

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petition :  
of :  
Leonard & Rose Frank :  
for Redetermination of a Deficiency or a Revision :  
of a Determination or a Refund of Gift Tax under :  
Article 26A of the Tax Law for the Quarterly :  
Periods Ending 12/72 & 3/73. :  
\_\_\_\_\_:

AFFIDAVIT OF MAILING

State of New York  
County of Albany

Connie Hagelund, being duly sworn, deposes and says that she is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 9th day of April, 1982, she served the within notice of Decision by certified mail upon Leonard & Rose Frank, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Leonard & Rose Frank  
c/o Malcolm D. Brutman  
2495 Kensington Ave.  
Buffalo, NY 14226

and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the petitioner herein and that the address set forth on said wrapper is the last known address of the petitioner.

Sworn to before me this  
9th day of April, 1982.

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STATE OF NEW YORK  
STATE TAX COMMISSION

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AFFIDAVIT OF MAILING

State of New York  
County of Albany

Connie Hagelund, being duly sworn, deposes and says that she is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 9th day of April, 1982, she served the within notice of Decision by certified mail upon Malcolm D. Brutman the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Malcolm D. Brutman  
2495 Kensington Ave.  
Buffalo, NY 14226

and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the representative of the petitioner herein and that the address set forth on said wrapper is the last known address of the representative of the petitioner.

Sworn to before me this  
9th day of April, 1982.

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STATE OF NEW YORK  
STATE TAX COMMISSION  
ALBANY, NEW YORK 12227

April 9, 1982

Leonard & Rose Frank  
c/o Malcolm D. Brutman  
2495 Kensington Ave.  
Buffalo, NY 14226

Dear Mr. & Mrs. Frank:

Please take notice of the Decision of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 1007(b) of the Tax Law, any proceeding in court to review an adverse decision by the State Tax Commission can only be instituted under Article 78 of the Civil Practice Laws and Rules, and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 months from the date of this notice.

Inquiries concerning the computation of tax due or refund allowed in accordance with this decision may be addressed to:

NYS Dept. Taxation and Finance  
Law Bureau - Litigation Unit  
Albany, New York 12227  
Phone # (518) 457-2070

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative  
Malcolm D. Brutman  
2495 Kensington Ave.  
Buffalo, NY 14226  
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petition	:	
of	:	
LEONARD and ROSE FRANK	:	DECISION
for Redetermination of a Deficiency or for	:	
Refund of Gift Tax under Article 26A of the Tax	:	
Law for the Quarterly Periods Ended December,	:	
1972 and March, 1973.	:	

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Petitioners, Leonard and Rose Frank, 180 Troy Del Way, Buffalo, New York 14221, filed a petition for redetermination of a deficiency or for refund of gift tax under Article 26A of the Tax Law for the quarterly periods ended December, 1972 and March, 1973 (File Nos. 15200 and 15201).

A formal hearing was commenced before Alan R. Golkin, Hearing Officer, at the offices of the State Tax Commission, State Office Building, 65 Court Street, Buffalo, New York, on May 18, 1978 at 2:45 P.M. and continued to conclusion before Doris E. Steinhardt, Hearing Officer, on July 6, 1981 at 1:15 P.M. Petitioners appeared by Malcolm D. Brutman, Esq. The Audit Division appeared by Peter Crotty, Esq. (Alexander Weiss, Esq., of counsel) on May 18, 1978 and by Ralph J. Vecchio, Esq. (Patricia Brumbaugh, Esq., of counsel) on July 6, 1981.

ISSUES

I. Whether the Audit Division properly valued the assets underlying stock, which was donated to three trusts by petitioner Leonard Frank.

II. Whether the gifts of stock were gifts of minority interest upon which a discount was properly allowable.

III. Whether the gift to the trust for the benefit of petitioner Rose Frank qualified for the marital deduction.

FINDINGS OF FACT

1. Petitioner Leonard Frank filed resident quarterly gift tax returns for the periods ended December, 1972 and January, 1973, which reflected no taxable gifts in either quarter.

Petitioner Rose Frank filed a resident quarterly gift tax return for the period ended December, 1972 which reflected no taxable gifts made during said quarter.

2. The gifts at issue in this proceeding were of shares in United Babcock, Inc. ("Babcock"), a New York corporation. Immediately prior to the gifts, petitioner Leonard Frank owned 100 shares of Babcock, which constituted 50 percent of the outstanding shares. The remaining 100 shares were owned by Mr. Edward Linder, who is not related to Mr. Frank.

Babcock's principal asset was a building which it leased to a related corporation. The cost of the land and building in 1958 was approximately \$140,000.00.

3. On November 29, 1972, Mr. Frank made gifts to three separate trusts of 13 shares each (6 2/3 percent of the shares of the corporation) and on January 3, 1973, made additional gifts to the same three trusts of 13 shares each. The trusts were for the benefit of petitioner Rose Frank; Linda J. Frank, petitioners' daughter; and Kenneth W. Frank, petitioners' son.

4. The three trust instruments are identical in terms. They name as trustee a party unrelated to the donor or beneficiary. The trustee is required to pay or apply net income to the beneficiary in such amounts and in such manner as he alone shall determine, and any income not paid or applied shall be added to capital:

"At the end of each calendar year during the life of the beneficiary, commencing with the year ended December 31, 1972, the Trustee shall accumulate the net income by adding and incorporating it into the capital of the trust estate and thereafter administering such net income as an integral part of the capital, provided, however, that the Trustee shall have power, in his absolute discretion, at any time or times during any year in the lifetime of the beneficiary, prior to the incorporation of that year's net income into capital, to utilize any or all of that year's net income by either paying or applying the same to the beneficiary, in such amounts as the Trustee may deem advisable, for the education, support and maintenance of the beneficiary, at such times, in such manner, as the Trustee may deem advisable..."

Since the inception of the trusts, all income earned has been paid or applied to the beneficiaries.

Upon the death of the donor, the trustee is required to pay out all income currently:

"Notwithstanding anything herein to the contrary, in the event the grantor shall die before the beneficiary, the Trustee shall pay all accumulations of income to the beneficiary, free of any trust whatsoever, and shall thereafter from time to time, but not less frequently than annually, distribute to the beneficiary all of the net income of the trust."

Distribution of the capital of the trust is to be made pursuant to a power of appointment, by will of the beneficiary, to the lineal descendants of the beneficiary:

"Upon the death of the beneficiary the Trustees shall pay over the trust estate, as it then exists, to such persons, and in such estates, interests, and proportions, as the beneficiary, in and by a will duly admitted to probate, and not otherwise, shall appoint; provided the beneficiary shall only appoint to or for the benefit of said beneficiary's children, grandchildren, or more remote issue."

5. Babcock's net after-tax earnings for the fiscal years ended November 30, 1968 through November 30, 1972 were as follows:

<u>FYE</u>	<u>NET EARNINGS</u>
11/30/68	\$13,146.00
11/30/69	14,825.00
11/30/70	13,292.00
11/30/71	15,706.00
11/30/72	10,537.00

In determining the value of the gift, Mr. Frank computed the five-year average earnings of Babcock and capitalized that figure at ten percent, for a per share value of \$675.00. He then estimated, by interpolation, the per share value on the gift dates at \$659.00. After application of a 30 percent discount factor, he arrived at a net market value of \$461.00 per share.

Mrs. Frank availed herself of the marital deduction with respect to the gift in trust to her, as provided in section 2523(e) of the Internal Revenue Code.

6. On January 8, 1976, the Audit Division issued a Notice of Deficiency to petitioner Leonard Frank, asserting taxes due under Article 26A, plus interest and late filing penalties, for the quarters ended December, 1972 and March, 1973, scheduled as follows:

<u>QUARTER ENDING</u>	<u>TAX</u>	<u>INTEREST</u>	<u>PENALTY</u>	<u>TOTAL</u>
12/72	\$ 559.93	\$122.41	\$139.98	\$ 822.32
3/73	744.87	149.23	186.22	1,080.32
	<u>\$1,304.80</u>	<u>\$271.64</u>	<u>\$326.20</u>	<u>\$1,902.64</u>

On January 8, 1976, the Audit Division issued a Notice of Deficiency to petitioner Rose Frank, asserting taxes due under Article 26A, plus interest and penalties, for the quarters ended December, 1972 and March, 1973, scheduled as follows:

<u>QUARTER ENDING</u>	<u>TAX</u>	<u>INTEREST</u>	<u>PENALTY</u>	<u>TOTAL</u>
12/72	\$279.97	\$ 61.21	\$ 69.99	\$411.17
3/73	279.96	56.09	69.99	406.04
	<u>\$559.93</u>	<u>\$117.30</u>	<u>\$139.98</u>	<u>\$817.21</u>

The Audit Division revalued the building at \$244,123.00, by multiplying the five-year average rental income (less repairs and taxes) for 1968 through 1972 by a factor of 8. The Division disallowed the discount applied for gifts of a minority interest. And further, the Division disallowed the marital deduction taken by Mrs. Frank.

7. At the hearing, counsel for the Audit Division conceded that prior to making the gifts in question, Mr. Frank was a minority shareholder in Babcock.

#### CONCLUSIONS OF LAW

A. That section 1009 of the Tax Law provides that the gift tax provisions of the Internal Revenue Code, as amended through December 31, 1971, shall apply to the determination of New York gift tax to the extent specified in Article 26A. Section 2512(a) of the Code provides that if a gift is made in property, the value thereof on the date of the gift shall be considered the amount of the gift.

B. That in valuing stock in the absence of sale and bid prices therefor, Federal gift tax regulations provide that the corporation's net worth, prospective earning power, dividend-paying capacity and other relevant factors are to be taken into consideration. Treas. Reg. Sec. 25.2512-2(f). With specific reference to closely-held real estate corporations, the value of the stock is deemed to be closely related to the value of the underlying assets. See Rev. Rul. 59-60, 1959-1 C.B. 237, as modified by Rev. Rul. 65-193, 1965-2 C.B. 370; Barton Theater Co., 40 T.C.M. 198 (1980).

C. That Mr. Frank's approach to valuing the gift is more appropriately applied to manufacturing or service corporations. See Matter of Clifford J. Lamb, State Tax Commission, October 3, 1980 [TSB-H-80(17)M]. Where a corporation owns and rents real property, the valuation method of preference refers to the



fair market value of such asset. Thus, the Audit Division's method, which capitalized average rents received, was proper.

D. That in valuing a minority interest in a close corporation, a discount is generally permitted, in recognition of the limited marketability of the shares and the inability of the holder to influence management. Rev. Rul. 59-60, supra; Estate of Heckscher, 63 T.C. 485 (1975); Estate of Grootemaat, 38 T.C.M. 198 (1979). As a result of the gifts, the beneficiaries of the trust in the instant case received minority interests in Babcock for which a 30 percent discount was permissible and appropriate.

E. That subdivision (f) of section 2523 of the Code allows a marital deduction with regard to the transfer by the donor of an interest in property to his spouse, provided that the spouse is entitled for life to all the income from the entire interest or from a specific portion of the entire interest, and further that she is granted the power to appoint the entire interest or the specific portion. The trust instrument herein does not entitle petitioner Rose Frank to all the income from the trust, but only to such amounts as the trustee in his discretion shall determine. Nor does the trust instrument grant to Mrs. Frank the full power to appoint to herself or to her estate. Consequently, petitioner Leonard Frank's gift to the trust for the benefit of Rose did not satisfy the requirements for the marital deduction, as set forth in Treas. Reg. Sec. 25.2523(e)-1(f) and (g).

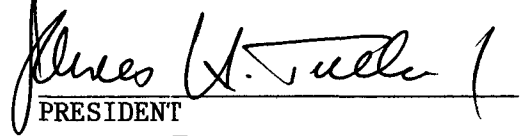
F. That the petition of Leonard and Rose Frank is granted to the extent indicated in Conclusion of Law "D"; that the notices of deficiency issued


January 8, 1976 are to be modified accordingly; and that except as so modified, the deficiencies are in all other respects sustained.

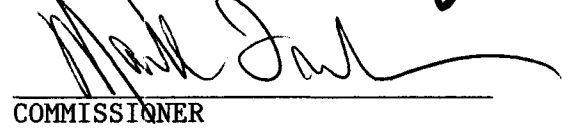
DATED: Albany, New York

APR 09 1982

STATE TAX COMMISSION

  
PRESIDENT

  
COMMISSIONER

  
COMMISSIONER