

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petition

of

HOWARD WEXLER

DECISION

for Redetermination of a Deficiency or for  
Refund of Unincorporated Business Taxes  
under Article 23 of the Tax Law for the  
Years 1976, 1977, 1978, 1979 and 1980.

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Petitioner, Howard Wexler, 300 East 40th Street, New York, New York 10016,  
filed a petition for redetermination of a deficiency or for refund of un-  
incorporated business taxes under Article 23 of the Tax Law for the years 1976,  
1977, 1978, 1979 and 1980 (File No. 54695).

On December 4, 1985, petitioner waived his right to a hearing and requested  
that a decision be rendered based on the entire record contained in the file.  
**After due consideration, the State Tax Commission renders the following decision.**

### ISSUE

Whether petitioner's income derived from his activities as a designer of  
toys and games **is** exempt from the imposition of unincorporated business tax  
either on the basis that such activities constitute the practice of his profession  
**of educational psychology or, alternatively, on the basis that the design of**  
educational toys **is** itself an exempt profession.

### FINDINGS OF FACT

1. Petitioner, Howard Wexler, Ph.D, ("Dr. Wexler"), timely filed New York  
State income tax resident returns for the years in issue reporting total New  
York income as follows:

<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>
-\$633.00	\$17,107.00	\$25,633.00	-\$9,455.00	-\$24,604.00

2. For each of the above years, Dr. Wexler also filed a Federal return, including a Schedule C, Profit or Loss from Business or Profession, on which he identified his main business activity as "Inventor - Games and Toys". In addition to reporting total income from this activity, he claimed business deductions for such expenses as: rent, salaries, legal fees, office supplies, travel and entertainment, model costs, advertising, art work, and office supplies. The following chart represents a summary of Dr. Wexler's reported profits or losses for each year under consideration.

	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>
Income	\$ 2,696.00	NONE	NONE	NONE	NONE
Deductions	\$70,326.00	\$121,875.00	\$147,782.00	\$157,953.00	\$162,76
Profit/Loss	-\$67,630.00	-\$121,875.00	-\$147,782.00	-\$157,953.00	-\$162,76

3. Dr. Wexler reported long-term capital gains for each year in issue identifying such gains as "income from royalty" pursuant to Internal Revenue Code, Section 1235,<sup>1</sup> the amount of gain was reported as follows:

<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>
\$116,014.00	\$228,555.00	\$311,853.00	\$368,712.00	\$416,301.00

4. A Statement of Audit Adjustment was issued to Dr. Wexler on March 9, 1984 containing the following explanation:

"Based on an evaluation of all data presented it has been determined that the application of your specialized knowledge as an educational psychologist towards your income - derived activities as an inventor of educational toys and games does not constitute the practice of a profession exempt from the imposition of unincorporated business tax."

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1 Royalty income does not qualify for capital gains treatment, but is to be reported as gross income pursuant to IRC §61(a). This discrepancy was not raised by the parties. It is assumed that the so-called "royalty income" was actually gain realized from the sale of intangible property under IRC

5. Accordingly, the Audit Division recomputed Dr. Wexler's tax liability for the years under consideration as follows:

	1976	1977	1978
Royalty income	\$116,014.00,	\$228,555.00	\$311,853.00
Less: Schedule C expenses	<u>73,326.00<sup>2</sup></u>	<u>121,875.00</u>	<u>147,782.00</u>
Net profit	\$ 42,688.00	\$106,680.00	\$164,071.00
Less: Allowance for taxpayer services	<u>5,000.00</u>	<u>5,000.00</u>	<u>5,000.00</u>
Net income from business	\$ 37,688.00	\$101,680.00	\$159,071.00
Less: Exemptions	<u>5,000.00</u>	<u>5,000.00</u>	<u>5,000.00</u>
Taxable business income	<u>\$ 32,688.00</u>	<u>\$ 96,680.00</u>	<u>\$154,071.00</u>
Tax at 5½%:1976 & 1977	\$ 1,797.84	\$ 5,317.40	
Tax at 5%:1978			\$ 7,703.55
	1979	1980	
Royalty income	\$368,712.00	\$416,301.00	
Less: Schedule C expenses	<u>157,953.00</u>	<u>162,761.00</u>	
Net Profit	\$210,759.00	\$253,540.00	
Less: Allowance for taxpayer services	<u>5,000.00</u>	<u>5,000.00</u>	
Net income from business	\$205,759.00	\$248,540.00	
Less: Exemptions	<u>5,000.00</u>	<u>5,000.00</u>	
Taxable business income	<u>\$200,759.00</u>	<u>\$243,540.00</u>	
Tax at 4½%:1979; 4%:1980	\$ 9,034.16	\$ 9,741.60	

6. The Audit Division issued two notices of deficiency to Dr. Wexler on June 22, 1984. The first, for the years 1976, 1977 and 1978, asserted tax due of \$14,818.79 plus interest; the second, for the years 1979 and 1980, asserted tax due of \$18,775.76 plus interest.

7. Dr. Wexler received a Bachelor of Science Degree with a major in Education from the College of the City of New York in 1960; in 1962, he received

2 Total Schedule C deductions for 1976 amount to \$70,326.00 with a reported net loss for the year of \$67,630.00. The record does not contain sufficient information to reconcile these figures with the figures shown

a Master of Science Degree from the same college. In 1970, Fordham University awarded Dr. Wexler a Doctorate in Educational Psychology.

8. From 1962 until 1968, Dr. Wexler worked as a school psychologist. After receiving his doctorate in 1970, Dr. Wexler accepted employment with Hasbro Industries, Inc., a well-known commercial toy manufacturer. His duties included the design and development of toys and games. He also served as a consultant for Hasbro's "Romper Room" television show and as a consultant for other toy and game products.

7. In 1973, Dr. Wexler began to independently develop toys and games for the toy industry. The playthings he has invented can be used to teach skills which range from the basic "3Rs" to more complex skills involving perception, logic, dexterity and socialization. Games created by Dr. Wexler include the following:

- (A) "Alphabet Bingo Game" - The first child to form a letter out of three shapes wins.
- (B) "Pre-School Writer" - The child holds a pencil-like apparatus and traces a path to form different letters as sounds are emitted.
- (C) "Spellbound" - Children spell words in an effort to accumulate the most points.
- (D) "Alphabet Jungle Game" - Children actually climb **on** and around a large structure built from letters. This apparatus is helpful for young children who tend to reverse the letters they see.

8. Dr. Wexler has been a member of the American Psychological Association since 1973. A prerequisite for membership in this professional organization **is** engagement "**in** study or professional work that is primarily psychological in nature"

9. The American Psychological Association issues a pamphlet entitled "Careers in Psychology" which sets forth the variety of careers which an educational psychologist may pursue as follows:

"Educational psychologists may actually be concerned with a range of activities from initial design through development and evaluation of both materials and procedures for education and training. Such positions exist in public school systems (usually large ones), in the military services, in private research and development companies, and in industrial concerns. This kind of psychologist may deal with analyzing education and training needs, with developing materials for instruction in various media, with designing the best conditions for instruction, and with evaluating the effectiveness of instructional programs. Typically, he or she has acquired skills associated with educational systems development, materials and media development, and educational evaluation."

10. Although conceding that educational psychology is a profession which is exempt from the imposition of the unincorporated business tax, it is the Audit Division's position that as an inventor of toys and games Dr. Wexler applied his special knowledge and experience as a psychologist towards a business pursuit rather than in the practice of his profession.

11. The sole issue raised by the parties is whether Dr. Wexler's income producing activities constituted the practice of a profession.

#### CONCLUSIONS OF LAW

A. That Tax Law section 703, subdivision (c) exempts from the imposition of the unincorporated business tax the practice of law, medicine, dentistry, architecture or any other profession in which capital is not a material income producing factor. It is undisputed that educational psychology is a profession within the meaning of the statute, but it does not necessarily follow that all income earned by an educational psychologist qualifies for the professional exemption. When a professional person is engaged in selling his services or products to further a business enterprise, he is not practicing a profession

Dr. Wexler made use of his professional knowledge and skills in his business, the invention of commercially marketed toys and games does not constitute the practice of a profession.

B. That four factors must be considered in determining whether an activity constitutes the practice of a profession for the purposes of section 703 of the Tax Law: (1) whether the activity requires a long-term educational background generally associated with a degree in an advanced field of science or learning; (2) whether licensing requirements exist; (3) whether the occupation is controlled by standards of conduct, ethics and malpractice liability; (4) whether there are legal barriers to carrying on the occupation as a corporation (Matter of Rosenbloom v. State Tax Comm., 44 A.D.2d 69, mot. for lv. to appeal den. 34 N.Y.2d 518). In light of the above, it is clear that the design of toys and games does not constitute the practice of a profession within the meaning and intent of Tax Law section 703. The petitioner's reliance on Matter of Argiro v. Gallman, 46 A.D.2d 397, is misplaced. The taxpayer in Argiro was an industrial designer who was engaged in designing toys for production by toy manufacturers. The Court found that as a matter of law (see, Matter of Teague v. Graves, 261 A.D. 652), the occupation of industrial designer fell within the exemption; that Argiro was qualified by education and experience as an industrial designer; and that toy design was indistinguishable from other areas of industrial design. Dr. Wexler does not claim to be an industrial designer, but rather a "designer of educational toys." That is not in itself a profession cognizable by section 703 of the Tax Law.

C. That the petition of Howard Wexler is denied and the notices of deficiency issued on June 22, 1984 are sustained.

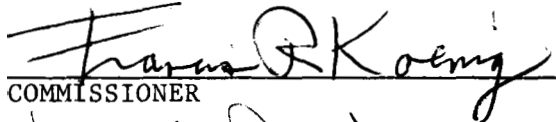
DATED: Albany, New York

STATE TAX COMMISSION

JN 121986



PRESIDENT



COMMISSIONER



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