

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition

of

WESTLY DISPLAYS, INC.

DECISION

for Redetermination of a Deficiency or for
Refund of Franchise Tax on Business Corporations :
under Articles 9-A and 27 of the Tax Law for the
Years 1978, 1979 and 1980.

Petitioner, Westly Displays, Inc., 589 Main Street, Westbury, New York 11590, filed a petition for redetermination of a deficiency or for refund of franchise tax on business corporations under Articles 9-A and 27 of the Tax Law for the years 1978, 1979 and 1980 (File No. 42084).

A hearing was held before Doris E. Steinhardt, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on September 11, 1985 at 2:45 P.M. Petitioner appeared by Murray M. Knight, CPA. The Audit Division appeared by John P. Dugan, Esq. (Anne W. Murphy, Esq., of counsel).

ISSUE

Whether the Audit Division properly asserted deficiencies against petitioner based on increments to its federal taxable income by the Internal Revenue Service, where the shareholders had resolved that any expenses disallowed to the corporation would be deemed additional salary or bonus income to them.

FINDINGS OF FACT

1. For the years 1978 through 1980, for federal corporation income tax purposes, petitioner, Westly Displays, Inc., was a small business corporation under subchapter S of the Internal Revenue Code. It was a corporation organized under the laws of the State of New York.

tax purposes, petitioner filed franchise tax reports remitting therewith the minimum tax of \$250.00.

2. Petitioner's sole officers are Meyer (Mike) Popolow and Harold Arowesty, each of whom owns 50 percent of the corporation's outstanding shares.

3. As the result of an examination conducted, the Internal Revenue Service disallowed certain travel and entertainment expenses incurred and deducted by petitioner during the years at issue. Denominated in the report as "field expenses," the disallowances totalled \$23,648.00, \$25,368.00 and \$17,392.00 for 1978, 1979 and 1980, respectively.

4. At a special meeting held on July 9, 1980, petitioner's shareholders adopted the following resolution:

"Should there be a disallowance of entertainment and/or travel or business expense incurred individually for the corporation by either Meyer Mike Popolow or Harold Arowesty, this disallowed expense would be deemed additional salary or bonus income to the officer who actually made the expenditure."

In accordance with their resolution, Messrs. Popolow and Arowesty submitted to the Audit Division reports of changes in federal taxable income (forms IT-115), advising the Division of the increments to their federal taxable income which arose from the disallowance of petitioner's expenses. Each shareholder reported one-half of the federal changes as "constructive dividends." Westly Displays, Inc. did not file with the Audit Division any report of the federal changes.

5. On November 5, 1982, the Audit Division issued to petitioner three notices of additional tax due, asserting franchise tax under Article 9-A of the Tax Law for 1978, 1979 and 1980 in the respective amounts of \$2,593.83, \$2,388.77 and \$1,440.25, plus accrued interest and penalty. The deficiencies were predicated on petitioner's failure to report the increases to its federal

taxable income and were calculated by applying the tax rate of 10 percent to such increases.

CONCLUSIONS OF LAW

A. That where the taxable income of a corporate taxpayer is changed or corrected by the Internal Revenue Service, Tax Law section 211.3 requires the taxpayer to report to the Audit Division such change or correction within ninety days after the final determination thereof. In the event the taxpayer fails to comply with this mandatory procedure, the Audit Division is authorized to assess a deficiency premised on the federal change by mailing to the taxpayer a notice of additional tax due (section 1081[e][1]). Petitioner does not dispute that it failed to advise the Audit Division of the Service's disallowance of certain expenses claimed. It follows that the Division was empowered to assert additional franchise tax upon the increments to petitioner's taxable income.

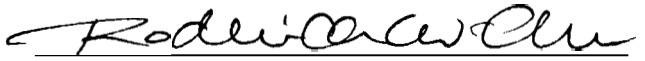
B. That it is immaterial that petitioner's shareholders reported to the Audit Division the changes to their income which flowed from the changes to petitioner's income. During the years under consideration, a small business corporation was subject to Article 9-A taxation, and increases to the corporation's income (due to disallowed deductions) would necessarily result in a double level of tax, at the corporate and at the shareholder levels. (See Tax Law section 209.8, added by the Laws of 1981, Chapter 103, section 26, effective for taxable years commencing on or after January 1, 1981,)

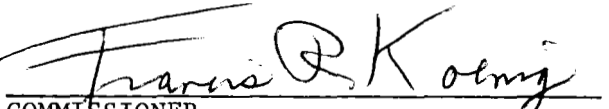
C. That the petition of Westly Displays, Inc. is denied, and the notices of additional tax due issued on November 5, 1982 are sustained in all respects.

DATED: Albany , New York

STATE TAX COMMISSION

JAN 17 1986


PRESIDENT


COMMISSIONER


COMMISSIONER