

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :

of

Edward L. Swan
and Helen H. Swan :

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 Year 1972. :

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 22nd day of April, 1983, he served the within notice of Decision by certified mail upon Edward L. Swan and Helen H. Swan the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Edward L. Swan
and Helen H. Swan
535 E. 19th St.
Brooklyn, NY 11226

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
22nd day of April, 1983.

David Parchuck

Samuel A. Hagelund

AUTHORIZED TO ADMINISTER
OATHS PURSUANT TO TAX LAW
SECTION 174

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
Edward L. Swan :
and Helen H. Swan :

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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 Year 1972. :

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 22nd day of April, 1983, he served the within notice of Decision by certified mail upon George Warhit the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

George Warhit
122 E. 42nd St.
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
22nd day of April, 1983.

David Parchuck

Anna R. Hagelberg

AUTHORIZED TO ADMINISTER
OATHS PURSUANT TO TAX LAW
SECTION 174

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

April 22, 1983

Edward L. Swan
and Helen H. Swan
535 E. 19th St.
Brooklyn, NY 11226

Dear Mr. & Mrs. Swan:

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
George Warhit
122 E. 42nd St.
New York, NY 10017
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petitions
of
EDWARD L. SWAN and HELEN H. SWAN
for Redetermination of a Deficiency or for
Refund of Gift Tax under Article 26-A of the
Tax Law for the Quarter Ending June 30, 1972.

DECISION

Petitioners, Edward L. Swan and Helen H. Swan, 535 East 19th Street, Brooklyn, New York 11226, filed petitions for redetermination of a deficiency or for refund of gift tax under Article 26-A of the Tax Law for the quarter ending June 30, 1972 (File Nos. 14259 and 14260).

A formal hearing was held before Archibald F. Robertson, Jr., Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on November 16, 1977 at 4:00 P.M. Petitioner appeared by George Warhit, Esq. The Audit Division appeared by Peter Crotty, Esq. (James J. Morris, Esq., of counsel).

ISSUES

I. Whether the Audit Division properly valued stock in closely-held corporations, the subject of the gift at issue, by reference to book value.

II. If the Audit Division used a proper method of valuation, whether book value should have been determined without consideration of earnings distributed to shareholders of the Subchapter S corporation prior to the date of the gift.

FINDINGS OF FACT

1. Prior to April 1, 1972, petitioner Edward L. Swan owned 250 of the 750 shares of common stock issued in William H. Swan & Sons, Inc., a Virginia ship-chandling corporation. Prior to that date, Mr. Swan also owned 540 shares

of the 1,620 issued shares of common stock in a New York ship-chandling corporation of the same name. The ownership of the shares of these corporations was equally divided between Mr. Swan, petitioner herein, and each of his two brothers. On April 1, 1972 said petitioner made a gift of his entire minority interest in each corporation to his son, Edward L. Swan, Jr., residing at 214 Linden Avenue, Westfield, New Jersey.

2. Mr. Swan filed a U.S. Quarterly Gift Tax Return (Form 709) in August, 1972 reporting the aforesaid gift which, since his spouse Helen H. Swan joined in the gift, reduced the amount of the taxable gift to \$41,900.00.

3. Mrs. Swan made a gift tax return (at the same time) reporting a similar gift. Copies of these federal returns were attached to petitioners' New York State Resident Quarterly Gift Tax Returns (MT-780) executed October 15, 1972, reporting a New York taxable gift of \$71,900, i.e., federal taxable gift of \$41,900 plus \$30,000, federal specific exemption. This resulted in a gift tax due from each donor of \$1,242.75. These taxes were paid with the returns filed.

4. Based upon appraisals for each corporation dated July 26, 1972 (discussed infra), petitioners utilized a value of \$340.00 per share for the Virginia corporation and \$120.00 per share for the New York corporation.

5. Both corporations were closely-held. John Swan was the only salaried officer of the Virginia corporation, and the petitioner-donor and the third brother, Harmanus Swan, were the only salaried officers of the New York corporation. In the five years before the gift at issue, John Swan earned a salary from the Virginia corporation in the following amounts:

<u>YEAR</u>	<u>SALARY</u>
1967	\$9,100.00
1968	9,100.00
1969	7,612.50
1970	4,550.00
1971	4,550.00

Edward and Harmanus Swan each earned \$9,100.00 annually. Petitioners maintain that Edward and Harmanus drew small salaries because the New York corporation was a Subchapter S corporation (and thus, they received additional income as shareholders).

6. The earnings of the New York corporation for the five years prior to 1972, the year of the gift, were as follows:

<u>YEAR</u>	<u>NET OPERATING PROFIT BEFORE TAXES</u>	<u>TAXES NORMALLY PAID ON PROFITS</u>	<u>NET PROFIT AFTER TAXES</u>
1967	\$86,800	\$35,100	\$51,700
1968	74,400	32,100	42,300
1969	71,100	30,300	40,800
1970	95,800	40,400	55,400
1971	93,300	38,200	55,100

The earnings of the Virginia corporation (which was not a Subchapter S corporation) for those years were as follows:

<u>YEAR</u>	<u>NET OPERATING PROFIT BEFORE TAXES</u>	<u>FEDERAL INCOME TAXES</u>	<u>NET PROFIT AFTER TAXES</u>
1967	\$ 50,000	\$17,500	\$32,500
1968	38,400	13,100	25,300
1969	63,300	25,700	37,600
1970	34,800	10,400	24,400
1971	108,900	45,200	63,700

7. The gift which was made by the donor to his son on April 1, 1972 was valued on the basis of the appraisers' (donor) report. In addition, the donor's son to whom the gift was made succeeded to the position of his father as a salaried officer of the New York corporation.

8. Petitioners' appraisers concluded that if realistic salaries had been paid to the officers, the profits of both corporations would have been nominal. The appraisers valued the stock in the New York corporation at \$120.00 per share and the stock in the Virginia corporation at \$340.00 per share on April 1, 1972. Though they claimed to have taken cognizance of the factors set forth in Revenue Ruling 59-60, 1959-1 C.B. 237, no analysis of the value attributed to each factor was ever submitted.

9. On December 26, 1971, a Statement of Audit Changes (MT-760) was issued to the donor advising that the Audit Division disagreed with the appraisals submitted and determined the value of the stock based on book value less a 5 percent discount for minority interest, i.e., \$293.30 per share less 5 percent discount, or \$278.63. The Virginia corporation showed a book value of \$719.61 per share less 5 percent discount, or \$683.63. The Statement of Audit Changes reflected an increase in the value of the shares of both corporations raising the taxable gifts from \$71,900.00 to \$157,683.85. The tax on the increased total was computed to be \$3,230.52, less payment of \$1,242.75 which had been made with the filing of the gift tax return, leaving \$1,987.77 plus interest accrued, additional tax due and owing.

10. The Audit Division computed the per share book value of stock in the New York corporation by adding capital stock of \$1,620.00, capital surplus of \$200,880.00 and shareholders' undistributed taxable income of \$272,659.00; and dividing the aggregate amount by the number of outstanding shares.

The undistributed taxable income was subsequently distributed to the shareholders between January 1 and March 15, 1972, as required by the provisions of the Internal Revenue Code, Subchapter S.

11. The Audit Division computed the per share book value of stock in the Virginia corporation by adding capital stock of \$110,500.00 and (unappropriated) retained earnings of \$464,709.00, subtracting therefrom cost of treasury stock of \$35,500.00 and dividing the result by the number of outstanding shares.¹

12. The aforesaid additional tax was asserted as a deficiency by Notice of Deficiency (MT-763) dated July 18, 1975, plus a penalty of \$484.58 and interest then accrued of \$345.09, totaling \$2,817.44.

13. The donor thereafter filed a timely petition for redetermination of deficiency (MT-770) October 15, 1975. The separate timely petition on behalf of donor's spouse, Helen H. Swan, duplicates that of her husband, since she had joined with her spouse in making the gift to their son.

14. Petitioners maintain that the books of the corporation reflected excessive profits because the shareholder principals, although working full time, had drawn unrealistically low salaries, resulting in excess surplus and that the certified appraisals support the values originally reported.

CONCLUSIONS OF LAW

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

B. That in valuing stock in the absence of sale and bid prices therefor, the corporation's net worth, prospective earning power, dividend-paying capacity

¹ Counsel for the Audit Division mistakenly stated at the hearing that the Division had not subtracted out the cost of treasury stock. This had in fact been done.

and other relevant factors are to be taken into consideration. Treas. Reg. Sec. 25.2512-2(f); Rev. Rul. 59-60, 1959-1 C.B. 237, as modified by Rev. Rul. 65-193, 1965-2 C.B. 370.

C. That the Audit Division properly rejected the appraisals relied upon by petitioners. Said appraisals presented conclusions rooted in general principles only and failed to provide a factual and financial analysis of the individual factors upon which the general conclusions were founded. By way of example, there is no formula in the reports for capitalizing the net earnings of the corporations. See Estate of Banac, 17 T.C. 748 (1951).

D. That the Audit Division erroneously and improperly included in its computation of the net worth (book value) of the New York corporation shareholders' undistributed taxable income, which income is required to be included in the gross income of the shareholders for their taxable year in which or with which the taxable year of the corporation ends. Internal Revenue Code section 1373(a) and (b); Treas. Reg. section 1.1373-1(a)(1).

E. 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 gift, petitioners' son received a minority interest in each corporation for which a 15 percent discount is permissible and appropriate. See Matter of Daniel E. Noonan and Patricia A. Noonan, State Tax Commission, June 7, 1977.

F. That aside from those adjustments made to the Audit Division's computations by Conclusions of Law "D" and "E", petitioners have failed to demonstrate that the Audit Division's method of valuation was erroneous or contrary to law,

especially inasmuch as several methods of valuation would have been permissible, and earnings or dividend-paying capacity may not have afforded as reliable a criterion as book value. Tax Law section 689(e), as made applicable to Article 26-A by section 1007(b); King v. United States, 545 F.2d 700 (10th Cir. 1976); Howell v. United States, 414 F.2d 45 (7th Cir. 1969); In Re Nathan's Estate, 166 F.2d 422 (9th Cir. 1948).

G. That the Audit Division is hereby directed to recompute the deficiencies, using a value per share of \$106.25 for the New York corporation and \$611.67 for the Virginia corporation.

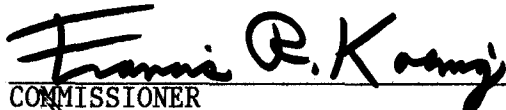
H. That the petitions of Edward L. Swan and Helen H. Swan are granted to the extent indicated in Conclusions of Law "D", "E" and "G"; that the notices of deficiency issued July 18, 1975 are to be modified accordingly; and that except as so modified, the deficiencies are in all other respects sustained.


DATED: Albany, New York

STATE TAX COMMISSION

APR 22 1983


PRESIDENT


COMMISSIONER


COMMISSIONER

TA-36 (9/76)

State of New York - Department of Taxation and Finance
Tax Appeals BureauREQUEST FOR BETTER ADDRESS

Requested by Tax Appeals Bureau Room 107 - Bldg. #9 State Campus Albany, New York 12227	Unit Tax Appeals Bureau Room 107 - Bldg. #9 State Campus Albany, New York 12227	Date of Request
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Please find most recent address of taxpayer described below; return to person named above.

Social Security Number	Date of Petition <i>Dec Formal</i> <i>4-22-83</i>
Name <i>SWAN, Edward L. & Helen H.</i>	
Address <i>535 E. 19th St.</i> <i>Brooklyn N.Y. 11226</i>	

Results of search by Files

<input type="checkbox"/> New address:	
<input type="checkbox"/> Same as above, no better address	
<input checked="" type="checkbox"/> Other:	<i>unclaimed</i>

Searched by <i>A. Haglund</i>	Section <i>Cal</i>	Date of Search <i>6-3-83</i>
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PERMANENT RECORDFOR INSERTION IN TAXPAYER'S FOLDER

TA 26 (9-79)

STATE OF NEW YORK

State Tax Commission

CLAIM CHECK
NO.

TAX APPEALS BUREAU

CAMPUS

J.Y. 12227

304231

☐ HOLD

DATE

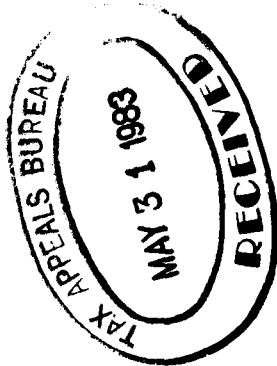
4-25

1ST NOTICE

2ND NOTICE

RETURN

Detached from
PS Form 3849
Oct. 1980



4-30
5-10

Edward L. Swan
and Helen H. Swan
535 E. 19th St.
Brooklyn, NY 11226

CERTIFIED
P 389 758 828

MAIL

ENCLOSURE

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

April 22, 1983

Edward L. Swan
and Helen H. Swan
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Law Bureau - Litigation Unit
Albany, New York 12227
Phone # (518) 457-2070

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative
George Warhit
122 E. 42nd St.
New York, NY 10017
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

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ISSUES

I. Whether the Audit Division properly valued stock in closely-held corporations, the subject of the gift at issue, by reference to book value.

II. If the Audit Division used a proper method of valuation, whether book value should have been determined without consideration of earnings distributed to shareholders of the Subchapter S corporation prior to the date of the gift.

FINDINGS OF FACT

1. Prior to April 1, 1972, petitioner Edward L. Swan owned 250 of the 750 shares of common stock issued in William H. Swan & Sons, Inc., a Virginia ship-chandling corporation. Prior to that date, Mr. Swan also owned 540 shares

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CONCLUSIONS OF LAW

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

B. That in valuing stock in the absence of sale and bid prices therefor, the corporation's net worth, prospective earning power, dividend-paying capacity

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D. That the Audit Division erroneously and improperly included in its computation of the net worth (book value) of the New York corporation shareholders' undistributed taxable income, which income is required to be included in the gross income of the shareholders for their taxable year in which or with which the taxable year of the corporation ends. Internal Revenue Code section 1373(a) and (b); Treas. Reg. section 1.1373-1(a)(1).

E. 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 gift, petitioners' son received a minority interest in each corporation for which a 15 percent discount is permissible and appropriate. See Matter of Daniel E. Noonan and Patricia A. Noonan, State Tax Commission, June 7, 1977.

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G. That the Audit Division is hereby directed to recompute the deficiencies, using a value per share of \$106.25 for the New York corporation and \$611.67 for the Virginia corporation.

H. That the petitions of Edward L. Swan and Helen H. Swan are granted to the extent indicated in Conclusions of Law "D", "E" and "G"; that the notices of deficiency issued July 18, 1975 are to be modified accordingly; and that except as so modified, the deficiencies are in all other respects sustained.


DATED: Albany, New York

STATE TAX COMMISSION

APR 22 1983


PRESIDENT


COMMISSIONER


COMMISSIONER