

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
	:	
of	:	
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<b>YACOV HAREL</b>	:	DETERMINATION
	:	DTA NO. 829515
	:	
for Redetermination of a Deficiency or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law for the Years 2014 and 2015.	:	

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Petitioner, Yacov Harel, 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 years 2014 and 2015.

A videoconferencing hearing via Cisco Webex was held before Kevin R. Law, Administrative Law Judge, on June 18, 2021, with all briefs to be submitted by November 5, 2021, which date commenced the six-month period for issuance of this determination. Petitioner appeared by Gallet, Dreyer and Berkey, LLP, (David I. Faust, Esq., of counsel) and Hertz Herson CPA LLP (Brian Gloznek, CPA, of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (Linda A. Farrington, Esq., of counsel).

***ISSUES***

I. Whether the Division of Taxation properly imposed taxation on petitioner's full distributive share of partnership income from ISOA, LLC.

II. Whether penalties were properly imposed.

***FINDINGS OF FACT***

1. ISOA, LLC (ISOA) is a domestic limited liability company located on West 30th Street in New York, New York. ISOA's business is brokering health insurance to college students.

2. During the years 2012 through, and including, 2015, Krenor Ziv, a New York State resident individual, held a 33% interest in ISOA. The other 67% was held by Yono Simu, Ltd. (Yono), an Israeli family company that is disregarded for tax purposes.

3. Yono is owned by petitioner, Yacov Harel, an Israeli citizen and nonresident of New York.

4. For the 2014 tax year, ISOA filed federal and New York State partnership returns reporting \$6,640,625.00 of ordinary income. ISOA issued a federal form K-1 to Yono reporting \$3,892,839.00 of ordinary income and \$20,155.00 of interest income. A statement attached to the federal partnership return provides, in relevant part, as follows:

“EFFECTIVELY CONNECTED U.S. SOURCE TAXABLE INCOME (IRC SEC. 864) ALLOCATED TO FOREIGN PARTNER AND SUBJECT TO U.S. TAX: AMOUNT: 1946419/FOREIGN SOURCE INCOME NOT EFFECTIVELY CONNECTED AND NOT SUBJECT TO U.S. TAX: AMOUNT: 1946419. . .”

5. In section 9 of its 2014 New York State partnership return, ISOA reported that all of its gross receipts of \$34,167,092.00 were New York source gross income and that its metropolitan commuter transportation district (MCTD) allocation percentage was 100%.<sup>1</sup> In contrast, in section 10 of said return, ISOA indicates that its books and records do not reflect income earned in New York and no allocation schedule was filled out; nor does part 1 of section 10 indicate all places, both in and out of New York, where the partnership carried on business.

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<sup>1</sup> Partnerships doing business within the MCTD must pay a Metropolitan Commuter Transportation Mobility tax.

6. For the 2015 tax year, ISOA filed federal and New York State partnership returns reporting \$1,799,018.00 of ordinary income. ISOA issued a federal form K-1 to Yono reporting \$736,742.00 of ordinary income and \$17,834.00 of interest income.<sup>2</sup> A statement attached to the federal partnership return provides in relevant part, as follows:

“Effectively connected U.S. Source Taxable Income (IRC Sec. 864) allocated to foreign partner and subject to U.S. tax: amount: 368371/foreign source income not effectively connected and not subject to U.S. tax: amount: 368371.....”

7. In section 9 of its 2015 New York State partnership return, ISOA reported that \$7,208,637.00 of its total gross receipts of \$14,390,656.00 was New York source gross income. Like the 2014 return, ISOA indicated, in section 10 of the 2015 return, that its books and records do not reflect income earned in New York. Part 1 of section 10 of this return was not filled out to indicate all places, both in and out of New York, where the partnership carried on business. ISOA, however, reported in part 2 of section 10, that 50% of its receipts were New York sourced.

8. Petitioner filed federal nonresident alien tax returns and New York State nonresident income tax returns for the 2014 and 2015 tax years reporting federal adjusted gross income consistent with the statements attached to ISOA’s federal partnership returns that 50% of the distributive share of such income during those years was not effectively connected income and not subject to federal (or state) taxation.

9. On or about September 7, 2017, the Division of Taxation (Division) commenced an audit of petitioner and ISOA for the period January 1, 2014 through December 31, 2015 (audit

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<sup>2</sup> There is no indication in the record explaining why the form K-1 issued to petitioner reported ordinary income of \$736,742.00 representing a 33% share of ISOA’s ordinary income despite the K-1 reporting his share of ISOA’s profits and losses as 67%. Conversely, the K-1 issued to Ms. Ziv, reports her profit and loss percentage as 33%, yet reports ordinary income representing a 67% share.

period). On such date, the Division's auditor sent an information document request (IDR) to ISOA, requesting the following:

“1. A written description of the business activities of the taxpayer both within and without NYS. Also include a description of the places of business and activities performed at each location, the number of employees. and whether the location is owned or leased.

2. Names, addresses, and Social Security numbers of [officers/shareholders/partners]. Please include their duties and responsibilities.

3. An organizational chart identifying parent, subsidiary, brother or sister entities as well as a detailed description of their business activity inside and outside of New York.

4. Advise whether or not any affiliated entities file New York State Tax Reports. If so, list the name and employer identification numbers of each.

5. Provide a federal audit history, including information about ongoing audits. If there are recently completed federal audits, please provide a copy of the RAR. If these changes have been reported NYS, provide a copy of the document filed with NYS and proof of payment.

a. Copies of New York State and federal returns filed by the entity.

b. Copy of the Schedule K-1 (federal and New York State equivalent) issued to you.

c. A description of the principal activity of the entity and the location where that activity is carried on.

d. Calculation showing how the New York amount from Schedule E was determined.

e. Form 1065, U.S. Return of Partnership Income, including Schedule K-1.

6. Provide the following information to support the computation of the allocation percentages used on the New York State return.

a. Workpapers supporting the computation of the allocation percentages used on the NYS return.

b. Provide a breakdown for Everywhere receipts by location.

c. A breakdown of total receipts by various revenue streams.

- d. Description of how each revenue stream was earned.
- e. Description of how each revenue stream was allocated to New York.
- f. Provide copies of any written procedures used to record receipts/revenue (internal controls).
- g. Provide a written description of the typical step-by-step process for allocating receipts from the source document to the financial statements.”

10. Because ISOA did not respond to the September 7, 2017 IDR, the Division resent the same IDR to it on October 31, 2017.

11. The Division’s auditor spoke with ISOA’s accountant, Brian Gloznek, CPA, on November 30, 2017, whereupon Mr. Gloznek requested a 30-day extension of time within which to respond to the IDR.

12. On January 4, 2018, the auditor again spoke to Mr. Gloznek. Mr. Gloznek requested these audits be put on hold pending the outcome of a prior audit involving the 2010 through 2013 tax years. Mr. Gloznek agreed to sign a waiver extending the statute of limitations for assessment until April 15, 2019, which was received by the Division on January 16, 2018.

13. On December 10, 2018, the auditor requested another waiver extending the statute of limitations be executed.

14. On February 20, 2019, the auditor received a facsimile from attorney David Faust indicating that petitioner would not be executing another waiver.

15. Thereafter, the auditor utilized prior audit information relating to petitioner as well as publicly available information to complete the audit of ISOA. Specifically, the auditor’s research determined that ISOA and Ms. Ziv were licensed insurance brokers located in New York City. Petitioner was not licensed. ISOA’s insurance broker information indicated it had a New York City address and telephone number and review of ISOA’s website confirmed the New York City address.

16. A prior audit of petitioner revealed that petitioner was an employee of International Service Optimization, Inc. (ISO, Inc.), a corporation that he and Ms. Ziv owned in the same proportion as their ownership interest in ISOA. The auditor explained that the prior audit determined that ISOA leased employees from ISO, Inc., and deducted such expenses as an “administrative expense” on its partnership returns. During 2014, ISO Inc., had 14 employees including petitioner and Ms. Ziv; in 2015, ISO Inc., had 12 employees, including petitioner and Ms. Ziv. These employees, other than petitioner, were New York based. The auditor also determined that ISO Inc.’s primary source of revenue was providing services to ISOA.

17. Based on her findings, the auditor determined that petitioner’s distributive share of income from ISOA was effectively connected and was also from New York sources based upon ISOA’s office location, the failure to provide information during the audit, and petitioner’s prior audit history.

18. On March 18, 2019, the Division issued to petitioner notice of deficiency L-049545098, asserting tax of \$173,763.00 and \$25,225.00 for the 2014 and 2015 tax years, respectively (the notice). In arriving at the asserted tax, the auditor first adjusted petitioner’s reported federal adjusted gross income by increasing it by the total amount of K-1 income from ISOA that ISOA deemed was not effectively connected income. The auditor then computed the New York source fraction based upon her finding that the full amount of ISOA K-1 income, as adjusted, was New York income. The notice also asserted negligence penalties and interest plus a penalty for failing to provide information upon audit.

19. At the hearing in this matter, petitioner did not present any witness or documentary evidence. Rather, petitioner presented arguments on the law as well as letters sent to the Division during the prior audit of petitioner. In those letters, petitioner claimed that all items of

income of ISOA were derived from commissions paid by non-United States insurance companies based on premiums paid by foreign students. Petitioner also claimed that ISOA's income was largely attributable to the work on behalf of ISOA he performed in Israel. Specifically, in a letter to the auditor dated February 27, 2015, Mr. Gloznek, asserted that petitioner:

- “1. Assessed company's existing mission, objectives and strategies with respect to products and services, operations, finance, technology, and management;
2. Developed strategic plan to expand company's services to universities, international students, scholars, dependents, non-U.S. citizens;
3. Defined goals company that are quantifiable, consistent, realistic and achievable and develop the' programs to implement the strategic plan that covers resources, objectives, timelines, deadlines, budgets and performance targets;
4. Oversaw the company's performance, defining goals, time lines, finance and budgeting parameters, and so on;
5. Analyzed the body of insured students and a financial analysis of profit/loss scenarios, negotiate student health insurance plans/products with insurance companies;
6. Constant contact with company's insurance advisors and brokers, insurance company legal and risk managers, and company's agents;
7. Oversaw budgets, perform project cash flow analysis, and fund allocations; and
8. Daily contact with company's manager via e-mails and phone.”

20. The contents of the letter have not been sworn to, nor does Mr. Gloznek provide a basis for his knowledge. Petitioner did not present any witnesses at the hearing in this matter nor submit any evidence in admissible form establishing the source of ISOA's income.

### ***CONCLUSIONS OF LAW***

A. It is well established that a notice of deficiency issued by the Division is presumed to be correct until the contrary is established, and the burden of showing that such a notice is incorrect rests upon the petitioner (*see* Tax Law 689 [e]; ***Matter of Leogrande v Tax Appeals***

*Tribunal* , 187 AD2d 768 [3d Dept 1992], *lv denied* 81 NY2d 704 [1993]; *Matter of Tavolacci v State Tax Commn.* , 77 AD2d 759 [3d Dept 1980]). As noted, in arriving at the asserted tax, the auditor first adjusted petitioner's reported federal adjusted gross income by increasing it by the total amount of K-1 income from ISOA that it deemed was not effectively connected income. The auditor also found the full amount of ISOA K-1 income, as adjusted, was New York sourced and computed tax accordingly.

B. Petitioner has challenged the notice of deficiency, asserting that (i) the Division has no authority to adjust his federal adjusted gross income, as reported to, and accepted by, the Internal Revenue Service; and (ii) 50% of his distributive share of income from ISOA was non-effectively connected income and not subject to taxation in the United States or New York.

C. First, petitioner's assertion that the Division has no authority to change his federal adjusted gross income as reported to the Internal Revenue Service is rejected. Section 601 (e) (1) of the Tax Law imposes tax on the income from New York sources of a nonresident individual. The tax imposed upon the nonresident is equal to the tax imposed upon a New York resident for the full year, reduced by certain credits, and then multiplied by the New York source fraction (*see* Tax Law § 601 [e] [2], [3]). The tax computed as if the taxpayer were a resident is determined by applying the appropriate graduated rate in Tax Law § 601(a) through (c) to the taxpayer's total income from all sources (less any statutory deductions, exemptions or credits [*see* Tax Law §§ 606, 611 (a)]). The taxpayer's total income is derived from "New York adjusted gross income" (Tax Law § 611 [a]), which is determined by reference to the taxpayer's "federal adjusted gross income *as defined in the laws of the United States for the taxable year . . .*" (Tax Law § 612 [a] [emphasis supplied]). In turn, the New York source fraction, is equal to the individual's New York source income divided by the individual's New York adjusted gross

income from all sources for the entire year (*see* Tax Law § 601 [e] [3]). A nonresident individual's New York source income is defined by Tax Law § 631 (a) (1) and (2) as “the net amount of items of income, gain, loss, and deduction entering into his federal adjusted gross income, *as defined in the laws of the United States* for the taxable year, derived from or connected with New York sources, including: (A) his distributive share of partnership income, gain, loss and deduction, determined under section six hundred thirty-two...”(emphasis supplied).

D. The New York source income of a nonresident partner includes his distributive share of all items of partnership income, gain, loss and deduction entering into his federal adjusted gross income to the extent such items are derived from or connected with New York sources (*see* Tax Law § 632 [a] [1]). The New York source partnership income is determined by calculating the percentage of partnership business activity both within and without New York, looking at partnership property, partnership payroll and partnership gross income (*see* 20 NYCRR 132.15 [d], [e], and [f]).

E. The references to “federal adjusted gross income, as defined in the laws of the United States” in Tax Law §§ 601, 612 and 631 undermine petitioner's claim that the Division is bound to accept petitioner's federal adjusted gross income as reported. The Division is not required to accept petitioner's federal adjusted gross income as reported. To suggest otherwise would permit all state taxpayers who, whether consciously or unconsciously, underreported their federal adjusted gross income to benefit from a misapplication of the law. Such is a result the legislature surely could not have intended.

F. Moreover, petitioner's argument is also in conflict with the plain language of Tax Law § 681, which provides if that upon examination of a return, the Division determines an

underpayment of tax, it may issue a notice of deficiency to the taxpayer. The statute does not limit the Division's examination to New York additions and subtractions or to issues concerning residency or domicile. To suggest otherwise is absurd.

G. Next, turning to petitioner's claim that only 50% of his distributive share of income from ISOA is effectively connected income, this argument is also rejected. Pursuant to IRC § 871 (b) (1), a non-resident alien individual engaged in a trade or business within the United States is taxable on the income effectively connected with the conduct of that trade or business. In turn IRC § 875 (1) provides that if a partnership is engaged in business in the United States, each of its members who are nonresident aliens or foreign corporations will be considered to be so engaged. Furthermore, income from any sources, including sources outside the United States, derived by the foreign partner may be treated as effectively connected to the conduct of that business. In this case it is clear that ISOA was, during the years in issue, a domestic LLC (taxed as a partnership) engaged in the insurance brokerage business in New York. While petitioner contends that much of the partnership work was done by him outside the United States, he has not offered a scintilla of evidence to support these factual assertions. It is the portion of the distributive share attributable to New York sources which is subject to taxation (*Matter of Debevoise v State Tax Commission*, 52 AD2d 1023 [3rd Dept 1976]). If one-half of ISOA's income was not effectively connected income as defined by IRC § 864, petitioner has failed to prove it. Based upon the foregoing, petitioner has not shouldered his burden of proving that the tax asserted is incorrect.

H. Penalties were imposed by the Division pursuant to Tax Law § 685 (b) (1) and (2) for negligence or intentional disregard of article 22 of the Tax Law, and pursuant to Tax Law § 685 (i), for failure to supply information upon audit. Petitioner did not address the impropriety of

such penalties in his briefs, nor introduce any evidence to support their abatement. Penalties are therefore sustained.

I. The petition of Yacov Harel is denied, and the March 18, 2019 notice of deficiency is sustained.

DATED: Albany, New York  
May 5, 2022

/s/ Kevin R. Law  
ADMINISTRATIVE LAW JUDGE