

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition

of

ANTONIO COPPOLA AND FRANCES COPPOLA

for Redetermination of a Deficiency or for
Refund of Personal Income Tax under Article 22 :
of the Tax Law for the Years 1979, 1980 and
1981.

DECISION

In the Matter of the Petition

of

JOSEPH COPPOLA AND MARIE COPPOLA

for Redetermination of a Deficiency or for
Refund of Personal Income Tax under Article 22 :
of the Tax Law for the Years 1979, 1980 and
1981.

Petitioners, Antonio Coppola and Frances Coppola, Violet Avenue #2, Hyde Park, New York 12538, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the years 1979, 1980 and 1981 (File No. 50033).

Petitioners, Joseph Coppola and Marie Coppola, 34 Gilbert Drive, Hyde Park, New York 12538, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the years 1979, 1980 and 1981 (File No. 50034).

A consolidated hearing was held before Brian L. Friedman, Hearing Officer, at the offices of the State Tax Commission, Building #9, State Office Campus, Albany, New York, on October 9, 1985 at 1:15 P.M., with all briefs to be submitted by December 26, 1985. Petitioners appeared by Paul A. Baldwin, CPA

The Audit Division appeared by John P. Dugan, Esq. (Thomas Sacca, Esq., of counsel).

ISSUE

Whether petitioners may properly include as personal service income subject to the maximum tax, distributions which were received from a subchapter S corporation.

FINDINGS OF FACT

1. Antonio Coppola and his wife, Frances Coppola, timely filed New York State income tax resident returns for the years 1979, 1980 and 1981 under the filing status "married filing separately on one return." Joseph Coppola and his wife, Marie Coppola, also timely filed New York State income tax resident returns for the years 1979, 1980 and 1981 under the filing status "married filing separately on one return."

2. On August 29, 1983, the Audit Division issued to Antonio Coppola, a Statement of Personal Income Tax Audit Changes which provided the following explanation:

	<u>1979</u>	<u>1980</u>	<u>1981</u>
audit it was found that savings accounts were jointly held, therefore adjustment is made.			
Maximum Tax:			
Personal service income do (sic) not include small business corporate earnings and profits - maximum tax adjusted.			
Interest income	367.42	1,258.63	1,224.50
Adjustment	367.42	1,258.63	1,224.50
able Income Previously Stated	<u>45,769.00</u>	<u>69,658.00</u>	<u>43,834.00</u>
ected Taxable Income	<u>46,136.42</u>	<u>70,943.63</u>	<u>45,058.50</u>
on Corrected Taxable Income	4,905.46	7,760.01	4,550.74

Corrected Tax Due	4,905.46	7,760.01	4,550.74	
Previously Computed	(4,493.00)	(6,855.38)	(3,744.00)	
Additional Tax Due	412.46	904.63	806.74	
Interest	154.85	262.50	135.72	
Total	<u>567.31</u>	<u>1,167.13</u>	<u>942.46</u>	\$2,676.

As a result of the adjustments for the jointly held savings accounts which were made to Antonio Coppola's taxable income for the years at issue, a Statement of Personal Income Tax Audit Changes was also issued to Frances Coppola on August 29, 1983, containing the following explanation:

	<u>1979</u>	<u>1980</u>	<u>1981</u>	
In the audit it was found that savings accounts were jointly held, therefore an adjustment is made.				
Interest income	(367.42)	(1,258.63)	(1,224.50)	
Adjustment	(367.42)	(1,258.63)	(1,224.50)	
able Income Previously Stated	<u>34.83</u>	<u>1,767.26</u>	<u>1,699.00</u>	
Corrected Taxable Income	<u>(332.59)</u>	<u>508.63</u>	<u>474.50</u>	
on Corrected Taxable Income	0	10.17	9.49	
Corrected Tax Due	0	10.17	9.49	
Previously Computed	.70	43.02	41.00	
Additional Tax Due	(.70)	(32.85)	(31.51)	
Interest	<u>(.00)</u>	<u>9.53</u>	<u>5.31</u>	
Total	<u>(.70)</u>	<u>(42.38)</u>	<u>(36.82)</u>	\$(79.4)

Accordingly, on October 21, 1983, the Audit Division issued to Antonio Coppola and Frances Coppola a Notice of Deficiency asserting additional tax due of \$2,058.77, plus interest of \$561.98, for a total due of \$2,620.75.

3. On August 29, 1983, the Audit Division issued to Joseph Coppola a Statement of Personal Income Tax Audit Changes which provided the following explanation:

	<u>1979</u>	<u>1980</u>	<u>1981</u>	
audit it was found that savings accounts were jointly held, therefore adjustment is made maximum tax:				
personal service income does not include all business corporate earnings and profits, therefore, maximum tax is justified.				
Interest income	1,992.06	2,799.61	3,219.00	
Adjustment	1,992.06	2,799.61	3,219.00	
able Income Previously Stated	<u>41,670.13</u>	<u>62,835.72</u>	<u>43,517.00</u>	
Corrected Taxable Income	<u>43,662.19</u>	<u>65,635.33</u>	<u>46,736.00</u>	
on Corrected Taxable Income	4,606.23	7,138.44	4,725.29	
Corrected Tax Due	4,606.23	7,138.44	4,725.29	
Previously Computed	(4,001.00)	(6,101.93)	(3,711.00)	
Additional Tax Due	605.23	1,036.51	1,014.29	
Interest	<u>227.23</u>	<u>300.68</u>	<u>170.93</u>	
Total	832.46	1,337.19	1,185.22	\$3,354.

As a result of the adjustments for the jointly held savings accounts which were made to Joseph Coppola's taxable income for the years at issue, a Statement of Audit Changes was also issued to Marie Coppola on August 29, 1983, containing the following explanation:

	<u>1979</u>	<u>1980</u>	<u>1981</u>	
audit it was found that savings accounts were jointly held, therefore adjustment is made.				
Interest income	(1,992.06)	(2,799.61)	(3,219.00)	
Adjustment	(1,992.06)	(2,799.61)	(3,219.00)	
able Income Previously Stated	<u>3,284.12</u>	<u>4,849.22</u>	<u>5,688.00</u>	
Corrected Taxable Income	<u>1,292.06</u>	<u>2,049.61</u>	<u>2,469.00</u>	
on Corrected Taxable Income	28.76	51.49	64.07	
Corrected Tax Due	28.76	51.49	64.07	
Previously Computed	(91.00)	(153.97)	(194.00)	
Additional Tax Due	(62.24)	(102.48)	(129.93)	
Interest	<u>(23.52)</u>	<u>(29.72)</u>	<u>(21.86)</u>	
Total	(85.76)	(132.20)	(151.79)	(\$369.75)

Accordingly, on October 21, 1983, the Audit Division issued to Joseph Coppola and Marie Coppola, a Notice of Deficiency asserting additional tax due of \$2,631.38, plus interest of \$650.98, for a total due of \$3,012.36.

4. Neither petitioners Antonio Coppola and Frances Coppola nor petitioners Joseph Coppola and Marie Coppola are contesting the adjustments to their respective taxable incomes for the years at issue which resulted from the Audit Division having credited one-half of the interest from the jointly-held savings accounts to the husband and one-half to the wife for each of the couples. Therefore, the only remaining issue is whether or not, for the years at issue, distributions to Antonio Coppola and Joseph Coppola from a subchapter S corporation a small business corporation which has made an election pursuant to Subchapter S of Subtitle A of the Internal Revenue Code, may be included as personal service income subject to the maximum tax computation.

5. Antonio Coppola and Joseph Coppola are the sole shareholders and officers of The Kitchen, Inc. and Coppola's Restaurant, Inc. In 1968 or 1969, Antonio Coppola and Joseph Coppola purchased all of the stock of the business corporation, The Kitchen, Inc., which operates a restaurant known as Coppola's Restaurant located on Route 9, Hyde Park, New York. Antonio Coppola oversees all of the activities involved in the operation and is also the head chef of this restaurant. Coppola's Restaurant, Inc. is a subchapter S corporation which operates a restaurant known as Coppola's located at 825 Main Street, Poughkeepsie, New York. Joseph Coppola oversees all of the activities involved in the operation and is also the head chef of this restaurant.

6. Antonio Coppola received wages from The Kitchen, Inc. in the amount of \$33,036.00 for 1979, \$50,934.00 for 1980 and \$33,900.00 for 1981. Antonio

Coppola also received a distribution from Coppola's Restaurant, Inc. in the amount of \$20,833.00 for 1979, \$27,601.00 for 1980 and \$18,434.00 for 1981.

7. Joseph Coppola received wages from Coppola's Restaurant, Inc. in the amount of \$23,036.00 for 1979, \$25,934.00 for 1980 and \$31,850.00 for 1981.

Joseph Coppola also received wages from The Kitchen, Inc. in the amount of \$10,000.00 for 1979, \$25,000.00 for 1980 and \$5,000.00 for 1981 and also received a distribution from said subchapter S corporation of \$20,833.00 for 1979, \$27,601.00 for 1980 and \$18,434.00 for 1981.

8. The sum obtained by combining the wages and distributions received by Antonio Coppola and Joseph Coppola for the years at issue results in the total gross income, excluding interest income and prior to income adjustments, of \$53,869.00 for each for 1979, \$78,535.00 for each for 1980 and \$52,334.00 for Antonio Coppola and \$55,284.00 for Joseph Coppola for 1981.

9. Antonio Coppola and Joseph Coppola each work approximately twelve hours per day, six days per week in their positions as supervisor of operations **and** head chef at Coppola's Restaurant in Hyde Park and Coppola's in Poughkeepsie, respectively. Although both of the restaurants are closed on Mondays of each week, Antonio Coppola and Joseph Coppola often work at their respective restaurants on Mondays as well.

10. Petitioners contend that the distributions from the subchapter S corporation, Coppola Brothers, Inc., were not distributions of earnings and profits, but were actually compensation for personal services rendered. No credible evidence was presented by petitioners to substantiate that the wages received were not reasonable compensation for personal services rendered nor was credible evidence presented that either Antonio Coppola or Joseph Coppola

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performed personal services for other than the restaurant for which they worked approximately twelve hours per day, six days per week.

CONCLUSIONS OF LAW

A. That for the years at issue, for purposes of determining the maximum tax rate on New York personal service income, section 603-A(b)(1) provided, in pertinent part:

For purposes of this section the term 'New York personal service income' means items **of** income includible as personal service income for purposes of section one thousand three hundred forty-eight of the internal revenue code, to the extent such items of income are includible in New York adjusted gross income, plus the amount of the modifications which must be added to federal adjusted gross income pursuant to paragraphs seven, eight and nine of subsection (b) of section six hundred twelve;...".

B. That, although promulgated subsequent to the years at issue, the position of the State Tax Commission regarding the definition of the term "personal service income" is set forth in 20 NYCRR.100.4(c)(2)(1) which provides, in pertinent part:

"(2) Personal service income. (i) For purposes of section 1348 of the Internal Revenue Code, personal service income generally includes wages, salaries, professional fees, bonuses, commissions on sales or on insurance premiums, tips and other amounts received as compensation for personal services actually rendered. It also includes prizes and awards that are not gambling winnings, taxable pensions or annuities if connected with income earned from past personal services, and group term life insurance purchased for employees to the extent included in gross income. It **also** includes property received by the taxpayer for the performance of services which has been transferred to another individual." (Emphasis added.)

C. That for the years at issue, section 1348 of the Internal Revenue Code (repealed by P.L. 97-34 for tax years beginning after 1981) provided, in pertinent part:

"(b) Definitions. -- For purposes of this section --

(1) Personal service income. --

(A) In general. -- The term 'personal service income' means 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,'.

D. That section 911(b) of the Internal Revenue Code, in effect for the years at issue, provided, in pertinent part, as follows:

"(b) Definition of earned income. -- For purposes of this section, the term 'earned income' means wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered, but does not include that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered..."

E. That Treasury Regulation §1.1348-3(a)(1)(i), in effect for the years at issue, defined "earned income" and provided that the term "does not include such income as dividends (including an amount treated as a dividend by reason of section 1373(b) and 51.1373-1),..."

F. That section 1373(b) of the Internal Revenue Code, in effect for the years at issue, provided as follows:

"Each person who is a shareholder of an electing small business corporation on the last day of a taxable year of such corporation shall include in his gross income, for his taxable year in which or with which the taxable year of the corporation ends, the amount he would have received as a dividend, if on such last day there had been distributed pro rata to its shareholders by such corporation an amount equal to the corporation's undistributed taxable income for the corporation's taxable year. For purposes of this chapter, the amount so included shall be treated as an amount distributed as a dividend on the last day of the taxable year of the corporation."

G. That in Migliore v. Commissioner, 36 TCM 1004, 1007 (1977), a case in which the taxpayer reported undistributed taxable income from a small business corporation as being income subject to the maximum tax on earned income, the Court stated:

"While we might be inclined to go along with petitioners' substance over form argument in the area of section 1348, petitioners have failed to lay the necessary factual foundation for such an argument. That is, petitioners have failed to show that the dividends received, actually or constructively, were paid to them in lieu of reasonable compensation."


H. That in view of the facts that the total gross incomes of Antonio Coppola and Joseph Coppola were identical for the years 1979 and 1980 and were \$2,950.00 apart for the year 1981, and that no credible evidence was presented to substantiate that wages received by each did not constitute reasonable compensation for personal services rendered, the distributions to Antonio Coppola and Joseph Coppola from Coppola Brothers, Inc. may not properly be included as personal service income subject to the maximum tax.


I. That the petition of Antonio Coppola and Frances Coppola **is** denied and the Notice of Deficiency issued on October 21, 1983 is sustained.


That the petition of Joseph Coppola and Marie Coppola is denied and the Notice of Deficiency issued on October 21, 1983 is sustained,

DATED: Albany, New York

STATE TAX COMMISSION


PRESIDENT


COMMISSIONER


COMMISSIONER