents. Instead of looking to Tax Law § 615 to determine the New York itemized deductions applicable to a nonresident, petitioners argue that "the New York adjusted gross income of a nonresident is equal to the net amount of items of income, gain, loss and deduction entering into his Federal adjusted gross income that is derived from New York sources," citing Tax Law § 631 (a) (1) and 20 NYCRR § 132.1 (a).

There are a number of problems with this argument. First, as the Division properly argues, even if Tax Law § 631 (a) were relevant to determining petitioners' tax base, petitioners would still not prevail here because that section includes in New York sourced income the "net amount of items of income, gain, loss, and deductions entering into [an individual's] federal adjusted gross income . . . derived from or connected with New York sources." Deductions that go into the calculation of federal AGI are found in IRC § 62. IRC § 62 (a) defines federal adjusted gross income, in the case of an individual, as "gross income minus [specified] deductions." There is no deduction in IRC § 62 (a) for investment interest expense. Rather, as petitioners acknowledge in their brief, investment interest expense is deductible from federal taxable income pursuant to IRC § 163 (a). Secondly, if, as petitioners argue, Tax Law § 615 does not apply to nonresidents, the question arises as to how a nonresident taxpayer would take advantage of the New York itemized deductions provided in that section.

The most significant flaw in petitioners' argument, however, is that it attempts to construe Tax Law §§ 615 and 631 in isolation. A fundamental principle of statutory construction is that a "statute or legislative act is to be construed as a whole, and all parts of an act are to be read and construed together to determine the legislative intent" (McKinney's Cons Law of NY, Book 1, Statutes § 97; ***see Matter of Coltec Indus., Inc.***, Tax Appeals Tribunal, March 18, 2016). Tax Law § 606 (e) (2) clearly provides that a nonresident individual's tax base is to be computed under Tax Law § 606 (a) through (d) as if the nonresident individual were a resident individual. That language can only mean that, because the deduction cap in Tax Law § 615 (g) applies to resident individuals, the cap also applies to nonresident individuals. Petitioners provide no alternate reading of Tax Law § 601 (e). Moreover, this view of Tax Law § 615 (e) is consistent with how the Court of Appeals has explained the scheme in article 22 for taxing nonresidents (***see Lunding v Tax Appeals Trib. of State of N.Y.***, 89 NY2d 283, 287 [1996], ***rev'd on other grounds sub nom. Lunding v New York Tax Appeals Trib.***, 522 U.S. 287 [1998] ["the tax of a nonresident is first calculated 'as if [the taxpayer] were a resident,' and the sum is then reduced by the percentage of income earned in New York compared to total inco me. . . . The hypothetical 'as if a resident' tax liability includes all deductions available to a resident"]). Similarly, petitioners' reliance on Tax Law § 631 to compute their tax base also cannot be squared with Tax Law § 615 (e). Tax Law § 631 is found in part III of article 22, and Tax Law § 601 (e) clearly provides that a resident individual's tax base is to be computed using the provisions of part II of article 22, while part III is to be used to compute the numerator of the New York source fraction. Thus, petitioners may not rely on Tax Law § 631 in computing their tax base.

Petitioners also contend that the Division's view that the cap on New York itemized deductions in Tax Law § 615 (g) applies to nonresidents is inconsistent with the personal income tax regulations. According to petitioners, the regulation "governing modifications to itemized deductions" is 20 NYCRR § 137.3 (b), which provides that:

> "In determining the New York itemized deduction of a nonresident partner, any modification, described in sections 115.2 through 115.4 of this Title, which relates to a partnership item which for Federal income tax purposes is allowable as an itemized deduction, must be made in accordance with the partner's distributive share of such item for Federal income tax purposes."

Petitioners point out that regulation § 137.3 (b) does not refer to any regulation limiting the amount of a nonresident's New York itemized deductions, whether in Tax Law § 615 (g), or the limitation in Tax Law § 615 (f). This argument is to no avail. The fact that 20 NYCRR § 137.3 (b) does not include any reference to limitations on the total amount of a nonresident's itemized deductions is not significant. The regulation's reference to "the New York itemized deduction of a nonresident partner" makes clear that the regulation is purporting only to explicate the rules applying to the itemized deductions of a nonresident partner *qua* partner. Since the cap on itemized deductions in Tax Law § 615 (g) applies to all nonresidents, regardless whether they are partners, there was no need for the regulation to refer to any regulation implementing the itemized deduction caps in Tax Law § 615 (f) or (g).

C. Finally, petitioners argue that applying the cap on itemized deductions in Tax Law § 615 (g) here amounts to an equal protection violation because such an application is arbitrary and capricious and amounts to discrimination. They emphasize how unfair it is to deny them any deduction in this situation where "petitioners were allocated gain from a partnership in excess of $1,000,000.00, but were also allocated losses from that very same partnership that also exceeded

$1,000,000," such that the taxpayer had no real economic gain, but, according to the Division, would be treated as having New York taxable income of over $1.4 million.[2]

While application of the Tax Law § 615 (g) cap arguably leads to a harsh result here by treating petitioners as having income that in reality is offset by closely related expenses, unfairness does not necessarily give rise to an equal protection claim. To establish such a claim, among other requirements, a taxpayer must be able to identify a class of similarly situated persons being treated in a different way because "[w]ithout a showing of uneven treatment, there is no equal protection violation [citations omitted]" (***Matter of Purcell***, Tax Appeals Tribunal, November 14, 2016). Here, petitioners have not identified any such class of similarly situated persons. In ***Matter of Karlsberg*** (Tax Appeals Tribunal, March 1, 2010, ***confirmed Matter of Karlsberg v Tax Appeals Trib. of the State of New York***, 85 AD3d 1347 [3d Dept 2011]), the Tax Appeals Tribunal rejected an equal protection claim made by a nonresident who had substantial income from gambling but whose gambling losses for the same year were found to be subject to the deductibility limitation in Tax Law § 615 (f), stating:

> "Tax Law § 615(f) effectively imposes a higher tax on higher income taxpayers by reducing the amount of their otherwise allowable itemized deductions. Despite the fact that petitioner did not retain her gambling winnings in the years at issue but proceeded to lose them in their entirety, the fact remains that during those years, her gambling gains were properly reported as income. New York's treatment of petitioner is no different than its treatment of any other New York resident taxpayer similarly situated in terms of annual income who has potentially off-setting itemized deductions for federal purposes due to medical expenses, *investment interest*, or casualty or theft losses. Such expenses and losses would be fully deductible for

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[2] In the course of making this argument, petitioners also contend that the itemized deduction cap in Tax Law § 615 (g) was not meant to apply in such a situation. Because petitioners point to nothing in the legislative history to support that contention, it is rejected.

> federal purposes, but limited for New York State purposes. Absent a showing of uneven treatment, there can be no equal protection violation (***see, Trump v. Chu***, 65 NY2d 20 [1985], ***lv dismissed*** 474 US 915 [1985])" (emphasis added).

Inasmuch as the equal protection claim in ***Karlsberg*** also involved a case where a taxpayer was being denied a full itemized deduction for an expense (gambling losses) closely related to the income on which the taxpayer was being taxed (gambling winnings), petitioners' equal protection claim cannot be sustained in the face of ***Karlsberg***. Petitioners argue that a taxpayer with taxable income from gambling winnings who, under Tax Law § 615 (f), is denied a full itemized deduction for gambling losses is not similarly situated to petitioners whose income arose from a capital gain related to a sale of real property and who is being denied an itemized deduction for related investment interest expense. The Tribunal's likening the taxpayer with gambling winnings and losses in ***Karlsberg*** to a taxpayer with "investment interest" expense indicates that the Tribunal would not agree with petitioners' attempt to distinguish the two situations. Accordingly, petitioners' equal protection claim is rejected.

D. The petition of Bruce and Danielle Lifton is denied, and the notice of deficiency dated July 31, 2015 is sustained.

DATED: Albany, New York
June 13, 2019

/s/ James P. Connolly
ADMINISTRATIVE LAW JUDGE