

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition

of

MICHAEL SOWISKI AND JEANNE C. SOWISKI

DECISION

for Redetermination of a Deficiency or for
Refund of Personal Income Tax under Article 22
of the Tax Law for the Year 1974.

Petitioners, Michael Sowiski and Jeanne C. Sowiski, 36 Forest Hills Road, Pittsburgh, Pennsylvania 15221, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the year 1974 (File No. 25377).

A hearing was held before James Hoefer, Hearing Officer, at the offices of the State Tax Commission, **Two** World Trade Center, New York, New York, on March 5, 1986 at 10:45 A.M., with all briefs to be submitted by May 20, 1986. Petitioners appeared pro se. The Audit Division appeared by John P. Dugan, Esq. (Irwin A. Levy, Esq., of counsel).

ISSUES

I. Whether petitioner Michael Sowiski, a nonresident partner in the partnership of D.G. Sisterson and Company, must allocate his distributive share of partnership income to New York State sources based on a percentage determined by dividing the partnership's net New York income by net partnership income from all sources.

11. Whether petitioner Michael Sowiski is entitled, pursuant to section 637(d) of the Tax Law, to use an alternate method of allocation to determine his nonresident partner's distributive share of partnership income derived from or

III. Whether petitioner Michael Sowiski may, if his request for an alternate method of allocation is denied, claim a subtraction modification of \$12,650.00 pursuant to Tax Law §612(c)(10) as an amount paid to the New York resident partner of D.G. Sisterson and Company.

FINDINGS OF FACT

1. On April 14, 1975, petitioners, Michael Sowiski and Jeanne C. Sowiski¹, timely filed a joint New York State Income Tax Nonresident Return for 1974. On page 2 of said return petitioner reported partnership income of \$90,172.00 in the Federal amount column and partnership income of \$3,858.00 in the New York State amount column.

2. On January 31, 1978, the Audit Division issued a Statement of Audit Changes to petitioner for 1974 proposing to increase partnership income derived from New York sources from a reported \$3,858.00 to \$16,507.92. Said statement also contained the following explanation:

"As the partnership D.G. Sisterson and Company allocated income to New York State on 18.0308%, your distributive share must be allocated accordingly."

3. Based on the aforementioned statement, the Audit Division, on April 4, 1978, issued a Notice of Deficiency to petitioner for 1974 asserting additional New York State personal income tax due of \$737.13, plus interest of \$186.07, for a total allegedly due of \$923.20.

4. D.G. Sisterson and Company (hereinafter "Sisterson") was a partnership which maintained its principal office in Pittsburgh, Pennsylvania and a branch

1 Jeanne C. Sowiski is involved in this proceeding solely as the result of having filed a joint income tax return with her spouse. Accordingly, the term "petitioner" shall hereinafter refer solely to Michael Sowiski.

office in New York, New York. Sisterson had a total of five partners, all of whom were certified public accountants. Petitioner, M. Sylvester Sieger, Edward R. Sieger and Robert F. Dickson **all** maintained residences in Pennsylvania and worked out of Sisterson's Pittsburgh office. Robert M. Davis, a resident of New York State, was the only partner who regularly worked out of Sisterson's New York City office.

5. The U.S. Partnership Return of Income filed by Sisterson for 1974 reported ordinary income of \$297,185.00. Federal Schedule K-1, Partner's Share of Income, Credits, Deductions, etc. - 1974, reported that petitioner had a 36 percent interest in the partnership and that his distributive share of Sisterson's ordinary income for 1974 amounted to \$91,554.00.

6. Sisterson also filed a New York State Partnership Return for 1974 reporting ordinary income of \$53,585.00. Pursuant to a schedule appended to said return, Sisterson indicated that petitioner's share of its New York State ordinary income totalled \$3,858.00.

7. Article Three of Sisterson's partnership agreement provided, in pertinent part, as follows:

"Robert M. Davis...shall be the Partner in charge of the New **York** office of the partnership and shall receive four-fifths (4/5) of the profits of the New York office..."

8. Petitioner's \$91,554.00 distributive share of Sisterson's ordinary income was computed in the following manner:

Total partnership ordinary income	\$297,185.00
Less: partnership ordinary income from New York City Office	<u>53,585.00</u>
Partnership ordinary income from Pittsburgh office	<u>\$243,600.00</u>

Petitioner's share of profits from Pittsburgh office (36% of \$243,600.00)	\$87,696.00
Petitioner's share of profits from New York City office (36% of 1/5 of \$53,585.00)	3,858.00

9. In accordance with Article Three of the partnership agreement, four-fifths of the profit generated from Sisterson's New York City office was allocated to Mr. Davis, the resident partner, and the remaining one-fifth (1/5 of \$53,585.00 or \$10,717.00) was allocated to the four nonresident partners pursuant to their percentage of interest in partnership profits.

10. It is the Audit Division's position that all nonresident partners of Sisterson must allocate 18.0308% of their distributive share of partnership income to New York State sources. Said allocation factor was computed by dividing New York State partnership ordinary income (\$53,585.00) by total partnership ordinary income (\$297,185.00). The Audit Division computed petitioner's share of Sisterson's ordinary income which was derived from or connected with New York State sources in the following manner:

Petitioner's distributive share of ordinary income	\$91,554.00
New York State allocation percentage	x .180308
New York State partnership income	<u>\$16,507.92</u>

11. Petitioner argued that if all nonresident partners of Sisterson allocated 18.0308 percent of their distributive share of partnership income to New York State sources, the collective shares of partnership income taxed by New York State would exceed the \$53,585.00 profit generated from Sisterson's New York State office. The following table details petitioner's position:

Four nonresident partners' distributive share of partnership income	\$254,317.00
New York State allocation percentage	x .180308
Subtotal	<u>45,855.39</u>
R.M. Davis (New York resident partner taxed on his full distributive share)	42,868.00
Total distributive shares taxed by New York	<u>\$ 88,723.39</u>

Petitioner maintains that the manner in which Sisterson computed his distributive share of partnership income derived from New York State sources was an appropriate

and equitable alternative method as contemplated by section 637(d) of the Tax Law.

12. Petitioner alternatively argued that, if he must allocate 18.0308 percent of his distributive share of partnership income to New York State sources, he is entitled, pursuant to Tax Law section 612(c)(10), to a subtraction modification of \$12,650.00 as an amount paid to Mr. Davis, the New York resident partner of Sisterson.

13. For Federal income tax purposes petitioner reported net income received from Sisterson of \$90,172.00. Said amount was computed as follows:

Distributive share of partnership income	\$91,554.00
Less: business expenses not charged to partnership	<u>1,382.00</u>
Net partnership income	<u><u>\$90,172.00</u></u>

CONCLUSIONS OF LAW

A. That section 637(a)(1) of the Tax Law provides that a nonresident partner's distributive share of partnership income derived from or connected with New York State sources "shall be determined under regulations of the tax commission". Subsection (b) of section 637 of the Tax Law further provides that:

"Special rules as to New York sources. In determining the sources of a nonresident partner's income, no effect shall be given to a provision in the partnership agreement which - -

* * *

(2) allocates to the partner, as income or gain from sources outside New York, a greater proportion of his distributive share of partnership income or gain than the ratio of partnership income or gain from sources outside New York to partnership income or gain from all sources, except as authorized in subsection (d)...".

B. That Commission regulation 20 NYCRR 134.2(b), as in effect during the year in issue, contains the following example of an application of Tax Law section 637(b)(1)

"For example, if the total distributive share of a nonresident partner from all sources is \$5,000 and 60 percent of the partnership's income is from New York sources, the nonresident partner would be required to report on his New York nonresident return \$3,000 (60 percent of \$5,000) as his partnership distributive share, even though, under the partnership agreement, his share of the total New York income of the partnership may have been fixed at less than \$3,000."

C. That a nonresident partner is required to allocate his distributive share of partnership income to New York State sources in the same proportion as the partnership allocates its income to sources within and without New York State. (Debevoise v. State Tax Comm., 52 A.D.2d 1023; Tax Law §§ 637 and 632; 20 NYCRR 134.1, 134.2, 131.10 and 131.13.)

D. That the Audit Division has properly computed petitioner's distributive share of Sisterson's income which was derived from or connected with New York State sources, by its use of the partnership's allocation percentage (18.0308%). Petitioner's request for an alternate method of allocation is denied inasmuch as the method of allocation utilized by the Audit Division produces an appropriate and equitable result.

E. That Tax Law section 612(c)(10) provides for a modification to reduce federal adjusted gross income for:

"Ordinary and necessary expenses paid or incurred during the taxable year for (i) the production or collection of income which is subject to tax under this article but exempt from federal income tax ... to the extent that such expenses...are not deductible in determining federal adjusted gross income and are attributable to a trade or business carried on by the taxpayer."

F. That petitioner is not entitled to a subtraction modification of \$12,650.00 pursuant to section 612(c)(10) of the Tax Law as an amount paid to the New York resident partner of Sisterson. Said subtraction modification is clearly inapplicable in the instant matter. (See 20 NYCRR 116.3[j].)

G. That petitioner, for federal income tax purposes, claimed a deduction of \$1,382.00 against Sisterson partnership income for business expenses not charged to said partnership. Said expenses of \$1,382.00 are to be allocated to New York State sources in the same manner as partnership income is allocated to New York State.

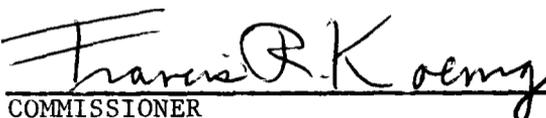
H. That the petition of Michael Sowiski and Jeanne C. Sowiski is granted to the extent indicated in Conclusion of Law "G", supra; that the Audit Division is directed to recompute the Notice of Deficiency dated April 4, 1978 consistent with the conclusions rendered herein; and that, except as so granted, the petition is in **all** other respects denied.

DATED: Albany, New York

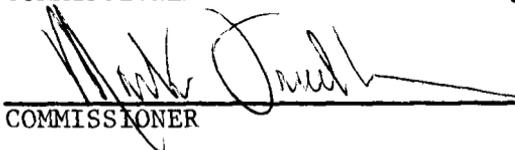
STATE TAX COMMISSION



PRESIDENT



COMMISSIONER



COMMISSIONER