STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
NEW YORK YANKEES PARTNERSHIP	:	DECISION DTA No. 800263
for Redetermination of a Deficiency or for Refund of Unincorporated Business Tax under Article 23 of the Tax Law for the Year 1978	:	

Petitioner New York Yankees Partnership, Yankee Stadium, Bronx, New York 10452 filed an exception to the determination of the Administrative Law Judge issued on October 25, 1990 with respect to its petition for redetermination of a deficiency or for refund of unincorporated business tax under Article 23 of the Tax Law for the year 1978. Petitioner appeared by Shea & Gould (Roger L. Cukras, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (James Della Porta, Esq., of counsel).

Petitioner submitted a brief on exception. The Division of Taxation filed a brief in response.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUE

Whether payments for unrealized receivables to a partner in liquidation of his partnership interest constitute payments for "services or use of capital" that are nondeductible by the partnership under Tax Law § 706(3).

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge and make an additional finding of fact. The Administrative Law Judge's findings of fact and the additional finding of fact are set forth below.

Petitioner, New York Yankees Partnership ("partnership"), has owned and operated the New York Yankee baseball team since 1973.

As stated in its petition, the partnership derives its revenue from gate receipts, concessions, television and radio and billboard advertising. Its primary expenses are roster costs, players' salaries and other expenses incidental to the operations of a baseball franchise, such as the rental and maintenance of Yankee Stadium.

We find as an additional fact as follows:

> In 1978, petitioner made certain payments to two of its partners in liquidation of their partnership interests. Such payments were computed in accordance with the terms of petitioner's partnership agreement. For purposes of computing the unincorporated business tax, petitioner deducted a portion of such payments (referred to as the "deducted portion").

A Notice of Deficiency, dated February 3, 1982, was issued to the partnership for unincorporated business tax in the amount of $62,260.00 plus interest for taxable year 1978.

By petition dated February 23, 1982, the partnership challenged the income tax deficiency on two grounds. It contended (1) that the Tax Commission improperly used the direct method of allocation rather than the three-factor formula in apportioning the entire net income of the partnership to New York for unincorporated business tax purposes, and (2) that the Commission erred in disallowing deductions with regard to payments made in 1978 for the liquidation of the partnership interests to two individuals (Gabe Paul and the Trust for F. J. O'Neill) in the total amount of $1,484,941.00.

On June 10, 1982, the Division of Taxation ("Division") issued a Notice of Claim increasing the amount of the original deficiency from $62,260.00 to $78,414.00. The notice stated that the greater deficiency resulted from (1) allowance of the three-factor allocation method, (2) allowance for partners' services not to exceed $5,000.00, and (3) disallowance of certain net operating loss carryover deductions because the total partnership percentage interest of partners common to the loss year and the deduction year did not equal the 80% interest as required by Tax Law § 706(2)(b).

A conference was held on August 1, 1983 to resolve these issues. The conferee's report, dated January 5, 1984, noted that an agreement could not be reached concerning the net operating loss carryover deductions, the deductibility of payments made to two partners in termination of their partnership interests, and the amount deductible for payments to partners for services rendered.

In a perfected petition, dated May 25, 1984, the partnership challenged the entire assessment of $78,414.00 plus interest alleging that the Division of Taxation erred in disallowing its 1978 deductions with respect to payments made to two retiring partners in termination of their partnership interests[1] and in disallowing a deduction for a net operating loss carryover.

OPINION

In her determination below, the Administrative Law Judge concluded that the payments to two retiring partners in liquidation of their partnership interests were for unrealized receivables and were considered guaranteed payments. Thus, the Administrative Law Judge determined that such payments were ordinary income to the retiring partners and were deductible to the partnership for Federal income tax purposes. However, the Administrative Law Judge further concluded that the payments were for "services or use of capital" and, thus, were required to be added back pursuant to Tax Law § 706(3).

The second issue addressed by the Administrative Law Judge was whether the Division properly applied the 80% rule of Tax Law § 706(2)(b) with respect to disallowances of certain net operating loss carryovers. The Administrative Law Judge cited to Goodbody & Co. v. State Tax Commn. (118 AD2d 1025, 500 NYS2d 826) in noting that in calculating the proportionate interests of the partners in the loss year and deduction year, the calculation should take into

[1]The perfected petition stated that the amount to the partners totalled $1,837,608.00. However, in its tax return, prior petition and initial brief to the Administrative Law Judge the amount in dispute is identified as $1,484,941.00 ($742,470.00 to Gabe Paul and $742,471.00 to the Trust for F. J. O'Neill).

account salaries and interest paid to partners that were deductible for Federal tax purposes, but were nondeductible under New York State tax law. The Administrative Law Judge concluded that whether the Division recalculated the percentages using the method approved under Goodbody could not be determined from the record. Moreover, the Administrative Law Judge reasoned that the burden of proof was on the Division with regard to any increase in a deficiency when such increase was asserted after a Notice of Deficiency had been mailed and a petition had been filed, as was the situation presented herein, where the deficiency with regard to the net operating loss carryover was made in a Notice of Claim after the mailing of the Notice of Deficiency and filing of the initial petition (see, Tax Law § 689[e][3]).

Therefore, the Administrative Law Judge concluded that the Division failed to show that petitioner was not entitled to a net operating loss carryover deduction under Tax Law § 706(2)(b) and, therefore, the Administrative Law Judge cancelled the Notice of Claim issued June 10, 1982. There was no exception taken with respect to this second issue.

In its exception, petitioner contends that the amount in question, i.e., the deducted portion, represents payments to partners for unrealized receivables. Petitioner further asserts that the payments represented amounts for player contracts that had been amortized in prior years. Petitioner states that the only dispute is whether payments for unrealized receivables constitute payments for the use of capital, and that "payments for the use of capital" means interest in the conventional sense or its economic equivalent. Petitioner contends that these payments for unrealized receivables do not constitute payments for interest and that such payments are allowable deductions pursuant to Tax Law § 706(3).[2]

In response, the Division argues, based upon Tax Law § 706, that for an unincorporated business deduction allowance, such deduction must be directly connected with or incurred in the

[2]Petitioner has also requested changes to two statements the Administrative Law Judge made in her summary of petitioner's position. Since this summary is not a part of our decision, we find it unnecessary to consider the requested changes.

conduct of the business. The Division argues that the payments in question did not pertain to the conduct of petitioner's business, i.e., the operation of a baseball team, but, as liquidation payments, were a transaction between the members of the partnership. Thus, the Division argues that the payments were not directly connected with or incurred in the conduct of the business and did not qualify for the deduction.

The Division further contends that, even if such payments satisfy the general criteria for the deduction under Tax Law § 706, under Tax Law § 706(3) the unincorporated business tax deduction is not allowed because the payments were for services or for the use of capital.

We affirm the determination of the Administrative Law Judge for the reasons stated in the following opinion.

Former Tax Law § 706[3] states, in pertinent part, that:

> "The unincorporated business deductions of an unincorporated business mean the items of loss and deduction directly connected with or incurred in the conduct of the business, which are allowable for federal income tax purposes for the taxable year . . . with the following modifications:"

Subdivision (3) of such section provides:

> "No deduction shall be allowed (except as provided in section seven hundred eight) for amounts paid or incurred to a proprietor or partner for services or for use of capital."

We will begin our analysis by first determining whether the payments made to the retiring partners were directly connected with or incurred in the conduct of the partnership which are allowable for Federal tax purposes. We begin our analysis by noting, as did the Administrative Law Judge, that it is undisputed that the payments in issue were for unrealized receivables and were considered guaranteed payments.

In considering Federal law, we focus upon Internal Revenue Code (hereinafter "IRC") § 736(a) which states:

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[3]Article 23 of the Tax Law, which includes § 706, was repealed by the Laws of 1978, ch 69 § 7, effective in 1982.

> "PAYMENTS CONSIDERED AS DISTRIBUTIVE SHARE OR GUARANTEED PAYMENT.--Payments made in liquidation of the interest of a retiring partner or a deceased partner shall, except as provided in subsection (b), be considered--
>
> (1) as a distributive share to the recipient of partnership income if the amount thereof is determined with regard to the income of the partnership, or
>
> (2) as a guaranteed payment described in section 707(c) if the amount thereof is determined without regard to the income of the partnership."

IRC § 736(b) states, in pertinent part, that:

> "(1) GENERAL RULE.--Payments made in liquidation of the interest of a retiring partner or a deceased partner shall, to the extent such payments . . . are determined . . . to be made in exchange for the interest of such partner in partnership property, be considered as a distribution by the partnership and not as a distributive share or guaranteed payment under subsection (a).
>
> "(2) SPECIAL RULES.--For purposes of this subsection, payments in exchange for an interest in partnership property shall not include amounts paid for--
>
> "(A) unrealized receivables of the partnership (as defined in section 751[c]), or
>
> "(B) good will . . . ."

In other words, section 736(a) determines whether the distribution made to the partner is to be considered as a distributive share of partnership income to the partner, or whether the distribution is deemed a guaranteed payment to the partner. If it is deemed a guaranteed payment, the payment is ordinary income to the partner and deductible by the partnership (see, IRC § 707[c]; see also, Matter of Quirk v. Commissioner, 928 F2d 751, 91-1 USTC ¶ 50,148). However, under section 736(b), if the liquidation payments are made in exchange for the partner's interest in partnership property, then such payment will be considered generally as a return of capital to the partner and not as payments under section 736(a) unless the amounts paid in exchange were for unrealized receivables or good will (see, IRC § 736[a] and [b]; Jackson Inv. Co. v. Commissioner, 346 F2d 187).

The Division argues that the payments in question do not qualify for the deduction since they are not "directly connected with or incurred in the conduct of the business" as that phrase is used in Tax Law § 706. We find this argument unpersuasive. The Division is placing undue emphasis upon that particular phrase. We interpret the opening provision of Tax Law § 706 as a whole, without taking the phrase in issue out of its context. Tax Law § 706 provides for deductions "directly connected with or incurred in the conduct of the business, which are allowable for federal income tax purposes for the taxable year" with certain modifications. Federal law, through the combination of IRC §§ 736(b)(2)(A), 736(a)(2) and 707(c), clearly provides the partnership with a deduction for the payments made in liquidation of a partner's interest in the partnership property to the extent the payments are for unrealized receivables of the partnership.[4] Therefore, since payments in liquidation of a partner's interest in unrealized receivables are deductible for Federal purposes, then the payments in question are deductible for State purposes, provided that they do not fall within any of the enumerated modifications set forth in Tax Law § 706.

Furthermore, 20 NYCRR 206.1 provides, in pertinent part, that:

> "Except as otherwise provided in this Part, the unincorporated business deductions of an unincorporated business engaged in or being liquidated by an individual or unincorporated entity mean the items of loss and deduction of the individual or unincorporated entity which are allowable for Federal income tax purposes for the taxable year and which are directly connected with or incurred in the conduct or the liquidation of the business including losses and deductions connected with any property of the individual or unincorporated entity, or a member thereof, employed in the business" (emphasis added).

[4]Section 707(c) of the IRC provides in pertinent part that guaranteed payments shall be considered as made to one who is not a member of the partnership, but only for purposes of section 61(a) and, subject to section 263, for purposes of section 162(a). Thus, to qualify as a deduction for Federal purposes, the guaranteed payments at issue had to satisfy the requirement of section 162(a) of the IRC as being paid or incurred "in carrying on any trade or business." Since the Division has never asserted that the payments were not properly deductible for Federal purposes, it follows that the payments were incurred in carrying on a business.

Contrary to the Division's argument, it is clear from the regulation set forth above that payments in liquidation of the business may be allowed by the Division within the meaning and intent of Tax Law § 706.

Next, we must determine whether the payments in issue were for services or for the use of capital. As stated earlier, there is no dispute in characterizing the payments in question as for unrealized receivables.

IRC § 736 provides that unrealized receivables shall be treated as guaranteed payments pursuant to IRC § 707(c). The Administrative Law Judge determined that, based on her reading of IRC §§ 707(c) and 736, guaranteed payments are allowable deductions as payments to a partner for services or use of capital. Thus, the Administrative Law Judge reasoned that unrealized receivables were deductible for Federal tax purposes because such payments were for services or use of capital and such payments should maintain their characterization as for services or use of capital for New York State tax purposes. Therefore, since payments for services or use of capital are required to be added back pursuant to Tax Law § 706(3), the Administrative Law Judge concluded that the unrealized receivables in question were required to be added back. We disagree with this analysis.

IRC § 707(c) provides that:

> "GUARANTEED PAYMENTS.--To the extent determined without regard to the income of the partnership, payments to a partner for services or the use of capital shall be considered as made to one who is not a member of the partnership, but only for the purposes of section 61(a) (relating to gross income) and, subject to section 263, for purposes of section 162(a) (relating to trade or business expenses)."

Based upon IRC §§ 707(c) and 736, it is clear that unrealized receivables are to be treated as guaranteed payments, but only for purposes of certain other specific sections of the Internal Revenue Code. Section 707(c) of the IRC does not define an unrealized receivable to be a guaranteed payment for all purposes. Therefore, we disagree with the Administrative Law Judge's conclusion that unrealized receivables were payments for services or the use of capital

because they were guaranteed payments. However, we do not disagree with the conclusion that the unrealized receivables in question were not for services or the use of capital.

We agree with the Administrative Law Judge that "whether and to what extent a deduction shall be allowed is a matter of legislative grace and, therefore, the taxpayer bears the burden of establishing its right to a particular deduction" (Matter of Royal Indemnity Co. v. Tax Appeals Tribunal, 75 NY2d 75, 550 NYS2d 610, 611, citing Matter of Grace v. New York State Tax Commn., 37 NY2d 193, 371 NYS2d 715, 719). We find that petitioner has not met its burden in this case of establishing that the payments in question were not for services or the use of capital.

We find no evidence in the record establishing the nature of the payments. Section 751(c) includes as unrealized receivables payments for certain goods delivered or to be delivered, payments for services rendered or to be rendered, as well as certain recapturable deductions taken by the partnership (see, IRC § 751[c]). The only assertion in the record before us as to the nature of the instant payments is the statement in the affidavit of David Weidler, Treasurer of petitioner during the audit period, that the payments "were not for the services performed by either such partner and were not for the use of capital by either such partner" (Affidavit of David Weidler, ¶ 12). We find such conclusions, unsupported by a detailed explanation of the specific nature of the payments,[5] an insufficient basis to determine the nature of the payments.

The only other characterization of the payments was offered by petitioner in its memorandum of law to the Administrative Law Judge and in its exception to us, where petitioner states that the payments were for player contracts which had been amortized in prior years (see, Petitioner's Memorandum of Law #1, p. 2 [submitted at Administrative Law Judge hearing]; petitioner's exception). We find this statement, made in argument, inadequate to determine either

[5]The affidavit also states that one of the partners never performed services for the partnership and the other partner performed services in prior years for which he had been fully compensated. Although these statements are more in the nature of basic allegations of fact, they do little to explain the nature of the payments.

the factual nature[6] or tax consequences of the payments. Simply stated, we conclude that petitioner has not provided us with adequate evidence to make a determination that the payments in issue were not properly considered as payments for services or for use of capital and were not properly added back to petitioner's income pursuant to section 706(3) of the Tax Law. Since petitioner bore the burden of proof on this issue (Tax Law § 722), we must resolve it against petitioner.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the New York Yankees Partnership is denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petition of the New York Yankees Partnership is granted to the extent of the Administrative Law Judge's Conclusion of Law "F"; the Division of Taxation is directed to cancel the Notice of Claim issued June 10, 1982, and except as so granted, the petition is denied in all other respects; and

4. The Notice of Deficiency dated February 3, 1982 is sustained.

DATED: Troy, New York
November 7, 1991

/s/John P. Dugan
John P. Dugan
President

/s/Francis R. Koenig
Francis R. Koenig
Commissioner

/s/Maria T. Jones
Maria T. Jones
Commissioner

[6]We note that the Administrative Law Judge did not find as a fact that the payments related to player contracts, but simply stated this as the position of petitioner.