STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
SELINA PETOSA AND BENJAMIN SKRAINKA	:	
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 2020.	:	DETERMINATION DTA NOS. 831253 AND 831264
In the Matter of the Petition	:	
of	:	
DANIEL WHEELER AND ANISSA WHEELER	:	
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 2020.	:	

Petitioners, Selina Petosa and Benjamin Skrainka, 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 2020.

Petitioners, Daniel Wheeler and Anissa Wheeler, 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 2020.

Petitioners, appearing by Clark, Raymond & Company, PLLC (D. Edson Clark, CPA) and the Division of Taxation, appearing by Amanda Hiller, Esq. (Stefan Armstrong, Esq., of counsel), agreed to have the controversies consolidated and determined without the need for a

hearing pursuant to section 3000.12 of the Rules of Practice and Procedure of the Tax Appeals Tribunal. The final brief was to be submitted by September 26, 2025, which date commenced the six-month period for the issuance of this determination.

After due consideration of the pleadings, documents and arguments submitted, Winifred M. Maloney, Administrative Law Judge, renders the following determination.

ISSUE

Whether self-created goodwill is investment income within the definition of Tax Law § 660 (i) (3).

FINDINGS OF FACT

The parties entered into a joint stipulation of facts and exhibits, which stipulated facts have been substantially incorporated into the following findings of fact.

1. Wipro Designit Services Inc. f/k/a Rational Interaction Inc. (WDS), a domestic corporation formed on July 29, 2009, made a federal S corporation election effective as of July 29, 2009. WDS marketed digital media services.

2. During tax year 2020, WDS filed returns as a "hybrid" corporation - a federal S corporation and a New York C corporation.

3. On February 21, 2020, WDS was acquired by Wipro IT Services LLC (WITS) for $57,760,071.00. The parties to the sale made a valid election to treat the transaction as a deemed asset sale under Internal Revenue Code (IRC) (26 USC) § 338 (h) (10). An IRC (26 USC) § 338 (h) (10) election allows the buyer to depreciate the assets acquired at their purchased value. Therefore, the transaction was treated for tax purposes as a purchase and sale of assets between WDS and WITS.

4. At the time that WDS was sold to WITS, WDS had three shareholders, petitioner Selina Petosa (petitioner Petosa), petitioner Daniel Wheeler (petitioner D. Wheeler) and another individual who is not a party to these proceedings.

5. According to the federal form 8883, asset allocation statement under section 338, filed by WDS, $49,464,597.00 of the total sale price came from self-created goodwill and other intangible assets.

6. When purchased through an IRC (26 USC) § 338 (h) (10) transaction, goodwill is an asset the nature of which is subject to allowance for depreciation or amortization. WITS is entitled to amortize the goodwill it purchased from WDS over 15 years pursuant to IRC (26 USC) § 197.

7. WDS has never been a regular dealer in property.

8. On or about November 11, 2020, WDS, filing under its former name Rational Interaction Inc., timely filed a form CT-3, general business corporation franchise tax return, for the tax period beginning January 1, 2020 and ending February 21, 2020 (NY corporate return). WDS filed as a New York C corporation for this tax period, reporting a New York business income base of $2,851,567.00 based upon total business income of $43,272,429.00 and a New York business apportionment factor (BAF) for the tax period of 6.5898%. WDS calculated tax due in the amount of $185,352.00 based upon its business income base tax, which it paid in full. WDS was an eligible S corporation for tax year 2020; however, its shareholders did not elect S corporation status for the tax year.

9. On May 11, 2022, the Division of Taxation (Division) assigned Kimberly Rybat, a Tax Auditor II in the Buffalo District Office of its Income/Franchise Field Audit Bureau, to conduct an audit of WDS f/k/a Rational Interaction Inc. The initial scope of the audit was to

determine whether the sale of WDS to WITS through an IRC (26 USC) § 338 (h) (10) deemed asset sale triggered the mandatory S corporation election provision in Tax Law § 660 (i). Tax Law § 660 (i) sets forth conditions which, if met, trigger a mandatory S corporation election for a tax year. Tax Law § 660 (i) provides that shareholders of an eligible S corporation that have not elected S corporation status will be deemed to have made such an election for the current tax year if the eligible S corporation's investment income for such taxable year is more than 50% of its federal gross income for the tax year.

10. During the audit, WDS provided a copy of its form 1120-S, U.S. income tax return for an S corporation, for the tax period beginning January 1, 2020 and ending February 21, 2020 (form 1120-S). WDS filed as an S corporation for this tax period, reporting total federal gross income of $60,210,360.00,[1] made up largely of long-term capital gain of $44,475,942.00 and ordinary business income of $10,901,359.00. All, or substantially all, of the reported long-term capital gain of $44,475,942.00 came from the sale of goodwill created by WDS during the course of its business operations. The form 1120-S included schedules K-1 issued to petitioner Petosa, as owner of a 41.182465% interest in WDS, petitioner D. Wheeler, as owner of a 17.635070% interest in WDS, and the third party, as owner of the remaining 41.182465% interest in WDS.

11. At the conclusion of the audit, the auditor determined that self-created goodwill is "investment income" within the meaning of that term as used in Tax Law § 660 (i) (3). Therefore, the auditor concluded that $44,475,942.00 in income from the sale of WDS to WITS should be considered investment income when determining whether WDS's investment income for tax year 2020 was greater than 50% of its federal gross income for that year for purposes of Tax Law § 660 (i).

[1] Paragraph 12 of the parties' joint stipulation of facts and exhibits erroneously reports WDS's total federal gross income as $61,210,360.00 rather than $60,210,360.00.

12. Based upon what WDS reported on its form 1120-S, the auditor calculated WDS's investment percentage as follows:

a. Total Investment Income = $49,266,347.00, consisting of:
   i. Long term capital gain = $44,475,942.00
   ii. Net gain from form 4797 = $4,728,509.00
   iii. Interest income = $61,896.00

b. Total Federal Gross Income = $60,210,360,00, consisting of:
   i. Total investment income = $49,266,347.00
   ii. Gross receipts or sales = $10,901,359.00
   iii. Other income = $42,654.00

c. Investment Income Percentage = $49,266,347.00 / $60,210,360.00 = **81.82%**.

13. Based upon the investment income percentage calculated by the auditor, the Division determined that WDS met the criteria in Tax Law § 660 (i), that triggered a mandatory S corporation election by WDS for tax year 2020. As a result of the mandatory S corporation election, WDS, as a New York S corporation, was responsible only for the fixed dollar minimum tax. Moreover, flow-through items of income, loss, deduction, etc., that were reported on the shareholders' schedules K-1, are now allocable to New York on the shareholders' individual New York income tax returns.

14. The auditor adjusted WDS's NY corporate return to reflect a change in its filing status from C corporation to S corporation. On August 29, 2022, the auditor issued a consent to field audit adjustment to WDS reflecting adjustments including recalculating the corporation's tax liability based upon the fixed dollar minimum for S corporations. The consent was signed by an authorized person from WDS on November 10, 2022. These adjustments resulted in a tax reduction of $184,852.00 for tax year 2020, which was refunded to the corporation.

15. The adjustments to WDS's return resulted in additional net taxable gain flowing through to its shareholders based on their pro rata membership interests in WDS. The Division assigned Ms. Rybat to perform the personal income tax audits of WDS's individual shareholders.

Selina Petosa and Benjamin Skrainka, DTA Number 831253

16. The audit of petitioners Petosa and Skrainka was conducted to determine their personal tax liability for tax year 2020 based upon WDS's acceptance of the mandatory S corporation election and petitioner Petosa's ownership interest in WDS.

17. Petitioners Petosa and Skrainka did not file a New York State personal income tax return for tax year 2020. Petitioners Petosa and Skrainka were nonresidents of New York State for tax year 2020 and did not have a New York filing requirement prior to the audit of WDS. Therefore, the auditor used their federal income tax return as a starting point to determine their New York tax liability.

18. The auditor determined that petitioners Petosa and Skrainka received $1,207,043.00 in taxable New York source capital gains from the sale of WDS, based upon petitioner Petosa's 41.182465% interest and WDS's BAF of 6.5898%. On October 31, 2022, the auditor issued a consent to field audit adjustment, reflecting adjustments including an additional $1,207,043.00 in New York source capital gains income attributed to petitioners Petosa and Skrainka from the sale of WDS. These adjustments resulted in $102,842.00 in additional tax for tax year 2020.

19. The Division issued notice of deficiency, assessment ID: L-057566408, to petitioners Petosa and Skrainka on December 22, 2022, asserting $102,842.00 in additional tax for tax year 2020, plus interest.

20. On February 28, 2023, petitioners Petosa and Skrainka filed a petition with the Division of Tax Appeals in protest of the notice of deficiency.

Daniel Wheeler and Anissa Wheeler, DTA Number 831264

21. The audit of petitioners Daniel and Anissa Wheeler was conducted to determine their personal tax liability for tax year 2020 based upon WDS's acceptance of the mandatory S corporation election and petitioner D. Wheeler's ownership interest in WDS.

22. Petitioners Daniel and Anissa Wheeler did not file a New York State personal income tax return for tax year 2020. Petitioners Daniel and Anissa Wheeler were nonresidents of New York State for tax year 2020 and did not have a New York filing requirement prior to the audit of WDS. Therefore, the auditor used their federal income tax return as a starting point to determine their New York tax liability.

23. The auditor determined that petitioners Daniel and Anissa Wheeler received $516,878.00 in taxable New York source capital gains from the sale of WDS, based upon petitioner D. Wheeler's 17.635070% interest and WDS's BAF of 6.5898%. On October 31, 2022, the auditor issued a consent to field audit adjustment to petitioners Daniel and Anissa Wheeler, reflecting adjustments including an additional $516,878.00 in New York source capital gains income attributed to these petitioners from the sale of WDS. These adjustments resulted in $43,963.00 in additional tax due for tax year 2020.

24. The Division issued notice of deficiency, assessment ID: L-057566409, to petitioners Daniel and Anissa Wheeler on December 22, 2022, asserting $43,963.00 in additional tax for tax year 2020, plus interest.

25. On March 7, 2023, petitioners David Wheeler and Anissa Wheeler filed a petition with the Division of Tax Appeals in protest of the notice of deficiency.

26. During the audits of Selina Petosa and Benjamin Skrainka, and Daniel Wheeler and Anissa Wheeler (collectively, petitioners), they disputed the classification of the sale of self-

created goodwill as "investment income" under Tax Law § 660 (i) (3). Their position[2] was that when the parties make a valid IRC (26 USC) § 338 (h) (10) election, the self-created goodwill, when created and used in the taxpayer's business, is of a character which is subject to the allowance for depreciation provided in IRC (26 USC) § 167, and, if held for more than one year, is treated as an IRC (26 USC) § 1231 asset for federal tax purposes. Self-created goodwill is not specifically excluded from IRC (26 USC) § 1231 treatment, meaning it can be classified as an IRC (26 USC) § 1231 asset if it meets the criteria. Therefore, gain from the sale of such self-created goodwill should be considered business income pursuant to IRC (26 USC) § 1231. Under Tax Law § 660 (i) (3), the term "investment income" is only taxed "to the extent such items would be includable in federal gross income for the taxable year." Under federal rules, the gain at issue is treated as business income and taxed under IRC (26 USC) § 1231. Accordingly, the gain should be classified as business income for New York tax purposes under Tax Law § 660 (i) (3) as well.

27. The parties agree that the BAF percentages used by the Division to calculate the New York source income of WDS and petitioners are correct. The only element of Tax Law § 660 (i) at issue in these matters is whether the 50% investment income threshold was met.

28. The parties stipulated that these matters turn on whether self-created goodwill falls within the definition of "investment income" in Tax Law § 660 (i) (3).

29. The parties stipulated:

(a) If self-created goodwill is "investment income," the 50% threshold in Tax Law § 660 (i) was met, and petitioners owe the additional tax assessed in the respective notices of deficiency.

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[2] In paragraph 17 of the joint stipulation of facts and exhibits, petitioners and the Division stipulated to petitioners' position set forth in this finding of fact.

(b) If self-created goodwill is not "investment income," the 50% threshold in Tax Law § 660 (i) was not met, and petitioners would not owe any tax to New York State for the tax year 2020.

CONCLUSIONS OF LAW

A. A presumption of correctness attaches to properly issued notices of deficiency and petitioners bear the burden of proving by clear and convincing evidence that the deficiencies are erroneous (***see Matter of Mayo***, Tax Appeals Tribunal, March 9, 2017, ***confirmed*** 172 AD3d 1554 [3d Dept 2019], ***lv denied*** 34 NY3d 1140 [2020], ***reag denied*** 35 NY3d 1005 [2020]; ***Matter of Gilmartin v Tax Appeals Trib.***, 31 AD3d 1008, 1010 [3d Dept 2006]; Tax Law § 689 [e]; ***see Matter of Leogrande v Tax Appeals Trib.***, 187 AD2d 768, 769 [3d Dept 1992], ***lv denied*** 81 NY2d 704 [1993]).

B. For federal income tax purposes, shareholders of an eligible S corporation may elect to treat the corporation as an S corporation and subject the shareholders to flow through taxation on the corporation's income (***see*** IRC [26 USC] § 1362 [a]). For eligible federal S corporations, the decision to elect New York S corporation status is generally voluntary (***see*** Tax Law § 660 [a]); however, an S election is required under the following circumstances:

> "Mandated New York S corporation election. (1) Notwithstanding the provisions in [Tax Law § 660 (a)], in the case of an eligible S corporation for which the election under [Tax Law § 660 (a)] is not in effect for the current taxable year, the shareholders of an eligible S corporation are deemed to have made that election effective for the eligible S corporation's entire current taxable year, if the eligible S corporation's investment income for the current taxable year is more than fifty percent of its federal gross income for such year. In determining whether an eligible S corporation is deemed to have made that election, the income of a qualified subchapter S subsidiary owned directly or indirectly by the eligible S corporation shall be included with the income of the eligible S corporation.
>
> (2) For purposes of this subsection, the term 'investment income' has the same definition as in [Tax Law § 660 (a)] .

> (3) For purposes of this subsection, the term 'investment income' means the sum of an eligible S corporation's gross income from interest, dividends, royalties, annuities, rents and gains derived from dealings in property, including the corporation's share of such items from a partnership, estate or trust, to the extent such items would be includable in federal gross income for the taxable year" (Tax Law § 660 [i])."

C. All, or substantially all, of the reported long-term capital gain at issue herein came from the sale of goodwill created by WDS during the course of its business operations. As such, the issue in this matter turns on whether this self-created goodwill is investment income under Tax Law § 660 (i) (3). If goodwill is not investment income under § 660 (i) (3), the 50% investment income threshold is not met. If goodwill is investment income, the 50% investment income is met and, therefore, a mandatory S corporation election is required pursuant to Tax Law § 660 (i).

The Division properly applied Tax Law § 660 (i) (3) when it determined that goodwill should be included in WDS's investment income. The Division's determination is supported by the decision in ***Matter of Lepage*** (Tax Appeals Tribunal, May 17, 2021). In ***Matter of Lepage***, the Tax Appeals Tribunal (Tribunal) held that goodwill is investment income under Tax Law § 660 (i) (3). As goodwill is investment income, the 50% investment income was met in this matter, and a mandatory S corporation election was required pursuant to Tax Law § 660 (i).

Petitioners argue that the Tribunal "wrongly decided" ***Matter of Lepage*** and such decision "should not be followed here." Petitioners' arguments are rejected. The Tribunal decision in ***Matter of Lepage*** is binding precedent and must be followed in this case. The notices of deficiency were proper in this matter.

D. The petition of Selina Petosa and Benjamin Skrainka and the petition of Daniel Wheeler and Anissa Wheeler are denied and the notices of deficiency, dated December 22, 2022, are sustained.

DATED: Albany, New York
March 19, 2026

/s/ Winifred M. Maloney
ADMINISTRATIVE LAW JUDGE