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UNPUBLISHED OPINION. CHECK COURT RULES BEFORE CITING.

Superior Court of Connecticut,
Judicial District of New Britain at New Britain.

Jonathan A. Sobel
v.
Commissioner of Revenue Services

Docket Number:HHBCV106006195S
|
File Date: March 7, 2017

Judge (with first initial, no space for Sullivan, Dorsey, and Walsh): Schuman, Carl J., J.

Memorandum of Decision

Carl J. Schuman Judge, Superior Court

***1** The plaintiff, Jonathan A. Sobel, appeals from the assessments issued against him by the defendant, commissioner of revenue services (commissioner), in connection with the plaintiff's individual state income tax liability for 1997 and 1998. The court conducted a de novo trial on six days in November 2016. For the following reasons, the court concludes that the commissioner erred in imposing the assessments and that judgment should enter for the plaintiff.

I

The procedural history of this case is long, but essentially undisputed. The plaintiff filed resident Connecticut income tax returns for tax years 1997 and 1998. In these returns, the plaintiff requested, under the provisions of General Statutes § 12-704(a) (1), [1] a credit for tax paid to the State of New York on income the plaintiff received as a member of Livingston Asset Management, LLC (I), a limited liability company.

In May 2003, after an extended audit, the state department of revenue services (department) proposed a deficiency assessment against the plaintiff for 1997 and 1998 based on disallowance of the credit for taxes paid to New York. In June 2003, the plaintiff filed a written protest with the commissioner against the proposed assessments.

Seven years later, by letter dated July 1, 2010, the commissioner denied the plaintiff's protest on the basis that the income in question was not derived from or connected with sources within New York. [2] However, the commissioner did reduce the 1997 assessment by approximately $14,000 and the 1998 assessment by approximately $24,000 by acknowledging that the plaintiff was not subject to state income tax for interest on United States government obligations. The final adjusted assessment was $170,717.78 for 1997 and $278,096.61 for 1998. With interest, the total assessment as of the commissioner's July 1, 2010 denial was $1,075,200.80. [3]

In July 2010, the plaintiff filed this action pursuant to General Statutes § 12-730 appealing the commissioner's decision. [4] The plaintiff, representing himself, filed a motion for partial summary judgment in October 2012. The court, Levine, J.T.R., denied the motion in chambers. The plaintiff, again representing himself, renewed his motion for partial summary judgment in June 2013. The court, Cohn, J., denied the motion by a memorandum of decision on September 10, 2013. After several changes of counsel and postponements of trial, the plaintiff, through counsel, sought permission to file another summary judgment motion. The court, Aronson, J.T.R., originally granted permission to file but then, on December 1, 2015, revoked permission. Represented by new counsel, the plaintiff again sought permission to file another summary judgment motion. The undersigned denied permission on October 20, 2016, and the case proceeded to trial. [5]

II

***2** Based on the trial, the court finds the following facts. The plaintiff is a lawyer with an M.B.A. from the University of Chicago and advanced training in tax law. He originally worked as an investment banker. He specialized in the trading of stock index options, which are essentially contracts to buy or sell, at or before a given time, securities tied to the value of a stock index such as the Dow Jones average.

In 1991, the plaintiff and his brother Peter Sobel decided to form their own investment management business. The structure of the business was complex. They created two limited partnerships—one for domestic investors and one for foreign investors. They registered the domestic limited partnership in Delaware and named it Livingston Asset Management, LP ("LAM, LP"). People who invested money in this company became limited partners.

Foreign investors could buy shares in a corporation known as Livingston International Fund, Ltd. (II) ("LIF, Ltd."), which the plaintiff formed in the British Virgin Islands. The private placement memorandum for the corporation stated that there was a minimum subscription of $500,000, that securities were "speculative and [entail] a high degree of risk," and that the shares were suitable for "sophisticated investors." It described the objective of its business as "to trade, buy, [or] sell" various forms of securities and commodities. The company listed a British firm on the Isle of Man as its administrator and claimed it used "clearing brokers" when dealing with commodity markets in the United States. (Plaintiff's Exhibit (Pl. Ex.) 8, pp. 2, 3, 11, 17.) LIF, Ltd. became the sole limited partner in a limited partnership known as Livingston International Fund, LP ("LIF, LP"), which was formed in the Cayman Islands.

The general partner of both limited partnerships was Livingston Asset Management, LLC (I) ("LAM, LLC"), a Delaware corporation. The function of the general partner was to manage the assets of the limited partnerships. LAM, LLC's operating agreement stated that the business of the company was "acting as a trading advisor or investment advisor ..." (Pl. Ex. 6, p. 5.) [6] The plaintiff and his brother were the only members of the general partner and each had a 50% interest. LAM, LLC had offices at 111 Broadway in New York City, not far from Wall Street. The plaintiff commuted every work day from his home to this office and often met with clients or investors after 4:15 p.m., when the markets closed.

During the years in question, the two partnerships held approximately $250 million in assets. These assets consisted primarily of U.S. Treasury bills and stock index options. LIF, LP held approximately $225 million, or 90%, of the assets, while LAM, LP held approximately $25 million, or 10%, of the assets.

As compensation for its management services, the general partner received a percentage—roughly 30% —of the capital gain or profit that the limited partnerships earned from trading their assets. [7] The LAM, LP partnership agreement explicitly stated that the "General Partner shall be paid no management fee." (Pl. Ex. 4, p. 5.) The general partner then allocated its income to the plaintiff and his brother.

***3** The plaintiff testified that he oversaw "millions" of trades per year and traded "other people's money." The court credits this testimony. There was ample corroborating evidence even if, as the commissioner contends, there were no actual trade confirmations. That evidence consisted of letters to and from investors, telephone records, handwritten records of transactions, register letters, audited financial statements, and testimony from the plaintiff's accountant. In addition, a November 1997 list of investors for LIF, Ltd. contained the names of 91 persons and entities from the Atlantic islands, Hong Kong, Brazil, Argentina, and numerous European nations. A list of limited partners of LAM, LP contained six names from five states. As detailed below, the plaintiff reported receiving millions of dollars each year in capital gains income. All of this evidence is fully consistent with the proposition that the plaintiff engaged in a very high volume of trading with client money. [8]

Under federal tax rules, the stock index options from which the plaintiff ultimately derived income constituted "section 1256 contracts." Income from the trading of section 1256 contracts received favorable treatment for federal tax purposes under the "60/40" rule. Under this rule, 60% of the gain from the trading of section 1256 contracts was deemed long-term capital gain and became taxable at a rate of 20%, which compared favorably to the customary rate at that time of up to 39.6% for persons in the plaintiff's income bracket. On his federal tax returns, the plaintiff reported capital gains of $3,850,649.81 for 1997 and $6,686,664.13 for 1998.

For 1997, the plaintiff reported adjusted gross income of $3,795,183.11 on his New York State individual income tax return and a tax obligation of $259,455.70. In Connecticut, based on a similar income figure, the plaintiff's tax liability initially amounted to $173,531.01. The plaintiff sought a credit of $170,717.78 for taxes paid to New York State. [9] For 1998, the plaintiff reported adjusted gross income of $6,182,440.76 to New York State and paid state income tax of $423,005.34. [10] The plaintiff reported a similar gross income to Connecticut and, based on a tax liability of $279,789.11, sought a credit of $278,108.64. The commissioner disallowed the entire credit sought for 1997 and all but approximately twelve dollars of the credit sought for 1998. [11]

III

Pursuant to § 12-730, a tax appeal is heard by the court as a de novo trial. See *Leonard v. Commissioner of Revenue Services,* 264 Conn. 286, 294, 302, 823 A.2d 1184 (2003). The plaintiff "must present clear and convincing evidence that the assessment is incorrect or that the method of audit or amount of tax assessed was erroneous or unreasonable." (Internal quotation marks omitted.) *Id.*, 302. The court must "strictly construe statutes that grant tax exemptions against the party claiming the exemption." *Bell Atlantic Nynex Mobile, Inc. v. Commissioner of Revenue Services,* 273 Conn. 240, 260, 869 A.2d 611 (2005).

***4** The test for determining whether a Connecticut resident is entitled to a credit under § 12-704 for taxes paid in another state is whether the income is "derived from sources therein and which is also subject to tax under this chapter." General Statutes § 12-704(a)(1). [12] In order for income to be considered derived from or connected with sources in a state when, as here, the income at issue results from the sale of "intangible" assets or investments, the income must, at a minimum, stem from "property employed in a business, trade or profession" within that state. [13] Thus, § 12-704(a)-4(a)(3) of the Regulations of Connecticut State Agencies provides: "[T]he credit against Connecticut income tax is allowed for income tax imposed by another jurisdiction upon compensation for personal services performed in the other jurisdiction, income from a business, trade or profession carried on in the other jurisdiction, and income from real or tangible personal property situated in the other jurisdiction. On the other hand, the credit is not allowed for tax imposed by another jurisdiction upon income from intangibles, *except where such income is from property employed in a business, trade or profession carried on in the other jurisdiction.* For example, no credit is allowed for an income tax of another jurisdiction on dividend income not derived from property employed in a business, trade or profession carried on in such jurisdiction." (Emphasis added.)

The commissioner has determined that certain activities, including trading securities for one's "own account," do not constitute a business or trade. Thus, the department's regulations for nonresidents of the state provide: "Where a nonresident individual who is not a dealer buys and sells property, or buys, sells or writes stock option contracts, or both, for his or her own account, such nonresident individual is not deemed to be carrying on a business, trade, profession or occupation within Connecticut. If the nonresident individual is otherwise carrying on a business, trade, profession or occupation within Connecticut, his or her income from buying and selling property, or buying, selling or writing stock option contracts, or both, for his or her own account, shall not be included in Connecticut adjusted gross income derived from or connected with sources within this state." Regs., Conn. State Agencies, § 12-711(f)-1(a). [14] Hence, the dispositive issues in this case are 1) whether the plaintiff was trading on "his ... own account" within the meaning of § 12-711(f)-1 and 2) whether the plaintiff's income was from "property employed in a business, trade or profession" within the meaning of § 12-704(a)-4(a)(3).

IV

A

On the first issue of whether the plaintiff traded on his own account, both parties debate the relevance of *Swid-Pearlman Management v. Tully,* 67 A.D.2d 1022, 413 N.Y.S.2d 239 (1979). Initially, both parties agree that the tiered-partnership organizational structure involved in that case is substantially similar to the one involved here. Petitioner Swid-Pearlman Management was a general partnership that served as a general partner of two limited partnerships. These two limited partnerships were "private investment partnerships in which the limited partners pooled their capital to be invested for their benefit by the general partner." *Id.*, 1023. The petitioner's function was to "[manage] the investments of the two limited partnerships ..." *Id.*, 1022. The petitioner earned no income from commissions, fees, or salary, but rather received a percentage of the net capital gain of the limited partnerships. *Id.*, 1022-23. [15]

***5** The issue was whether the general partnership was subject to a now-repealed New York State unincorporated business tax. *Id.*, 1023. The state tax law created an exemption for an unincorporated business engaged in the purchase and sale of property "for his own account." [16] (Internal quotation marks omitted.) *Id.* The Appellate Division of the Supreme Court concluded that the petitioner was not exempt under this exception. *Id.*, 1023-24. The court reasoned as follows: "Petitioner's contention that it was engaged in trading solely for its own account ... fails to recognize that managing investments or property of others is considered the conduct of a business, and taxable under article 23 of the Tax Law *(Matter of Elkind v. State Tax Comm.,* 63 [A.D.]2d 789 [404 N.Y.S.2d 1010 (1978)]). [17] Petitioner was not investing its own funds in securities, but rather the capital funds of the limited partners. Since petitioner was created to 'engage in general investment activities' and serve as general partner of the two limited partnerships, it is evident that the trading of securities in 'hundreds of transactions was part and parcel of the regular conduct of petitioner's 'investment management' business. There was ample justification for the Commission's finding that the petitioner's income was 'derived principally from services rendered by the petitioner' for the limited partnerships, and for concluding that such trading 'did not constitute the purchase and sale of property for its own account.' Since the assessment was rendered because the petitioner was performing a service for which it was being compensated and for no other reason, it is of no importance whether the activities of the management business were conducted as here by a general partner composed of two individuals or by a corporate or individual general partner. Management of property by a fellow partner constitutes the operation of a business taxable under the Unincorporated Business Tax Law." *Swid-Pearlman Management v. Tully, supra*, 1023. Thus, the core holding of the case was that an entity in a position similar to that of the plaintiff was performing an investment management service and not trading on its own account. *Id.*; see also *Wohlreich v. Tully,* 72 A.D.2d 825, 421 N.Y.S.2d 660 (1979) (applying *Swid-Pearlman* to New York state personal income tax).

The commissioner seeks to dismiss or distinguish *Swid-Pearlman* on several grounds. As a threshold matter, the commissioner claims that the Appellate Division reversed its position only three years later in *Todd v. State Tax Commission,* 90 A.D.2d 244, 457 N.Y.S.2d 975 (1982). That result would be remarkable in view of the fact the *Todd* court did not even cite *Swid-Pearlman.* In fact, *Todd* is different from *Swid-Pearlman* in a crucial way. In *Todd,* a husband and wife formed an investment partnership in which the wife contributed money raised from independent sources and the husband conducted the investment activities. The court found that the husband "was not engaged in the separate business of providing services. He received no fee for conducting the investment activity. Rather, he simply shared in the profits and losses of the joint venture." *Id.*, 247. The court technically held that the taxpayers did not have a taxable unincorporated business and thus it did not reach the exemption for trading on one's own account. *Id.* However, the facts of the case illustrate that the husband was essentially trading on his own family account and, unlike the petitioner in *Swid-Pearlman* and the plaintiff here, was not providing a service to third-party investors. Thus, *Todd* is readily distinguishable.

Next, the commissioner contends that the language of the exemption in the New York unincorporated business tax interpreted in *Swid-Pearlman* substantially differs from the relevant language in the applicable Connecticut regulation. The court disagrees. The New York unincorporated business tax provided for an exemption for a person or entity "solely by reason of the purchase and sale of property for his own account." (Internal quotation marks omitted.) *Swid-Pearlman Management v. Tully, supra*, 67 A.D.2d. 1023. (quoting N.Y. Tax Law § 703(d) (McKinney 1966) (repealed 1978)). Section 12-711(f)-1(a) of the Regulations of Connecticut State Agencies provides, in relevant part: "Where a nonresident individual who is not a dealer buys and sells property, or buys, sells or writes stock option contracts, or both, for his or her own account, such nonresident individual is not deemed to be carrying on a business, trade, profession or occupation within Connecticut ..." The only arguably substantive difference between the two provisions is that the Connecticut regulation specifically mentions stock options, which arc at issue here, whereas the New York statute does not. This difference is not significant because there is no dispute that stock options are a form of property. Thus, logically the term "property" in the New York statute would encompass stock options, making both provisions substantively equivalent. [18] More importantly, both provisions contain the phrase "his [or her] own account" in the context of purchasing, buying or selling property. Hence, the *Swid-Pearlman* interpretation of what constitutes buying or selling property on one's "own account" is fully relevant here.

***6** Finally, the commissioner argues that *Swid-Pearlman* should have little weight because New York treats partnerships as separate taxable entities while Connecticut follows the "conduit theory" whereby partnerships are disregarded entities and partners are deemed to be in the same business as the partnership. This argument requires a fair amount of discussion. As noted by the commissioner, our Supreme Court discussed the conduit theory of partnerships in *Bell Atlantic Nynex Mobile, Inc. v. Commissioner of Revenue Services, supra*, 273 Conn. 262-63. According to the *Bell Atlantic* Court, the conduit theory provides that "partnerships ... are conduits through which the taxpaying obligation passes to the individual partners in accord with their distributive share." *Id.*, 263 (quoting *United States v. Basye,* 410 U.S. 441, 448 n.8, 93 S.Ct. 1080, 35 L.Ed.2d 412 (1973)). The commissioner relies on the principle stated in *Bell Atlantic* that "corporation business tax attributes pass through the partnership to the partners with the same character that they had at the partnership level ..." *Bell Atlantic Nynex Mobile, Inc. v. Commissioner of Revenue Services, supra*, 273 Conn. 264. The commissioner reasons that, because the limited partnerships were trading partnership money and thus essentially trading on their own accounts within the meaning of § 12-711(f)-1(a) of the regulations, that characterization should "pass through" to the plaintiff, who should also be deemed to have been trading on his own account under the regulation.

The commissioner's argument does not withstand analysis. It is one thing to say that the "character" of the income received by a partnership remains the same when ultimately taxed at the individual level. As the commissioner states, the term "character" refers to "the distinction between ordinary income such as compensation and investment income from the sale of capital assets." (Commissioner's brief, p. 9 n.13.) The characterization of income is a policy decision for the legislature or the executive branch to make. See General Statutes § 12-715(b). [19]

It is quite another thing to say that the *activities* of the partnership are identical to those of the partner. That proposition may conflict with objective facts. Indeed, *Bell Atlantic* itself observed: "Not every action taken by the partnership passes through to the partners as if they performed the act." *Bell Atlantic Nynex Mobile, Inc. v. Commissioner of Revenue Services, supra*, 273 Conn. 264. Thus, the commissioner departs from reality in saying that, because the partnerships are investing their own funds, the plaintiff is investing his own funds. The proposition that the plaintiff is investing his own funds is simply untrue in this case.

An important principle of tax law is that "[s]ubstance, reality and total effect of a particular transaction will determine the tax consequences thereof." *Dixon v. United States,* 224 F.Sup. 358, 364 (S.D.N.Y. 1963), aff'd, 333 F.2d 1016 (2d Cir. 1964), aff'd, 381 U.S. 68, 85 S.Ct. 1301, 14 L.Ed.2d 223 (1965). The reality is that the plaintiff was in the full-time business of being an investment manager, not an investor. The investment partnerships were funded by others and the plaintiff was managing the property of unrelated limited partners. He was splitting large profits—wholly disproportionate and unrelated to his own minimal investment—with clients from trading the clients' securities. The plaintiff was not trading on his own account. [20]

***7** Ultimately, the commissioner's theory rests on a legal fiction. That fiction is that, because the partnership is trading its own assets and arguably trading on its own account, that characterization travels all the way down or flows through the organizational map to the member of the general partner. The commissioner provides no direct support for this formalistic proposition, and the court has found none. [21] Here, although it could be said that the partnership traded on its own assets, these assets ultimately came from persons other than the taxpayer. Technically, these persons were limited partners but in reality they were clients or customers. The consequence is that the plaintiff was trading his clients' money, not his own.

This position is fully consistent with Connecticut partnership law. General Statutes § 34-313 states: "A partnership is an entity distinct from its partners." General Statutes § 34-315 provides: "Property acquired by a partnership is property of the partnership and not of the partners individually."

The commissioner points to several admissions made by the plaintiff or his attorneys. In the plaintiff's 1997 and 1998 New York City unincorporated business tax returns for LAM, LP and LAM, LLC, the plaintiff sought exemption from the tax under § 11-502(c) of the City's administrative code and stated that the nature of his business or profession was "options trading—own account." (Defendant's Exhibits (Def. Exs.) 3, 4, 20, 21.) Section 11-502(c)(2)(A) of that code provided an exemption for an unincorporated entity engaged in business solely by reason of "the purchase, holding and sale for his, her or its own account of property ..." N.Y. City Admin. Code § 11-502(c)(2)(A) (2006 ed.) The plaintiff's admission that LAM, LP was engaged in trading on its "own account" is consistent with the conclusion reached above that the partnerships may have been trading on their own account but that the general partner and its members were not. [22]

In addition, the plaintiff's lawyers, in 2005 and 2009 memos or letters to the department, stated that the two limited partnerships were "trading for their own accounts." Although the commissioner relies heavily on these statements, they merely reflect the same theory that the limited partnership, but not the plaintiff, may have been trading its own capital. Indeed, both letters from the plaintiff's attorneys made this distinction. In the 2005 letter, plaintiff's counsel stated in a footnote: "We note the crucial distinction here between the partnerships' trading for their own accounts, which is undisputed, and Sobel trading for his own account by virtue of trading the assets of the partnerships, which position does not comport with the facts outlined above." (Def. Ex. 1, p. 7 n.4.) In a second letter, written in 2009, plaintiff's counsel wrote that the limited partnerships were "two hedge funds that trade for their own accounts." (Def. Ex. 2, p. 7.) The letter then contrasted the limited partnerships with the general partner, there called LAMI. "LAMI is not a hedge fund. It is an active operating investment services company that derives the substantial majority of its income from managing the assets and investments of other entities. LAMI did not trade for its own account. LAMI did *not have* its own account." (Def. Ex. 2, p. 7 (emphasis in original).) Thus, the statements of the plaintiff's lawyers do not constitute an admission that the plaintiff himself was trading on his own account or trading his own money.

***8** The court recognizes that Connecticut statutes and regulations, and not New York law, ultimately govern here. Further, because § 12-704(a)(1) of our statutes provides for a credit on income "derived from sources therein and which is also subject to tax under this chapter," the real question is whether Connecticut would tax a nonresident in the plaintiff's situation. See *Allen v. Commissioner of Revenue Services,* 324 Conn. 292, 316 (2016) ("It is equally well established that a state may tax the income of nonresidents earned within the taxing state"). However, there is no Connecticut appellate or even Superior Court authority on the question of whether a person in the plaintiff's situation is buying or selling "for his or her own account" within the meaning of § 12-711(f)-1(a) of the Regulations of Connecticut State Agencies. *Swid-Pearlman* remains the closest and most persuasive authority because New York law is so similar. Under the reasoning of *Swid-Pearlman,* the plaintiff was not trading on his own account.

B

The next issue under the Connecticut regulations is whether the plaintiff's income was from "property employed in a business, trade or profession" within the meaning of § 12-704(a)-4(a)(3). Connecticut regulations define the similar phrase "business, trade, profession or occupation" for a nonresident (which, as discussed, also applies to a resident seeking a tax credit) as follows: "A 'business, trade, profession or occupation' (as distinguished from personal services as an employee) is carried on within Connecticut by a nonresident individual:

> (A) when such nonresident individual occupies, has, maintains or operates desk space, an office, a shop, a store, a warehouse, a factory, an agency or other place where such nonresident's affairs are systematically and regularly carried on, notwithstanding the occasional consummation of isolated transactions outside Connecticut (this list is not intended to be all-inclusive); or
>
> (B) if activities in connection with the business are conducted in Connecticut with a fair measure of permanency and continuity. An individual may enter into transactions for profit within Connecticut and yet not be engaged in a trade, business, profession or occupation within Connecticut. If an individual pursues an undertaking continuously as one relying on the profit therefrom for such taxpayer's income or part thereof, such taxpayer is carrying on a business, trade, profession or occupation. Notwithstanding the provisions of this subparagraph (B), a nonresident individual is not deemed to be carrying on a business, trade, profession or occupation in Connecticut if the nonresident's presence for business in this state is casual, isolated and inconsequential, as provided in subdivision (1) of subsection (c) of this section." Regs., Conn. State Agencies § 12-711(b)-4(a) (2). [23]

***9** The court finds that the plaintiff has satisfied all elements of both (A) and (B). The plaintiff maintained and operated an office in New York City. He conducted his business in a systematic, regular, permanent, and continuous basis by working at this office on a full-time, daily basis. The profit from the plaintiff's business activity in New York constituted the major source of his income. The plaintiff's presence in New York was not casual, isolated, or inconsequential. Thus, the plaintiff operated a "business, trade, profession or occupation" in New York within the meaning of § 12-711(b)-4(a)(2). Similarly, he derived his income from New York "property employed in a business, trade or profession" within the meaning of § 12-704(a)-4(a)(3).

In arguing that the plaintiff did not engage in a trade or business, the commissioner relies on a line of federal cases that distinguish between persons trading securities who are "investors" and persons who engage in that activity as a "trade or business," sometimes referred to as "traders" or "day traders." Thus, the Federal Circuit Court of Appeals has stated: "[I]n order to be a trader, a taxpayer's activities must be directed to short-term trading, not the long-term holding of investments, and income must be principally derived from the sale of securities rather than from dividends and interest paid on those securities. In determining whether a taxpayer who manages his own investments is a trader, and thus engaged in a trade or business, relevant considerations are the taxpayer's investment intent, the nature of the income to be derived from the activity, and the frequency, extent, and regularity of the taxpayer's securities transactions." *Moller v. United States,* 721 F.2d 810, 813 (Fed.Cir. 1983).

These cases are inapplicable because they all involve persons who were investing their own money or their family's money. See *id.* ("[i]n determining whether a taxpayer who manages *his own investments* is a trader, and thus engaged in a trade or business, relevant considerations are") (emphasis added); *Endicott v. C.I.R.,* 106 T.C.M. (CCH) 184, 2013 WL 4558714, at *1 (T.C. 2013) ("[p]etitioner's primary strategy was to purchase shares of stock and then sell call options on the underlying stock") (footnote omitted). In these cases, the courts developed standards to determine whether the taxpayer was essentially engaging in a hobby or pastime investing surplus money or, alternatively, practicing a business or full-time profession, all for purposes of determining eligibility for home office deductions or other business expenses. See *Moller v. United States, supra*, 721 F.2d 810 (because taxpayers derived income from long-term holding of securities and not short-term trading, their investment activities did not constitute "trade or business," and thus they were not entitled to deduct home-office expenses relating to investment activities); *Purvis v. Commissioner,* 530 F.2d 1332 (9th Cir. 1976) (activities did not constitute the carrying on of a trade or business and taxpayer was thus not entitled to carry over operating losses or to deduct lobbying expenses); *Assaderaghi v. C.I.R.,* 107 T.C.M. (CCH) 1179, 2014 WL 717209 (T.C. 2014) (trading activities of taxpayer's money were not sufficiently frequent or substantial to constitute "trade or business" and thus taxpayer could not use "mark-to-market" method, as opposed to capital gains method, of reporting gain and losses); *Endicott v. C.I.R., supra*, 2013 WL 4558714, at *1 (taxpayer was investor, not trader, and thus his trading expenses were required to be taken as itemized, not business-expense, deductions). [24]

***10** In contrast, in the present case, the plaintiff was managing other people's money and not his own. The practice of investing and managing other people's money is invariably a trade or business and thus it is unnecessary to rely on the case law advanced by the commissioner. The cases relied upon by the commissioner that distinguish between investors and day traders managing their own money simply do not apply to this action.

In any event, these cases focus on the "the frequency, extent, and regularity of the taxpayer's securities transactions." *Moller v. United States, supra*, 721 F.2d 813. Here the plaintiff commuted every work day to an office where he worked long hours, met with clients and investors, engaged in millions of trades, and managed approximately $250 million of their money. The daily frequency and enormous volume of the plaintiff's trading activity clearly satisfy the day trading standards.

Hence, even under the standards urged by the commissioner, the plaintiff was engaged in a trade or business. Given the additional conclusion, reached above, that the plaintiff was not trading intangibles on his own account, the commissioner should have ruled that New York was the source of the plaintiff's income. [25] The commissioner erred in denying a personal income tax credit to the plaintiff for taxes he paid to New York. [26]

V

The plaintiff's alternative argument rests on his contention that, for the second half of 1998, his domicile was New York State. The plaintiff contends that if, as the commissioner maintains, his income was from trading intangibles on his own account and was not from a trade or business, that income is taxable in the state of domicile and that, for the second half of 1998, his state of domicile was New York. The court addresses this issue in the event that a reviewing court deems it necessary to reach it. [27]

The general rule is that the income derived from the sale of intangibles can be taxed in the state of domicile. "From the beginning of our constitutional system control over the person at the place of his domicile and his duty there, common to all citizens, to contribute to the support of government have been deemed to afford an adequate constitutional basis for imposing on him a tax on the use and enjoyment of rights in intangibles measured by their value. Until this moment that jurisdiction has not been thought to depend on any factor other than the domicile of the owner within the taxing state, or to compel the attribution to intangibles of a physical presence within its territory, as though they were chattels, in order to support the tax." *Curry v. McCanless,* 307 U.S. 357, 366-67, 59 S.Ct. 900, 83 L.Ed. 1339 (1939).

***11** In the present case, there is no dispute that the plaintiff lived in the Cos Cob section of Greenwich, Connecticut during all of 1997 and at least the first half of 1998. The plaintiff, therefore, was a Connecticut domiciliary during that time period. The dispute focuses on plaintiff's claim that, in July 1998, he moved to New York City and his domicile became New York State. If that point is true then, according to the plaintiff, even if a court rejected the plaintiff's first argument and concluded that the plaintiff's income stemmed from the sale of intangibles on his own account or that the plaintiff was not engaged in a trade or business, his income for the second half of 1998 would be sourced to New York as his state of domicile.

In statutory terms, the plaintiff claims that he was a "[p]art-year resident of this state" in 1998. General Statutes § 12-701(a)(3). Under the regulations, a part-year resident would be taxed on capital gains income in a manner proportional to the part of the year he resided in Connecticut. Regs., Conn. State Agencies § 12-717-1. [28] Application of this formula yields a Connecticut state income tax liability for 1998 of $140,789 instead of $279,789.11, as the commissioner originally assessed. (Def. Ex. 42; Commissioner's reply brief, p. 14 & n.21.) The net result would be a reduction in the amount of taxes that, according to the commissioner, the plaintiff owes the department.

Our statutes define a " '[p]art-year resident of this state' as "any natural person who is not either a resident of this state for the entire taxable year or a nonresident of this state for the entire taxable year." General Statutes § 12-701(a)(3). Because there is no question that the plaintiff was not a nonresident for the entire taxable year, the pivotal issue is whether the plaintiff was a "resident of this state" for the entire taxable year. The statutes define "[r]esident of this state" in pertinent part as follows: "any natural person (A) who is domiciled in this state ... or (B) who is not domiciled in this state but maintains a permanent place of abode in this state and is in this state for an aggregate of more than one hundred eighty-three days of the taxable year ..." General Statutes § 12-701(a)(1). [29]

***12** In this case, the questions of whether the plaintiff was domiciled in this state for the entire year and whether he maintained a "permanent place of abode" in this state for the entire year are largely the same. The plaintiff can realistically only prove that he changed his domicile to New York if he can also prove that he left his place of abode in Cos Cob and moved to New York City in July 1998. Thus, the court focuses on whether the plaintiff proved that he was not a domicile of Connecticut for the entire taxable year.

The department's regulations define "domicile" as follows: "(1) Domicile, in general, is the place which an individual intends to be his or her permanent home and to which such individual intends to return whenever absent. (2) A domicile once established continues until the individual moves to a new location with the bona fide intention of making his or her fixed and permanent home there. No change of domicile results from a removal to a new location if the intention is to remain there only for a limited time; this is the case even though the individual may have sold or disposed of his or her former home. The burden is upon an individual asserting a change of domicile to show that the necessary intention existed. In determining an individual's intention in this regard, declarations shall be given due weight, but they shall not be conclusive if they are contradicted by conduct. The fact that an individual registers and votes in one place is important but not necessarily conclusive, especially if the facts indicate that he or she did this merely to escape taxation in some other place." Regs., Conn. State Agencies § 12-701(a)(1)-1(d)(1) and (2). The department has established a more specific, though nonexclusive, twenty-eight-factor test for determining domicile. Regs., Conn. State Agencies § 12-701(a)(1)-1(d)

(8). These definitions are consistent with those in the case law, which has "unanimously define[d] domicile as residency combined with an intent to remain permanently." *In re Bachand,* 306 Conn. 37, 45, 49 A.3d 166 (2012).

In this case, the evidence is clear that the plaintiff moved to an apartment in Central Park West, New York City in July 1998. While the parties stipulated that there was no written lease for this rental, the plaintiff documented his move with invoices from the moving company, bills for painting and other work done on the new apartment, statements from the plaintiff's homeowners, medical, and auto insurance companies reflecting his move, a letter from his Connecticut landlord and return of his security deposit, and items labeled "final bill" for telephone and electricity for his Cos Cob apartment dated in July 1998. Further, in 2006, the plaintiff filed an audit questionnaire with the department stating under oath he "moved in July 1998 to N.Y. City." (Pl. Ex. 25A.)

In 1999, the plaintiff purchased a different apartment in New York City. Also in that year, the plaintiff purchased a 10.2-acre building site. Ten acres of that parcel were located in North Castle, New York. The remaining two-tenths of an acre were located in Connecticut on a lake that straddled North Castle and adjoining Greenwich, Connecticut. Although the plaintiff never built a residence on this site, the plaintiff has continued to live in New York State since July 1998.

This evidence unequivocally shows that the plaintiff's domicile from July 1998 on has been New York. [30] The confusion about domicile in this case is largely of the plaintiff's own making. First, the plaintiff did not disclose many of the documents that tended to substantiate his July 1998 move to New York until shortly before trial in this case, thus depriving the department of this evidence during its consideration of the plaintiff's administrative protest. Second, not until 2003, the year that the department completed its audit of the plaintiff, did the plaintiff amend his 1998 New York State tax returns to claim part-year residency in New York in 1998. The plaintiff never amended his 1998 Connecticut return to assert this fact.

***13** Finally, the plaintiff wrote a letter to Governor M. Jodi Rell in February 2010, in which he asked her to have the commissioner personally review his assessment. In the letter, the plaintiff stated: "In July 1998 I moved to New York, but in 1999, I purchased a large tract of land in Greenwich, intending to build a residence." (Def. Ex. 15.) This statement was highly misleading, as the large tract of land that the plaintiff purchased was primarily in New York and only tangentially in Connecticut, and the residential portion was entirely in New York. The plaintiff's explanation for this statement at trial was unsatisfactory. [31]

While the court does not approve of the plaintiff's conduct in this regard, it must decide the case based on the most convincing facts. The documentary evidence shows unequivocally that the plaintiff did not maintain a permanent place of abode in Connecticut for the entire year, that he moved to New York in July 1998 and that he continued to live in New York through the present time. The court concludes that the plaintiff proved that he was a New York domicile in the second half of 1998 and thus a "part-year resident of this state" for that year. Accordingly, even if the plaintiff does not ultimately prevail at the appellate level on his first claim covering the entire 1997-98 time period, the commissioner should reduce the plaintiff's tax liability for 1998 to $140,789 with any appropriate adjustments.

VI

Judgment shall enter for the plaintiff in accordance with this opinion.

It is so ordered.

All Citations

Not Reported in A.3d, 2017 WL 1240119

Footnotes

1 See note 10 *infra*.

2 There is no fully adequate explanation for the excessive length of the protest period, but during this period the original department officer assigned to the case retired, the plaintiff retained two separate law firms, and the plaintiff failed to provide information requested by the department.

3 Although there was no specific evidence on this point, presumably the interest has continued to accrue.

4 General Statutes § 12-730 provides: "Notwithstanding the provisions of chapter 541 to the contrary, any taxpayer aggrieved because of any determination or disallowance by the commissioner under section 12-729, 12-729a or 12-732 may, within one month after notice of the commissioner's determination or disallowance is mailed to the taxpayer, take an appeal therefrom to the superior court for the judicial district of New Britain, which shall be accompanied by a citation to the commissioner to appear before said court. Such citation shall be signed by the same authority, and such appeal shall be returnable at the same time and served and returned in the same manner, as is required in case of a summons in a civil action. The authority issuing the citation shall take from the appellant a bond or recognizance to the state of Connecticut, with surety to prosecute the appeal to effect and to comply with the orders and decrees of the court in the premises. Such appeals shall be preferred cases, to be heard unless cause appears to the contrary, at the first session by the court or by a committee appointed by it. Said court may grant such relief as may be equitable and, if such tax has been paid prior to the granting of such relief, may order the Treasurer to pay the amount of such relief, with interest at the rate of two-thirds of one per cent per month or fraction thereof, to the aggrieved taxpayer. If the appeal has been taken without probable cause, the court may charge double or triple costs, as the case demands, and upon all such appeals which may be denied, costs may be taxed against the appellant at the discretion of the court but no costs shall be taxed against the state."

5 Notwithstanding the outcome of this case, these summary judgment motions, or attempts to file them, were ill-conceived. The plaintiff made numerous admissions, such as stating that the limited partnerships in this case were "trading for their own accounts," or that in 1999 he "purchased a large tract of land in Greenwich, intending to build a residence," that created genuine disputes on material factual issues. The court discusses these admissions below.

6 The private placement memorandum of LIF, Ltd. refers to the general partner as a "Hedge Fund Manager that searches for and [capitalizes] on price inefficiencies in options worldwide" and states that the general partner "primarily trades options on U.S. stock market indexes and options in the stock indexes of the major [industrialized] countries of Europe and the Far East." (Pl. Ex. 8, p. 15.)

7 The partnership agreement for LIF, LP described the general partner's profit participation as 2.75% of the value of the partnership's assets plus 20% of the trading profits. (Pl. Ex. 5, p. 5.) The plaintiff testified that this formula essentially amounted to a 30% share for the general partner. The amended complaint makes the slightly different allegation that this allocation went "directly to Sobel for the investment management services provided by Sobel, on behalf of [LAM, LLC], as the general partner of the Foreign Partnership, equal to fifty percent (50%) of the Foreign Partnership Management Service Consideration." (Amended Appeal, para. 26.) In either event, the plaintiff, as one of two members of the general partner, received 50% of the profits distributed by LIF, LP.

The partnership agreement for LAM, LP explicitly provided that the general partner would receive 30% of the "Net Profits" plus a share based on each partner's contribution to the aggregate capital account, in which the general partner had only a small share. (Pl. Ex. 4, p. 4.)

8 The plaintiff and his brother did invest $150,000 in the company at the outset. To his credit, the plaintiff reported earnings on this fund separately and, following the rule of domicile discussed below, paid Connecticut state income tax on these earnings.

9 The small difference between the amount of tax liability in Connecticut and the credit sought reflected the Connecticut income tax that the plaintiff paid on the earnings from his personal investment in the company. See note 8 *supra*.

10 In 2003, the plaintiff filed an amended 1998 New York state return that claimed that he was a part-year resident of New York in 1998 and that reported an adjusted New York state gross income of $6,201,238.22 and a tax liability of $424,272.62. (Pl. Ex. 24G.) The plaintiff did not amend his 1998 Connecticut income tax return.

11 These figures reveal that Connecticut had a lower state income tax rate than did New York. Notwithstanding that fact, the plaintiff paid income tax in New York, an action that would be unlikely unless the plaintiff truly believed that he conducted business in New York.

12 Section 12-704(a)(1) provides: "Any resident or part-year resident of this state shall be allowed a credit against the tax otherwise due under this chapter in the amount of any income tax imposed on such resident or part-year resident for the taxable year by another state of the United States or a political subdivision thereof or the District of Columbia on income derived from sources therein and which is also subject to tax under this chapter."

13 The United States Supreme Court has described "intangibles" as "rights which are not related to physical things. Such rights are but relationships between persons, natural or corporate, which the law recognizes by attaching to them certain sanctions enforceable in courts." *Curry v. McCanless,* 307 U.S. 357, 365-66, 59 S.Ct. 900, 83 L.Ed. 1339 (1939).

14 Although this regulation literally applies to taxation of nonresident income in Connecticut, there is no dispute that the sourcing of income for purposes of determining whether a nonresident owes Connecticut income tax is the same as that used for purposes of determining whether a Connecticut resident, such as the plaintiff, is entitled to a credit under the Connecticut state income tax for tax paid to another jurisdiction. See Commissioner's brief, pp. 6-7, 14-15. See also Regs., Conn. State Agencies § 12-704(a)-4(a)(3) (incorporating by reference Part II of the state income tax regulations, which addresses the taxation of nonresidents.)

15 It is true that, in the present case, the taxpayer is an individual who is a member of a limited liability corporation that in turn serves as a general partner to the limited partnerships, whereas in *Swid-Pearlman* the taxpayer was a general partnership that served as a general partner to the limited partnerships. However, neither party attributes any significance to this difference.

16 As quoted in the decision, section 703(d) of the Tax Law provided: "An individual or other unincorporated entity, except a dealer holding property primarily for the sale to customers in the ordinary course of his trade or business, shall not be deemed engaged in an unincorporated business solely by reason of the purchase and sale of property for his own account ..." *Id.*, 240 (quoting NY Tax Law § 703(d) (McKinney 1966) (repealed 1978)).

17 In *Elkind,* the court held that an individual partner who managed real property owned by several partnerships was not an "owner" of the property within the meaning of an exemption from the unincorporated business tax that provided: "[a]n owner of real property, a lessee or a fiduciary shall not be deemed engaged in an unincorporated business solely by reason of holding, leasing or managing real property." *Elkind v. State Tax Commission, supra*, 63 A.D.2d 789 (quoting N.Y. Tax Law § 703(e) (McKinney 1966) (repealed 1978)). The court stated that "the partnership owns the property rather than petitioner." *Id. Elkind* is analogous to the present case in that an entity that is not an "owner" is similar to an entity that is not trading "on its own account."

18 In 1976, the New York legislature added the phrase "or the purchase, sale or writing of stock options contracts or both" so that an entity would not be deemed an unincorporated business "solely by reason of the purchase and sale of property or the purchase, sale or writing of stock options contracts or both, for his own account." 1976 N.Y. Sess. Laws 442; *Todd v. State Tax Commissioner, supra*, 457 N.Y.S.2d 977 n.*. At that point, the New York statute and the Connecticut regulation became virtually identical. This result is not surprising because, as the commissioner has stated, "in developing its income tax, Connecticut relied heavily on New York law. To this end, the provisions under Connecticut law whereby partnerships trading for their own accounts are not deemed to be carrying on a trade or business [are] virtually identical to New York law." (Defendant's Pre-Trial Memorandum of Law, November 10, 2016, p. 13 n.15.)

19 General Statutes § 12-715(b) provides: "Each item of partnership and S corporation income, gain, loss or deduction shall have the same character for a partner or shareholder under this chapter as for federal income tax purposes. Where an item is not characterized for federal income tax purposes, it shall have the same character for a partner or shareholder as if it were realized directly from the source from which it was realized by the partnership or S corporation or as if it was incurred in the same manner as it was incurred by the partnership or S corporation."

20 The commissioner agreed at oral argument that, if a Connecticut resident worked as a partner in a New York law firm and received as his or her sole compensation a percentage of the partnership's profits, then those profits would also be sourced to New York. Although this hypothetical case is not exactly analogous, because the law firm does not trade on its own account, it still exposes the weakness of the commissioner's theory. In both cases, a partner provides services to other people—one legal services, the other investment management services—and yet the law partner would pay state income tax in New York and investment management partner (here the plaintiff) must pay state income tax in Connecticut. It is hard to see a rationale for this sort of disparate treatment. As one court has stated, "Selling one's investment expertise to others is as much a business as selling one's legal expertise or medical expertise." *Dagres v. C.I.R.,* 136 T.C. 263, 281 (2011).

21 The commissioner repeatedly quotes the statement of the United States Tax Court in *Arens v. C.I.R.,* 59 T.C.M. (CCH) 589, 1990 WL 64030 (1990), that "the business of a partnership is the business of its partners." The context for this quote is whether certain activity constitutes a "trade or business" under federal law. The court discusses this issue in the next section. *Arens* and the cases it cites do not address the concept of trading on one's own account.

22 The plaintiff's statement that LAM, LLC was trading on its own account, however, seems improvident.

23 The commissioner's brief cites to an otherwise identical regulation as "§ 12-711-(c)2." (Commissioner's brief, pp. 18-19.) The regulations also contain the following examples: "Example 1: A plumber, who is a resident of Rhode Island, carries on his business from an office in Danielson, Connecticut. He has maintenance contracts with housing authorities in the Worcester, Massachusetts area which require him to regularly perform his services at various locations in and around Worcester. This individual is considered to be carrying on business in Connecticut (by reason of his office in this state) and in Massachusetts (because his business is conducted there with a fair measure of permanency and continuity).

Example 2: Assume the same facts as in Example 1, except that the taxpayer carries on his business from an office in Auburn, Massachusetts and has maintenance contracts with housing authorities in northeast Connecticut. This individual is considered to be carrying on business in Massachusetts (by reason of his office there) and in Connecticut (because his business is conducted in this state with a fair measure of permanency and continuity)." Regs., Conn. State Agencies § 12-711(b)-4(a)(2)(B).

24 In *Stoller v. C.I.R.,* 60 T.C.M. (CCH) 1554, 1990 WL 212864 (T.C. 1990), aff'd in part, reversed in part, on other grounds, 994 F.2d 855 (D.C. Cir. 1993), the Tax Court held that, although a partnership that invested the monies of the taxpayer partner and ten other partners was "a trader and not an investor, its trading activities did not rise to the level of a trade or business ..." The court added: "[w]hen a taxpayer, in this case a partnership, is trading solely for its own account, the volume of trading must be very regular and substantial in order to rise to the level of a trade or business." *Id.*, at *12. Thus, according to this court, a person or entity trading on its own account could, under some circumstances, engage in a "trade or business."

25 The import of this decision is, of course, that Connecticut could tax a nonresident in the plaintiff's situation who worked through an office in Connecticut.

26 In view of this conclusion, the court does not reach the plaintiff's alternative argument, which raises only a question of law, that denial of a credit in Connecticut would amount to double taxation in violation of the federal constitution and authorities such as *Comptroller of the Treasury v. Wynne,* 135 S.Ct. 1787, 191 L.Ed.2d 813 (2015).

27 The commissioner contends that the court lacks jurisdiction over the plaintiff's claim for a refund because the plaintiff did not timely seek that relief in an amended return or administrative claim. The short answer is that the plaintiff is not seeking a refund. He is seeking a cancellation or reduction of the assessment against him. The commissioner has had ample notice of that claim.

28 Section 12-717-1(a) provides: "Where an individual changes resident status during the taxable year, the capital gains or losses or passive activity income or loss attributable to such individual are to be computed separately for the period of residence and for the period of nonresidence. In each case the computation of the capital gain or loss or passive activity income or loss to be computed as if separate federal income tax returns had been filed for the period of residence and for the period of nonresidence, except that: (1) the separate computations applicable to the respective periods of residence and nonresidence shall include any special accruals required in this Part; and (2) the capital gain or loss or passive activity income or loss to be reported on the Connecticut part-year resident income tax return for the period of nonresidence includes only those capital gains and losses or passive activity income and losses reported for federal income tax purposes which are derived from or connected with Connecticut sources during the nonresident period."

29 In full, § 12-701(a)(1) provides: " 'Resident of this state' means any natural person (A) who is domiciled in this state, unless (i) the person maintains no permanent place of abode in this state, maintains a permanent place of abode elsewhere and spends in the aggregate not more than thirty days of the taxable year in this state, or (ii) within any period of five hundred forty-eight consecutive days the person is present in a foreign country or countries for at least four hundred fifty days, and during such period of five hundred forty-eight consecutive days the person is not present in this state for more than ninety days and does not maintain a permanent place of abode in this state at which such person's spouse, unless such spouse is legally separated, or minor children are present for more than ninety days, and during the nonresident portion of the taxable year with or within which such period of five hundred forty-eight consecutive days begins and the nonresident portion of the taxable year with or within which such period ends, such person is present in this state for a number of days which does not exceed an amount which bears the same ratio to ninety as the number of days contained in such portion of the taxable year bears to five hundred forty-eight, or (B) who is not domiciled in this state but maintains a permanent place of abode in this state and is in this state for an aggregate of more than one hundred eighty-three days of the taxable year, unless such person, not being domiciled in this state, is in active service in the armed forces of the United States."

30 In reaching this conclusion, the court has considered the twenty-eight-factor test detailed in the department's regulations.

31 The plaintiff claimed that he meant to say that he purchased a large tract of land "near" Greenwich rather than "in" Greenwich. That sort of mistake seems most unlikely in a letter written to the Governor of the state. Moreover, the plaintiff's explanation would essentially have the sentence read: "In July 1998, I moved to New York, but in 1999 I purchased a large tract of land near Greenwich, Connecticut." Such a sentence does not make sense, as the "but" in the middle of the sentence suggests a

contrast between the first and second part of the sentences that does not exist. The court concludes that the plaintiff was trying to suggest—inaccurately—to the Governor that he was still a Connecticut resident.

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