STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
KENNETH R. AND CHERYL ETHEREDGE	:	DECISION
for Redetermination of a Deficiency or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law and New York City Nonresident Earnings Tax under Chapter 46, Title U of the Administrative Code of the City of New York for the Years 1981 and 1982.	:	

The Division of Taxation filed an exception to the Administrative Law Judge's determination issued on November 22, 1989 which granted, in part, the petition of Kenneth R. and Cheryl Etheredge, 750 North St. Paul Street, Dallas, Texas 75201 for redetermination of a deficiency or for refund of New York State personal income tax under Article 22 of the Tax Law and New York City nonresident earnings tax under Chapter 46, Title U of the Administrative Code of the City of New York for the years 1981 and 1982 (File No. 803820). Petitioners appeared by Larry Kars, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Andrew Zalewski, Esq., of counsel).

Both the Division and petitioners filed a brief on exception. Oral argument was not requested.

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

ISSUE

Whether penalties imposed against petitioners should be abated.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge and such relevant facts are stated below except that we modify finding of fact "9" as indicated below.

Petitioners, Kenneth R. and Cheryl Etheredge, were during the years in question residents of the State of Texas and were not residents of New YorkState or New York City.[1] During such years, Mr. Etheredge was listed in Standard and Poor's Publication "Security Dealers of North America" as a partner in the New York stock brokerage partnership known as Schaenen Fellerman and Company ("S & F"). S & F is a member of the New York Stock Exchange ("the Exchange"), and engages in stock trading thereon. S & F maintained offices in New York City and in Dallas, Texas during the years in question.

Petitioner Kenneth Etheredge worked out of S & F's Dallas, Texas office as a stockbroker engaged in the analysis and sale of stock in small to medium sized growth companies.

S & F is known as a "non-clearing" firm, meaning that S & F hires another firm, namely Wall Street Clearing, Inc., to process its stock trades. Petitioner's function within S & F was as follows: petitioner would obtain an order to either buy or sell stock for a Texas client; such order would be placed by S & F with a trader on the floor of the New York Stock Exchange; once the trade was made, Wall Street Clearing, Inc. would handle confirmation of the trade and all collections and disbursements of funds. In fact, Wall Street Clearing, Inc. would send a confirmation of the trade to the client with a duplicate confirmation sent to S & F. Such confirmations were labeled "S & F courtesy of Wall Street Clearing".

A daily production run of all trades was sent to both the Texas and New York offices of S & F, showing all trades and all commissions thereon earned by S & F. These production runs were reconciled at the end of each month by petitioner in Dallas and were also confirmed as to accuracy with Wall Street Clearing, Inc. and with S & F's New York office. Wall Street Clearing, Inc. would then send a check in the amount of the commissions earned by S & F to

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[1]Cheryl Etheredge, listed as a petitioner herein, appears solely by virtue of the fact that she filed a joint Federal income tax return for each of the years 1981 and 1982 with petitioner Kenneth R. Etheredge. Accordingly, all references to petitioner in this determination shall, unless otherwise noted, pertain solely to petitioner Kenneth R. Etheredge.

S & F's New York office, and thereafter, S & F's New York office would send petitioner a check equal to 50% of the commission amounts earned on the various trades.[2]

During 1981 there appear to have been a total of seven general partners in S & F, including petitioner, and three limited partners.

Petitioner explained that the payment to each partner of 50% of the commissions generated by each such partner was a policy in effect to compensate each partner based on his own sales efforts, as opposed to enabling a partner who had done less sales work to obtain a disproportionately large compensation based solely on his percentage partnership interest. In fact, in one year petitioner received a larger share of partnership distribution than some other partners who had a greater partnership ownership interest.

S & F's New York State partnership returns (Form IT-204) for the years in question were filed reflecting total income (primarily commissions) less expenses resulting in ordinary income. For 1981, ordinary income (total income less expenses) totaled $994,424.00, while for 1982 ordinary income totaled $49,533.00. As noted hereinafter, petitioner claims the partnership actually incurred a "loss"[3] and that gain (i.e. "ordinary income") was shown only to avoid being put on a financial "watch" list by the Exchange. The partnership, as confirmed by a Division of Taxation review and audit thereof, calculated a partnership allocation percentage (allocation of items of income, loss, gain and deduction within and without New York) of 85.16% for 1981 and 90.216% for 1982.

In the years in question, petitioner received from the partnership $150,443.00 and $53,549.00, respectively. These amounts were reported as distributions of partnership ordinary income on both the partnership's returns and petitioner's individual returns. Such amounts were not calculated based upon petitioner's 4.21% partnership owner's interest.

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[2]The amount of commission (percentage) on a given transaction was negotiated between petitioner and each client. Clients executing large volume trades received comparatively more favorable commission rates.

[3]The "loss" petitioner speaks of would result if the commission amounts distributed to the partners were treated as expenses of the partnership rather than as distributions of partnership net ordinary income.

We modify finding of fact "9" of the Administrative Law Judge's determination to read as follows:

> Petitioner filed no New York State or New York City tax returns for the years in question upon the basis that all of his earnings from the partnership represented commissions derived from services he performed for his institutional and individual clients, all of whom were located in Texas. Petitioner spent no more than one or two days in New York State during each of the years in question and all of his working time was spent in Texas. Petitioner has no background of education in tax law, and he engaged an accountant in Texas to prepare his tax returns for the years in question. Petitioner reviewed his personal income tax returns with his accountant before signing them, although he relied on his accountant in their preparation. According to the auditor's report (Exhibit I), petitioner's accountant contacted the Division during the audit process and told the auditor he, the accountant, was not familiar with New York tax law.[4]

On April 11, 1986, the Division of Taxation issued to petitioners, Kenneth R. and Cheryl Etheredge, a Notice of Deficiency asserting additional personal income tax due for the years 1981 and 1982 in the aggregate amount of $11,196.00, plus penalties under Tax Law § 685(a)(1), (2) and (b), plus interest. A Statement of Audit Changes previously issued to petitioners on January 16, 1986 provided computations for each of the years in question (relative to the respective amounts of New York State and New York City tax imposed). The deficiency in question is premised upon treatment of petitioner's commission earnings from S & F as representing a distributive share of partnership income from a New York partnership derived from or connected to New York sources to the extent of the partnership allocation percentages previously mentioned.

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[4]Finding of fact "9" of the Administrative Law Judge's determination read as follows:

> "9. Petitioner filed no New York State or New York City tax returns for the years in question upon the basis that all of his earnings from the partnership represented commissions derived from services he performed for his institutional and individual clients, all of whom were located in Texas. Petitioner spent no more than one or two days in New York State during each of the years in question and all of his working time was spent in Texas. Petitioner has no background of education in tax law, and he engaged an accountant in Texas to prepare his tax returns for the years in question.

The last two sentences were added to more fully reflect the record before us.

OPINION

In the determination below, the Administrative Law Judge found that petitioner was a partner in the brokerage firm of Schaenen Fellerman and Company and that he owed New York personal income tax on payments made to him by the partnership in 1981 and 1982. The Administrative Law Judge cancelled the penalties asserted against petitioner for his failure to file tax returns and pay tax for 1981 and 1982. The Administrative Law Judge based his decision to cancel the penalties on petitioner's testimony that he lacked education in tax matters and that he relied on his accountant to file his personal income tax returns.

On exception, the Division asserts that the penalties should not have been cancelled. Arguing that ignorance of the law and reliance on one's accountant does not establish reasonable cause in this case, the Division requests that the Administrative Law Judge's conclusion on this issue be reversed. The Division asserts that petitioner failed to offer additional evidence in an attempt to show he had reasonable cause for not filing returns. Additionally, the Division argues that a finding that petitioner did not willfully neglect or negligently fail to pay his taxes is not enough to cancel the penalty; rather, the record must support a finding that reasonable cause actually existed.

Without mentioning specific evidence in the record, petitioner asserts that the record does support a finding that reasonable cause existed for his not filing tax returns for 1981 and 1982.

We reverse the Administrative Law Judge's determination that the penalties should not be imposed.

Tax Law § 685(a)(1) and (2) imposes penalties for failing to file a return and pay tax, "unless it is shown that such failure is due to reasonable cause and not due to willful neglect." The taxpayer has the burden of proving he had reasonable cause for failing to file income tax returns (Tax Law § 689[e]; see, McCauley v. State Tax Commn., 67 AD2d 51, 415 NYS2d 118).

Petitioner has not shown that his failure to file tax returns was due to reasonable cause. The only evidence petitioner presented was that he was uneducated in tax matters and that he relied on his accountant to do his taxes. Ignorance of the Tax Law is not itself reasonable cause for failure to file a tax return (see, 20 NYCRR 102.7). Nor does reliance on a tax professional's advice necessarily constitute reasonable cause (Matter of LT & B Realty v. State Tax Commn., supra, 535 NYS2d 121, 123; Matter of A&V Crown, Inc., Tax Appeals Tribunal, May 24, 1990; Matter of Norwest Bank International, Tax Appeals Tribunal, May 3, 1990). "To permit consulting with a tax professional to act as immunity to penalties would effectively remove the penalty provisions" (Matter of LT & B Realty v. State Tax Commn., supra, 535 NYS2d 121, at 123).

Matter of Bachman v. State Tax Commission (89 AD2d 679, 453 NYS2d 774) involved facts very similar to this case. There, a nonresident partner did not file a tax return on income earned from his New York law firm. The Court said the taxpayer did not show reasonable cause for his failure to file, finding it significant that the taxpayer relied on his local, Washington. D.C., tax advisor who presumably would be less familiar with New York tax law than the partnership's accountant. The Court gave additional weight to the fact that the accountant did not appear to testify or give a sworn statement to "verify his alleged advice and the basis for it" (Matter of Bachman v. State Tax Commn., supra, 453 NYS2d 774, at 776).

> "Also to be considered in evaluating petitioner's assertion is the complexity, or lack thereof, of the statute which spawned the inquiry. There is nothing ambiguous, misleading, or mysterious about the relevant law. Specific provisions for nonresidents with New York partnership income are clearly spelled out . . . ." (id., at 776).

Here, petitioner relied on his Texas accountant rather than the partnership's New York accountant who presumably would have been more familiar with New York tax law. Petitioner offered no testimony from his accountant as to why the accountant made the decision he did, although the auditor's report showed that the accountant told the auditor he was simply

unfamiliar with New York law (see, Division's Exhibit I). In addition, former Tax Law § 637(a)(1) provided that a nonresident partner's taxable income included "such partner's distributive share of items of partnership income, gain, loss and deduction entering into his federal adjusted gross income", and former § 637(b)(1) stated that no effect would be given to a partnership agreement's characterization of payments as being for services. "[R]eliance [on a tax advisor] cannot function as a substitute for compliance with an unambiguous statute" (U.S. v. Boyle, supra, 85-1 USTC ¶ 13,602 at 88,257). For these reasons, petitioner failed in his burden of proving that reasonable cause existed for his not filing income tax returns from the partnership in 1981 and 1982.

Tax Law § 685(b) imposes an additional penalty when a tax deficiency is due to negligence or intentional disregard of the law. Here, too, petitioner has the burden of proving that this penalty assessment was erroneous (Tax Law § 689[e]). We conclude that the evidence supports a finding of negligence. Petitioner's bare assertion that he relied on the advice of his accountant is not sufficient to prove that his failure to file and pay was not negligent (see, Plante v. Commr., T.C. Memo 1985-117, 49 TCM 963, 967). The imposition of the negligence penalty should therefore also be sustained.

Accordingly, it is ORDERED, ADJUDGED, and DECREED, that

1. The exception of the Division of Taxation is granted;

2. The determination of the Administrative Law Judge with respect to the imposition of the penalty is reversed;

3. The petition of Kenneth R. and Cheryl Etheredge is in all respects denied; and

4. The Notice of Deficiency dated April 11, 1986 is sustained.

DATED: Troy, New York
July 26, 1990

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

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

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