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Income Tax Determinations A-Z

BUREAU OF LAW

MEMORANDUM Kastor, Margaret R. & Robert N.

x-ref Unincorp. Bus. Tax Determin. A-Z

TO: Commissioners Murphy, Macduff and Conlon

FROM: Solomon Sies, Hearing Officer

SUBJECT; ROBERT N. KASTOR
1955 Assessment No. B-463646
1956 Assessment No. B-748870
Articles 16 and 16-A

MARGARET L. KASTOR
1955 Assessment No. B-464645
1956 Assessment No. B-761516

Article 16

A combined hearing in the matters of Robert N. Kastor and Margaret L. Kastor who are husband and wife but filed separate non-resident tax returns for the years in issue, was held before me at 80 Centre Street, New York, on February 14, 1964. The appearances and the evidence produced were as shown in the stenographic minutes submitted herewith.

The issues involved herein are: (1) whether certain income received by the taxpayers from Gartman, Rose & Co., a New York limited partnership, is taxable as a distributive share of partnership income attributable to sources within the state in accordance with Section 351-a of the Tax Law or whether the aforementioned income constituted interest received by non-resident taxpayers exempt from inclusion of gross income attributable to New York sources in accordance with subdivision 3, §359 of the Tax Law; and (2) the disallowance of a portion of entertainment expenses of the taxpayer Robert N. Kastor for the years in issue.

On December 23, 1953, Mortimer J. Gartman, Charles Rose, Leo J. Goldwater, Daniel Cowin and Margaret L. Kastor entered into a limited partnership agreement pursuant to Article 8 of the New York Partnership Law to carry on a general brokerage and commission business, including the buying, holding and selling for the account of the partnership and others, of stocks, bonds, other securities, commodities, investments and other properties with its sole place of business located in the City of New York. Pursuant to said agreement Margaret L. Kastor was the only limited partner and contributed to the capital of the co-partnership the sum of $150,000.00

in cash. On December 20, 1954, an agreement was entered into modifying the aforementioned partnership agreement and admitting Arthur A. Burkhart as an additional general partner. On June 23, 1955, an agreement was entered into further modifying the partnership agreements of December 23, 1953 and December 20, 1954 and admitting Robert N. Kastor as an additional limited partner.

Pursuant to the latter agreement, Margaret L. Kastor, as a limited partner, contributed the sum of $110,000.00 in cash and Robert N. Kastor as limited partner contributed the sum of $80,000.00 in cash to the capital of the co-partnership. Margaret L. Kastor and Robert N. Kastor were not to be liable for any obligations or losses of the partnership beyond the amount of their capital contributions. In accordance with the provisions of the co-partnership agreements, the taxpayers, as limited partners, were to receive 6% per annum on their capital contributions payable at the end of every partnership year, whether or not there are net earnings sufficient to pay the same. The partnership agreements further provided that if there are net earnings of the partnership, after all payments and provisions for reserves as mentioned therein, there was to be paid the taxpayer Margaret L. Kastor "an amount equal to 2 1/2% of such net earnings, payable at the end of every partnership year".

Article "13" of the partnership agreement of June 23, 1955 provides in part as follows:

> "13. <u>Distribution of Assets.</u> Upon dissolution and termination of the partnership or the withdrawal, death, or insanity of any partner, a final audit and settlement shall be made and the obligations and interests of the respective partners shall be fixed and determined. Proper reserves shall be provided for estimated losses and liabilities, including taxes assessable against the partnership, and all partnership obligations shall be satisfied and discharged or provided for, before any assets are distributed to any of the partners."

The taxpayer, Margaret L. Kastor reported on her non-resident returns for 1955 and 1956 partnership income received from Gartman, Rose & Co., in the sums of $10,500.00 and $8,819.52, respectively but deducted therefrom $2,400.00 for each of said years on the ground that said sums represented "interest paid on loans" to said partnership. The Income Tax Bureau made additional assessments on the basis of the distributive share to her of partnership income as shown on said partnership returns of Gartman, Rose & Co. including the so-called "interest." However, for the year 1955, the Income Tax Bureau allowed this taxpayer a deduction of $2,600.00 (which apparently includes $2,400.00 interest plus $200.00 contributions) whereas she was only entitled to a deduction of $200.00/

The taxpayer, Robert N. Kastor on his non-resident returns for 1955 and 1956, in addition to reporting compensation as an employee of Rotfak, Corp., New York City, also reported income consisting of trading commissions. It appears that the aforementioned taxpayer during said years was engaged as an independent stock broker. In connection with said operations he claimed business expenses of $5,930.00 for the year 1955 and $5,440.68 of which $4,000.00 and $3,000.00 respectively, represented entertainment expenses. The Income Tax Bureau disallowed a portion of said expenses in the sum of $1,000.00 for each of said years, imposed additional normal tax to include distributive share of partnership income as shown on the New York partnership returns filed by Gartman, Rose & Co. for years 1954 and 1955, not included by said taxpayer on his non-resident returns. In addition, the Income Tax Bureau imposed unincorporated business taxes for said years on ground that taxpayer's activities constituted an unincorporated business subject to tax pursuant to Article 16-A of the Tax Law. The taxpayer Robert N. Kastor is not contesting the assessments in so far as they relate to unincorporated business taxes except as they affect a portion of the disallowed business expenses.

No evidence was submitted at the hearing in connection with the business expenses, but the attorney indicated that he would submit additional information after the hearing. The attorney submitted a letter dated April 7, 1965 stating that "documentation of the taxpayer's expenses is not available for the years in question." He also submitted a letter from the accountant for the taxpayer to the effect that the Internal Revenue Service examined the returns of the taxpayer for the years in question and allowed such expenses.

The taxpayers contend that the capital contributions advanced by them to the co-partnership represented loans and that the income which they received from the co-partnership was in the nature of interest so that as non-residents this income is exempt from tax in accordance with subdivision 3, §359 of the Tax Law. In addition, the taxpayers further contend that the facts in this case are similar to that in the case of Shearson, Hammill & Co. v. State Tax Commission, 19 A.D. 2d 245, 241 N.Y.S. 2d 764, aff'd. without opinion 15 N.Y. 2d 608.

In the Shearson, Hammill case (supra), the partnership agreements with respect to the securities in both "capital accounts" and "personal accounts" provided that all profits, losses, income and charges in connection therewith were not to be deemed partnership income or expenses. In the instant cases, the capital contributions of the taxpayers as limited partners were subordinated to the rights of general creditors to the extent of such capital contributions and were, therefore, subject to risk of loss.

In the case of Chapman v. Browne, 268 App. Div. 886, 48 N.Y.S. 2d 598, the taxpayer contributed $100,000.00 to the capital of the co-partnership and received 6% interest on such contribution plus an additional percentage if net earnings exceeded a certain amount. The court in that case held that although the taxpayer was a non-resident limited partner, her income from a New York partnership was taxable to the extent that it was derived from partnership business carried on within the State of New York notwithstanding the fact that she did not personally participate in the management of the co-partnership.

In the case of Cromwell v. Bates, 284 App. Div. 1081, leave to appeal denied, 308 N.Y. 1053, where the partnership agreement provided that the "investment of special capital" should be liable for all debts of the partnership and that there should be no personal liability on the part of any of the partners to repay it, it was held that payments made to the limited partners were subject to tax since the investment of special capital was subordinated to the rights of general creditors and subject to risk of loss.

I am of the opinion that the income which the taxpayer received on the New York partnership of Gartman, Rose & Co. was properly taxable to the extent that it was derived from partnership business carried on within the State of New York notwithstanding the fact that the taxpayers who are non-residents did not personally participate in the management of the partnership business in accordance with §351a of the Tax Law.

With respect to the disallowing of a portion of the business expenses of the taxpayer, Robert N. Kastor, since the taxpayer failed

To: Commissioners Murphy, Macduff and Conlon
Re: Robert N. Kastor and Margaret L. Kastor
continued

to substantiate said expenses and further failed to submit proof that the same were ordinary and necessary in connection with said business, I am of the opinion that the Income Tax Bureau properly disallowed the same.

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

/s/ SOLOMON SIES
HEARING OFFICER

/s/ MARTIN SCHAPIRO
Approved:

/s/ SAUL HECKELMAN
Approved

10-10-67

SS:nbl

STATE OF NEW YORK

STATE TAX COMMISSION

IN THE MATTER OF THE APPLICATION

OF

ROBERT S. KASTOR

FOR REVISION OR REFUND OF PERSONAL INCOME TAXES UNDER ARTICLE 16 AND UNINCORPORATED BUSINESS TAXES UNDER ARTICLE 16A OF THE TAX LAW FOR THE YEARS 1955 and 1956.

The taxpayer, Robert S. Kastor, having filed applications for revision or refund of personal income taxes under Article 16 and unincorporated business taxes under Article 16-A of the Tax Law for the years 1955 and 1956 and a hearing having been held in connection therewith at the Office of the State Tax Commission at 80 Centre Street, New York, N. Y. on the 14th day of February, 1964, before Solomon Sies, Hearing Officer of the Department of Taxation and Finance, at which hearing the taxpayer appeared personally and was represented by Greenbaum, Wolff & Ernst, Esqs., by Maurice C. Greenbaum, Esq., Of Counsel, testimony having been taken and the matter having been duly examined and considered,

The State Tax Commission hereby finds:

(1) That at all of the times hereinafter mentioned the taxpayer, Robert S. Kastor was and still is a resident of the State of New Jersey; that the taxpayer filed non-resident income tax returns for the years 1955 and 1956 in which he reported salary compensation from Rotfak Corp., New York City, and in addition, trading commissions as an independent broker; that the taxpayer deducted as business expenses the sums of $5,930.00 and $5,480.68 for the years 1955 and 1956, of which $4,000.00 and $3,000.00

represented entertainment and travelling expenses; that on August 27, 1958 and on February 29, 1960, the Department of Taxation and Finance made additional assessments against the taxpayer for the years 1955 and 1956 (Assessment #B-463646 and B-748870, respectively) disallowing $1,000.00 of the amount claimed for entertainment expenses for each of the said years on the ground that it was excessive and personal and that a portion of same represented home entertainment which is considered primarily a personal expense and further adjusted the taxpayer's taxes for said years to include the distributive share of income received from the New York partnership of Gartman, Rose and Co. as set forth in said partnership returns but which was not reported by the taxpayer on his non-resident returns; that in addition, the independent brokerage commissions reported by the taxpayer were held to constitute the carrying on of an unincorporated business subject to unincorporated business, Article 16-A of the Tax Law; that the taxpayer is not contesting that portion of the assessment insofar as it relates to unincorporated business tax except only as it affects a portion of the above mentioned disallowed business expenses.

(2) That on December 23, 1953, Mortimer S. Gartman, Charles Rose, Leo J. Goldwater, Daniel Cowin and Margaret L. Mastor entered into a limited partnership agreement pursuant to Article 8 of the New York Partnership Law to carry on a general brokerage and commission business, including the buying, holding and selling for the account of the partnership and others, of stocks, bonds, other securities, commodities, investments and other properties with its sole place of business located in the City of New York; that

pursuant to said agreement Margaret L. Kastor was the only limited partner and contributed to the capital of the co-partnership the sum of $150,000.00 in cash; that on December 20, 1954, an agreement was entered into modifying the aforementioned partnership agreement and admitting Arthur A. Burkhart as an additional general partner; that on June 23, 1955, an agreement was entered into further modifying the partnership agreements of December 23, 1953, and December 20, 1954 and admitting Robert H. Kastor as an additional limited partner; that pursuant to the latter agreement Margaret L. Kastor as limited partner contributed the sum of $110,000.00 in cash and Robert H. Kastor as limited partner contributed the sum of $90,000.00 in cash to the capital of the co-partnership.

(3) That pursuant to the provisions of the partnership agreements, as last modified on June 23, 1955 and in effect during the years in issue, the limited partners, Margaret L. Kastor and Robert H. Kastor, were not to be liable for any obligations or losses of the partnership beyond the amount of their capital contributions; that Article "5" of the partnership agreement dated June 23, 1955 provides, in part, as follows:

> "5. <u>Interest and additional compensation</u>. Each partner shall be paid amounts, which shall be charged as expenses in the partnership business, in the following order of priority
>
> (a) ARTHUR A. BURKHART * * * *
>
> (b) MARGARET L. KASTOR and ROBERT H. KASTOR: 6% per annum on their capital contributions payable at the end of every partnership year, whether or not there are net earnings sufficient to pay the same. * * * ";

(4) That Article "13" of the aforementioned co-partnership agreement provides, in part, as follows:

> "13. <u>Distributions of Assets</u>. Upon dissolution and termination of the partnership or the withdrawal,

death, or insanity of any partner, a final audit and settlement shall be made and the obligations and interests of the respective partners shall be fixed and determined. Proper reserves shall be provided for estimated losses and liabilities, including taxes assessable against the partnership, and all partnership obligations shall be satisfied and discharged or provided for, before any assets are distributed to any of the partners."

(5) That although the taxpayer contends that the capital contribution to the partnership was in the nature of a loan and that 6% represented interest on said loan which is exempt from taxation by the State of New York to a non-resident, such contention is contra to the provisions contained in the partnership agreements and the evidence adduced at the hearing; that the monies advanced by the taxpayer to the co-partnership did not constitute a bona-fide loan but rather constituted an investment of partnership capital; that the taxpayer's investment of capital in the co-partnership was subordinate to the rights of the general creditors of the co-partnership to the extent of such capital investment and subject to risk of loss.

(6) That the taxpayer failed to substantiate by proof or evidence the travel and entertainment expenses claimed by him on his income tax returns for the years 1955 and 1956, and further failed to submit any evidence or proof that that portion of entertainment expenses which was disallowed on the assessments for the years in issue were ordinary and necessary in the conduct of the business.

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

DETERMINES:

(A) That the capital investment of the taxpayer in the New York partnership firm of Gartman, Rose & Co. did not constitute a loan or debtor-creditor relationship but constituted a capital investment in such co-partnership subordinate to the rights of the general creditors of such co-partnership to the extent of such contribution as more fully set forth in finding (5) above; that the income of the taxpayer, a nonresident limited partner received from the New York partnership firm of Gartman, Rose & Co. was taxable to the extent that it was derived from partnership business carried on within the State of New York within the intent and meaning of §351-a of the Tax Law.

(B) That the disallowance of a portion of business expenses in the sum of $1,000.00 for each of the years 1955 and 1956 was proper as more fully set forth in Finding (6) above in accordance with subdivision 1, §360 of the Tax Law.

(C) That accordingly, the additional assessments made against the taxpayer for the years 1955 and 1956 (assessment Nos. B-463646 and B-748070, respectively) are correct; that said assessments do not include any taxes or other charges which could not have been lawfully demanded and that the taxpayer's applications for revision or refund with respect thereto be and the same are hereby denied.

DATED: Albany, New York, on the 27th day of November 1967.

STATE TAX COMMISSION

/s/ JOSEPH H. MURPHY
President

Commissioner

/s/ WALTER MACLYN CONLON
Commissioner

STATE OF NEW YORK

STATE TAX COMMISSION

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IN THE MATTER OF THE APPLICATION

OF

MARGARET L. KASTOR

FOR REVISION OR REFUND OF PERSONAL INCOME TAXES UNDER ARTICLE 16 OF THE TAX LAW FOR THE YEARS 1955 AND 1956.

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The taxpayer, Margaret L. Kastor, having filed applications for revision or refund of personal income taxes under Article 16 of the Tax Law for the years 1955 and 1956 and a hearing having been held in connection therewith at the office of the State Tax Commission at 80 Centre Street, New York, N. Y. on the 14th day of February, 1964, before Solomon Sies, Hearing Officer of the Department of Taxation and Finance, at which hearing the taxpayer was represented by Greenbaum, Wolff & Ernst, Esqs., by Maurice C. Greenbaum, Esq. of Counsel, testimony having been taken and the matter having been duly examined and considered,

The State Tax Commission hereby finds:

(1) That at all of the times hereinafter mentioned, the taxpayer was and still is a resident of the State of New Jersey; that the taxpayer filed a non-resident income tax return for the year 1955 in which she reported as normal income her share of distribution from the New York partnership of Gartman, Rose & Company, in the sum of $10,300.00 and deducted therefrom "interest paid on loan used for investment in above partnership—$2,400.00"; that the net income reported by the taxpayer subject to normal tax amounted to $7,900.00; that taxpayer further reported capital gains from an unidentified partnership the sum of $10,970.00; that on

August 27, 1959, the Department of Taxation and Finance made an additional assessment against the taxpayer (Assessment #B-463645) for the year 1955 adjusting the income tax of the taxpayer in accordance with the New York partnership return of Gartman, Rose & Co. so as to include therein the taxpayer's distributive share of partnership income in the sum of $12,096.60, plus interest on investment of capital received from said co-partnership in the sum of $7,000.00so that the total partnership distribution amounted to $19,096.60 and accordingly adjusted the net income of taxpayer for said year in the sum of $16,296.60 and imposed additional tax due in the sum of $387.81, after crediting the taxpayer with the tax paid by her on her return for said year.

(2) That on her non-resident income tax return for the year 1956, the taxpayer reported partnership income from Gartman, Rose and Co. in the sum of $8,319.52; that she deducted therefrom "interest paid on loan used for investment in co-partnership--$2,400.00"; that the net income subject to normal tax reported by her on said return amounted to$5,719.52; that on March 10, 1960, the Department of Taxation and Finance made an additional assessment against the taxpayer (Assessment #B-761516) for the year 1956 in which it was indicated that examination of New York State partnership return filed by Gartman, Rose & Co. disclosed that she was in receipt of a distributive share of partnership income in the sum of $14,919.52 so that additional taxable income was disclosed in the sum of $6,600.00;

that the taxpayer's income for the year 1956 was adjusted accordingly so that additional tax due amounted to $406.00 after crediting the taxpayer with the amount paid on her return for said year.

(3) That on December 23, 1953, Mortimer J. Gartman, Charles Rome, Leo J Goldwater, Daniel Cowin and Margaret L. Kastor entered into a limited partnership agreement pursuant to Article 8 of the New York Partnership Law to carry on a general brokerage and commission business, including the buying, holding and selling for the account of the partnership and others, of stocks, bonds, other securities, commodities, investments and other properties with its sole place of business located in the City of New York; that pursuant to said agreement Margaret L Kastor was the only limited partner and contributed to the capital of the co-partnership the sum of $150,000.00 in cash; that on December 20, 1954, an agreement was entered into modifying the aforementioned partnership agreement and admitting Arthur A Burkhart as an additional general partner; that on June 23, 1955, an agreement was entered into further modifying the partnership agreements of December 23, 1953, and December 20, 1954 and admitting Robert H Kastor as an additional limited partner; that pursuant to the latter agreement Margaret L Kastor as limited partner contributed the sum of $110,000.00 in cash and Robert H Kastor as limited partner contributed the sum of $90,000.00 in cash to the capital of the co-partnership.

(4) That pursuant to the provisions of the partnership agreements, as last modified on June 23, 1955 and in

effect during the years in issue, the limited partners, Margaret L. Kastor and Robert W. Kastor, were not to be liable for any obligations or losses of the partnership beyond the amount of their capital contributions; that Article "5" of the partnership agreement dated June 23, 1955 provides, in part, as follows:

> "5. Interest and additional compensation. Each partner shall be paid amounts, which shall be charged as expenses in the partnership business, in the following order of priority:
>
> (a) ARTHUR A. BURCHARD * * * *
>
> (b) MARGARET L. KASTOR and ROBERT W. KASTOR: 6% per annum on their capital contributions payable at the end of every partnership year, whether or not there are net earnings sufficient to pay the same. * * * *";

that Paragraph (f) of Article "5" of the above mentioned partnership agreement also provides for an additional payment to be made to the taxpayer, Margaret L. Kastor, as follows:

> "If there are net earnings of the partnership, after all payments and provisions for reserves as hereinabove provided, an amount equal to 2 1/2% of such net earnings payable at the end of every partnership year."

(5) That Article "13" of the aforementioned co-partnership agreement provides, in part, as follows:

> 13. Distributions of Assets. Upon dissolution and termination of the partnership or the withdrawal, death, or insanity of any partner, a final audit and settlement shall be made and the obligations and interests of the respective partners shall be fixed and determined. Proper reserves shall be provided for estimated losses and liabilities, including taxes assessable against the partnership, and all partnership obligations shall be satisfied and discharged or provided for, before any assets are distributed to any of the partners."

(6) That although the taxpayer contends that the capital contribution to the partnership was in the nature of a loan and that 6% represented interest on said loan which is exempt from taxation by the State of New York to a non-resident, such contention is contra to the provisions contained in the partner-

ship agreements and the evidence adduced at the hearing; that the monies advanced by the taxpayer to the co-partnership did not constitute a bona-fide loan but rather constituted an investment of partnership capital; that the taxpayer's investment of capital in the co-partnership was subordinate to the rights of the general creditors of the co-partnership to the extent of such capital investment and subject to risk of loss.

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

DETERMINES:

(A) That the capital investment of the taxpayer in the New York partnership firm of Gertman, Rose & Co. did not constitute a loan or debtor-creditor relationship but constituted a capital investment in such co-partnership subordinate to the rights of the general creditors of such co-partnership to the extent of such contribution as more fully set forth in finding (6) above; that the income of the taxpayer, a non-resident limited partner received from the New York partnership firm of Gertman, Rose & Co. was taxable to the extent that it was derived from partnership business carried on within the State of New York within the intent and meaning of §351-e of the Tax Law.

(B) That, accordingly, the additional assessments (Assessments Nos. B-463645 and B-761516, for the years 1955 and 1956, respectively) are correct; that said assessments do not include any taxes or other charges which could not have been lawfully demanded and that the taxpayer's applications for revision or refund with respect to said assessments be and the same are hereby denied.

DATED: Albany, New York on the 27th day of November 1967.

STATE TAX COMMISSION

/s/ JOSEPH H. MURPHY
PRESIDENT

COMMISSIONER

/s/ WALTER MACLYN CONLON
COMMISSIONER