

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition

of

GAVRIEL YONATY and MARCELINE YONATY

DECISION

for Revision of a Determination or for Refund :
of Personal Income Tax and Unincorporated
Business Tax under Articles 22 and 23 of the
Tax Law for the Years 1977 through 1979.

Petitioners, Gavriel Yonaty and Marceline Yonaty, 88 Grand Boulevard, Binghamton, New York 13905, filed a petition for revision of a determination or for refund of personal income tax and unincorporated business tax under Articles 22 and 23 of the Tax Law for the years 1977 through 1979 (File Nos. 35918, 36049 and 36050).

A hearing was held before Arthur Bray, Hearing Officer, at the offices of the State Tax Commission, 164 Hawley Street, Binghamton, New York, on June 16, 1986 at 1:15 P.M., with all briefs to be submitted by September 1, 1986. Petitioners appeared by Richardson & Company, P.C. (James B. Richardson, C.P.A.). The Audit Division appeared by John P. Dugan, Esq. (Deborah J. Dwyer, Esq., of counsel).

ISSUES

I. Whether the Audit Division properly determined that \$50.00 a week was a reasonable allowance for the services of petitioner Marceline Yonaty.

II. Whether petitioner Gavriel Yonaty properly reported 100 percent of his business net profit as personal service income in computing the maximum tax on personal service income for the years 1978 and 1979.

FINDINGS OF FACT

1. During the periods in issue, petitioner Gavriel Yonaty operated a Hess gasoline station in downtown Binghamton, New York. Mr. Yonaty leased the gasoline station from Amerada Hess Corporation. The station had both full-service and self-service gasoline pumps. It **also** sold oil. The station did not provide automotive repair services.

2. Petitioners, Gavriel Yonaty and Marceline Yonaty, filed a joint New York State Income Tax Resident Return for the year 1977. Mr. Yonaty **also** filed a New York State Unincorporated Business Tax Return for the year 1977. To the extent at issue herein, petitioners claimed an itemized deduction for charitable contributions in the amount of \$2,552.65 on their personal income tax return.

3. Petitioners filed separately, on one return, a New York State Income Tax Resident Return for the year 1978. Mr. Yonaty also filed a New York State Unincorporated Business Tax Return for this year. Subsequently, petitioners filed separately, on one return, an amended income tax return for the year 1978. To the extent at issue herein, Mr. Yonaty reported that the entire net profit from his activity of operating a Hess service station, i.e. \$63,201.00, was eligible for the New York State maximum tax on personal service income computation. Included with the return was a Federal Schedule C captioned Profit (or **Loss**) From Business or Profession. It was indicated on the return that Mr. Yonaty was the proprietor of a Hess station which sold gasoline and oil. The cost of goods sold section of this schedule revealed that Mr. Yonaty had a beginning inventory of \$6,822.00, purchases of \$1,211,161.00 and ending inventory of \$5,910.00 resulting in a cost of goods sold of \$1,212,073.00. This schedule also reported gross receipts or sales of \$1,361,301.00 less the cost of goods sold of \$1,212,073.00 for a total income of \$149,228.00. Mr.

Yonaty also reported depreciation on machinery or equipment with a cost or other basis of \$10,174.00 and depreciation expense for the year 1975 of \$1,546.00.

4. Petitioner filed separately, on one return, a New York State Income Tax Resident Return for the year 1979. On this return, Mr. Yonaty reported that his net profit from the operation of a Hess gasoline station. i.e. \$53,670.00, was eligible for the New York State maximum tax on personal service income computation. In addition, Mrs. Yonaty reported that she had wage income from the Hess gasoline station of \$10,400.00 and claimed an adjustment to income based upon a contribution to an individual retirement account of \$1,500.00. Mr. Yonaty also filed a New York State Unincorporated Business Tax Return for 1979 and a Federal Schedule C. The Federal Schedule C disclosed that Mr. Yonaty had a beginning inventory of \$5,910.00 and purchases of \$1,615,917.00. Mr. Yonaty also paid \$2,152.00 for materials and supplies. Mr. Yonaty reported that his inventory at the end of the year was \$8,153.00 resulting in a cost of goods sold of \$1,615,826.00. The income section of the Federal Schedule C reported that Mr. Yonaty had gross receipts or sales of \$1,874,623.00 less returns and allowances of \$36.00 for a balance of \$1,874,587.00. Mr. Yonaty also reported that the Hess station had interest income of \$1,068.00.

5. Mr. Yonaty reported that the Hess station had depreciable property in 1979 with a cost basis of \$11,275.00. The total depreciation claimed by Mr. Yonaty with respect to the Hess station in 1979 was \$1,817.00.

6. On November 19, 1981, as a result of a field audit, the Audit Division issued three notices of deficiency to petitioners which, in unison, asserted deficiencies of personal income tax and unincorporated business tax for the Years 1977 through 1979. The first Notice of Deficiency asserted a deficiency

of personal income tax for the years 1977 and 1979 in the amount of \$3,084.20 plus interest of \$579.86 for a total amount due of \$3,664.06. The second Notice of Deficiency asserted a deficiency of unincorporated business tax of \$260.32 for 1977 and \$140.55 for 1978. It also asserted a deficiency of personal income tax for the year 1978 of \$777.75. The total amount of interest asserted to be due was \$294.23 resulting in a balance due of \$1,472.85. The third Notice of Deficiency asserted a deficiency of unincorporated business tax for the year 1979 in the amount of \$719.70 plus interest of \$104.98 for a total amount due of \$824.68.

7. To the extent at issue herein, the proposed adjustment of personal income tax due for the year 1977 was premised upon the disallowance of charitable contributions in the amount of \$685.65. The respective statements of personal income tax audit changes and unincorporated business tax audit charges explained, to the extent at issue herein, that for the years 1978 and 1979 the Audit Division considered 30 percent of Mr. Yonaty's net profits from the operation of the Hess service station as income eligible for the maximum tax on personal service income. With respect to 1979, the Audit Division determined that \$50.00 a week was reasonable compensation for Mrs. Yonaty's services. Therefore, Mr. Yonaty's wage expense and Mr. Yonaty's income and individual retirement account contribution were adjusted accordingly.

8. In the course of the audit examination it was observed that Mrs. Yonaty had not been paid a salary throughout the year. Rather, at the end of the year Mrs. Yonaty received her entire annual salary of \$10,400.00. In addition, there wasn't any schedule of hours worked by Mrs. Yonaty. Further, upon the Audit Division's inquiry as to what services Mrs. Yonaty performed, it was advised that Mrs. Yonaty's duties included among other things ordering

gas, taking care of the mail, making deposits, writing letters, secretarial work and taking care of the station. However, when the records of the gasoline station were reviewed, all of the records appeared to be in Mr. Yonaty's handwriting. On the basis of the foregoing, the Audit Division concluded that since Mrs. Yonaty probably did some **work**, weekly wages of \$50.00 constituted a reasonable allowance for her personal services.

9. At the hearing, petitioners' representative asserted that **Mrs.** Yonaty worked approximately 40 hours a week or approximately 2,000 hours a year and that this work was performed at home because the station did not have an office. The work allegedly consisted of, among other things, secretarial work, ordering gasoline, answering the telephone, handling mail, laundry and sewing uniforms and managing the station in her husband's absence. Petitioners' representative also asserted that during the year in issue Mrs. Yonaty met with a law firm regarding such items as incorporation, insurance and pension and profit sharing plans. Further, **Mrs.** Yonaty allegedly helped train new employees. **No** evidence was presented to substantiate that the duties allegedly performed were in fact performed.

10. At the hearing, petitioners' representative asserted that **Mr.** Yonaty's functions included sales, marketing, purchases, disbursements, receipts, personnel, finance and public relations. **Mrs.** Yonaty allegedly assisted **Mr.** Yonaty with these duties. After the hearing, petitioners' representative submitted documents showing that Mr. Yonaty paid employees for a total of 14,251.7 hours of employment during 1978. He then asserted that it took 18,980 hours to operate the station. On this basis, petitioners' representative maintained that **Mr.** Yonaty and **Mrs.** Yonaty were required to work 4,728.3 hours during: 1978. Utilizing a **similar analysis** petitioners' representative maintained

that Mr. and Mrs. Yonaty were required to work for the station 7,979.7 hours during 1979. Petitioners' representative also stated that **Mr.** Yonaty was able to create a good profit because of the long hours he worked and because **of** his efforts **to** increase sales volume despite price controls and restrictions placed on him by Amerada Hess Corporation.

11. Neither Mr. Yonaty nor Mrs. Yonaty appeared at the hearing to present testimony on their **own** behalf. Petitioners' representative explained that the reason they did not appear was because petitioners did not speak English well and because they did not understand the maximum tax on personal service income concept.

12. At the hearing, the Audit Division conceded that petitioners were entitled to the contribution for 1977 which had previously been disallowed as unsubstantiated.

CONCLUSIONS OF LAW

A. That petitioners have failed to sustain their burden of proof of establishing that \$50.00 a week was not a reasonable allowance for the personal services **of** Mrs. Yonaty (Tax Law § 689[e]). It **is** noted that petitioners have not presented any documentary or testimonial evidence to show that the duties allegedly performed were, in fact, performed. It is well established that the failure to testify leads to the inference that petitioners' testimony would not have supported petitioners' version **of** the case and authorizes the strongest inference that the opposing evidence supports (~~see~~ Matter of Jose Rodrigues, State Tax Commn, November 16, 1981).

B. That section 603-A of the Tax Law provides for a maximum tax rate on New York personal service income. Section 603-A(b)(1), in effect for the years at issue, defined the term "New York personal service income" to mean. **in Dart.**

items of income includible as personal service income for purposes of section 1348 of the Internal Revenue Code.

C. That section 1348(b)(1)(A) of the Internal Revenue Code, in effect for the year 1978, defined "personal service income" as:

"any income which is earned income within the meaning of section 401(c)(2)(C) or section 911(b) or which is an amount received as a pension or annuity."

D. That section 1348(b)(1)(A) of the Internal Revenue Code, in effect for the year 1979, defined the term "personal service income" as:

"any income which **is** earned income within the meaning of section 401(c)(2)(C) or section 911(b) or which is an amount received as a pension or annuity which arises from an employer-employee relationship or from tax-deductible contributions to a retirement plan. For purposes of this subparagraph, section 911(b) shall be applied without regard to the phrase 'not in excess of 30 percent of his share of net profits **of** such trade or business,'."

E. That Treasury Regulation 1.1348-3(a)(3)(i) provided, in part, that:

"[i]f an individual is engaged in a trade or business... in which both personal services and capital are material income-producing factors, a reasonable allowance as compensation for the personal services actually rendered by the individual shall be considered earned income...."

Treasury Regulation 1.1348-3(a)(3)(ii) provided, in part, that:

"[c]apital **is** a material income-producing factor if a substantial portion of the gross income of the business is attributable to the employment of capital in the business, as reflected, for example, by a substantial investment in inventories, plant, machinery or other equipment. In general, capital **is** not a material income-producing factor where gross income of the business consists principally of fees, commissions, or other compensation for personal services performed by an individual."

F. That it is clear that personal services and capital were material income-producing factors **in** Mr. Yonaty's business. The significance of capital is evidenced by the fact that in 1978 **Mr.** Yonaty's total income arose from the

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from the gasoline station arose from the sale of product. It is also noted that the physical premises of the gasoline station are also considered capital since leased property is considered capital for the purpose of determining whether capital is a material income-producing factor (Moore v. Commissioner, 71 TC 533 [1970]). Since personal services and capital were material income-producing factors in Mr. Yonaty's business, Mr. Yonaty was entitled to a reasonable allowance as compensation for the personal services which he rendered to the business.

G. That petitioner Gavriel Yonaty has failed to sustain his burden of proving that the Audit Division's allowance of thirty percent of the net profit from the gasoline station as personal service income was improper (see Matter of David H. and Kathleen C. Dibble, State Tax Commn., December 13, 1985).


H. That in accordance with Finding of Fact "12", petitioners are entitled to the benefit of the contributions which had previously been disallowed for 1977.

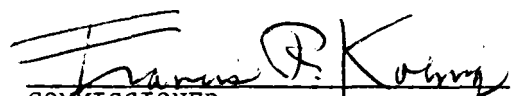
I. That the petition of Gavriel Yonaty and Marceline Yonaty is granted to the extent of Conclusion of Law "H" and the Audit Division is directed to modify the notices of deficiency accordingly; except as modified, the notices of deficiency are sustained.

DATED: Albany, New York

STATE TAX COMMISSION

APR 17 1987


PRESIDENT


COMMISSIONER


COMMISSIONER