

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition

of

DIC-UNDERHILL, JOINT VENTURE

DECISION

for Redetermination of a Deficiency or for
Refund of Unincorporated Business Tax under
Article 23 of the Tax Law for the Years 1979
and 1980.

Petitioner, Dic-Underhill, Joint Venture, 211 East 46th Street, New York,
New York 10017, filed a petition for redetermination of a deficiency or for
refund of unincorporated business tax under Article 23 of the Tax Law for the
years 1979 and 1980 (File No. 47982).

A hearing was held before Allen Caplowaith, Hearing Officer, at the
offices of the State Tax Commission, Two World Trade Center, New York, New
York, on December 11, 1986 at 1:15 P.M., with all briefs submitted by March 24,
1987. Petitioner appeared by Robert D. Tolz, Esq. The Audit Division appeared
by John P. Dugan, Esq. (Herbert Kamrass, Esq., of counsel).

ISSUE

Whether certain interest income, characterized by petitioner as "passive"
income, is exempt from the imposition of unincorporated business tax.

FINDINGS OF FACT

1. Dic-Underhill, Joint Venture (hereinafter "petitioner"), 211 East 46th
Street, New York, New York 10017, filed a New York State Partnership Return for
each of the years 1979 and 1980 whereon its kind of business was reported as
"construction". Petitioner was comprised of two equal corporate partners: Dic
Concrete Corporation and Underhill Construction Corporation. On both the 1979

and 1980 returns, petitioner claimed an exemption equal to its reported net income. Accordingly, taxable business income was reported as zero and no unincorporated business tax was computed or paid.

2. On November 15, 1982, the Audit Division issued a Statement of Audit Changes to petitioner wherein unincorporated business tax was computed based on the following explanation:

"The exemption under Section 709 for a corporate partner is limited to the lesser of:

(a) The corporate partner's actual distributive share of the partnership income.

(b) The corporate partner's proportionate share of the partnership income after the salary allowance.

(c) The New York taxable income as shown on the corporation tax return.

Since the Dic Concrete Corporation and Underhill Construction Corporation both reported a negative corporation taxable income for 1979, no additional exemption is allowed under Section 709 of the Tax Law.

Your allowable Section 709 exemption for the Dic Concrete Corporation is ~~\$-0-~~ for 1980 since they report a negative corporate taxable income for 1980. Your allowable 709 exemption for Underhill Construction Corp., is \$138,130.00 which represents the corporate taxable income for 1980. Total additional exemption under Section 709 for 1980 is \$138,130.00.

| | <u>1979</u> | <u>1980</u> | |
|--------------------------|----------------|-------------------|---------------|
| Net income reported | \$5,089,954.00 | \$2,466,548.00 | |
| Exemptions: | | | |
| Statutory exemption | 5,000.00 | 5,000.00 | |
| 709 Exemption | <u>-0-</u> | <u>138,130.00</u> | |
| Taxable income corrected | \$5,084,954.00 | \$2,323,418.00 | |
| Tax Due at 4½% and 4% | \$ 228,822.93 | 92,936.72 | |
| Business credit | <u>-0-</u> | <u>-0-</u> | |
| Balance | \$ 228,822.93 | \$ 92,936.72 | |
| Tax previously paid | <u>-0-</u> | <u>-0-</u> | |
| ADDITIONAL TAX DUE | \$ 228,822.93 | \$ 92,936.72 | \$321,759.65" |

3. Based on the aforesaid statement, the Audit Division issued a Notice of Deficiency against petitioner on October 5, 1983 asserting unincorporated business tax for 1979 and 1980 of \$321,759.65 plus interest of \$113,689.34 for a total due of \$435,448.99.

4. In its petition of November 9, 1983, petitioner listed the grounds upon which relief is claimed. The basic grounds listed thereon are as follows:

a - The joint venture is entitled to apply as deductions against its income any and all indirect expenses allocable to the joint venture, but paid by a joint venturer.

b - The joint venture is entitled to an exemption against net income equal to the amount of the net income which is included in the partners' corporate income allocable to New York.

5. On December 11, 1986, Mr. Tolz, the petitioner's representative, entered into a "Stipulation of Partial Settlement" with Mr. Kamrass, the Audit Division's representative, as follows:

"WHEREAS, on October 5, 1983, the New York State Department of Taxation and Finance (the "Department") issued a Notice of Deficiency (the "Notice") for taxable periods 1979 and 1980 to the above-referenced taxpayer (the "Taxpayer"); and

WHEREAS, the Notice alleges additional tax due of \$321,759.65 for both years, plus interest thereon; and

WHEREAS, a Statement of Audit Changes in this matter prepared by the Department on November 15, 1982 reflects that the additional tax due is allocated as follows:

| <u>1979</u> | <u>1980</u> | <u>Total</u> |
|--------------|-------------|--------------|
| \$228,822.93 | \$92,936.72 | \$321,759.65 |

WHEREAS, the taxpayer is willing to agree to a portion of the alleged deficiency representing all additional taxes except for those attributable to passive income which income the taxpayer contends is not includable in Unincorporated Business Taxable Income; and

WHEREAS, the taxpayer contends that the following amounts constitute passive income not subject to Unincorporated Business Tax:

| <u>1979</u> | <u>1980</u> | <u>Total</u> |
|--------------|--------------|----------------|
| \$558,116.99 | \$663,959.73 | \$1,222,076.72 |

WHEREAS, the tax attributable to the foregoing contested passive income, taxed at the rate of four percent (4%) is:

| <u>1979</u> | <u>1980</u> | <u>Total</u> |
|-------------|-------------|--------------|
| \$22,324.68 | \$26,558.39 | \$48,883.07 |

WHEREAS, the agreed portion of the alleged tax, after reduction for the tax attributable to the contested passive income is:

| <u>1979</u> | <u>1980</u> | <u>Total</u> |
|--------------|-------------|--------------|
| \$206,498.25 | \$66,378.33 | \$272,876.58 |

NOW, THEREFORE, it is hereby stipulated and agreed as follows:

1. For the year 1979, it is agreed that the sum of \$206,498.25 additional taxes is due and owing from the taxpayer. The remaining \$22,324.68 of the proposed deficiency remains unagreed. The unagreed portion of the proposed deficiency shall remain the subject of the hearing before the State Tax Commission.

2. For the year 1980, it is agreed that the sum of \$66,378.33 additional taxes is due and owing from the taxpayer. The remaining \$26,558.39 of the proposed deficiency remains unagreed. The unagreed portion of the proposed deficiency shall remain the subject of the hearing before the State Tax Commission.

3. Interest for the agreed taxes for 1979 is determined to be \$178,470.60 through December 15, 1986.

4. Interest for the agreed taxes for 1980 is determined to be \$49,692.77 through December 15, 1986."

6. Although the issue with respect to "passive" interest income was not raised in the petition, the petitioner was allowed to amend such petition at the hearing to include said issue.

7. The total interest income reported on petitioner's 1979 and 1980 New York State partnership returns, inclusive of the amounts now characterized by petitioner as "passive", was \$577,257.00 and \$678,940.00, respectively. Said amounts were also reported as interest income on petitioner's Federal returns for 1979 and 1980.

8. On December 23, 1986, Mr. Tolz entered into an "Amended Stipulation of Partial Settlement" with Mr. Kamrass. The amendment incorporated into this

stipulation consisted of the application of the proper tax rate of 4½% to the contested "passive" income for 1979. On the original stipulation a tax rate of 4% was applied.

9. Pursuant to the aforesaid stipulations, the petitioner conceded the issues raised in its petition. Accordingly, the sole remaining issue herein is whether certain interest income, characterized by petitioner as "passive" income is exempt from the imposition of unincorporated business tax.

10. Petitioner paid the tax and interest due on the issues conceded as follows:

| <u>Year</u> | <u>Tax Paid</u> | <u>Interest</u> | <u>Total</u> |
|----------------------------|-----------------|-----------------|---------------------|
| 1979 | \$203,707.67 | \$176,058.78 | \$379,766.45 |
| 1980 | \$ 66,378.33 | \$ 49,692.77 | <u>\$116,071.10</u> |
| TOTAL TAX AND INTEREST DUE | | | <u>\$495,837.55</u> |

11. Petitioner alleged that the interest income at issue was erroneously included as taxable business income on its returns for the years 1979 and 1980.

12. Petitioner alleged that since the bulk of the interest income reported for each year at issue was derived from passive investments, rather than from the business of the entity, such income is exempt from the imposition of unincorporated business tax. Petitioner further alleged that the passive interest income is exempt since the joint venture was not active during the years at issue.

13. Petitioner did not claim a deduction on its returns for salaries and wages during 1979 and 1980.

14. The total interest income characterized by petitioner as passive non-business income was comprised primarily of interest income derived from

GNMA bonds, United States Treasury bills, commercial paper and certificates of deposit.

15. Petitioner invested primarily in cash equivalents, due to the greater return, rather than deposit the invested funds in a savings account.

16. The joint venture continued to exist beyond the years at issue. It was alleged that during the years at issue it only remained in existence for the purpose of collecting open accounts receivable and investing its funds.

17. Review of petitioner's 1979 U.S. Partnership Return shows that petitioner had income from Crane Rental during said year of \$96,000.00. Said return also showed that petitioner paid payroll taxes of \$46,024.00; that petitioner claimed depreciation on various equipment which had a basis of approximately \$200,000.00; and that included in its reported cost of operations was an amount paid to subcontractors of \$240,309.00.

18. Review of petitioner's 1980 U.S. Partnership Return shows that included in its reported cost of operations were materials of \$92,403.00 and an amount paid to sub-contractors of \$24,240.00. For 1980 petitioner claimed depreciation on the same equipment it claimed depreciation on in 1979.

CONCLUSIONS OF LAW

A. That Tax Law § 705(a) provides, in pertinent part that:

"Unincorporated business gross income of an unincorporated business means the sum of the items of income and gain of the business, of whatever kind and in whatever form paid, includible in gross income for the taxable year for federal income tax purposes, including income and gain from any property employed in the business, or from liquidation of the business or from collection of installment obligations of the business" (emphasis supplied).

B. That the interest income earned by petitioner during the years at issue was properly included in the unincorporated business gross income pursuant to Tax Law § 705(a). It is clear that petitioner was, during the years in

and was not engaged in activities relating to the investment or reinvestment of its own funds as contemplated in regulation 20 NYCRR 203.1(b). The partnership returns filed by petitioner reveal that it claimed expenses and deductions indicative of an entity engaged in business. Furthermore, the interest income which petitioner claims to be nontaxable passive income represents a small percentage of its reported net income (e.g. in 1979 reported net income totalled \$5,089,954.00 and claimed passive income totalled \$558,116.99 or 11%, while in 1980 reported net income totalled \$2,466,548.00 and claimed passive income totalled \$663,959.73 or 27%).

C. That petitioner's reliance on 635 Associates v. STC, 95 AD2d 913 and Merrick V. Tully, 68 AD2d 289 is misplaced as the instant matter is distinguishable from said cases. In 635 Associates, supra, the petitioner therein was a joint venture consisting of 29 members each of whom contributed capital which amounted to a total of \$850,000.00. The contributed capital was loaned by 635 Associates to a corporation which used the money to purchase a leasehold. The loan from 635 Associates to the corporation was secured by a leasehold mortgage and a promissory note and the sole purpose for the formation and existence of 635 Associates **was** to conserve and protect the leasehold mortgage and to collect and distribute the proceeds received from the promissory note. In the instant matter, petitioner's activities were in no way narrowly defined and limited as in 635 Associates. In Merrick, supra, the petitioner therein was an individual engaged in an unincorporated business and the issue for review was whether certain other activities carried on by petitioner were in furtherance of his unincorporated business so as to subject the income from said other activities to the unincorporated business tax.

D. That the petition of Dic-Underhill, Joint Venture is denied and the Notice of Deficiency dated October 5, 1983 is sustained together with such additional interest as may be lawfully owing. Petitioner is entitled to a credit for amounts previously paid (see Finding of Fact "10", supra).

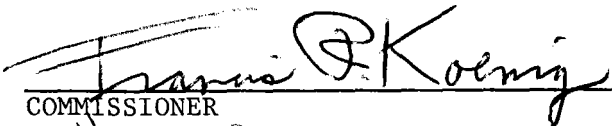
DATED: Albany, New York

STATE TAX COMMISSION

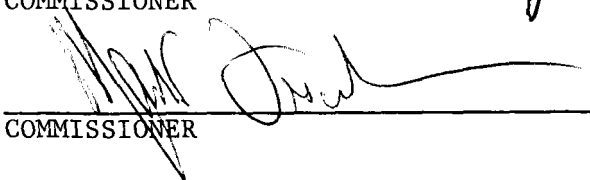
AUG 28 1987



PRESIDENT



COMMISSIONER



COMMISSIONER