STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
DAVID L. SIEGEL	:	DECISION DTA NO. 823107
for Redetermination of a Deficiency or for Refund of New York State and New York City Personal Income Tax under Article 22 of the Tax Law and the New York City Administrative Code for the Years 2002 and 2003.	:	

Petitioner, David L. Siegel, filed an exception to the determination of the Administrative Law Judge issued on August 18, 2011. Petitioner appeared by Hodgson Russ LLP (Timothy P. Noonan, Esq., of counsel). The Division of Taxation appeared by Mark Volk, Esq. (Christopher O'Brien, Esq., of counsel).

Petitioner filed a brief in support of his exception. The Division of Taxation filed a brief in opposition. Petitioner filed a reply brief. Oral argument, at petitioner's request, was heard on May 23, 2012, in Albany, New York.

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

ISSUE

Whether it was appropriate for the Division of Taxation to assert that tax was due from petitioner on the gain from the sale of Blimpie International, Inc., shares.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge, except for findings of fact "3," "8" through "11," "13," "14," "20," "22" through "24," "27," "32," and "34," which have been modified. The Administrative Law Judge's findings of fact and the modified findings of fact are set forth below.

Petitioner, David L. Siegel, grew up in Far Rockaway, New York. He graduated from Marietta College and received a J.D. degree in 1968 and an L.L.M. degree in 1970 from New York University School of Law. In 1968, as a member of Volunteers in Service to America (VISTA), he started a program to create jobs for a community group in East Harlem that he represented. As a part of this program, he negotiated with Blimpie Corporation of America, at the time a 16-store sandwich franchise company based in Jersey City, New Jersey, to open a Blimpie franchise to be owned and run by the East Harlem group.

In 1970, petitioner was offered a job with the Blimpie Corporation of America as corporate counsel. He operated the Blimpie Corporation with Anthony Conza and Peter DeCarlo out of Jersey City, New Jersey. In 1976, the principals separated, and petitioner and Mr. Conza formed another company that became Blimpie International, Inc. (Blimpie). Mr. DeCarlo formed Metropolitan Blimpie. At the time of the separation, petitioner, Mr. Conza and Mr. DeCarlo divided up the approximately 40 stores between the two companies, created exclusive marketing areas throughout the United States, and signed a trademark distribution agreement.

We have modified finding of fact "3" of the Administrative Law Judge's determination to read as follows:

> In 1981, Blimpie completed a small public registration and became a public company. Stephen D. Dreyer, Esq., was hired as the company's securities

lawyer. In 1981, Blimpie was controlled by four officers, one of whom was petitioner. They collectively controlled approximately 59 percent of the common stock when Blimpie was sold.[1]

Blimpie struggled until the early 1990s, when it began selling territorial franchises. By 2000, Blimpie had approximately 2,000 franchises.

Francinelee Hand

In 1975, petitioner married Francinelee Hand. Petitioner and his wife had a "very loving and warm relationship. . ." but maintained independent lives. Throughout their lives, they maintained separate finances, with separate bank accounts.

In 1994, Ms. Hand, who worked as a New York City school teacher, was diagnosed with breast cancer. Following a lumpectomy and radiation treatment, she decided to retire and move back to Florida where she had grown up. At the time, Blimpie International was finally succeeding after many years of struggle, and petitioner felt that he could not leave New York. Ms. Hand purchased a house in Boca Raton, Florida, using her own savings and money borrowed from her mother. Petitioner moved into the Boca Raton house with his wife in the fall of 1994 and commuted to New York for the next seven years.

In 2000, Ms. Hand decided to move from Boca Raton, Florida, to Miami Beach, Florida, where she spent her childhood. Petitioner did not want to move from the Boca Raton house. Ms. Hand offered to use her own money from the subsequent sale of the Boca Raton house and money inherited from her mother to purchase a house in Miami Beach. In January of 2001, they signed a contract for a house in Miami Beach that needed major renovations. The purchase price of the house was $1,250,000.00. Ms. Hand used $1,000,000.00 of her own money, which

[1] We modify this fact to clarify the record.

constituted the bulk of her savings, and petitioner provided the remaining $250,000.00 from his savings. Ms. Hand and petitioner were listed on the deed as owners of the house.

We have modified finding of fact "8" of the Administrative Law Judge's determination to read as follows:

> Financial security was very important to Ms. Hand, and she was very distressed as a result of having used the majority of her savings to purchase the Miami Beach house in 2001. On July 11, 2001, petitioner presented his wife with a letter, which stated:
>
> > "Nothing could make me prouder than your trust in me by the use of your life savings to help buy our new home. I want to make sure that you do not have one moment of regret or anxiety.
> >
> > For that reason, I, by execution of this letter, hereby gift to you (I am unconditionally assigning and conveying to you) 624,693 shares of Blimpie stock represented by stock certificate #0956 of Blimpie International Inc. which is owned by me.
> >
> > If the Endervelt deal under negotiation goes thru (questionable) these shares will be worth $2.75 per share. The shares I am giving you must remain in my name and I must retain voting rights until sold, so, even though they are yours, I will hold them in trust for you and I will be your agent. These shares will, after the payment of taxes, net you 1,000,000 plus; enough to cover some or all of the following; presents for many future birthdays and anniversaries, presents for me; presents for the house; presents for Halle, more presents for me. I am sure that you will figure out how to spend the $$$$ and I know you will make the correct decisions.
> >
> > In the future you may have to execute stock powers in my favor. I will at my expense execute any and all other documents necessary to confirm your ownership of these shares and to make sure that you will receive their proceeds if they are sold to the Endervelt group or pursuant to another transaction.
> >
> > If the Endervelt deal fails then I want us to take a mortgage on our home with you getting the proceeds and me paying the note . . . ."
>
> This letter bears only petitioner's signature and lacks notarization. The record fails to clearly indicate whether the letter was accompanied by any other document. Further, there is no evidence that this letter was presented to Blimpie

or a transfer agent on or after July 11, 2001.[2]

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

> Petitioner asserts that he gave Ms. Hand the letter and the shares in the hope that a merger of Blimpie would occur, but petitioner was not certain that a merger would take place.[3]

We have modified finding of fact "10" of the Administrative Law Judge's determination to read as follows:

> On August 2, 2001, petitioner wrote a second letter attempting to clarify the legal implications of his previous letter. In this letter, petitioner wrote that Ms. Hand was the owner of the shares, but that no one would know that she was the owner of the shares. Petitioner wrote that he would act as Ms. Hand's agent and trustee to vote the shares in her interest. The letter also explained that, if signed and approved, it would serve as a voting proxy, allowing petitioner to vote the shares. The letter provides as follows:
>
> "I cannot sell, transfer, pledge, encumber or otherwise dispose of the Shares without your consent and I must make sure that the shares have no debts attached to them and I am not allowed to do anything that is in your disinterest . . . ."
>
> The letter goes on to state:
>
> "I have retained the right to vote the Shares which means that for such a right to be effective you must grant me a written proxy to have and exercise such rights. In other words you own the shares without the right to vote until the proxy expires which will be one year from today unless renewed or extended . . . ."
>
> In the letter, petitioner also promised Ms. Hand that she would become the public owner in 12 months if the shares were not sold. The letter referred to Ms. Hand as an "undisclosed principal" and stated that no one else knew that he was representing her or acting on her behalf. The letter was not notarized and there is

---

[2] We modify this fact to more accurately reflect the record.

[3] We modify this fact to more accurately reflect the record.

> no indication that Blimpie or any party, other than petitioner and his wife, knew of this agreement. Ms. Hand signed and approved the August 2, 2001 letter on August 6, 2001.[4]

We have modified finding of fact "11" of the Administrative Law Judge's determination to read as follows:

> Beginning in or about September 2001, Ms. Hand began to have discussions with her investment advisor, Beverly Whitney of Prudential Securities/Wachovia Securities, about how to best utilize the proceeds from the Blimpie sale. Ms. Hand informed Ms. Whitney that she wanted to place most of the stock proceeds into investments. The remaining amount would be used to pay off the mortgage on the Miami Beach house, cover the costs of some of the home renovations, and pay federal taxes on the proceeds. Ms. Hand also discussed with petitioner her plans regarding what she would do with the stock proceeds if the merger occurred. Although she never held record ownership of Blimpie shares, as discussed herein, Ms. Hand did receive stock sale proceeds from the Blimpie merger.[5]

5313 North Bay Road Enterprises

In the summer and fall of 2001, petitioner discussed with his accountant, Lloyd Abrahams, CPA, the possibility of forming another company so that petitioner could go into a new business in Florida if the merger of Blimpie occurred.

We have modified finding of fact "13" of the Administrative Law Judge's determination to read as follows:

> On September 7, 2001, Mr. Abrahams wrote petitioner a letter advising him of the tax consequences of both his previous gift of Blimpie stock to his wife and his plans to create a new company. Mr. Abrahams advised petitioner by phone and in the letter of September 7, 2001 that if the Blimpie sale occurred, he could, pursuant to New York law, reduce his New York State tax liability on the proceeds from the sale of the stock if he capitalized a Subchapter S corporation

---

[4] We modify this fact to more accurately reflect the record.

[5] We modify this fact to more accurately reflect the record.

with some of the Blimpie stock.[6]

We have modified finding of fact "14" of the Administrative Law Judge's determination to read as follows:

> On December 14, 2001, petitioner formed a Subchapter S corporation, 5313 North Bay Road Enterprises, Inc. (Enterprises), for federal tax purposes. Consistent with petitioner's understanding of New York law at the time, petitioner did not elect to have Enterprises taxed in New York as an S corporation.
>
> On December 21, 2001, petitioner held the organizational corporate meeting and executed all of the initial formation documents in accordance with his understanding of what was required under New York State corporate law. Petitioner held the organization, shareholder, and director meetings, recording the minutes from those meetings in the corporate books, and appointed himself the officers and sole director of the corporation.
>
> At the December 21, 2001 director meeting, petitioner subscribed to 100 shares of stock in Enterprises in exchange for contributing 801,270 shares of Blimpie stock to Enterprises. Petitioner was the sole shareholder of Enterprises. Representing Enterprises, petitioner executed a letter of agreement with himself that provided petitioner with the right to hold and vote the Blimpie shares as an agent of Enterprises. In addition, the assignment agreement provided that the shares would stay in petitioner's name. The assignment agreement also expressly recognized the impending merger transaction. The record does not indicate that any transfer agent or Blimpie was notified of the foregoing arrangement when it was consummated. At the hearing, petitioner testified that he entered into this arrangement because he was "saving" a lot in taxes.[7]

Background to the Sale of Blimpie

In 1999 and 2000, there were unsuccessful attempts to sell Blimpie and Metropolitan Blimpie (the company owned by Mr. DeCarlo after the split in 1976) together to a single buyer.

In 2000, Mr. Conza, the chairman, CEO and largest stockholder of Blimpie, announced that he no longer wanted to "work the business" and instead only wanted to engage in marketing and promotion. As a result, petitioner and Mr. Conza began looking for a buyer for the company.

---

[6] We modify this fact to more accurately reflect the record.

[7] We modify this fact to more accurate reflect the record.

At a franchise convention in 2000, petitioner was approached by Jeffrey Endervelt, a territorial franchisee in California, about purchasing Blimpie. By 2001, Blimpie had two potential purchasers: Mr. Endervelt and another territorial franchisee, Todd Recknagel.

In April and May of 2001, Blimpie engaged in negotiations with its two potential purchasers. The Endervelt Group initially offered to buy the company without specifying a price per share. The Recknagel Group then offered $1.75 per share and the Endervelt Group responded with the same offer. Thereafter, the Recknagel Group offered $4.00 per share for the manager's shares, including Mr. Siegel's. The Endervelt Group counter offered $2.75 per share and further offered to permit Anthony Conza to maintain an ownership interest.

On June 6, 2001, Blimpie's board of directors agreed to a letter of intent with the Endervelt Group. The letter of intent was a nonbinding agreement outlining the general terms of prior discussions between the Endervelt Group and members of the board of directors.

Prior to signing the letter of intent, Blimpie's board of directors met with Mr. Dreyer. Mr. Dreyer advised the board members of their obligations under applicable securities laws and the necessary procedures for a sale of the company.

We modify finding of fact "20 "of the Administrative Law Judge's determination to read as follows:

> Based on Mr. Dreyer's advice, on June 8, 2001, Blimpie's board of directors appointed a special committee to negotiate the sale of the company and to "recommend it or reject it" to the shareholders. The committee consisted of three outside directors, who were not employees of the company, but did not include petitioner, Mr. Conza or the other inside directors, because they were going to receive additional compensation as officers of the company as part of the sale. The special committee had sole responsibility and authority for recommending acceptance or rejection of the purchase offer from the Endervelt Group and remained involved in the deal until the merger was completed on January 24, 2002. As part of its responsibilities, the special committee hired

> Greenberg Traurig, LLP, as its independent legal counsel and hired Capitalink L.C. as its financial advisor.[8]

The special committee examined the issues subject to extensions of the exclusivity periods. During its review, the special committee acknowledged that Mr. Conza and Mr. Siegel had already assented to the sale of the shares to the Endervelt Group.

We modify finding of fact "22" of the Administrative Law Judge's determination to read as follows:

> The special committee hired Capitalink L.C. to study the proposed sale of Blimpie and produce a fairness opinion to determine whether the latest offer of $2.80 per share offered by the Endervelt Group was a fair price to the shareholders. On October 5, 2001, Capitalink issued its report, which concluded that the $2.80 per share price was a fair price and the parties executed a definitive merger agreement, dated October 5, 2001. On October 8, 2001, the Blimpie board of directors approved the merger agreement. On the same date (October 8, 2001), the five Blimpie officers controlling the majority of the Blimpie stock, including petitioner, signed a voting agreement agreeing to vote all of their shares in Blimpie in favor of the merger on the terms outlined in the October 5, 2001 merger agreement.[9]

We modify finding of fact "23" of the Administrative Law Judge's determination to read as follows:

> Despite the execution of the merger agreement and voting agreement, several conditions and contingencies remained. For instance, the merger agreement required a 30-day market check after its approval by Blimpie's board, which obligated the special committee to solicit other offers to purchase Blimpie. On or about October 8, 2001, Capitalink commenced a 30-day market check. If the committee received a superior proposal with a higher share price, and the Endervelt Group was unable or unwilling to match that proposal, Blimpie would have the right to terminate the merger agreement. The merger agreement could be terminated after the 30-day market check if a buyer approached the special committee with a superior proposal. The committee was obligated to accept that

---

[8] We modify this fact to more accurately reflect the record.

[9] We modify this fact to more accurately reflect the record.

> proposal and terminate the merger agreement prior to the shareholder vote scheduled for December 27, 2001.[10]

We have modified finding of fact "24" of the Administrative Law Judge's determination to read as follows:

> On October 22, 2001, a Blimpie franchisee filed a complaint in a class action in New Jersey Superior Court challenging the merger on the basis of grossly inadequate compensation to the shareholders and seeking an injunction to bar the merger. During the deal process, the board of directors was concerned that the New Jersey court would issue a restraining order to prevent the shareholder vote on December 27, 2001, or to prevent the closing of the merger on January 24, 2002. No restraining order was issued to prevent the shareholder vote on December 27, 2001. This litigation was ultimately dismissed and did not prevent the closing of the merger on January 24, 2002.[11]

Financing was also a critical aspect of the deal because, as part of the merger agreement, the Endervelt Group had represented to the seller that approximately 95 percent of the $32,000,000.00 purchase price would be financed by banks. Because of this, the merger agreement required the buyer to represent that he had the necessary financing to complete the merger at the agreed-on price. The merger agreement also gave the buyer an opportunity to arrange for alternative financing if its primary financing fell through. Most important, the buyer's failure to come through with the promised financing or arrange for alternative financing constituted a "Material Adverse Effect" and a breach of the buyer's representations under the agreement, allowing Blimpie to terminate the merger agreement and to take other legal recourse against the buyer.

An issue was also presented by Metropolitan Blimpie, the company formed by Mr.

---

[10] We modify this fact to more accurately reflect the record.

[11] We modify this fact to more accurately reflect the record.

DeCarlo in 1976, which needed to be resolved prior to the closing. In 2001, Metropolitan Blimpie claimed that it had not consented to the transfer of the Blimpie domestic trademarks to Blimpie. The merger agreement stated that if the Metropolitan Blimpie trademark issue was not resolved by the date of the closing, the Endervelt Group had the right to terminate the merger and Blimpie would be required to pay it $600,000.00 in damages. Petitioner believed that Metropolitan Blimpie had consented to the transfer in 1999 but needed to locate the document evidencing that transfer. Petitioner was unable to locate the document until January 20, 2002, at which time the issue was resolved to the satisfaction of the buyer.

We have modified finding of fact "27" of the Administrative Law Judge's determination to read as follows:

> On or about December 7, 2001, the shareholders of Blimpie were served with a Proxy Statement and notice of shareholder meeting to be held on December 27, 2001. The record includes a copy titled, "Proxy Statement pursuant to Section 14 (a) of the Securities Exchange Act of 1934" (Ex H), which was filed with the Securities Exchange Commission (SEC). The Proxy Statement reflects that petitioner was recognized as the "Beneficial Owner" of all of the shares in question as of the record date for the shareholder merger vote (Ex H at 53-54 of 100). The record date for the shareholder vote was established as November 30, 2001 (Ex H at 5 of 100). The Proxy Statement indicates that, as of the record date, petitioner beneficially owned all of the shares at issue, including those related to Ms. Hand and Enterprises. The document explicitly recognized that petitioner's ownership did not extend to shares beneficially held by his daughter.
>
> On December 27, 2001, the shareholder vote occurred, approving the merger.[12]

The Blimpie merger did not close until January 24, 2002, almost a month after the shareholder vote. The delay was due to Mr. Endervelt's inability to meet the financing provisions of the merger agreement. The issue arose soon after the shareholder vote. On

---

[12] We modify this fact to more accurately reflect the record.

December 29, 2001, Blimpie received notice from the Endervelt Group that it did not have the money to close the deal because the group was having trouble coming up with its share of the financing.

On January 3, 2002, Mr. Dreyer sent an e-mail to Michael Rubinger, a senior associate at the law firm representing the buyer. The e-mail outlined some of the reductions in compensation that Blimpie's current officers had agreed to in order to help resolve the buyer's financing problems, including Mr. Conza's purchase of $1,000,000.00 in stock in the new company; a $500,000.00 reduction in noncompete payments to petitioner and other Blimpie officers; and deferral of $1,000,000.00 in additional noncompete payments.

On January 8, 2002, Arthur Schwartz, the senior partner representing the buyer, wrote a letter to Rebecca Orand, an attorney representing Blimpie's special committee, specifically noting that all of the conditions required for closing under the terms of the merger agreement had not been satisfied.

By January 15, 2002, the parties had still not resolved the changes to the inside directors' compensation. On that date, Mr. Rubinger, an attorney for the buyer, sent an e-mail to Mr. Dreyer outlining the terms of the "Conza restructuring" and asking whether Mr. Dreyer agreed to those terms. Mr. Dreyer testified that there was "no way" the deal would have closed without the renegotiation of the purchase price and the agreement of the inside directors to reduce their compensation as part of the merger.

We have modified finding of fact "32" of the Administrative Law Judge's determination to read as follows:

> On January 23, 2002, Mr. Dreyer went to Atlanta for the closing of the Blimpie merger. On that date, he waited to finalize the merger while the buyer

> and his counsel took steps to satisfy the lenders. On January 24, 2002, the Blimpie merger closed.[13]

Redemption of Blimpie Stock

Once the Blimpie merger occurred on January 24, 2002, the shares were to be cancelled and converted into cash to be paid to the shareholders pursuant to paragraph 1.8(b) of the merger agreement. This paragraph set forth the procedure to be followed for a shareholder to redeem his or her shares for cash. The "Special Issuance Instructions" required a beneficial owner who was not the record owner of the shares to provide the paying agent with the stock shares endorsed to the beneficial owner and a signature guarantee. Only a financial institution can provide a signature guarantee, which is a medallion or stamp officially guaranteeing the signature on the particular document.

We have modified finding of fact "34" of the Administrative Law Judge's determination to read as follows:

> On January 23, 2002, in anticipation of the completion of the merger, petitioner called the paying agent, Mr. Ken Brotz of the Register and Transfer Company, to ask how to surrender the Blimpie shares.[14] Petitioner testified that he informed Mr. Brotz that he was the record owner, but that Ms. Hand and Enterprises were the beneficial owners of certain Blimpie shares. As such, petitioner sought to pay the stock proceeds of the merger into the accounts of Ms. Hand and Enterprises.
>
> Mr. Brotz instructed petitioner to provide a letter of transmittal along with the Blimpie shares and the executed stock power assignments. Mr. Brotz also instructed petitioner that he would need to get a signature guarantee in order for the stock proceeds to be transferred to Ms. Hand and Enterprises as required by the merger agreement.

We have modified finding of fact "35" of the Administrative Law Judge's determination

---

[13] We modify this fact to clarify the record.

[14] As paying agent, Mr. Brotz's job was to collect and cancel the shares and deposit the money into the shareholders' accounts.

to read as follows:

> On January 24, 2002, the date the merger closed, petitioner executed the relevant assignment and transfer provisions on the Blimpie stock certificates in favor of Ms. Hand and Enterprises. Prior to January 24, 2002, the assignment and transfer provisions on the stock certificates had not been executed.
>
> On January 24, 2002, petitioner provided the paying agent with a letter of transmittal, indicating the following:
>
> "1. I have assigned 624,693 (certificate #0956) of the shares pursuant to the enclosed stock power/assignment described below to my wife Francinelee Hand, Social Security No. [redacted], address 5313 North Bay Road, Miami Beach, Florida 33140 and have assigned by the enclosed stock power/assignment 801,270 shares to a New York corporation that I am the sole stockholder of, 5313 North Bay Road Enterprises, Inc., Tax I.D. No. 02-0534925. The corporation's mailing address is also 5313 North Bay Road, Miami Beach, Florida 33140.
> 2. Inasmuch as these shares will now be redeemed for $2.80 per share, it is my desire and intention that the assignees of the shares receive the proceeds of the merger transaction. As per our conversation of yesterday's date, it seems to me that you do not need to issue new shares to the assignees, to wit, my wife and the corporation but rather just forward the funds to each of them . . . ."
>
> Subsequent to January 24, 2002, the paying agent directly deposited approximately $2,244,539.00 into Enterprises' bank account and $1,749,000.00 into Ms. Hand's individual bank account. Blimpie shares were never issued to Ms. Hand or Enterprises before or after the merger.[15]

Petitioner delivered a letter dated February 12, 2002 to his wife outlining the transaction and providing the following instructions:

> "1. You will receive a wire transfer to your account in the amount of $1,749,140.40. From this you will owe taxes of $349,828.08 leaving a net balance of $1,399,312.40.
>
> 2. From the $1,399,312.40 the following payments are to be made:

---

[15] We modify this fact to more accurately reflect the record. We redacted a portion of the letter to protect the privacy of Ms. Hand.

a. $248,445.08 in payment of the mortgage.

b. $150,867.40 to our construction account which includes $100,000 of your money and $50,867.40 of my money.

c. That will leave you a balance of $1,000,000, giving you back all of the money invested in 5313 North Bay Road except for $100,000 which is being used for construction completion . . . ."

The Division of Taxation's Audit of Enterprises

The Division of Taxation (Division) ascertained that, since 2003, Enterprises earned limited receipts on consulting work performed in Florida. Most of its income was derived from investments. Its clients included a radiology clinic and a franchise company called Chicken Kitchen USA, LLC. In most years, petitioner received small distributions from Enterprises and most of the assets and cash remained in the company for the years subsequent to 2003. Enterprises' federal returns for the years 2002 through 2007 report the following business income after a capitalization of $2,270,170.00:

Year	Business Income
2002	$0.00
2003	45.00
2004	(120.00)
2005	419.00
2006	3,190.00
2007	(32,308.00)

In 2003, petitioner received a distribution of $400,000.00 to pay federal taxes on the income petitioner received from Enterprises. It is common for S corporations to pay dividends to shareholders to cover the tax liabilities related to income earned by a corporation.

Enterprises filed a New York State corporate franchise tax return for the year 2002, reporting its gain from the sale of Blimpie shares. On June 27, 2007, after an audit of Enterprises, the Division issued a Consent to Field Audit Adjustment to Enterprises for the 2002 tax year. The Division's adjustment was based on an error made by petitioner's accountant, Mr. Abrahams, on Enterprises' 2002 return relating to the allocation percentage used for apportioning the gain on the sale of Blimpie stock owed by Enterprises. On July 12, 2007, Enterprises paid the tax assessed against it and subsequently paid the interest and penalty due. The Division believes that, due to the two-year statute of limitations for refund claims, it cannot credit or refund this payment to Enterprises.

The Division's Audit of Petitioner

Petitioner filed a New York State Resident Income Tax Return for the year 2002 and a Nonresident and Part-Year Resident Income Tax Return for the year 2003. On each return, petitioner elected a filing status of married, filing a separate return.

On his 2002 New York return, petitioner reported capital gains of $2,248,710.00, which was offset by a subtraction modification of $2,241,302.00. Part of the reported capital gain was from the sale of the stock of Blimpie, which flowed through to petitioner from Enterprises.

In 2005, the Division initiated an audit of petitioner for the 2002 and 2003 tax years. The Division thought that the forgoing subtraction modification on petitioner's 2002 return for capital created an "audit issue."

The Division issued a Notice of Deficiency to petitioner, dated May 18, 2009, asserting that New York State personal income tax was due for the year 2002 in the amount of $273,408.00 plus penalty and interest. It also asserted that New York City personal income tax

was due for the year 2002 in the amount of $145,509.00 plus penalty and interest. The asserted deficiencies for the year 2002 were premised upon the Division's position that the transfers of Blimpie stock to petitioner's wife and to Enterprises were invalid under the anticipatory assignment of income doctrine. That is, the Division found that petitioner anticipated the merger and planned for it by sending a gift letter to his wife and by incorporating Enterprises and then transferring the stock to each. The penalties were asserted pursuant to Tax Law §§ 685(b) (1) and (2) for negligence and Tax Law § 685 (p) for substantial understatement of income. For the year 2003, the Division asserted a deficiency in the amount of $12,852.00 plus penalty and interest. However, at the hearing, the Division stipulated that it would no longer pursue this portion of the asserted deficiency.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge initially noted that the Division was no longer pursuing the deficiency with regard to tax year 2003. The Administrative Law Judge then reviewed the record and determined that the issue to be resolved was whether it was appropriate for the Division to tax petitioner on the gain from the subject sales of Blimpie stock. The Administrative Law Judge determined that resolving this question turned on whether proceeds of the sales were attributable to petitioner or to Ms. Hand and Enterprises.

The Administrative Law Judge found that the gains from the Blimpie stock sale were properly attributed to petitioner. The Administrative Law Judge found that petitioner had not relinquished dominion and control over the shares to Ms. Hand on the transfer date suggested by petitioner, because petitioner appointed himself as the trustee over the shares. Moreover, the Administrative Law Judge determined that petitioner exerted actual and apparent control by

voting the shares and by specifically providing instructions on how the proceeds were to be used (i.e., to benefit both himself and Ms. Hand). As such, the Administrative Law Judge concluded that petitioner's transfer to his wife was ineffective because petitioner did not sufficiently surrender dominion and control over the assets.

The Administrative Law Judge also found that the capitalization of Enterprises lacked economic substance. In reviewing the record, the Administrative Law Judge found that Enterprises did not have any employees, office staff, or facilities other than petitioner's Florida home. At the hearing, petitioner admitted that Enterprises was heavily capitalized in order to save petitioner a lot in taxes. Given this evidence, the Administrate Law Judge found it proper to disregard the transfers to Enterprises for tax purposes, and attributed the gains to petitioner.

In reaching these conclusions, the Administrative Law Judge noted that the anticipatory assignment of income doctrine need not be addressed because the transfers were disregarded for tax purposes. The Administrative Law Judge also sustained penalties because petitioner failed to present a sufficient basis for waiving said penalties. Accordingly, the Administrative Law Judge cancelled the Notice of Deficiency with respect to 2003, as conceded by the Division, but sustained the Notice in all other respects.

ARGUMENTS ON EXCEPTION

The parties agree that New York may impose personal income tax on the January 24, 2002 Blimpie stock sale only if such amounts are attributable to petitioner, who was then a New York resident. Petitioner takes exception to the entire determination, except for the cancellation of the assessment with respect to 2003. In submissions to this Tribunal, the parties focused their arguments on whether it was proper for the Division to recharacterize the stock sale proceeds as

income to petitioner.

Petitioner argues that the Administrative Law Judge incorrectly recharacterized the proceeds claimed by Ms. Hand. In addressing the shares transferred to Ms. Hand, petitioner submits that the July 11, 2001 letter establishes that he completed a transfer of the Blimpie shares to his wife. He contends that this letter shows that this transfer was motivated by a genuine donative intent and not tax avoidance. Petitioner further contends that the August 2, 2001 letter proves his surrender of control and clarified the legal relationship established by the July 11, 2001 letter. Citing to the Dreyer testimony, petitioner states that under federal and New York law, he completed the transfer on July 11, 2001. As such, petitioner submits that it is proper to consider whether the 624,693 Blimpie shares, transferred to Ms. Hand on July 11, 2001, constituted an interest in a company or a mere right to income.

Petitioner argues that federal jurisprudence on the assignment of income doctrine does not permit attributing Ms. Hand's gains to petitioner because the shares were not a fixed right to income. His contention is that, on July 11, 2001, Blimpie was very early in the merger process, as the independent review had not even returned with a recommendation on the Endervelt deal. Petitioner contends that applying the standard established in federal assignment of income cases leads to the conclusion that income from the Blimpie sale had not yet "ripened." As such, petitioner submits that the interest, transferred on July 11, 2001, did not constitute a right to income, but instead an interest in Blimpie itself.

Addressing the intrafamily nature of the transfer, petitioner distinguishes this case from other assignment of income cases by arguing that, on July 11, 2001, he surrendered actual control over the 624,693 Blimpie shares to Ms. Hand. He notes that, even if he benefitted from his

wife's receipt of the shares, it is of no moment because it was Ms. Hand's legal choice to utilize the proceeds in favor of petitioner and the marital property. In considering other form over substance arguments, petitioner contends that it would be improper to discard his gift to Ms. Hand because the July 11, 2001 transfer did, actually, alter his economic realities at that time. Accordingly, petitioner contends that this Tribunal should reverse the determination insofar as it permitted recharacterizing the proceeds received by his wife, Ms. Hand, as income attributable to him.

Petitioner similarly argues that the Division improperly recharacterized Enterprises' Blimpie stock sale gains as his own. Citing to documents from the organizational and director meeting, petitioner contends that on December 21, 2001, he transferred 801,270 Blimpie shares to Enterprises. Citing to the Dreyer testimony, petitioner states that, under federal and New York law, the transfer to Enterprises was completed on December 21, 2001. As such, petitioner submits that it is proper to consider whether, on December 21, 2001, the 801,270 Blimpie shares represented an interest in a viable corporation or a mere right to receive income.

Citing to various potential impediments, petitioner argues that the interest transferred on December 21, 2001 was not a fixed right to income. He contends that, despite the voting agreement and shareholder approval, the merger could have failed, and references the certain concessions accepted by the inside directors' group that, ultimately, facilitated the financing of the merger. As with the assets transferred to Ms. Hand, petitioner contends that, as of December 21, 2001, the right to proceeds from the Blimpie merger had not yet ripened. Accordingly, petitioner contends that the assets transferred to Enterprises were not a right to income, but instead an interest in Blimpie itself.

Petitioner also argues that it would be inappropriate to use a substance over form argument to attribute Enterprises' gains to him. Although he admitted that tax savings motivated the capitalization of the company, petitioner contends that the record shows that Enterprises was a bona fide consulting business. He notes that under the economic substance test, as applied by the Tribunal, the inquiry is not whether the business actually produced a profit, but whether there was a potential for profit at the time of the transaction. He argues that his discussions with his accountant prior to the redemption of Blimpie shares evidence a profit-making potential, and that the other facts in the record do not diminish this finding. As such, petitioner submits that this Tribunal should reverse the determination insofar as it permits recharacterizing the proceeds received by Enterprises as income attributable to petitioner.

Regarding penalties, petitioner contends that they should be cancelled because this case is one of first impression and petitioner substantially complied with the Division's audit. He submits that the regulations do not explicitly define reasonable cause, but permit the abatement of penalties where there is an absence of willful neglect and reasonable grounds for the delinquency. Petitioner contends that it was reasonable for him to believe that the gain from the Blimpie stock sale should have been attributed to Enterprises and Ms. Hand. Moreover, he submits that this position is supported by ample guidance in federal and New York law and that his filing of a New York tax return to report the gain indicates a lack of willful neglect. Accordingly, petitioner submits that, in the event that the deficiency is sustained, penalties should be abated.

The Division argues that the Administrative Law Judge properly resolved this matter. In the case of Ms. Hand, it argues that the determination is supported by both the law and the

record. The Division maintains that the Administrative Law Judge properly utilized an economic substance analysis because, it contends, the transfer to Ms. Hand did not alter petitioner's position with respect to the proceeds or among the parties. It notes that Ms. Hand was never the record owner of the stock, and evidenced no control over the shares, much less the ability to alter the merger. It also contends that the record shows that petitioner exerted control over the shares, as though he were the owner, because he used the attendant power to complete the Blimpie sale and direct the proceeds as he saw fit. The Division also argues that petitioner accrued a benefit from the shares similar to ownership because the proceeds were used on the marital property, as directed by petitioner's February 12, 2002 letter. As such, the Division submits that the Blimpie proceeds were properly attributed to petitioner because the economic reality did not match the legal form and, therefore, for tax purposes, should be disregarded.

With regard to the assets transferred to Enterprises, the Division similarly argues that the Administrative Law Judge properly invoked an economic substance analysis. Utilizing cases elevating substance over form, it notes that petitioner presented no non-tax business purpose for transferring the 801,270 Blimpie shares to Enterprises at the time of the transfer. The Division responds to petitioner's argument regarding the post-transfer character of Enterprise by noting that the company only had two clients, and the majority of its income was derived from the original capitalization. The Division argues that the evidence shows that tax savings, not profit potential, motivated the capitalization of Enterprises. Therefore, the Division submits that the Administrative Law Judge properly discarded the form of the transfer and correctly recharacterized the proceeds, received by Enterprises, as income attributable to petitioner.

The Division also argues that applying an assignment of income analysis to the instant

matter yields the same outcome. Citing to federal jurisprudence, the Division analogizes the instant matter to cases where taxpayers defeat the income tax rate structure by assigning income amongst family members. It notes that, in cases involving intrafamily transfers, strict scrutiny is appropriate because, if allowed, they would permit taxpayers to avoid income tax while still reaping the benefits of their earnings or income-producing property. The Division argues that this is precisely the case herein, where petitioner transferred the assets during the merger process, but ultimately, retained control for himself. It contends that, under similar federal cases, control is dispositive because the right to the Blimpie merger proceeds "ripened" while the shares were under petitioner's control. Accordingly, the Division submits that it is proper for the proceeds received by Ms. Hand and Enterprises to be recharacterized as income attributable to petitioner.

The Division contends that the Administrative Law Judge properly sustained penalties. It argues that the record does not present either reasonable grounds for the delinquency or the absence of willful neglect. The Division notes that it has informed petitioner that the gain will not be taxed twice by New York State. To this end, the Division has conceded to any necessary adjustments or modifications pending a final resolution in this matter.

OPINION

This matter presents the question of whether the Division may attribute gains from a stock sale to petitioner by disregarding certain transfers, for tax purposes, made by petitioner to his wife and wholly owned corporation.

To resolve this matter, we must address the anticipatory assignment of income doctrine. While the New York courts have not yet fully addressed this analysis,[16] this income tax doctrine

[16] The sole direct reference to the assignment of income doctrine appears in ***Madison Liquidity Invs. 119, LLC v Griffith*** (57 AD3d 438 [2008]), wherein the Appellate Division, First Department noted the following: "[W]here an assignment of income is made after it is earned, the income is constructively received by the assignor

is well established in federal jurisprudence (***see e.g. Lucas v Earl***, 281 US 111 [1930]; ***Corliss v Bowers***, 281 US 376 [1930]). This doctrine provides that "[a] taxpayer cannot exclude an economic gain from gross income by assigning the gain in advance to another party" (***C.I.R. v Banks***, 543 US 426, 433 [2005]). This is how the Division has characterized petitioner's transfers to his wife, Ms. Hand, and Enterprises.

The Division argues that the income from the subject Blimpie shares should be attributed to petitioner because he transferred the shares to Ms. Hand and to Enterprises knowing that the sale was certain to occur. Based upon this theory, the Division issued the subject Notice, which is presumed correct (***Matter of Tavolacci v State Tax Commn.***, 77 AD2d 759 [1980]). As petitioner bears the burden of rebutting this presumption (Tax Law § 689 [e] [3]; 20 NYCRR 3000.15 [d] [5]), petitioner must establish, by clear and convincing evidence (***see e.g. Matter of Blodnick v New York State Tax Commn.***, 124 AD2d 437 [1986]), that the transfers to Ms. Hand and the capitalization of Enterprises were not assignments in anticipation of the Blimpie stock sale.

The assignment of income analysis inquires as to whether a transaction constitutes more than the transferor's surrender of income. This doctrine flows from the principle that income taxes are due from "those who earn or otherwise create the right to receive it and enjoy the benefit of it when paid" (***Helvering v Horst***, 311 US 112, 119 [1940]). As currently construed, this inquiry may be reduced to the following:

> "[T]he ultimate question is whether the transferor, considering the realities and substance of the circumstances, had a fixed right to income in the property at the time of the transfer" (***Ferguson v C.I.R.***, 108 TC 244, 259 [1997], ***affd*** 174 F3d 997 [1999]; ***see also C.I.R. v Banks***, 543 US 426 [2005]).

---

when it is received by the assignee" (***id.*** at 440).

As in all tax controversies, the "economic reality" drives this analysis (***Matter of Muraskin v Tax Appeals Trib.***, 213 AD2d 91, 95 [1995], ***lv denied*** 87 NY2d 806 [1996]). In evaluating whether an assignment is a right to income,

> "[the] reality and substance of a transfer of property govern the proper incidence of taxation and not formalities and remote hypothetical possibilities" (***Ferguson v C.I.R.***, 108 TC 244, 257 [1997], ***affd*** 174 F3d 997 [1999]).

While income taxes on wages are always due from the earner (***see e.g. Lucas v Earl***, 281 US 111 [1930]; ***Burnet v Leininger***, 285 US 136 [1932]), a transfer may be set aside and income taxes attributed to the transferor where a transfer provides, essentially, only the right to claim revenue (***see e.g. Corliss v Bowers***, 281 US 376 [1930]). "A mere transfer which is in form a gift of appreciated property may be disregarded for tax purposes if its substance is an assignment of a right to income" (***Rauenhorst v C.I.R.***, 119 TC 157, 164 [2002]). Furthermore, the Supreme Court has stated:

> "The [assignment of income doctrine] is preventative and motivated by administrative as well as substantive concerns, so we do not inquire whether any particular assignment has a discernible tax avoidance purpose. As *Lucas* explained, 'no distinction can be taken according to the motives leading to the arrangement by which the fruits are attributed to a different tree from that on which they grew'" (***C.I.R. v Banks***, 543 US 426, 434 [2005], ***citing Lucas v Earl***, 281 US 111, 115 [1930]).

To determine the timing of the transfer, the federal courts have looked to the point when the transferor relinquished control over the asset. Control over the income is significant:

> "The power to dispose of income is the equivalent of ownership of it. The exercise of that power to procure the payment to another is the enjoyment, and hence the realization, of the income by him who exercises it" (***Helvering v Horst***, 311 US 112, 118 [1940]; ***see also C.I.R. v Banks***, 543 US 426 [2005]).

While "only one factor to be considered in ascertaining the 'realities and substance' of the transaction" (***Allen v C.I.R.***, 66 TC 340, 347-348 [1976]), the control over the asset has been

closely scrutinized (***see e.g. Carborundum Co. v C.I.R.***, 74 TC 730 [1980]), particularly in matters involving intrafamily transfers (***see e.g. CI.R. v Sunnen***, 333 US 591 [1948]; ***Helvering v Clifford***, 309 US 331 [1940]). Therefore, it is necessary to determine the point at which the donor transferred control to the donee (***see e.g. Rauenhorst v C.I.R.***, 119 TC 157 [2002]), and inquire whether the donor severed his connection to the economic benefits of the asset (***see e.g. Helvering v. Horst***, 311 US 112 [1940]).

The federal courts have also addressed the question of whether transfers of stock constitute invalid assignments of income (***see e.g. Ferguson v CI.R.***, 108 TC 244 [1997], ***affd*** 174 F3d 997 [1999]*;* ***Rauenhorst v C.I.R.***, 119 TC 157 [2002]; ***Applestein v. C.I.R.***, 80 TC 331 [1983]). Where stock is assigned prior to a merger, the transfer will be considered an anticipatory assignment of income if:

> "the timing of the transfer makes it clear that petitioner's right to the merger proceeds had virtually ripened prior to the transfer and that the transfer of the stock constituted a transfer of the merger proceeds rather than an interest in a viable corporation" (***Applestein v C.I.R.***, 80 TC 331, 346 [1983]; ***see also Greene v U.S.***, 13 F3d 577 [1994]).

Typically, the courts have searched for whether the merger was virtually certain as of the transfer date; however, these are mere guidelines for determining whether the right to income has ripened (***Ferguson v C.I.R.***, 174 F3d 997 [1999], ***affg*** 108 TC 244 [1997]).

The determination of whether a transferor conveys a right either in a corporation or to merger proceeds turns on the date when the transfer occurs. ***Londen v C.I.R.*** (45 TC 106 [1965]) presented a case in which there as a question regarding the transfer date of a gift of stock. The Tax Court summarized ***Londen*** as follows:

> "In [Londen v. Commissioner], the taxpayer delivered an executed stock certificate to his agent (though the taxpayer argued that the agent was the agent of the donee) and instructed the agent to transfer the stock to a charity in December

> 1959; the transfer became effective in January 1960. The Court held that the date on which the donor instructed his agent to transfer the stock to the donee was not determinative of when the gift was complete. See id. at 110. Delivery of the gift of stock was complete upon relinquishment of dominion and control of the stock by the donor, which occurred upon actual transfer on the books of the issuing corporation. Id.; Morrison v. Commissioner, TC Memo. 1987-112. The Court noted that even if the taxpayer's obligation upon delivery to his agent 'were a legal instead of a moral one, the existence of an obligation is not synonymous with its implementation'" (***Ferguson v CI.R.***, 108 TC 244, 255 [1997], ***affd*** 174 F3d 997 [1999]).

The foregoing analysis is particularly instructive because petitioner's assignments involve stock and merger proceeds. We now review the facts related to said merger because the timing of those events is critical to determining whether petitioner assigned either rights in a company or rights to merger proceeds.

The record indicates that by June 2001, a framework for selling Blimpie to the Endervelt Group had emerged. On June 6, 2001, the board of directors, including petitioner, signed a letter of intent with the Endervelt Group. On June 8, 2001, the board appointed a special committee to negotiate the merger and recommend whether it should be accepted or rejected. On October 5, 2001, the committee recommended accepting the Endervelt Group merger. On October 8, 2001, the board approved the definitive merger agreement, and the five majority shareholders, including petitioner, executed a voting agreement to vote their shares in favor of the merger on the terms in the agreement. On December 7, 2001, a proxy statement was sent to the remaining shareholders of record as of November 10, 2001. In the proxy statement, petitioner was recognized as the beneficial owner of all of the shares at issue. On December 27, 2001, the shareholders held their meeting and approved the merger. Subsequent to the approval, insider compensation was renegotiated to facilitate the merger. On January 24, 2002, the merger deal closed and all outstanding Blimpie shares were cancelled and shareholders were paid for their

shares. In the course of these events, petitioner made the subject transfers to Ms. Head and Enterprises.

We first address whether petitioner's transfer to his wife, Ms. Hand, was made in anticipation of the Blimpie merger and redemption. The record provides that, on July 11, 2001, petitioner sent a letter, which was not notarized, to his wife allegedly gifting her some interest in 624,693 Blimpie shares, represented by stock certificate #0956. Although it stated that petitioner was "unconditionally assigning and conveying" the shares to Ms. Hand, the letter itself clearly expressed that petitioner was retaining record ownership and control over the voting rights of the 624,693 shares.

In an August 2, 2001 letter, petitioner clarified the July 11, 2001 letter. The first three provisions of this letter, are relevant to our analysis. In its first provision, petitioner claimed that the initial letter established a trust relationship, whereby Ms. Hand holds beneficial ownership of the shares, but petitioner, as the trustee, remained the record owner. He explained that there were certain limits on his ability to act:

> "I cannot sell, transfer, pledge, encumber or otherwise dispose of the Shares without your consent and I must make sure that the shares have no debts attached to them and I am not allowed to do anything that is in your disinterest . . . ."

In the second provision, petitioner provided for his control over the voting rights of the 624,693 shares:

> "I have retained the right to vote the Shares which means that for such a right to be effective you must grant me a written proxy to have and exercise such rights. In other words you own the shares without the right to vote until the proxy expires which will be one year from today unless renewed or extended . . . ."

The provision continued, stating that, as of the execution of the letter, Ms. Hand agreed to appoint petitioner as her proxy. The third provision informed Ms. Hand that petitioner may, as

her agent, do whatever is necessary to protect or improve her rights and benefits for the duration of his appointment. Ms. Hand countersigned this letter on August 6, 2001.

On January 24, 2002, petitioner filed an assignment and stock power with his transfer agent, Mr. Brotz, assigning 624,693 shares to Ms. Hand and 801,270 shares to Enterprises. The January 24, 2002 assignment provides the following:

> "Inasmuch as these shares will now be redeemed for $2.80 per share, it is my desire and intention that the assignees of the shares receive the proceeds of the merger transaction. As per our conversation of yesterday's date, it seems to me that you do not need to issue new shares to the assignees, to wit, my wife and the corporation but rather just forward the funds to each of them . . . ."

The correlating stock certificates, including certificate #0956, accompanied the assignment. The assignment and transfer provisions of the stock certificates were signed and dated by petitioner on January 24, 2002, and bear signature guarantees. As a result of this transfer, neither Ms. Hand nor Enterprises received any shares in Blimpie, but only cash deposits into their bank accounts. A letter, dated February 12, 2002, memorialized the amounts paid to petitioner's wife and also contained instructions on the disbursement of some proceeds.

In order to ascertain whether the assignment was made in anticipation of income, we must first determine when petitioner completed the Blimpie stock transfer to his wife, Ms. Hand. This was a donative transfer and, as such, we find that a discussion and application of New York jurisprudence on gifts inescapable. As stated by the Court of Appeals in ***Beaver v Beaver*** (117 NY 421 [1889]),

> "The elements necessary to constitute a valid gift are well understood . . . . There must be on the part of the donor an intent to give, and a delivery of the thing given, to or for the donee, in pursuance of such intent, and on the part of the donee, acceptance" (***id.*** at 428; ***see also Matter of Van Alstyne***, 207 NY 298 [1913]).

The proponent of the gift must establish each element by clear and convincing evidence, which

will be "carefully and critically scrutinized" (***Matter of Kelsey***, 29 AD2d 450, 456 [1968], ***affd*** 26 NY2d 792 [1970]).

A donative transfer is not complete until the element of delivery is met (***see e.g. Hardy v Rose***, 60 AD3d 904 [2009]; ***McElroy v National Sav. Bank***, 8 App Div 192 [1896]). On the element of delivery, the Court of Appeals opined that,

> "The delivery necessary to consummate a gift must be as perfect as the nature of the property and the circumstance and surroundings of the parties will reasonably permit; there must be a change of dominion and ownership; intention or mere words cannot supply the place of an actual surrender of control and authority over the thing intended to be given" (***Vincent v Rix***, 248 NY 76, 83 [1928]).

Delivery must be sufficient to divest the donor with dominion and control over the property (***see e.g. Gruen v Gruen***, 68 NY2d 48 [1986]). For the purposes of our analysis, the question of whether petitioner transferred an interest in a viable corporation or the mere right to merger proceeds turns on the timing of when petitioner delivered the assets to his wife.

The Court of Appeals has held that the transfer of stock may be considered complete when it is recorded on the corporate books and records (***Matter of Szabo***, 10 NY2d 94 [1961]). The transfer may only be considered complete at this point because, until such time, the donor may withdraw the directive and the gift (***Matter of Szabo***, 10 NY2d 94 [1961]; ***Matter of Carroll***, 100 AD2d 337 [1984]). Similarly, the Uniform Commercial Code provides that in the case of a gift (***see*** UCC 1-201 [32], [33]), delivery occurs when appropriate entries are made on the corporate records (UCC 8-313, UCC 8-320; ***see also Matter of Carroll***, 100 AD2d 337, 339-340 [1984]). Bearing these principles in mind, we turn to the record as it relates to petitioner's transfers to his wife, Ms. Hand.

We find clear evidence in the record that petitioner satisfied the element of delivery on January 24, 2002. On that date, which is also the date that all Blimpie shares were cancelled and

were converted to cash, petitioner delivered a notarized assignment to the transfer agent, clearly and unequivocally assigning shares to his wife and Enterprises. The record shows that stock certificate #0956, which bears a signature guarantee, was assigned to Ms. Hand by petitioner on January 24, 2002. At this point, the transfer of shares from petitioner to Ms. Hand became irrevocable. In our view, these documents constitute clear and convincing evidence that petitioner executed the requisite transfer of control on January 24, 2002.

Petitioner failed to introduce clear and convincing evidence that he completed a gift of shares to his wife, Ms. Hand, on July 11, 2001. Through the Hand affidavit and his testimony at the hearing, petitioner contends that he physically delivered stock certificate #0956 to his wife on July 11, 2001. However, no evidence supports these allegations. The record lacks any indication that the Blimpie transfer agent was placed on notice of a transfer on July 11, 2001, as required under New York law (***Matter of Sazbo***, 10 NY2d 94 [1961]). Rather, at the merger negotiations, petitioner represented himself to the Endervelt group and the Blimpie shareholders as owning the 624,693 shares outright. Stock certificate #0956, which bears a signature guarantee, indicates that it was assigned to Ms. Hand on January 24, 2002. Based on our review of the record, we find that petitioner acted as though a transfer of shares never occurred on July 11, 2001.

Given these facts, we must reject the argument that petitioner transferred an interest to Ms. Hand prior to January 24, 2002, because the record does not contain clear and convincing evidence proving delivery of a gift prior to that date (***see e.g. Matter of Carroll*** 100 AD2d 337 [1984]; ***Matter of Szabo***, 10 NY2d 94 [1961]). Moreover, as of November 10, 2001, the record date for the relevant shareholder vote, the Proxy Statement filed with the Securities Exchange Commission establishes that petitioner was in fact the "Beneficial Owner" of all of the shares at issue. Contrary to petitioner's assertions now, there is no indication in the Proxy Statement that

Ms. Hand was the beneficial owner of such shares on November 10, 2001. The record does not include and amended Proxy Statement reflecting that Ms. Hand was in fact the beneficial owner of the subject shares in late 2001. Having resolved the timing of the transfer, we must now evaluate the nature of the asset transferred on January 24, 2002.

We find that petitioner conveyed a fixed right to merger proceeds, not an interest in Blimpie. On January 24, 2002, petitioner delivered a notarized letter to the transfer agent, which stated the following:

> "[I]t is my desire and intention that assignees of the shares receive the proceeds of the merger transaction."

As a result of petitioner's direction, Ms. Hand received in excess of $1,000,000.00. However, the transfer did not result in Ms. Hand's receipt of shares in Blimpie because, on the same date, January 24, 2002, the existing Blimpie stock shares were cancelled. As Ms. Hand had neither record nor beneficial ownership prior to January 24, 2002, Ms. Hand was powerless to affect the course set by petitioner (***see e.g. Applestein v C.I.R.***, 80 TC 331 [1983]; ***Jones v U.S.***, 531 F2d 1343 [1976]). These facts require the conclusion that on January 24, 2002, petitioner assigned only Blimpie merger proceeds to his wife.

The record does not sufficiently support petitioner's arguments favoring a transfer of an interest in the corporation, as opposed to merger proceeds. It is his contention that, by the July 11, 2001 letter, petitioner conveyed a beneficial interest in the 624,693 Blimpie shares to his wife, Ms. Hand. Petitioner has argued that in this context, the letter alone is sufficient to form a valid transfer under federal and New York law. However, in reviewing the record and petitioner's briefs, both at the hearing and on appeal, petitioner made absolutely no reference to statutes, cases, or even law review articles that persuasively support finding a transfer of

beneficial ownership under these circumstances.[17]

The absence of sufficient legal support is fatal to this contention. Our inquiry into applicable New York law concludes that a donative transfer is complete when the donor surrenders dominion and control over the item to the donee (***Vincent v Rix***, 248 NY 76 [1928]). In the case of stock shares, this can only be accomplished by a transfer on the correlating company's records because, until such time, the gift may be revoked (***Matter of Szabo***, 10 NY2d 94 [1961]; ***Matter of Carroll***, 100 AD2d 337 [1984]). Similarly, federal jurisprudence on the assignment of stock teaches the following:

> "Generally, the delivery of a gift of stock is 'complete upon relinquishment of dominion and control of the stock by the donor, which [occurs] upon actual transfer on the books of the issuing corporation." (***Rauenhorst v Commissioner***, 119 TC 157, 173 [2002], ***citing Ferguson v Commissioner***, 108 TC 244, 255 [1997]).

We conclude that petitioner's transfer to his wife, Ms. Hand, was as assignment of the Blimpie merger proceeds. The record indicates that petitioner intended to and did provide his wife a gift of stock proceeds in excess of $1,000,000.00. Petitioner failed to introduce evidence that clearly and convincingly supports a finding to the contrary. Consistent with the foregoing analysis, we affirm the determination insofar as it recharacterized the proceeds received by Ms. Hand as income attributable to petitioner.

Turning to petitioner's transfer of shares to Enterprises, we note that petitioner formed Enterprises for federal tax purposes on December 14, 2001. On December 21, 2001, petitioner held the organizational meeting for Enterprises. Petitioner was the sole shareholder, sole

---

[17] Instead, petitioner primarily relies upon testimony provided by Mr. Dreyer at the hearing. We take notice of Mr. Dreyer's years of experience and work in the securities law field. While testimony on the ultimate issue is permissible and may merit consideration, standing alone, such testimony is insufficient to support petitioner's argument. Absent references to case law, statutes, or other authorities, the testimony of Attorney Dreyer lacks proper support and is conclusory. As such, we find the testimony to be unpersuasive.

director, and held all officer positions of the company. On the same date, petitioner subscribed to 100 shares of stock in Enterprises in exchange for 801,270 Blimpie shares. Petitioner, representing Enterprises, also entered into an assignment agreement with himself that would permit him to hold and vote the shares on Enterprises' behalf. The assignment agreement, dated December 21, 2001, was signed by petitioner, both on behalf of Enterprises and in his individual capacity. Notwithstanding these arrangements, pursuant to the Proxy Statement, petitioner had already represented himself as the owner of the subject shares as of the relevant record date, November 10, 2001. Subject to the October 8, 2001 voting agreement, petitioner was already bound to vote all of the shares in favor of the merger at the December 27, 2001 shareholder meeting. Petitioner voted the shares in favor of the merger, and the process continued as though no shares were transferred to Enterprises on December 21, 2001.

The facts related to the redemption in favor of Enterprises are the same as the redemption in favor of Ms. Hand. On January 24, 2002, the same day that the shares were to be cancelled and proceeds for the merger paid, petitioner sent the transfer agent the aforementioned transmittal letter, assignment, and signed stock certificates, that were executed on January 24, 2002, for the transfer of shares to Enterprises. As with Ms. Hand, the company did not receive shares of stock because the merger had already closed or was closing later that day.[18] Rather, at petitioner's direction, the transfer agent deposited the merger proceeds into Enterprises' bank account.

We now consider whether petitioner's transfer to Enterprises may be ignored, for tax purposes, as an assignment in anticipation of income. As discussed above, this inquiry is

[18] The share certificates for the shares at issue were transferred by petitioner on January 24, 2012, the same day such shares were cancelled and converted to cash pursuant to the merger agreement. The record does not indicate whether the transfers to Ms. Hand and Enterprises were executed prior to, post or contemporaneously with the cancellation of Blimpie shares into cash.

whether the right to proceeds was "fixed at the time of the transfer" (***Ferguson v C.I.R.***, 108 TC 244, 259 [1997], ***affd*** 174 F3d 997 [1999]). The analysis turns on the substance of the transaction (***C.I.R. v. Court Holding Co.***, 324 US 331 [1943]), in light of the circumstances (***Ferguson v C.I.R.***, 108 TC 244 259 [1997], ***affd*** 174 F3d 997 [1999]). To determine whether the right to income is fixed, we must first consider when the transfer occurred.

Our analysis of the record shows that petitioner transferred 801,270 Blimpie shares to Enterprises on January 24, 2002. This conclusion is based on documents dated January 24, 2002, including petitioner's notarized assignment, his notarized correspondence with the transfer agent, and the stock certificates themselves, which were signed January 24, 2002. Accordingly, we conclude that there is clear and convincing evidence that petitioner transferred 801,270 shares to Enterprises on that date.

The analysis then becomes whether the interest transferred on January 24, 2002 was a right to receive income. The facts do not materially differ from those related to the transfers made to Ms. Hand. On January 24, 2002, petitioner sent a transmittal letter, assignment, and stock certificates to Mr. Brotz in order to redeem the shares. No shares were ever issued to Enterprises and, pursuant to the merger agreement and petitioner's intent, the proceeds of the 801,270 Blimpie shares were deposited into a bank account belonging to Enterprises.

In reviewing the record, we conclude that petitioner merely assigned the income of the Blimpie merger to Enterprises. The merger was closed on January 24, 2002. By the time the transfer occurred, the shares were no longer an interest in a corporation, but a voucher to be redeemed for cash. The record establishes that Enterprises never held shares in Blimpie, and received only the cash proceeds from the merger. As such, we conclude that on January 24, 2002, petitioner transferred merger proceeds to Enterprises.

Petitioner seeks to sever tax liability from control and ownership by way of the agreement assigning the Blimpie shares to Enterprises on December 21, 2001. However, the assignment agreement provided petitioner with a voting proxy and the right to retain record ownership over the shares. His argument is that this arrangement sufficiently transferred the shares to Enterprises on December 21, 2001. We disagree.

Even if, on December 21, 2001, petitioner had executed the assignment and transfer provision on the stock certificate transferring the shares to Enterprises, for tax purposes, the stock proceeds would still be attributable to petitioner. We find the timing of the purported assignment and petitioner's maintenance of control throughout the merger process to be highly persuasive of finding that petitioner's purported assignment was made in anticipation of the Blimpie stock sale. As stated by the Supreme Court,

> "In an ordinary case attribution of income is resolved by asking whether a taxpayer exercises complete dominion over the income in question . . . . In the context of anticipatory assignments, however, the assignor often does not have dominion over the income at the moment of receipt" (***C.I.R. v Banks***, 543 US 426, 434 [2005]) (citations omitted).

In the instant matter, petitioner did exercise dominion over the income at the moment of receipt. Our review of the record shows that he maintained actual ownership and control over the subject 801,270 Blimpie shares until they were redeemed, at his direction, on January 24, 2002. Moreover, as indicated in the Proxy Statement, petitioner committed voting all of his shares in favor of the merger in the October 8, 2001 shareholder agreement. As the owner on the record date, November 30, 2001,[19] petitioner held the voting power of the 801,270 shares and voted in

[19] In the December 7, 2001 proxy and notice sent to shareholders, petitioner discounted his share in Blimpie by the amount that was beneficially owned by his daughter. Had a change in beneficial ownership occurred in favor of Ms. Hand or Enterprises, it would have been important to disclose this information as it directly contradicted

favor of the merger at the December 27, 2001 shareholder meeting. While we are not concerned with "remote hypothetical possibilities" (***Ferguson v. C.I.R.***, 108 TC 244, 257 [1997], ***affd*** 174 F3d 997 [1999]), we find it improbable that petitioner's shareholder agreement with the Endervelt Group and representations made in the Proxy Statement, filed with the SEC, would permit him to transfer meaningful control or ownership of the shares prior to the shareholder vote. In light of the foregoing, we conclude that petitioner exercised dominion over the subject 801,270 Blimpie shares through the "ripening" of the right to merger proceeds.

We reject petitioner's argument that he completed a transfer of 801,270 Blimpie shares to Enterprises on December 21, 2001. The record simply lacks clear and convincing evidence that the assignment was completed or that there was any transfer in actual control over the shares. Furthermore, in light of the circumstances, we also find that it would be appropriate to disregard the purported assignment to Enterprises on December 21, 2001, because, in reality, petitioner retained ownership and control over the shares. Consistent with the foregoing, we affirm the determination of the Administrative Law Judge insofar as it recharacterized the proceeds received by Enterprises as income attributable to petitioner.

We note that our conclusions regarding the transfers to Ms. Hand and Enterprises eliminate the need to determine whether the right to income was fixed as of July 11, 2001, and December 21, 2001, respectively. We also need not apply the economic substance analysis, alter ego test, or any other substance over form doctrine. The continuation of petitioner's domination and control over the 624,693 and 801,270 Blimpie shares, respectively, indicates that no genuine transfer of shares occurred. As such, we conclude that the right to receive income "ripened"

---

representations made by petitioner to the Endervelt Group, the Blimpie shareholders, and the SEC.

under petitioner's control and that personal income taxes are due from him.

We hold that the Administrative Law Judge properly determined that petitioner failed to provide a reasonable cause for the abatement of penalties. Our holding is guided by the Appellate Division, which has ruled:

> "Advancement of a reasonable legal theory in good faith or reliance upon professional advice, in the absence of inquiry to ascertain the position of the [Division of Taxation], does not constitute reasonable cause or provide us with a basis to disturb [the Division of Taxation]'s imposition of a penalty" (***Matter of CBS Corp. v Tax Appeals Trib. of N.Y.***, 56 AD3d 908, 911 [2008], ***lv denied*** 12 NY3d 703 [2009]).

Had petitioner sought an advisory opinion from the Division prior to assigning the merger proceeds to Ms. Hand and Enterprises, he may have established grounds for the abatement of penalties, or avoided this controversy entirely. However, by failing to do so, petitioner has determinatively limited our ability to provide relief. As such, we affirm the determination of the Administrative Law Judge on the issue of penalties.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of David L. Siegel, is denied;

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

3. The petition of David L. Siegel is granted to the extent that the assessment is cancelled for the year 2003, but in all other respects is denied; and,

4. The Notice of Deficiency, dated May 18, 2009, as modified in paragraph "3" above, is sustained.

DATED: Albany, New York
November 21, 2012

/s/ James H. Tully, Jr.
James H. Tully, Jr.
President

/s/ Charles H. Nesbitt
Charles H. Nesbitt
Commissioner