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MEMORANDUM

Income Tax Determinations
McBride, Joseph A.
A-2

TO: Commissioners Murphy and Macduff

FROM: E. H. Best, Counsel

SUBJECT: Joseph A. McBride, petition for a redetermination of a deficiency or for refund of personal income taxes under Article 22 of the Tax Law for the year 1960

On November 22, 1965 a hearing was held at 80 Centre Street, New York, New York. Taxpayer and his representative, Gerald J. Morrissey, C.P.A. appeared.

The issues involved herein are:

(1) Allocation of a nonresident's income earned within and without the State prior to retirement (2) Allocation of a nonresident's severance pay, and (3) Whether a nonresident taxpayer's income from his employer, following his retirement, constituted allocable severance pay.

Taxpayer, a resident of New Jersey, was employed by Buell Engineering Co., Inc. at 123 William Street, New York City, in 1938 and retired on March 9, 1960, at which time he was president of the corporation. His salary of \$18,500 per annum was continued to June 30, 1960. As of June 30, 1960 a written agreement was executed by Buell and the taxpayer whereby the employer agreed to pay him certain salaries from July 1, 1960 to June 30, 1965, in monthly installments, for "advisory and consultative services" and a pension for life thereafter. Taxpayer also agreed to refrain from "activity damaging to Buell's business or reputation or in any business competitive with any business of Buell."

During 1960, the taxpayer received \$30,338.41 from Buell. Of this sum, \$9,000 was paid pursuant to the agreement, between July 1, 1960 and December 31, 1960; \$12,088.41 was paid on August 24, 1960, for commissions earned on sales for the fiscal year ended June 30, 1960; and \$9,250 was paid in salary for the 6 months ended June 30, 1960.

Taxpayer filed a nonresident return for 1960 allocating \$4,334.06 to New York, based on 33 days worked in New York (between January 1, 1960 and March 9, 1960) and 198 days worked out of State.

Audit changes issued April 13, 1964 recomputed taxpayer's New York income as \$30,338.41, based on failure of taxpayer to substantiate that any days had been spent in work out of the State, and including all payments received after March 9, 1960 as severance pay.

Taxpayer contends that his New York income should be computed as follows:

That of the 48 working days between January 1, 1960 and March 9, 1960, the day of his retirement, only 31 days were worked in New York, and that his salary earned during that period (\$3,997.86) should be so allocated at 64%. That the commissions paid for the fiscal year ended June 30, 1960, earned during the years 1959 and 1960, should be allocated on the basis reported on his returns for 1959 and 1960 at 63 1/4%.

That the balance of his salary paid to him for the period March 10, 1960 to June 30, 1960 (\$5,638.74) was severance pay and should be allocated on the basis reported on his returns for 1957, 1959 and 1960 at 66 1/4%.

That the sum of \$9,000 paid to taxpayer during the second half of 1960, pursuant to the agreement with Buell, dated June 30, 1960, should be completely excluded on the ground that the same was not income from New York sources.

Taxpayer's allocations for 1957 and 1959 taken together average 66%, consistent with the reported 64% for 1960 and the 67% average for the three years, and were accepted by the Bureau for the years 1957 and 1959. The differences are minimal and for the years involved result in an allocation of two-thirds. An allocation of two-thirds of the taxpayer's 1960 income would accurately reflect the portion attributable to New York sources.

Taxpayer errs, however, in excluding all of the salary paid to him from July 1, 1960 to December 31, 1960. At no time during 1960 did he ever render any service pursuant to the so-called consultation contract with his employer. Nor does it appear that any services were expected of him. He did not communicate with his employer except that he "called them up to see where my check was, something like that" and they never contacted him. In answer to an inquiry by the Income Tax Bureau, as to the nature of the payments received

from Buell, pursuant to the agreement dated June 30, 1960, the taxpayer replied by letter dated February 17, 1964 that "the money I received from Buell Engineering during 1961 was 'severance pay'. You just stay home and hunt for a job ever 60."

Taxpayer also contends that payments made pursuant to the agreement dated June 30, 1960 were consideration for his refraining from accepting employment with competitors of Buell. As evidence he submits a telegram, apparently dated 1964, sent to him by V. C. Allen, which states "Regarding your telegram call your attention to paragraph seven of agreement if liquidation in anyway competitive to Buell's business or reputation it would appear to be in violation and company cannot consent thereto." The telegram, at best, is an equivocal statement of opinion, and paragraph seven of the agreement refers not only to competitive business but to "activity damaging to Buell's business or reputation" and to this extent the meaning of the agreement is not sufficiently clear, nor does the agreement furnish any indication of what part of the payments, if any, are attributable to paragraph seven.

Nevertheless, were such payments, or any part of them, held to be consideration for taxpayer's refraining from competitive business activities pursuant to the covenant the result would be the same, the income being derived from the same sources and allocable in the same proportions.

A similar situation was involved in Korfund, 1 TC 1180, Docket No. 110007, where it was held that the source of income earned for refraining from an activity was the place where the covenant was to be observed. Here, the McBride's negative agreement could only be effective where he had previously been active, and his covenant applicable in the same manner, negatively. His income must be allocated to the same sources, in the same proportion.

I am of the opinion that the payment of \$9,000 received in 1960 by the taxpayer, pursuant to the agreement by him and his employer, dated June 30, 1960, was severance pay, and subject to allocation; that the allocation of the taxpayer's income should be modified by allocating two-thirds of the total received by him in 1960, resulting in New York income of \$20,223.60.

For the reasons stated above, the determination of the State Tax Commission should be substantially in the form submitted herewith.

/s/

E. H. BEST

Counsel

October 11, 1966

AR:cp

Enc. *AA*

(Oct. 17, 1966)

**STATE OF NEW YORK
STATE TAX COMMISSION**

IN THE MATTER OF THE PETITION

OF

JOSEPH A. MCBRIDE

**FOR A REDETERMINATION OF A DEFICIENCY
OR FOR REFUND OF PERSONAL INCOME TAXES
UNDER ARTICLE 22 OF THE TAX LAW FOR THE
YEAR 1960**

Joseph A. McBride having filed a petition for a redetermination of a deficiency or for refund of personal income taxes under Article 22 of the Tax Law for the year 1960 (File No. C-4577973), and a hearing having been held on November 22, 1965 at 80 Centre Street, New York, New York, at which the taxpayer appeared with his representative, Gerald J. Morrissey, C.P.A., and the matter having been duly examined and considered,

The State Tax Commission hereby finds:

(1) That Joseph A. McBride filed a nonresident income tax return for 1960 on which he reported New York income of \$4,334.06 as allocated out of total compensation of \$30,338.41 paid to him by Buell Engineering Co., Inc., and claimed overpayment of New York income tax of \$37.80; that of the total compensation received by him \$9,250 was paid, as salary, during the six months ended June 30, 1960, at the rate of \$18,500 per year, \$12,088.41 was paid to him as over-ride commissions for the fiscal year ended June 30, 1960, and the balance, \$9,000, was paid to him pursuant to a written agreement dated June 30, 1960.

(2) That by notice of deficiency and statement of audit

changes dated April 13, 1964 the Income Tax Bureau recomputed taxpayer's New York income at \$30,338.41, finding a deficiency of taxes and interest due in the sum of \$2,232.77, by disallowing any allocation for days worked outside the State as to his salary and over-ride commissions, and including in his New York income the \$9,000 received pursuant to the agreement of June 30, 1960 on the ground that such payment constituted severance pay, in consideration of past services.

(3) That the taxpayer was employed by Buell Engineering Co., Inc. from 1938 to 1960 when he retired as president; that on the taxpayer's retirement on March 9, 1960 his salary was continued to June 30, 1960 by which date he had received the sum of \$9,250, and at which time an agreement was made between taxpayer and his employer containing a provision for payment to taxpayer of certain sums for consultation services and a covenant by taxpayer not to compete in business; that pursuant to the said agreement taxpayer was paid \$9,000 during 1960; and that on August 24, 1960 taxpayer received \$12,088.41 as and for over-ride commissions on sales made between July 1, 1959 and June 30, 1960.

(4) That taxpayer never rendered any consultation services or any other services to his employer after March 9, 1960, pursuant to the written agreement, or otherwise; that from January 1, 1960 to March 9, 1960 taxpayer earned salary of \$3,997.26; that payments received by the taxpayer between March 9, 1960 and June 30, 1960 in the sum of \$5,652.74 and \$9,000 received between June 30, 1960 and December 31, 1960, pursuant to the agreement were severance pay and compensation for past services; that the sum of \$12,088.41 paid to the taxpayer on August 24, 1960, as and for over-ride

commissions was based on sales made during the employer's fiscal year July 1, 1959 to June 30, 1960.

(5) That during 1960, prior to his retirement, the taxpayer worked 48 days of which 33 days were worked in New York; that in 1959 the taxpayer worked 230 days of which 158 days were worked in New York, as stated on his return for that year filed with the Income Tax Bureau; that in 1957 the taxpayer worked 171 days of which 130 days were worked in New York, as stated on his return for that year filed with the Income Tax Bureau.

Based upon the foregoing findings and all of the evidence presented herein, the State Tax Commission hereby

DECIDES:

(A) That during 1960 the total income of the taxpayer from sources within and without the State was in the amount of \$30,338.41; of this amount, \$9,000, paid to taxpayer in 1960 by his employer, pursuant to a written agreement dated June 30, 1960 was not remuneration for consultation services rendered without the State, but deferred compensation for past services, as set forth in finding (4) herein above.

(B) That two-thirds of taxpayer's total income for 1960 was allocable to New York sources by virtue of the facts as set forth in finding (5) herein above and that portion, if any, of taxpayer's income attributable to the covenant not to compete, set forth in finding (3) above, as compensation therefore is allocable as income from sources within and without the state in the same proportion.

(C) That the notice of deficiency and statement of audit changes issued April 13, 1964 be and hereby is modified and the taxpayer's income for 1960 recomputed as follows:

| | | | |
|-----------------------------------|---------------|--------------|------------------|
| Total Income | | \$ | 10,118.41 |
| Less: 1/3 out-of-state | | | <u>10,112.81</u> |
| New York Income | | | 20,225.60 |
| Less: Standard Deduction | | | <u>1,000.00</u> |
| | | | 19,225.60 |
| Less: Exemption | | | <u>1,200.00</u> |
| New York Taxable Income, Adjusted | | | 18,025.60 |
| Tax on Adjusted Income | 1,162.96 | | |
| Less: Statutory Credit | <u>25.00</u> | | |
| | 1,137.96 | | |
| Less: 10% Reduction | <u>113.79</u> | | |
| Personal Income Tax Due | 1,024.17 | | |
| Tax Withheld | 79.20 | | |
| Less: Refund | | | |
| #9774678 | 32.82 | <u>46.38</u> | 982.40 |
| Interest | | | 174.60 |
| TOTAL | | \$ | 1,199.00 |

(D) That, accordingly, the notice of a deficiency and statement of audit changes are hereby corrected and modified in accordance with paragraph (C) above, and as so modified, affirmed, together with additional interest and other lawful statutory charges; that the petition of the taxpayer for reconsideration of a deficiency or for refund of personal income taxes under Article 22 of the Tax Law for the year 1960, except to the extent granted herein, be and the same hereby is denied.

DATED: Albany, New York, the 21st day of October, 1966.

STATE TAX COMMISSION

/s/

JOSEPH H. MURPHY

PRESIDENT

/s/

JAMES R. MACDUFF

COMMISSIONER