STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
ROBERT AND FRANCES TOSTI	:	DETERMINATION DTA NO. 822915
for Redetermination of a Deficiency or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law for the Years 2004 through 2006.	:	

Petitioners, Robert and Frances Tosti, filed a petition for redetermination of a deficiency or for refund of New York State personal income tax under Article 22 of the Tax Law for the years 2004 through 2006.

A hearing was held before Dennis M. Galliher, Administrative Law Judge, at the offices of the Division of Tax Appeals, 633 Third Avenue, New York, New York, on October 6, 2009 at 10:30 A.M., with all briefs to be submitted by January 20, 2010, which date commenced the six-month period for issuance of this determination. Petitioners appeared by Robert Tosti, Esq. The Division of Taxation appeared by Daniel Smirlock, Esq. (Sarah Dasenbrock, Esq., and Kevin R. Law, Esq., of counsel).

ISSUE

Whether petitioner Robert Tosti, who resides and practices law exclusively in New Jersey for a law firm which does business in New York and maintains an office in New York, may be subjected to New York personal income tax by virtue of his denomination as a partner in such law firm.

FINDINGS OF FACT

1. Petitioners, Robert and Frances Tosti, filed Form IT-203 (New York State Nonresident and Part-Year Income Tax Return) for each of the years 2004, 2005 and 2006 as nonresidents of New York.[1] Petitioner also filed an amended Form IT-203 (Form IT-203-X) for the years 2004 and 2005. It is undisputed that petitioner, an attorney, is a resident of New Jersey who practiced law exclusively in New Jersey on behalf of the law firm Wilson, Elser, Moskowitz, Edelman & Dicker, LLP (WEMED) during each of the years in issue. WEMED maintains offices in many locations, including at least three offices in New York State.

2. As is relevant to the matter at issue, petitioner received payments from WEMED in the amounts of $245,821.00 for 2004, $266,447.00 for 2005 and $266,460.00 for 2006. Petitioner treated these payments, for New York tax purposes, as follows:

> a) For 2004, petitioner reported his entire WEMED payment amount as New York source income on Form IT-203. Thereafter, petitioner removed the entire amount from New York source income on his subsequently filed Form IT-203-X.
>
> b) For 2005, petitioner reported as New York source income the portion of his entire WEMED payment resulting from the application of WEMED's New York partnership allocation percentage to such payment amount. Thereafter, petitioner removed the entire amount from New York source income on his subsequently filed Form IT-203-X.
>
> c) For 2006, petitioner reported none of his WEMED payment as New York source income.

3. The Division of Taxation (Division) examined petitioner's returns and concluded, in reliance on Treasury Regulation § 1.707-1(c), that the foregoing payments, denominated

---

[1] Petitioner Frances Tosti's name appears herein solely by virtue of the fact that she filed joint income tax returns with petitioner Robert Tosti. Mrs. Tosti filed a certification that she had no New York source income during the years in issue, and unless otherwise noted or required by context, all references to petitioner shall mean Robert Tosti.

guaranteed payments, represented petitioner's distributive share of partnership ordinary income properly allocable to and taxable by New York to the extent of WEMED's partnership allocation percentage. Upon this basis, the Division issued the following documents to petitioner:

> a) For 2004, a Notice of Deficiency dated February 19, 2008 asserting additional personal income tax due in the amount of $8,401.37, plus interest.
>
> b) For 2005, a Notice of Disallowance dated February 8, 2008 denying the refund of personal income tax claimed on petitioner's amended Form IT-203-X in the amount of $9,130.00.
>
> c) For 2006, a Notice of Deficiency dated April 14, 2008 asserting additional personal income tax due in the amount of $7,691.98, plus interest.

4. Petitioner described WEMED as a large, well-known insurance defense firm interested in branching out to establish locally-based legal practices in areas of law other than insurance defense matters. Petitioner had been a partner in a small law firm in New Jersey for approximately 20 years, where his areas of practice concentration centered on labor law, including school law, municipal law and civil rights matters. WEMED approached petitioner, and in or about August 2003, petitioner commenced his tenure with WEMED.

5. Petitioner's relationship with WEMED is memorialized in an August 12, 2003 letter addressed to petitioner from WEMED and captioned "Partnership." This letter specifies that:

> a) Petitioner's status in the firm will be as a "non-equity or limited partner as opposed to a general or capital partner." As a non-equity partner, petitioner "will not be responsible for any obligations or liabilities incurred by WEMED, LLP," and " will not have any right, title, interest or claim in any of the assets, income or files of the firm" nor "have the right or power to demand or effect an accounting or a dissolution of WEMED, LLP."
>
> b) Petitioner's compensation "will be established by the Executive Committee of WEMED, LLP and will be in such amount as the Executive Committee in the exercise of its sole discretion may from time to time

decide," and petitioner will "receive a 'draw' which has been established by the Executive Committee."

c) Petitioner, as a non-equity partner will be entitled to life insurance, disability insurance, health insurance and professional liability insurance benefits, as determined by the Executive Committee.

d) In the event of his death while the letter agreement was in effect, WEMED would pay to petitioner's estate his then current "draw for a period of one year from the date of death," and petitioner's estate and beneficiaries "shall have no other claim against WEMED, LLP or any of its partners."

e) The agreement was terminable by either party upon receipt of a 90-day written notice of termination.

f) Petitioner agreed to devote his professional and business time and attention exclusively to the business of WEMED, LLP.

g) The "Partnership Agreement and partnership relationship" shall be "interpreted, determined and controlled by" the law of New York State. The Agreement set forth provisions for the resolution of disputes and claims arising out of the Partnership Agreement and partnership relationship, included a requirement of confidentiality with respect thereto as well as a general "Confidentiality Agreement."

6. Petitioner had at least one, and when his work load was heavier more than one, WEMED associate attorney whose time was dedicated to working in petitioner's labor law practice at WEMED. Petitioner did not have any management role, per se, other than to make recommendations as to whether a given associate should receive a pay raise or should or should not be retained as an associate. Petitioner described these recommendations as merely his opinion to be "passed up the line." Petitioner noted that he "participated" but had no real input with regard to the hiring committee (presumably for the Newark, New Jersey, office of WEMED).

7. Petitioner's IT-203-X (amended return) for 2004 included the following statement:

> Taxpayer erroneously received an incorrect Form K-1 from [WEMED]. The taxpayer is a non equity partner in this firm and should not be taxed by New York State. Taxpayer works, lives and derives all income from New Jersey.

8. In response to the Division's letter request for a copy of petitioner's form K-1 and a statement as to where petitioner's services were performed, WEMED furnished an August 6, 2007 letter confirming that petitioner was a "Partner in our Newark, New Jersey office . . ." together with the form K-1 (Partner's Share of Income, Deductions, Credits, etc.) issued to petitioner for 2004. This form K-1 lists petitioner as an "Individual" (line K), "Domestic partner" (line J), "General partner or LLC member-manager (line I), with "245" as petitioner's "Partner's Identifying Number" (line G). Line L lists petitioner's "Partner's share of profit, loss and capital" as "None" for each such item. Part III (Partner's Share of Current Year Income, Deductions, Credits, and Other Items) reflects WEMED's payments to petitioner as "Guaranteed payments" (Line 4) and "Self-employment earnings" (Line 14), and reflects thereafter the portion of such guaranteed payments to partners allocated to New York (Line 54) per WEMED's partnership allocation percentage.

9. Petitioner did not see or have access to WEMED's partnership agreement. He received his pay bi-weekly with the amount, denominated as a draw, determined by dividing his annual guaranteed payment by 24. In response to petitioner's inquiry for information as to what his salary would be based on, the managing partner in WEMED's Newark office advised petitioner that he had no information and that "it's all done in New York – I just get a piece of paper with a guy's name on it and a number and I have nothing to do with it." Petitioner stated that he completed a withholding tax form (Form W-4), but that no taxes were withheld, and he was advised that "the taxes are on you."

10. In order to obtain expense money, petitioner had to go to the managing partner in the Newark office to request the same. Petitioner described an instance where he did so when he needed expense money for taxicabs and incidentals in connection with client development while attending a school board convention in Atlantic City, New Jersey, and alluded to instances where the managing partner had to get authority from WEMED's New York office for expense money in excess of that which he had authority to approve.

11. Petitioner noted in testimony that he received a relatively small "bonus" amount of approximately $500.00 at the end of the first year in which he was with WEMED (from August 2003 through the end of 2003), and that he received substantially more in the following year.

CONCLUSIONS OF LAW

A. There exist two bases upon which New York may assert jurisdiction and apply its personal income tax, to wit, residence of the person and source of the income, gain, loss or deduction (Tax Law § 601[a],[e]). Residents are subject to tax on their worldwide income regardless of source, while nonresidents are subject to tax only on their New York source income (***id.***). Inasmuch as petitioner was a nonresident, it is only upon the latter basis that he may be subjected to New York's personal income tax.

B. The New York source income of a nonresident individual includes the sum of the net amount of items of income, gain, loss and deduction entering into the individual's federal adjusted gross income "derived from or connected with New York sources, including: (A) his distributive share of partnership income, gain, loss and deduction, determined under [Tax Law] section six hundred thirty-two, . . ." (Tax Law § 631[a][1]). The New York source income of a nonresident partner includes his distributive share of all items of partnership income, gain, loss and deduction entering into his federal adjusted gross income to the extent such items are derived

from or connected with New York sources (Tax Law § 632[a][1]). The New York source of partnership income is determined by the partnership's business in New York, with the allocation percentage thereof determined by the business activity of the partnership both within and without New York calculated as the partnership's business allocation percentage (or as calculated by an alternative method authorized by the Division). The business allocation percentage results from the three percentages of partnership property, partnership payroll and partnership gross income (20 NYCRR 132.15[d], [e], [f]).

C. Petitioner maintains that since he owned no capital in WEMED, and did not participate in its profits and losses or in its management, his relationship to the firm was that of an employee or "glorified" associate and not a true partner such that the compensation he received from WEMED may not be subjected to tax by New York State. In contrast, however, petitioner's relationship to the firm was described in the letter he received from WEMED upon joining the firm as a nonequity partner. He was treated as a partner by WEMED for tax purposes and received forms K-1 from the WEMED on which he was described as a partner. No tax was withheld from his payments by the firm, and his forms K-1 indicated the amounts of such payments, which were treated as New York source income pursuant to the partnership's allocation percentage. Further, petitioner's payments from WEMED were reported as guaranteed payments to a partner. The manner of how such payments were calculated is not disclosed in the record. However, while petitioner's payments are set forth as a total amount (guaranteed payment) for each year, there is also mention of petitioner's receipt of a bonus amount at year end (***see*** Finding of Fact 11). It is not known if this amount was in addition to a base amount determined by WEMED's executive committee (***see*** Findings of Fact 9 and 11). In any event, petitioner received a "draw" during the year and the total payment amount to petitioner was, as

noted, reported by WEMED as a guaranteed payment. Given the lack of information as to how petitioner's annual amount of guaranteed payment was determined or calculated, it cannot be concluded that the same bore no relationship to WEMED's profits.

D. Petitioner had at least one, and sometimes more than one, WEMED associate attorney assigned to him to assist him in carrying out his work, and he presumably directed and supervised such associates. The record does not specifically detail how petitioner held himself out to clients and to the public. However, it is reasonable to presume that he held himself out as a partner of WEMED, with the backing, support and resources of the firm at his disposal in this capacity, with the obvious attendant benefit derived from presenting oneself under this status. This conclusion is supported by the fact that petitioner was denominated a partner, albeit a nonequity partner, in his agreement with WEMED, as well as by petitioner's description of attending a convention in Atlantic City for purposes of client development. Having been designated as a partner leads strongly to a conclusion that one would maximize the benefit by presenting himself as so designated.

E. Case law has addressed the issue of whether a nonresident who is denominated a partner in a law firm doing business in New York, but who practices law outside of New York, may be subjected to New York tax on his payments from such law firm to the extent of its income allocation percentage. ***Matter of Heller v. New York State Tax Commn.*** (116 AD2d 901, 498 NYS2d 211 [1986]), concerned a nonresident attorney who was not required to contribute to the firm's capital, held no interest in partnership assets, and did not share in partnership profits and losses or participate in partnership management decisions. Mr. Heller's compensation was reported as partnership income, he was listed as a partner on the partnership's tax returns, had no taxes withheld from his compensation and paid his own Social Security taxes.

He alleged that he was designated as a partner merely to enhance his reputation and assist in attracting clients. Under these facts, Mr. Heller was held to be a partner and was required to pay New York tax on his distributive share of partnership income (as allocated). Likewise, in ***Matter of Heffron v. Chu***. (144 AD2d 729, 535 NYS2d 141 [1988]), a nonresident attorney working pursuant to a two-year agreement with the partnership, received a fixed amount of compensation per year regardless of the partnership's profits or losses. Mr. Heffron had no capital account or interest in the firm's assets, did not participate in its management, and maintained that he was admitted to the firm purely to enable him to attract clients and to sign filings in federal court. He was authorized and held himself out to clients and to the courts as a partner. Mr. Heffron was designated as a "nonresident partner sharing Washington office profits only," his compensation was reported by the firm as partnership income, and there were no deductions therefrom for Social Security taxes or withholding. As in ***Heller***, Mr. Heffron was required to pay New York tax on his distributive share of partnership income (as allocated) (***see also Matter of Weinflash v. Tully,*** 93 AD2d 369, 463 NYS2d 94 [1983]).

F. There is no evidence as to how the amount of petitioner's guaranteed payments were determined or calculated, and no evidence that petitioner's guaranteed payments were isolated to or determined by his work in New Jersey, as opposed to being calculated and paid by the firm from its earnings from all sources. Likewise, there is no sense that he was functioning in the role of, and being compensated as, a sole practitioner under a referral agreement or in an "of counsel" capacity with WEMED, as opposed to functioning and being held out as a partner of WEMED (***see Matter of Yohalem v. State Tax Commn.***, 70 AD2d 996, 417 NYS2d 816 [1979]). Having been designated a partner by WEMED, receiving payments reported as guaranteed payments (***see*** Treas. Reg. § 1.707-1[c]), being treated consistently as a partner for tax purposes by WEMED,

and having held himself out as a partner, supports the conclusion that petitioner was properly considered a partner for tax purposes. As in the cases cited above, petitioner's agreement with WEMED indicates his choice and acceptance to be designated a partner. This choice carries with it certain tax ramifications and petitioner is held to those ramifications (***Matter of Faulkner, Dawkins & Sullivan v. State Tax Commn.***, 63 AD2d 764, 404 NYS2d 735 [1978]; ***see Matter of Jablin v State Tax Commn.***, 65 AD2d 891, 410 NYS2d 414 [1978]. Under the foregoing circumstances, the portions of the payments to petitioner for the years in question reported as New York source income on petitioner's forms K-1, in accordance with WEMED's partnership allocation percentage, were properly determined to be subject to tax by New York.

G. The petition of Robert and Frances Tosti is hereby denied and the notices of deficiency dated February 19, 2008 (2004 tax year) and February 8, 2008 (2006 tax year), as well as the Notice of Disallowance dated April 14, 2008 (2005 tax year) are sustained.

DATED: Troy, New York
July 1, 2010

/s/ Dennis M. Galliher
ADMINISTRATIVE LAW JUDGE