STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
CHARLES E. BENISCH	:	DECISION DTA No. 806775
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Years 1983 and 1984.	:	

Petitioner Charles E. Benisch, 108 Remington Road, Manhasset, New York 11030 filed an exception to the determination of the Administrative Law Judge issued on April 18, 1991 with respect to his petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the years 1983 and 1984. Petitioner appeared by Lopez, Edwards, Frank & Co. (Felix A. Tornatore, C.P.A.). The Division of Taxation appeared by William F. Collins, Esq. (Andrew J. Zalewski, Esq., of counsel).

Petitioner filed a brief on exception. The Division of Taxation filed a letter in lieu of a brief. Petitioner's request for oral argument was denied.

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

ISSUE

Whether certain distributions petitioner received from two subchapter "S" corporations during the years at issue constitute personal service income subject to the maximum tax limitation.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

On August 20, 1984, petitioner, Charles E. Benisch, filed a 1983 New York State Resident Income Tax Return. An application for automatic extension of time to file to August 15, 1984 had been filed by petitioner on April 13, 1984.

On October 15, 1985, petitioner filed a 1984 New York State Resident Income Tax Return. An application for automatic extension of time to file to August 15, 1985 had been filed by petitioner on April 12, 1985 andpetitioner requested, and was granted, an additional extension to October 15, 1985 in which to file.

Throughout the years 1983 and 1984 petitioner owned 100 percent of Don Travel Service NY, Inc. and Don Travel Service of Westchester, Inc., electing small business corporations within the meaning of Tax Law § 660. Both corporations were involved in the travel agency business.

For the year 1983, petitioner reported $1,967,956.00 as personal service income subject to the maximum tax limitation. The personal service income as shown was composed of the following:

Wage/salary income from Don Travel Service NY, Inc. (per wage and tax statement)	$ 478,000.00
Wage/salary income from Don Travel Service of Westchester, Inc. (per wage and tax statement)	24,000.00
Miscellaneous Income	1,770.00
Distribution from Don Travel Service NY, Inc. (subchapter "S" distribution)	893,113.00
Distribution from Don Travel Service of Westchester, Inc. (subchapter "S" distribution)	571,073.00
	$1,967,956.00

For the year 1984, petitioner reported $2,060,577.00 as personal service income subject to the maximum tax limitation. The personal service income as shown was composed of the following:

Wage/salary income from Don Travel Service NY, Inc. (per wage and tax statement)	$ 472,288.00
Wage/salary income from Don Travel Service of Westchester, Inc. (per wage and tax statement)	29,000.00

Miscellaneous Income	1,372.00
Distribution from Don Travel Service NY, Inc. (subchapter "S" distribution)	888,857.00
Distribution from Don Travel Service of Westchester, Inc. (subchapter "S" distribution)	669,060.00
	$2,060,577.00

On its income tax return for 1983, Don Travel Service NY, Inc. listed distributions, other than dividend distributions, paid during the year to petitioner of $832,683.00 and undistributed income of $41,005.00, for a total of $893,113.00. For 1984, this same corporation listed distributions, other than dividend distributions, paid during the year to petitioner of $303,203.00 and undistributed income of $585,654.00, for a total of $888,857.00.

On its income tax return for 1983, Don Travel Service of Westchester, Inc. listed undistributed income of $571,073.00. For 1984, this same corporation listed distributions, other than dividend distributions, paid during the year to petitioner of $669,060.00.

For 1983 and 1984, Don Travel Service NY, Inc. reported the following:

	1983	1984
Salaries	$3,239,202.00	$4,855,069.00
Cost basis of depreciable assets	1,737,501.00	2,249,533.00
Depreciation	710,024.00	1,009,250.00
Rent paid	438,288.00	768,602.00

For 1983 and 1984, Don Travel Service of Westchester, Inc. reported the following:

	1983	1984
Salaries	$1,309,614.00	$1,132,455.00
Cost basis of depreciable assets	573,871.00	707,387.00
Depreciation	270,159.00	405,169.00
Rent paid	134,356.00	170,113.00

The depreciable assets of both corporations included computers and office equipment.

The Division of Taxation ("Division") issued, on July 6, 1987, a Statement of Audit Changes recomputing petitioner's income with the explanation that "undistributed taxable income from an electing small business corporation is not personal service income." The Division allowed only the wages shown on the wage and tax statements as personal service

income, disallowing the amounts distributed by the subchapter "S" corporations to petitioner during the years at issue as well as the undistributed earnings of the corporations.

On August 7, 1987, the Division issued to petitioner a Notice of Deficiency asserting additional tax due of $123,715.96, plus interest, for the years 1983 and 1984.

The accountant for petitioner and the subchapter "S" corporations during the years at issue testified at the hearing that the corporations were successful and profitable because of the personal efforts of petitioner. The accountant testified that petitioner was one of the first to employ computers in the travel agency business to set up systems for automated ticketing, reservations and customized billing statements. The combination of petitioner's efforts and extensive use of computers were the main factors which contributed to the growth of the corporations. The computer systems allowed the corporations to successfully compete for corporate travel business.

The accountant testified that the accounting firm made a mistake by not including in the wage and tax statements the amounts distributed during the years at issue. Furthermore, according to the accountant, petitioner sold the business in 1986 due to personal reasons and his concern over the total dependency of the success of the business on his own efforts.

OPINION

The Administrative Law Judge concluded that the record failed to support petitioner's claim that certain distributions made during the years at issue constituted compensation for personal services. The Administrative Law Judge stated that petitioner's businesses involved both personal services and capital as material income-producing factors and the existence of a personal service factor entitled petitioner to a reasonable allowance for personal services rendered. However, the Administrative Law Judge emphasized that a determination regarding what distributions would be reasonable compensation for services actually rendered could not be made without the testimony of petitioner or someone with the knowledge of the personal services he performed. The Administrative Law Judge cited to Matter of Matson (Tax Appeals Tribunal, March 10, 1988), and determined that because both corporations paid salaries equal to

approximately one-third of the corporate income and both had substantial investments in depreciable assets, petitioner failed to prove that the Division improperly characterized the amounts shown on the wage and tax statements as personal service income and the distributions made during the years at issue as unearned income. The Administrative Law Judge also concluded that nothing in the record indicated what the proper amounts on the wage and tax statements should have been and because the distributions made showed up on both the corporate income tax returns and petitioner's returns as distributions of the corporations' earnings, petitioner failed to prove his claim that the distributions were mistakenly excluded from his wage and tax statements.

On exception, petitioner argues that his representative gave sworn testimony as to the nature of the services petitioner performed, based on the representative's knowledge of petitioner as the accountant for petitioner and both corporations since 1968. Petitioner asserts that personal services predominate over capital as a material income-producing factor and that his personal services to the corporations included the development and implementation of software which increased the growth of the businesses. Petitioner argues that the Administrative Law Judge's opinion fails to establish the legal principle governing the determination rendered below. He requests a conclusion of law on whether an item treated on the corporate books as a distribution of earnings can be considered in determining a reasonable allowance for compensation for services actually rendered under former Tax Law § 603-A, and he cites to two recent cases where the Federal court of appeals recharacterized dividends paid by a corporation as compensation subject to Federal income taxes. Petitioner argues that if personal service income includes such dividends, then the Administrative Law Judge erroneously failed to consider the representative's sworn testimony as to the value of petitioner's services in determining what amount of dividends should have been included as compensation for petitioner's personal services.

In response, the Division relies on the analysis of the Administrative Law Judge and argues that the corporate distributions represented distributions of earnings or profits rather than

a reasonable allowance for personal services actually rendered. The Division points to a "paucity" of evidence in the record regarding those personal services rendered by petitioner and it contends that no evidence suggests that the Division erred in determining that through his wage income petitioner received adequate and reasonable compensation for personal services actually rendered. The Division states that petitioner's representative explained the successful nature of petitioner's travel agency operations, but because petitioner failed to appear to testify as to the nature of his activities during the audit period, he failed to meet his burden of proof in the matter.

We affirm the determination of the Administrative Law Judge for the reasons stated below.

Former Tax Law § 603-A(b)(1)(A) defined personal service income, in pertinent part, as "wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered" (see also, 20 NYCRR 100.4[c]). The statute also provided that in the case of a taxpayer engaged in a trade or business where material income-producing factors included both personal services and capital, "a reasonable allowance as compensation for personal services rendered by the taxpayer shall be considered as earned income" (former Tax Law § 603-A[b][1][A]).

The statute involves a two-fold test: first, it must be determined that material income-producing factors included both capital and personal services, and second, if both factors existed, then a reasonable allowance was made as compensation for the personal services rendered by the taxpayer (Matter of Matson, supra). Here, the Administrative Law Judge determined that material income-producing factors included both capital (i.e., computers, office equipment and physical premises) and personal services and, therefore, petitioner was entitled to a reasonable allowance as compensation for personal services rendered. The Administrative Law Judge concluded that the Division properly characterized the amounts shown on the wage and tax statements as reasonable compensation for petitioner's personal services and that petitioner failed to prove that the Division improperly characterized the distributions as unearned income generated by the capital that petitioner invested in the businesses.

We agree that the record fails to support petitioner's claim that the distributions constituted compensation for personal services. Petitioner's representative testified at hearing that in a memorandum he prepared for the Division (see, Exhibit 1), he stated what petitioner did for the company over the years and why petitioner was instrumental in the growth of the company (Tr., p. 24). The memorandum also stated that petitioner should receive the entire amount of distribution as personal service income because petitioner was never compensated for past services and because the compensation was commensurate with that paid to other executives whose personal services created the income. But the representative failed to show, through documentary or testimonial evidence, exactly what personal services petitioner rendered, how many hours petitioner worked, how many other employees worked for the corporations and what those other employees did. Petitioner had the burden of proving that the amounts of compensation allowed by the Division were incorrect or unreasonably low, and he failed to prove either (see, Tax Law § 689[e]; Matter of Matson, supra).

Petitioner requests a conclusion of law as to whether an item treated on the corporate books as a distribution of earnings can be considered in determining "a reasonable allowance as compensation for the personal services actually rendered" within the meaning and intent of former Tax Law § 603-A(b)(1)(A). Petitioner points out that two Federal courts of appeals concluded that dividends paid were wages, but the issue in those two cases involved FICA and FUTA withholdings and the definition of wages under IRC § 3401(a) (see, Spicer Accounting v. United States, 918 F2d 90, 91-1 USTC ¶ 50,103; Radtke v. United States, 895 F2d 1196, 90-1 USTC ¶ 50,113).

Former Tax Law § 603-A(b)(1)(A) stated that New York personal service income "does not include that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for personal services actually rendered." Thus, the statute itself allowed for the treatment of distributions of earnings or profits as personal service income as long as the distributions represented "a reasonable allowance as compensation for personal services rendered." However, the real issue here is not whether distributions of earnings and profits in general can be considered personal service income under former Tax Law § 603-A, but whether the distributions at issue here constitute personal service income

subject to the maximum tax limitation. Petitioner failed to prove that it was improper for the Division to characterize the distributions as unearned income given petitioner's wage and tax statements, the amount of capital invested in both businesses, and the lack of evidence to substantiate that petitioner's internal bookkeeping department made a mistake in not including the distributions on petitioner's wage and tax statements. Thus, the Division's characterization must be upheld.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Charles E. Benisch is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petition of Charles E. Benisch is denied; and
4. The Notice of Deficiency dated August 7, 1987 is sustained.

DATED: Troy, New York
November 27, 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