

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :  
of :  
James R. Forgan, Jr. :  
and Petronella Forgan :

AFFIDAVIT OF MAILING

for Redetermination of a Deficiency or a Revision :  
of a Determination or a Refund of Unincorporated :  
Business Tax under Article 23 of the Tax Law for :  
the Years 1968 - 1972. :

State of New York  
County of Albany

Jay Vredenburg, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 18th day of May, 1982, he served the within notice of Decision by certified mail upon James R. Forgan, Jr., and Petronella Forgan the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

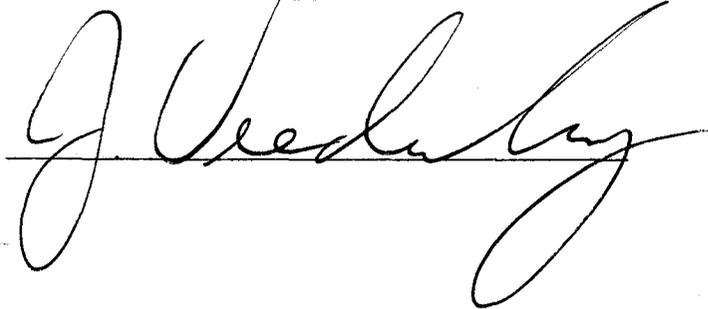
James R. Forgan, Jr.  
and Petronella Forgan  
c/o E.H.L. Investment Service, Inc.  
20 Copthall Ave., 2nd Fl.  
London, E.C.2, ENGLAND

and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the petitioner herein and that the address set forth on said wrapper is the last known address of the petitioner.

Sworn to before me this  
18th day of May, 1982.





STATE OF NEW YORK  
STATE TAX COMMISSION

In the Matter of the Petition :  
of :  
James R. Forgan, Jr. :  
and Petronella Forgan :

AFFIDAVIT OF MAILING

for Redetermination of a Deficiency or a Revision :  
of a Determination or a Refund of Unincorporated :  
Business Tax under Article 23 of the Tax Law for :  
the Years 1968 - 1972 :

State of New York  
County of Albany

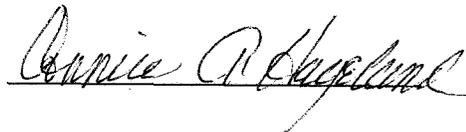
Jay Vredenburg, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 18th day of May, 1982, he served the within notice of Decision by certified mail upon Barry Salkin the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

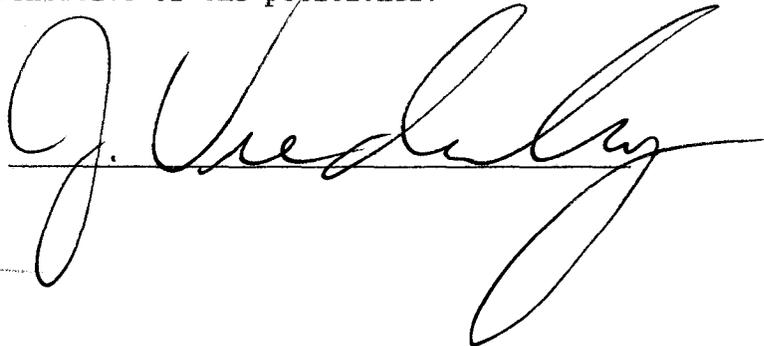
Barry Salkin  
Kelley, Drye & Warren  
350 Park Ave.  
New York, NY 10022

and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the representative of the petitioner herein and that the address set forth on said wrapper is the last known address of the representative of the petitioner.

Sworn to before me this  
18th day of May, 1982.

  
Annice R. Hyslop

  
Jay Vredenburg

STATE OF NEW YORK  
STATE TAX COMMISSION  
ALBANY, NEW YORK 12227

May 18, 1982

James R. Forgan, Jr.  
and Petronella Forgan  
c/o E.H.L. Investment Service, Inc.  
20 Copthall Ave., 2nd Fl.  
London, E.C.2, ENGLAND

Dear Mr. & Mrs. Forgan:

Please take notice of the Decision of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 722 of the Tax Law, any proceeding in court to review an adverse decision by the State Tax Commission can only be instituted under Article 78 of the Civil Practice Laws and Rules, and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 months from the date of this notice.

Inquiries concerning the computation of tax due or refund allowed in accordance with this decision may be addressed to:

NYS Dept. Taxation and Finance  
Law Bureau - Litigation Unit  
Albany, New York 12227  
Phone # (518) 457-2070

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative  
Barry Salkin  
Kelley, Drye & Warren  
350 Park Ave.  
New York, NY 10022  
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

---

In the Matter of the Petitions  
of  
JAMES R. FORGAN, JR. and PETRONELLA FORGAN  
for Redetermination of Deficiencies or for  
Refund of Unincorporated Business Tax under  
Article 23 of the Tax Law for the Years 1968  
through 1972.

DECISION

---

Petitioners, James R. Forgan, Jr. and Petronella Forgan, 580 Park Avenue, New York, New York 10021, filed petitions for redetermination of deficiencies or for refund of unincorporated business tax under Article 23 of the Tax Law for the years 1968 through 1972 (File No. 12607).

On October 17, 1980, petitioners, by their attorneys Kelley, Drye & Warren, Esqs. (E. Lisk Wyckoff, Jr., Esq., of counsel), waived a formal hearing and consented to submission of this matter to the State Tax Commission. The following decision is rendered upon the file as presently constituted.

ISSUE

Whether income derived from petitioner James R. Forgan, Jr.'s activities as an associate odd lot broker was properly subject to unincorporated business tax.

FINDINGS OF FACT

1. Petitioners, James R. Forgan, Jr. and Petronella Forgan, filed New York State combined income tax returns for 1968 through 1970 and joint income tax returns for 1971 and 1972 in which petitioner, James R. Forgan, Jr., reported income he received as a stockbroker as business income on page 2 of

his income tax returns. He did not file unincorporated business tax returns for the years at issue.

2. On October 28, 1974, the Audit Division issued to petitioners two notices of deficiency asserting unincorporated business taxes due, plus penalties and interest, for each of the years in question, as follows:

<u>YEAR</u>	<u>TAX</u>	<u>PENALTIES</u>	<u>INTEREST</u>	<u>TOTAL</u>
1968	\$ 2,846.23	\$ 711.56	\$ 945.32	\$ 4,503.11
1969	2,909.86	1,382.19	791.86	5,083.91
1970	2,070.63	911.08	439.24	3,420.95
1971	2,933.21	1,114.62	446.23	4,494.06
1972	201.68	64.58	23.25	289.51
	<u>\$10,961.61</u>	<u>\$4,184.03</u>	<u>\$2,645.90</u>	<u>\$17,791.54</u>

The penalties were asserted under section 685(a) and 685(a)(1) and (a)(2) of the Tax Law for failure to file unincorporated business tax returns and to pay the tax required to be shown thereon.

Petitioners take exception to the deficiencies on the ground that Mr. Forgan's activities as an odd lot broker did not constitute the carrying on of an unincorporated business for purposes of Article 23. As a result of a Default Order, dated May 25, 1977, the Audit Division issued, for each year, a "Notice and Demand for Payment of Income Tax Due". On September 5, 1979, collection of tax on said notices was suspended and on September 18, 1979, the Default Order was vacated.

3. Carlisle & Jacquelin and DeCoppet & Doremus, New York Stock Exchange ("Exchange") firms, were the two principal odd lot dealers on the Exchange. On January 1, 1970, the firms merged. The successor firm, known as Carlisle, DeCoppet & Co., a New York partnership, was the only principal odd lot dealer

on the Exchange. Mr. Forgan was an associate odd lot broker at DeCoppet & Doremus in 1968 and 1969 and at Carlisle, DeCoppet & Co. in the subsequent years at issue.<sup>1</sup>

4. In connection with doing business as an odd lot dealer, the firm maintained for its own account, an inventory of the securities listed on the Exchange and used by the firm on a daily basis, to satisfy buy and sell odd lot orders (orders for less than 100 shares) received from members and member firms of the Exchange.

5. In order to function as an odd lot dealer, the firm engaged the services of "associate odd lot brokers," such as Mr. Forgan. While partners of the firm executed odd lot orders, such associate odd lot brokers, who were not member partners, executed most of the odd lot orders on behalf of the firm.

6. The duties, responsibilities and functions of all of the associate odd lot brokers were identical.

7. The first duty of an associate odd lot broker, after acquiring a seat on the Exchange, was an assignment to work, for a short period of time, with an experienced associate odd lot broker engaged by the firm, who would teach the new associate odd lot broker. As a new associate odd lot broker became more experienced, the odd lot dealer assigned him a "book" which contained stocks at a trading post in which he was to execute odd lot orders on behalf of the firm.

---

<sup>1</sup>The firms operated in almost identical fashion, at least vis-a-vis the odd lot brokers associated with them. The findings which follow refer generally to "the firm" or "the odd lot dealer" but apply to DeCoppet & Doremus or Carlisle, DeCoppet & Co. depending upon the specific year.

8. The work of an associate odd lot broker was divided into two parts: (a) the filling of odd lot orders on behalf of the firm received by the firm from its customers, solely other member firms of the Exchange, and (b) execution of offsetting round lot trades in securities owned by the firm which it used to fill odd lot orders received from other member firms of the Exchange.

9. The firm's Floor Committee, consisting of firm partners, was in full charge of all the firm's operations on the floor of the Exchange, including the management of positions. The associate odd lot broker was to keep each position within a prescribed limit (e.g., under 200 shares) with the following exceptions: (a) a partner instructed the associate odd lot broker to increase the inventory in a particular stock; (b) the associate odd lot broker, believing that it would be beneficial to carry more than the minimum inventory in a particular stock, suggested such course of action to a partner, who then approved. The associate odd lot broker was expected to maintain accurate and current records of his position in each stock assigned to him. When utilizing the round lot market to keep each position in line with firm policy, the broker was of course expected to exercise good judgment with an eye to the firm's profit.

10. The associate odd lot broker was required to compute the net position change for his book (the cumulative net sum of changes in inventory of all stocks on his book) at 11:30 A.M., 1:00 P.M. and 2:30 P.M. daily and to promptly report the changes to the firm. Throughout the day, the associate odd lot broker was required to notify the firm of significant "up books" or "down books", important turns of position from long to short or vice versa, and any other unusual situation.

11. The physical processing of limited orders received by the firm was handled not by the associate odd lot broker, but by clerks of the firm who

frequently trained to be associate odd lot brokers and who also handled the physical processing of market orders when volume was too great for an associate odd lot broker to handle.

12. Until 1968, the associate odd lot broker received 2 1/4 cents per share on stocks selling at or over \$10 per share and 1 1/8 cents per share on stocks selling under \$10 per share (the "differential"), for executing odd lot orders; the odd lot differential was added to the price of the effective round lot sale or to the effective offer on customers' orders to buy, and subtracted from the effective round lot sale or the effective bid on customers' orders to sell. The rate was established by the firm. In 1968, the rate was reduced to the minimum set by the Exchange.

13. In 1968, the physical processing and handling of most odd lot orders was taken away from the associate odd lot brokers, moved off the floor of the Exchange and handled exclusively by clerks of the firm below the floor; but an associate odd lot broker still continued to receive monies from the execution by the firm of odd lot orders although the associate odd lot broker no longer actually processed such orders. From 1968 until mid-1972, pricing and processing of odd lot orders was done by clerks of the firm. Again, however, the actual execution of the orders was done by the associate odd lot broker.

14. The associate odd lot broker, in addition to the sums paid him for executing odd lot orders, also earned commissions on round lot orders executed by him in maintaining the firm's inventory of stock. Such commissions were paid to the associate odd lot broker by the firm.

15. By mid-1972 Carlisle, DeCoppet & Co. caused the complete computerization of the execution of odd lot orders by its back office, and the payment to the associate odd lot broker on execution of odd lot orders ceased. The only

compensation which the associate odd lot broker thereafter received was derived from the execution of round lot orders on behalf of the firm. In this regard, the associate odd lot broker received instructions from the firm's computer as to what round lot transactions to effect.

16. Books were assigned by the firm primarily on the basis of an individual associate odd lot broker's performance in executing odd lot orders and managing the inventory of stocks of the firm.

17. The associate odd lot broker never shared in any profit made by the firm on the broker's execution of round lot trades, nor did he have to make up any losses which he incurred in such execution; his activities in this respect were riskless although he might be given a poorer book if he sustained substantial losses. He did not participate in the profits or losses of the firm.

18. The associate odd lot broker was not required to, and did not, contribute or use any of his own capital in executing odd lot or round lot orders on behalf of the firm. At all times, the inventory of stocks in the book which he was running were owned by the firm. He was not required to and did not contribute his Exchange membership to the odd lot dealer, but he had to own said membership in order to transact business on the floor of the Exchange.

19. The associate odd lot broker was required to work exclusively for the firm.

20. The associate odd lot broker was engaged under an oral contract by the firm. The arrangement was terminable, without notice, at any time by either the associate odd lot broker or the firm. After the merger of the two odd lot dealers in 1970, many associate odd lot brokers were fired.

21. The associate odd lot broker was responsible for his assigned book during the entire five and one-half hours of the trading day. He was permitted

one-half hour for lunch, during which time his book was run by a relief broker or by another associate odd lot broker assigned to the same post.

22. The associate odd lot broker was permitted such vacation time as he desired, so long as the firm had enough associate odd lot brokers available each day to conduct the day's business efficiently.

23. The firm provided rent-free a desk or office space in the office of the odd lot dealer; secretarial help, if needed, at no charge; and local telephone services to the brokers. Long-distance telephone calls were billed to the associate odd lot broker at cost. The firm urged the associate odd lot broker to belong to the Stock Exchange Luncheon Club and reimbursed the broker for the entertainment of customers at the Club. If approved in advance by the firm, certain other exceptional customer relations activity was also reimbursed by the firm.

24. Associate odd lot brokers were provided with the same hospitalization and group life insurance coverage as was issued to employees. They were also issued insurance identification cards describing them as "employees".

25. Carlisle, DeCoppet & Co. issued to petitioner, James R. Forgan, Jr., Form 1099 - "Miscellaneous Income" which showed the amount of commissions paid to him. Said payments were labeled "Commissions and fees to nonemployees".

26. Neither Federal, state nor social security taxes were withheld from sums paid to the associate odd lot broker by the firm. He was not covered by disability or workmen's compensation insurance.

27. Petitioner, James R. Forgan, Jr., paid self-employment tax on the net profit he derived from his business activities as a stockbroker.

28. The DeCoppet & Doremus Brokers' Manual, in its definition of "associate broker", stated in relevant part:

"An Exchange Member acting thus as an odd-lot broker associated with the firm is an independent contractor who undertakes, as a condition of his association with the firm, to devote his entire time to the responsibilities assigned to him by the firm." (Emphasis in original.)

29. On its New York State partnership returns for 1970, 1971 and 1972, Carlisle, DeCoppet & Co. deducted commissions paid to associate brokers at the line denominated "other deductions", and not at the line denominated "salaries and wages" to employees.

#### CONCLUSIONS OF LAW

A. That the rendering of services by an individual as an employee is not considered an unincorporated business for purposes of Article 23 of the Tax Law.

"The performance of services by an individual as an employee or as an officer or director of a corporation, society, association, or political entity, or as a fiduciary, shall not be deemed an unincorporated business, unless such services constitute part of a business regularly carried on by such individual." Section 703(b).

B. That the determination whether services were performed by an individual as an "employee" or as an "independent agent" turns upon the unique facts and circumstances of each case.

"The distinction between an employee and an independent contractor has been said to be the difference between one who undertakes to achieve an agreed result and to accept the directions of his employer as to the manner in which the result shall be accomplished, and one who agrees to achieve a certain result but is not subject to the orders of the employer as to the means which are used.' (Matter of Morton, 284 N.Y. 167, 172.) It is the degree of control and direction exercised by the employer that determines whether the taxpayer is an employee. (E.g., Matter of Greene v. Gallman, 39 A.D.2d 270, 272, affd. 33 N.Y.2d 778; Matter of Frishman v. New York State Tax Comm., 33 A.D. 2d 1071, mot. for lv. to app. den. 27 N.Y.2d 483; Matter of Hardy v. Murphy, 29 A.D.2d 1038; see 20 NYCRR 203.10; cf. Matter of Sullivan Co., 289 N.Y. 110, 112.)" Matter of Liberman v. Gallman, 41 N.Y.2d 774, 778.

The degree of direction and control which results in the conclusion that an employer/employee relationship exists cannot be stated with mathematical precision. Nor is any one particular characteristic of the relationship dispositive. The entire fabric of the relationship between Mr. Forgan and the odd lot dealer must be scrutinized.

C. That the firm failed to withhold income taxes from the odd lot differentials and commissions received by Mr. Forgan: the firm treated him, for withholding tax purposes, as self-employed. Id. In a similar vein, Carlisle, DeCoppet & Co. deducted commissions paid to associate brokers under the category "other deductions", as opposed to under "salaries and wages" on its partnership returns. According to the DeCoppet & Doremus Brokers' Manual, the firm considered its associate odd lot brokers "independent contractors". Mr. Forgan stated that certain business expenses were assumed by the firm (e.g., secretarial and local telephone) and others reimbursed (e.g., entertainment); however, the reimbursements were limited. Matter of Pochter v. State Tax Commission, 70 A.D. 2d 972; Matter of Seifer v. State Tax Commission, 58 A.D. 2d 726.

D. That Mr. Forgan was restricted from doing business for any other firm carries no weight in the present context. Prior to 1970, there were only two odd lot dealers with which a broker could associate if he wished to pursue an occupation as an odd lot broker; after the merger, of course, there was only one odd lot dealer.

E. That petitioners lay great emphasis upon the supervision the firm exercised over Mr. Forgan's daily activities. As to his working hours, these were the hours of the trading day. As to the procedures prescribed by the firm, these were mainly of the clerical type. The source of most of the substantive constraints upon Mr. Forgan's activities was the rules of the Exchange,

of which he was an independent member. The very nature of acting as a broker on the floor of the Exchange demanded that Mr. Forgan fully utilize and rely on his experience, business acumen and good judgment, in determining to whom stock should be sold and from whom purchased, and in maximizing the profits which would enure to the firm and to him.

F. That capital, in the form of a Stock Exchange membership, which petitioner James Forgan, Jr. was required to own, was a material income-producing factor within the meaning and intent of section 703 of the Tax Law and 20 NYCRR 203.11(b)(2). This regulation is substantially the same as 20 NYCRR 281.4, Question 43, which had been promulgated under Article 16A of the Tax Law. Petitioner, without said membership, would not have received commission income since he would not have been allowed to transact business on the floor of the Stock Exchange.

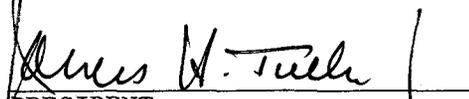
G. That petitioner James R. Forgan, Jr. was an independent agent associated with DeCoppet & Doremus in 1968 and 1969 and with Carlisle, DeCoppet & Co. in 1970 through 1972; therefore, income derived from his activities as an odd lot broker was properly subject to unincorporated business tax.

H. That the petitions of James R. Forgan, Jr. and Petronella Forgan are hereby denied in all respects and the notices of deficiency issued October 28, 1974 are sustained, together with penalties and interest.

DATED: Albany, New York

MAY 18 1982

STATE TAX COMMISSION

  
PRESIDENT

  
COMMISSIONER

  
COMMISSIONER