

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
Seymour Merberg : AFFIDAVIT OF MAILING
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 Quarter Ending :
6/30/77. :

State of New York
County of Albany

David Parchuck, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 11th day of February, 1983, he served the within notice of Decision by certified mail upon Seymour Merberg, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Seymour Merberg
977 Mercer Rd.
Baldwin, NY 11510

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
11th day of February, 1983.

David Parchuck

Annice A. Skuplinski

AUTHORIZED TO ADMINISTER
OATHS PURSUANT TO TAX LAW
SECTION 174

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
Sheila Merberg : AFFIDAVIT OF MAILING
for Redetermination of a Deficiency or a Revision :
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Article 26A of the Tax Law for the Quarter Ending :
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State of New York
County of Albany

David Parchuck, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 11th day of February, 1983, he served the within notice of Decision by certified mail upon Sheila Merberg, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Sheila Merberg
977 Mercer Rd.
Baldwin, NY 11510

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
11th day of February, 1983.

David Parchuck

James A. Hyslop

AUTHORIZED TO ADMINISTER
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SECTION 174

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6/30/77.

State of New York
County of Albany

David Parchuck, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 11th day of February, 1983, he served the within notice of Decision by certified mail upon Herbert Sitver the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Herbert Sitver
Brout & Company
380 Madison Ave.
New York, NY 10017

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
11th day of February, 1983.

David Parchuck

Annice A. Haglund

AUTHORIZED TO ADMINISTER
OATHS PURSUANT TO TAX LAW
SECTION 174

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition
of
Sheila Merberg

:

:

AFFIDAVIT OF MAILING

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 Quarter Ending :
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State of New York
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David Parchuck, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 11th day of February, 1983, he served the within notice of Decision by certified mail upon Herbert Sitver the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

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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
11th day of February, 1983.

David Parchuck

James A. Haglund

AUTHORIZED TO ADMINISTER
OATHS PURSUANT TO TAX LAW
SECTION 174

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

February 11, 1983

Seymour Merberg
977 Mercer Rd.
Baldwin, NY 11510

Dear Mr. Merberg:

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
Herbert Sitver
Brout & Company
380 Madison Ave.
New York, NY 10017
Taxing Bureau's Representative

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

February 11, 1983

Sheila Merberg
977 Mercer Rd.
Baldwin, NY 11510

Dear Ms. Merberg:

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
Herbert Sitver
Brout & Company
380 Madison Avenue
New York, NY 10017
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
SEYMOUR MERBERG :
for Redetermination of a Deficiency or for :
Refund of Gift Tax under Article 26-A of the :
Tax Law for the Quarter Ended June 30, 1977. :

DECISION

In the Matter of the Petition :
of :
SHEILA MERBERG :
for Redetermination of a Deficiency or for :
Refund of Gift Tax under Article 26-A of the :
Tax Law for the Quarter Ended June 30, 1977. :

Petitioners, Seymour Merberg and Sheila Merberg, 977 Marcel Road, Baldwin, New York 11510, filed a petition for redetermination of a deficiency or for refund of gift tax under Article 26-A of the Tax Law for the quarter ended June 30, 1977 (File Nos. 28686 & 28685).

A formal hearing was held before Arthur Bray, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on January 15, 1982 at 9:45 A.M. Petitioners appeared by Brout & Company (Herbert Sitver, CPA and Emanuel D. Tonelson, CPA). The Audit Division appeared by Paul B. Coburn, Esq. (Patricia L. Brumbaugh, Esq., of counsel).

ISSUE

Whether the Audit Division properly imposed additional gift tax due upon the transfer of shares of stock by petitioner Seymour Merberg to Merri Beth Merberg and to himself, as custodian for Gregg Noel Merberg.

FINDINGS OF FACT

1. On April 10, 1977 Seymour Merberg made a gift of the value of two and one-half shares of Tandem International, Inc. ("Tandem") to each of his children, Merri Beth Merberg and Gregg Noel Merberg. The gift to Gregg Noel Merberg was made under the New York Uniform Gifts to Minors Act.

2. Petitioners filed a New York State Quarterly Gift Tax Return for the quarter ending June, 1977. On this return petitioners consented to have the gift considered to have been made one-half by each of them and reported that the value of the stock transferred to each of their children was \$10,713.00. After subtracting the \$3,000.00 exclusion then in effect which was applicable to each petitioner, the total amount of the New York taxable gift was \$4,713.00. This resulted in a reported gift tax due of \$71.00.

3. On November 9, 1979 the Audit Division issued Notices of Deficiency to Seymour Merberg and Sheila Merberg based upon Statements of Audit Changes dated August 19, 1976. The amounts of the deficiencies of gift tax were determined by capitalizing at ten percent a weighted average of the income of Tandem for the years 1974 through 1977. This resulted in valuing each share of stock at \$47,353.80 and valuing the total gift to each child at \$118,384.50. Therefore, the split gift for each child, less the \$6,000.00 total of exemptions then in effect, was \$112,384.50. Consequently, the deficiency imposed against each petitioner was \$2,082.56 plus interest of \$413.22 for a total of \$2,495.87.

4. Prior to the making of the gifts mentioned above, Seymour Merberg owned five shares of Tandem. Two other individuals owned the remaining ten shares of Tandem. Tandem was a domestic international sales corporation ("DISC").

5. Tandem's assets as of June 30, 1977 consisted of working capital of \$3,831.00, trade receivables of \$51,275.00, and producer's notes due in five years of \$82,000.00. Tandem's total liabilities were \$19,099.00 and its stockholder's equity consisted of capital stock of \$2,550.00 and accumulated DISC income of \$115,457.00.

6. During the fiscal year ended June 30, 1977, Tandem had net income per its books of \$72,025.00 and distributed \$39,723.00 to its stockholders.

7. The only sources of income which Tandem had during the fiscal year ended June 30, 1977 were commissions on direct foreign sales of textile products of \$64,855.00 and interest on producer's loans of \$7,420.00. The commission income was received pursuant to a contract which Tandem had with Tandem Textile. These contracts were negotiated on a yearly basis and limited the amount of commission income which Tandem could earn to a maximum of four percent of sales. If the shares of Tandem were acquired by an individual not approved by Tandem Textile, the commission income of Tandem could be terminated by Tandem Textile. However, the same people who controlled Tandem Textile, controlled Tandem.

8. Tandem's taxable income during the three years prior to the gift was as follows:

| <u>Period Ending</u> | <u>Taxable Income</u> |
|----------------------|-----------------------|
| June 30, 1976 | \$85,639.00 |
| June 30, 1975 | \$63,020.00 |
| June 30, 1974 | \$22,653.00 |

9. As a DISC, one-half of Tandem's taxable income automatically "passed through " and was taxable to its shareholders regardless of whether a distribution of income was made.

CONCLUSIONS OF LAW

A. That, during the quarter in issue, Tax Law section 1009 provided that the gift tax provisions of the United States Internal Revenue Code of 1954, as amended through December 31, 1974, applied to the determination of the gift tax imposed by Article 26-A of the Tax Law.

B. That, in general, the value of property is the price at which such property would change hands between a willing buyer and a willing seller, neither being under a compulsion to buy or to sell, and both having reasonable knowledge of relevant facts. (Treas. Reg. §25.2512-1). "The value of stocks... is the fair market value per share on the date of the gift." (Treas. Reg. §25.2512.2). Since the fair market value of the Tandem shares cannot be determined from restrictive agreements or market transactions, reference to "intrinsic factors" is required. In Revenue Ruling 59-60, 1959-1 C.B. 237, the following factors, though not exclusive, were deemed fundamental:

"(a) The nature of the business and the history of the enterprise from its inception.

(b) The economic outlook in general and the condition and outlook of the specific industry in particular.

(c) The book value of the stock and the financial condition of the business.

(d) The earning capacity of the company.

(e) The dividend-paying capacity.

(f) Whether or not the enterprise has goodwill or other intangible value.

(g) Sales of the stock and the size of the block of stock to be valued.

(h) The market price of stocks of corporations engaged in the same or a similar line of business having their stocks actively traded in a free and open market either on an exchange or over-the-counter."

C. That the Audit Division properly utilized a weighted average of Tandem's prior earnings. Moreover, the Audit Division properly declined to take into account Tandem's after tax earnings since a DISC is not subject to

the Federal corporate income tax (Mertens, Law of Federal Income Taxation, Vol. 8, §45A-1.02). However, in view of the facts: that Tandem operated in the textile market; that Tandem's commission earnings were limited to four percent of sales; that Tandem's earnings were largely dependent upon a single contract which could be terminated; and that except for working capital, the corporation's assets consisted of producer notes due in five years, capitalizing earnings at a rate of twenty-five percent is appropriate.

D. That the Audit Division erred in failing to take into account the lack of a market for the stock and that only a minority interest was transferred. Accordingly, after capitalizing earnings at a rate of twenty-five percent, there should be a discount of thirty-three and one-third percent to take these factors into account.

E. That the petitions of Seymour Merberg and Sheila Merberg are granted to the extent of Conclusions of Law "D" and "E"; that the notices of deficiency dated November 9, 1979 are to be modified accordingly; and except as so modified, the asserted deficiencies are in all other respects sustained.

DATED: Albany, New York

FEB 11 1983

STATE TAX COMMISSION

Robert A. Schuch
ACTING PRESIDENT

Francis R. Koenig
COMMISSIONER

Mark J. [Signature]
COMMISSIONER