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MEMORANDUM

*Income Tax Determinations**A-2**Garlin, Ralph*

TO: **Commissioners Murphy, Palestin & Macduff**

FROM: **Solomon Sies, Hearing Officer**

SUBJECT: **RALPH GARLIN**

**Petition for a Redetermination of a Deficiency
or for Refund of Personal Income Taxes Under
Article 22 of the Tax Law for the Year 1962**

File No. 62-6156216

Case No. CC 1413

A formal hearing with reference to the above matter was held before me at 80 Centre Street, New York, New York on the 14th day of December, 1964. The appearances and the evidence produced were as shown in the stenographic minutes and exhibits submitted herewith.

The issue involved herein is whether the taxpayer is entitled to a modification reducing Federal adjusted gross income for Sub-chapter S income (Sections 1371 through 1377 of Internal Revenue Code) whereas Section 612 of the Tax Law applicable to a resident taxpayer makes no such provision for same.

The taxpayer is a shareholder in Fox Lumber Company Inc., a domestic corporation organized under the law of the State of New York, owning sixty shares of stock in said corporation. This corporation filed with the U.S. Internal Revenue Service on November 28, 1958, an election to be taxable under Sub-chapter S of the Internal Revenue Code. Its fiscal taxable year is from September 1st through August 31st. Under Sub-chapter S, a small business corporation is permitted to have its accumulated earnings and profits reduced to the extent that its undistributed taxable income for such year shall be required to be included in the gross income of the shareholders of such corporation.

The taxpayer, on his Federal Income Tax Return for the year 1962, reported undistributed dividends from Fox Lumber Company Inc., under Sub-chapter S, \$8279.97 and deducted this sum from his New York adjusted gross income. The Income Tax Bureau issued a statement of audit changes and notice of deficiency including this income as taxable income of the taxpayer for the year 1962.

The taxpayer contends that Section 612 of the Tax Law violates Article XVI, Section 3 of the New York State Constitution which provides that "Undistributed profits shall not be taxable". However, Section 22, Article III, (as amended vote of the people, November 3, 1959) provides in part as follows:

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RE: RALPH GARLIN

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"Notwithstanding the foregoing or any other provision of this constitution, the legislature, in any law imposing a tax or taxes on, in respect to or measured by income, may define the income on, in respect to or by which such tax or taxes are imposed or measured, by reference to any provision of the laws of the United States as the same may be or become effective at any time or from time to time, any may prescribe exceptions or modifications to any such provision."

It is to be noted that Section 632 (4) (A) provides that Sub-chapter S income of a non-resident taxpayer shall not constitute income or gain derived from New York sources.

I am, therefore, of the opinion that the omission in Section 612 of the Tax Law, applicable to a resident taxpayer, to provide for a modification of Sub-chapter S income is not in violation of any of the Provisions of the New York State Constitution, and that Section 3 Article XVI is superseded by Section 22, Article III of the State Constitution.

For the reasons stated above, I recommend that the determination of the Tax Commission in the above matter be substantially in the form submitted herewith.

JUL 2 - 1965

SOLOMON SIES

Hearing Officer

/s/ **MARTIN SCHAPIRO**

Approved

/s/ **E. H. BEST**

Approved

SS/te (10/25/65)

STATE OF NEW YORK

STATE TAX COMMISSION

IN THE MATTER OF THE PETITION

OF

RALPH GARLIN

FOR A REDETERMINATION OF A DEFICIENCY
OR FOR REFUND OF PERSONAL INCOME TAXES
UNDER ARTICLE 22 OF THE TAX LAW FOR
THE YEAR 1962.

Case No. CC 1413

Ralph Garlin, having duly filed a petition for a redetermination of a deficiency of personal income taxes for the year 1962 (File No. 62-6195216), and a hearing having been held in connection therewith at the office of the State Tax Commission, 80 Centre Street, New York, N.Y., before Solomon Sica, Hearing Officer of the Department of Taxation and Finance on December 14, 1964 at which hearing the taxpayer appeared personally and was represented by Isidore Feldman, CPA, testimony having been taken and the matter having been duly examined and considered,

The State Tax Commission hereby finds:

(1) That the taxpayer, a resident, filed a New York State Income Tax Return for the year 1962 in which he subtracted from income reported on his Federal return Sub-chapter S income in the sum of \$8,279.97; that on July 1, 1963 the Department of Taxation and Finance issued a statement of audit changes to include the aforementioned Sub-chapter S income as additional income subject to tax and issued a notice of deficiency in accordance therewith.

(2) That at all of the times hereinafter mentioned, the taxpayer was and still is a shareholder in Fox Lumber Company, Inc., a domestic corporation organized under the laws of the State of New York, maintaining its sole place of business within the state of New York; that the taxpayer was and still is the owner of 60 shares or 30% of the stock in said corporation; that on November 26, 1958, Fox Lumber Company Inc., filed a Form 2793 (Election by Small Business Corporations as to Taxable Status Under Sub-chapter S of the Internal

Revenue Code) with the United States Treasury Department, Internal Revenue Service: to be effective for the taxable year beginning September 1st, 1958 through August 31st, 1959; that such election was in effect for the period, September 1st, 1961 through August 31st, 1962 and is still in effect; that during the year 1962 the taxpayer received from Fox Lumber Company Inc., the sum of \$8,279.97 as undistributed shareholder's earnings in accordance with Sub-chapter S, Sections 1371 through 1377 of the Internal Revenue Code which permits the accumulated earnings and profits of an electing small business corporation as of the close of its taxable year to be reduced to the extent that its undistributed taxable income for such year is required to be included in the gross income of the shareholders of such corporation.

(3) That although the taxpayer contends that Section 612 of the Tax Law, which does not permit a modification of Sub-chapter S income, is violative of Article XVI, Section 3 of the New York State Constitution which provides in part that: "Undistributed profits shall not be taxable", Section 22, Article III, (as amended, by vote of the people, November 3, 1959) provides in part as follows:

"Notwithstanding the foregoing or any other provision of this constitution, the legislature, in any law imposing a tax or taxes on, in respect to or measured by income, may define the income on, in respect to or by which such tax or taxes are imposed or measured, by reference to any provision of the laws of the United States as the same may be or become effective at any time or from time to time, and may prescribe exceptions or modifications to any such provision."

Based upon the foregoing findings, the State Tax Commission hereby

DETERMINES AND DECIDES:

(A) That the taxpayer's undistributable shareholder's earnings from Fox Lumber Company Inc., in the sum of \$8,279.97 for the year 1962 was properly includable in his New York adjusted gross income for said year and therefore taxable in accordance with Section 612, Article 22 of the Tax Law.

(B) That, accordingly, the audit changes and notice of

deficiency issued for the year 1962 are correct and are hereby sustained; that the same does not contain any tax or other charges which could not have been lawfully demanded and that the taxpayer's petition for a redetermination of a deficiency of personal income taxes for the year 1962 be and the same is hereby dismissed.

DATED: Albany, New York on the 19th day of November, 1965.

STATE TAX COMMISSION

/s/

JOSEPH H. MURPHY

President

/s/

IRA J. PALESTIN

Commissioner

/s/

JAMES R. MACDUFF

Commissioner