

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition

of

JERALD R. and RUTH M. MC CRACKEN

DECISION

for Redetermination of a Deficiency or for
Refund of Personal Income and Unincorporated
Business Taxes under Articles 22 and 23 of the :
Tax Law for the Years 1974 through 1979.

Petitioners, Jerald R. and Ruth M. McCracken, 7961 Batavia Strafford
Townline Road, Batavia, New York 14020, filed a petition for redetermination of
a deficiency or for refund of personal income and unincorporated business taxes
under Articles 22 and 23 of the Tax Law for the Years 1974 through 1979 (File
Nos. 34028, 34650, 34651 and 34652).

A formal hearing was held before James J. Morris, Jr., Hearing Officer, at
the offices of the State Tax Commission, State Office Building, 65 Court
Street, Buffalo, New York, on June 19, 1985, at 12:00 Noon. Petitioner appeared
by Albert J. Brightenfield. The Audit Division appeared by John P. Dugan, Esq.
(Deborah Dwyer, Esq., of counsel).

ISSUE

Whether petitioner Jerald McCracken's activities as an insurance agent for
Farmers and Traders Life Insurance Company for the years 1974 through 1979
constituted the carrying on of an unincorporated business thereby subjecting
the income received by petitioner therefrom to unincorporated business tax.

FINDINGS OF FACT

1. On December 11, 1980 the Audit Division issued to petitioners Jerald R.
and Ruth M. McCracken a statement of personal income tax audit changes for the

year 1975 and \$70.45 for the year 1976 plus accrued interest based upon "unreported federal audit changes."

2. On December 11, 1980, the Audit Division also issued to petitioners a statement of personal income tax audit changes for the years 1977 and 1978. Among other adjustments, petitioners' joint returns for such years were "converted to separate returns to reduce total tax due". Said statement showed (a) credits of \$131.88 for the year 1977 and \$290.66 for the year 1978 as recomputed tax due for the "husband" together with accrued interest and (b) tax due of \$24.53 for the year 1977 and \$145.60 for the year 1978 as taxes due for the "wife" together with accrued interest for a net total credit of \$297.03.

3. On December 11, 1980 statements of unincorporated business tax audit changes were issued to petitioners asserting unincorporated business tax due of (a) \$773.45, \$1,074.37 and \$879.53 for the years 1974, 1975 and 1976 respectively and (b) \$1,136.63, \$943.75 and \$611.35 for the years 1977, 1978 and 1979 respectively plus accrued interest.

4. On March 25, 1981 notices of deficiency were issued as follows:

(a) to petitioners Jerald and Ruth McCrackin (sic) for the years 1974, 1975 and 1976 asserting additional tax of \$2,889.70 plus accrued interest (Notice #A8008102381)

(b) to petitioners Jerald and Ruth McCrackin (sic) for the years 1977 and 1978 asserting additional tax of \$1,657.90 plus accrued interest (Notice #A8008102391)

(c) to petitioner Ruth McCrackin (sic) for the years 1977 and 1978 asserting additional tax of 170.13 plus accrued interest (Notice #A8008102392)

(d) to petitioners Jerald and Ruth McCrackin (sic) for the year 1979 asserting additional tax of \$611.35 plus accrued interest (Notice #A8008102401)

5. Petitioners filed New York State personal income tax returns on a

"married filing a joint return" basis for the years 1976 through 1979

6. Petitioner Jerald McCracken did not file an unincorporated business tax return for the years 1974 through 1979.

7. Petitioners did not personally appear and testify in their behalf at the hearing.

8. Submitted at the hearing was a copy of a contract dated May 4, 1967 ("Contract") between Jerald McCracken and Farmers and Traders Life Insurance Company, ("F & T Co.") together with several amendments thereto.

9. The latest dated amendment to the Contract is one dated October 31, 1969 although several attachments to the Contract, such as commission schedules, appear to bear print dates for the years 1970, 1971 and 1972.

10. Although certain amendments to the Contract provide that Jerald McCracken for certain periods was an "Agency Manager" and as such was salaried and "shall be an employee", the amendment dated October 31, 1969 states that such periods were terminated prior to that amendment and that as of October 31, 1969 petitioner acted solely as a general agent of Farmers and Traders Life Insurance Company and not as an agency manager thereof.

11. Insofar as is pertinent herein the Contract with amendments provided:

"The General Agent agrees to devote his entire time exclusively to the business of said Company, and promptly forward to the Home Office of the Company all applications for insurance obtained by him, or by persons in his employ or under his control, and neither directly nor indirectly to work for any other life insurance company or engage in any other business or occupation.

Nothing contained herein shall be construed to create the relationship of employer and employee between the Company and the General Agent. Within the territory described, the General Agent shall be free to exercise his own judgment as to the persons he will solicit for life insurance, but the Company may from time to time prescribe rules and regulations respecting the conduct of the business covered hereby, which rules and regulations, not interfering with such

freedom of action, shall be observed and conformed to by the General Agent."

12. An attachment to the Contract provides:

"To assist you in the development of your agency, the Company will, until further notice on the basis outlined herein, reimburse you for legitimate expenses incurred in connection therewith, to the extent of said legitimate expenses, but not exceeding the amounts set forth below. All such expenses are to be itemized and substantiated by receipts or verifiable vouchers and statements signed by you and submitted to the Home Office in the form and manner prescribed by the Company.

(1) The paid-for business of your Agency during each calendar year will determine the maximum amount of your expense reimbursement allowable for the next calendar year when and as premiums are paid at the Home Office as follows:

From \$ 50,000 to \$ 99,000 paid-for business...	\$3.50 per thousand
From \$100,000 to \$199,000 inclusive.....	\$5.00 per thousand
From \$200,000 to \$349,000 inclusive.....	\$5.50 per thousand
From \$350,000 to \$499,000 inclusive.....	\$6.00 per thousand
\$500,000 or more.....	\$6.50 per thousand

* * *

(3) The above schedule is subject to the following exception:

* * *

(e) The maximum expense reimbursement allowed on the juvenile policy which increases \$1,000 to \$5,000 at age 21 will be \$4.00 per thousand on initial face amount. All other juvenile forms will have expense reimbursement of \$4.00 per thousand on policies with \$2,000 or more face amount."

13. Petitioner Jerald McCracken's business income includes his expense reimbursement allowance.

14. Petitioner Jerald McCracken's "Agents Annual Report - Expense Reimbursement Allowance" for the years 1974 through 1979 reflect:

(a) 100% of petitioner's income for the year 1974 was from F & T Co. His agency expenses for the period 10/1/73 through 11/74 was \$14,575.69 and his expense reimbursement allowance (FPA) received was \$12,888.12

(b) 59% of petitioner's income for the year 1975 was from F & T Co. His total expenses were \$19,329.32, \$18,978.46 of which he allocated to F & T Co. and his ERA received was \$19,162.20.

(c) 96% of petitioner's income for the year 1976 was from F & T Co. His expenses allocated to F & T Co. were \$18,725.07 and his ERA received was \$16,437.64.

(d) 99% of petitioner's income for the year 1977 was from F & T Co. His expenses allocated to F & T Co. were \$17,572.73 and his ERA received was \$15,534.73.

(e) 99% of petitioner's income for the year 1978 was from F & T Co. His expenses allocated to F & T Co. were \$17,399.26 and his ERA received was \$17,349.44.

(f) 95% of petitioner's income for the year 1979 was from F & T Co. His expenses allocated to F & T Co. were \$22,822.75 and his ERA received was \$19,450.64.

15. There were "Schedule C - Profit or (Loss) from Business or Profession" forms attached to petitioners' returns for the years 1976 and 1979. Some of the expenses reported per the Schedule C were not reported in the same amount on the ERA Annual Report (eg. wages and salaries), while other expenses were reported exactly the same on both reports (eg. telephone). Petitioner Jerald McCracken showed deductions on his Schedule C for depreciation and "interest on business indebtedness" which expenses did not appear as a permissible expense on the ERA Annual Report. Furthermore, petitioner Jerald McCracken on his Schedule C's showed a deduction for "office expenses in home" and no deduction for rent, whereas his ERA reports showed annual deductions for rent which amounts (rent/office expenses) were not equal.

16. The Schedule C's (finding of fact 15) refers to the business name as the "Jerald R. McCracken Agency",

17. Information provided on petitioners' returns showed that petitioner Jerald McCracken paid his own social security taxes and had no withholding from

18. It is clear from the returns as filed that petitioner Ruth McCracken was not involved in petitioner Jerald McCracken's insurance business.

19. The Notice of Deficiency with respect to the years 1974, 1975 and 1976 (Notice #A8008102381) asserted taxes due with respect to personal income taxes for the years 1975 and 1976 and unincorporated business taxes for the years 1974 through 1976.

20. The Notice of Deficiency with respect to the years 1977 and 1978 (Notice #A8008102391) asserts tax due with respect to unincorporated business taxes due for such years reduced by the personal income tax credit shown due with respect to petitioner Jerald McCracken for such years.

21. There was no evidence or testimony as to: (a) whether or not the Contract was in effect for the years 1974 through 1979, (b) whether petitioner Jerald McCracken's expense reimbursement allowance for such years was computed as per the Contract (as a percent of commissions) or otherwise and (c) the amount of supervision or control exercised by the principal Farmers & Traders Insurance Company over the activities of its agent Jerald McCracken.

CONCLUSIONS OF LAW

A. That the degree of direction and control exercised by a principal is of paramount importance when determining whether a taxpayer is an employee or independent contractor (Matter of Greene v. Gallman, 39 A.D.2d 270, aff'd. 33 N.Y.2d 778). That an employee-employer relationship exists where the principal has the right to control and direct the individual performing services, not only as to the end result to be accomplished, but also as to the means and details to be employed (Matter of Liberman v. Gallman, 41 N.Y.2d 774).

B. That the record in this matter is basically void of any substantial evidence on the key element of direction and control except to the extent that

the Contract provides that petitioner Jerald McCracken was generally not subject to direction and control (Finding of Fact "11"). Accordingly, petitioner Jerald McCracken has failed to sustain the burden of proof imposed by sections 722 and 689(e) of the Tax Law to show that his activities as a general agent of Farmers & Traders Insurance Company were controlled to the degree necessary to be considered an employee within the purview of subdivision (b) of section 703 of the Tax Law and 20 NYCRR 203.10.

C. That although petitioner Jerald McCracken received substantial amounts as reimbursement of expenses (which he reported as income) it appears that such monies were in the nature of increased commissions rather than actual expense reimbursements as evidenced, inter alia, in particular, by the fact that his reimbursement for the year 1975 exceeds his allocated expenses. (See Findings of Fact "12", "14" and "15"). Petitioner Jerald McCracken therefore is not within the "exception" guidelines to "maintenance of an office" of 20 NYCRR §203.14(b) of the Commission Regulations.

D. That petitioner Jerald McCracken's activities as a general agent during the years 1974 through 1979 constituted the carrying on of an unincorporated business pursuant to section 703(a) of the Tax Law and the income derived from said activities is subject to unincorporated business tax imposed by section 701(a) of the Tax Law.

E. That there being no evidence or testimony by petitioners with respect to the asserted income tax deficiencies for the years 1975, 1976, 1977 and 1978 they are sustained and there being no request for a greater deficiency at or before the hearing by the Audit Division the income tax credits for the years 1977 and 1978 are granted. (See Findings of Fact "2" and "20").

F. That petitioner Ruth McCracken was not connected with the operation of her husband's unincorporated business.

G. That in accordance with Conclusions of Law "D", "E" and "F";

(a) Notice #A8008102381 relating to the years 1974, 1975 and 1976 is sustained against petitioner Ruth McCracken only insofar as the deficiency thereon asserted relates to personal income tax and is otherwise sustained in full with respect to petitioner Jerald McCracken.

(b) Notice #A800810239 relating to the years 1977 and 1978 is cancelled with respect to petitioner Ruth McCracken and said notice is otherwise sustained in full with respect to petitioner Jerald McCracken.

(c) Notice #A8008102382 with respect to the years 1977 and 1978 is sustained in full against petitioner Ruth McCracken and

(d) Notice #A8008102401 relating to the year 1979 is cancelled with respect to petitioner Ruth McCracken and said notice of deficiency is otherwise sustained in full against petitioner Jerald McCracken.

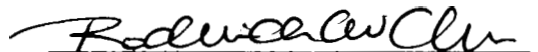
Said notices are sustained as above noted together with applicable interest as by law allowed including such interest as may required by law be allowed with respect to the credits due petitioner Jerald McCracken in respect of the years 1977 and 1978.

H. That the petitions *of* Jerald R. and Ruth M. McCracken are granted to the extent noted in Conclusion of Law "G" and are in all other respects denied.

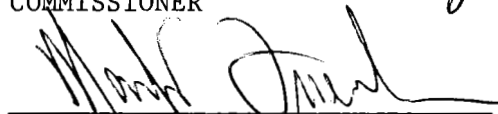
DATED: Albany, New York

STATE TAX COMMISSION

JAN 03 1986


PRESIDENT


COMMISSIONER


COMMISSIONER