

STATE OF NEW YORK
STATE TAX COMMISSION

In the Matter of the Petition

of

SAMUEL M.S. & HEDY M. LANHAM

For a Redetermination of a Deficiency or
a Refund of Personal Income
Taxes under Article(s) 22 of the
Tax Law for the (Year(s) 1968.

AFFIDAVIT OF MAILING
OF NOTICE OF DECISION
BY (CERTIFIED) MAIL

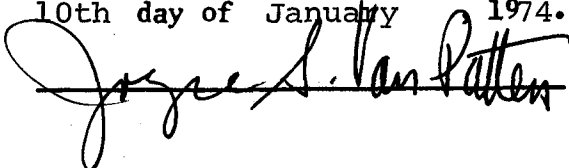
State of New York
County of Albany

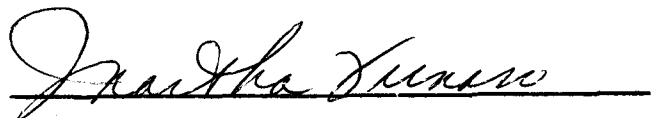
Martha Funaro, being duly sworn, deposes and says that she is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 10th day of January, 1974, she served the within Notice of Decision (or Determination) by (certified) mail upon Samuel M.S. & Hedy M. Lanham (representative of) the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows: Mr. & Mrs. Samuel M.S. Lanham
125 East 72nd Street
New York, New York 10021
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 Post Office Department within the State of New York.

That deponent further says that the said addressee is the (representative of) 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

10th day of January 1974.







STATE OF NEW YORK
DEPARTMENT OF TAXATION AND FINANCE

BUILDING 9, ROOM 214A

STATE CAMPUS

ALBANY, N. Y. 12226

AREA CODE 518

457-2655, 6, 7

STATE TAX COMMISSION -
HEARING UNIT

EDWARD ROOK
SECRETARY TO
COMMISSION

STATE TAX COMMISSION

Mario A. Procaccino,
~~XXXXXXXXXXXXXXXXXXXX~~ PRESIDENT

A. BRUCE MANLEY
MILTON KOERNER

ADDRESS YOUR REPLY TO

DATED: Albany, New York
January 10, 1974

Mr. & Mrs. Samuel M.S. Lanham
125 East 72nd Street
New York, New York 10021

Dear Mr. & Mrs. Lanham:

Please take notice of the **DECISION**
of the State Tax Commission enclosed herewith.

Please take further notice that pursuant to
Section(s) **690** of the Tax Law, any
proceeding in court to review an adverse deci-
sion must be commenced within **4 months**
from the date of this notice.

Any inquiries concerning the computation of tax
due or refund allowed in accordance with this
decision or concerning any other matter relative
hereto may be addressed to the undersigned.
These will be referred to the proper party for
reply.

Very truly yours,

Nigel G. Wright
HEARING OFFICER

Enc.

cc: Petitioner's Representative
Law Bureau

STATE TAX COMMISSION

In the Matter of the Petition :
of :
SAMUEL M.S. & HEDY M. LANHAM :
for a Redetermination of a Deficiency :
or for Refund of Personal Income Taxes :
under Article 22 of the Tax Law for :
the Year 1968. :

DECISION

A hearing was duly held on June 8, 1973, at the offices of the State Tax Commission, 80 Centre Street, New York City, before Nigel G. Wright, Hearing Officer. The petitioner was not represented. The Income Tax Bureau was represented by Saul Heckelman, Esq., appearing by James A. Scott, Esq. The record of said hearing has been duly examined and considered.

The issue in this case is whether or not the undistributed capital gains received by the petitioner from a regulated investment company, in this case a "swap fund" are includable in New York State adjusted gross income and thereby subject to tax. The applicable Federal law is not in dispute and may

be taken as a fact.

FINDINGS OF FACT

1. Prior to 1967, Mr. Lanham had two stocks in public corporations which had appreciated greatly in value. On March 17, 1967, Mr. Lanham exchanged these stocks with the Fifth Empire Fund, Inc. of Pittsburgh, Pennsylvania, receiving in return shares in the Fifth Empire Fund, Inc. Under Federal law at that time (I.R.C. 351) and prior to a statutory amendment this exchange was a tax-free exchange for Federal income tax purposes and no gain was recognized at the time of the exchange.

2. The Fifth Empire Fund, Inc. is a corporation organized in Maryland. Its principle office is at Pittsburgh, Pennsylvania. It is a regulated investment company and is of the "open-end" type although it has not issued any shares since the original issue on March 17, 1967. This original issue was in exchange for stock in publicly held corporations. This fund is of a type commonly referred to as a "tax-free-exchange fund", or "swap fund". It is one of seven such funds managed by Federated Research Corp. of Pittsburgh, Pennsylvania. This fund follows a regular policy of retaining for further investment any gains realized on the sale of securities. (The tax-free notice of the exchange of securities is no longer permitted, see I.R.C. Sec. 351; U.S. Treas. Reg. 1.351-1(c)).

3. Mr. Lanham received notification from the fund on a Federal "form 2439" that his share of undistributed long-term

capital gains for 1968 was \$3,330.96 and that the fund had paid a tax of \$908.96 on such share. Mr. Lanham reported the gains on Schedule "D" of his Federal income tax return and took a credit against his Federal tax due for the amount of tax paid by the fund. This treatment is mandated and permitted by section 852(b)(3)(D) of the Internal Revenue Code. This section also provides that the shareholder, Mr. Lanham here, can increase the tax basis of his shares by, in effect, the difference between the gain reported and the tax credited which here would be \$2,422.00. (The fund also distributed some capital gain in 1968, Mr. Lanham's share being \$1,474.80. These distributed capital gains were included in both Federal and state tax returns and are not in dispute).

4. On their New York tax return, petitioners subtracted the amount of \$3,440.96 from the income shown on their Federal return to arrive at their New York income. The deficiency notice in issue in effect does not allow the above subtraction.

CONCLUSIONS OF LAW

The petitioner's complaint here is not that a tax must be paid at some time, but rather that a tax must be paid presently on income which is only imputed to him and which he has not actually received. It should be noted that the fact that petitioner's problem arises with respect to shares in a "swap fund" is not legally significant since the applicable law relates to all regulated investment companies (mutual funds) although

of course the problem of undistributed capital gains will occur most frequently with respect to such "swap funds".

The income taxes to petitioner here is imputed to him by the Federal Tax Law. It is clear that although the fund remits an amount to the Federal Government for a capital gains tax that amount is paid on behalf of the shareholder to whom credit is given for the amount already paid and who must recompute the tax which will in effect be paid by himself. The effect of the Federal credit is simply that a tax at the corporate level is avoided while a tax at the shareholder level is collected. It is clear that the effect of the Federal provisions is to treat the amount of the undistributed capital gain hypothetically as if it were entirely distributed to the shareholders with a tax paid by them and with the amount remaining as if it were reinvested in the fund - thus justifying the increase in the shareholder's basis for his shares.

This income is also imputed to petitioner by operation of the New York Tax Law. The personal income tax statute provides that New York adjusted gross income means Federal adjusted gross income as defined in the laws of the United States (Tax Law section 612(a)). The petitioners herein, therefore, must report the undistributed capital gains as New York income. It is also true that the increase in tax basis which the petitioner obtains for Federal purposes by reason of the fact that he did not actually receive the gains is used also for state purposes.

Therefore, petitioner will not be taxed twice on the income here in question.

Of course, while the fund has paid Federal taxes on the gain in question and petitioner has received credit for such payment, this is not true with respect to the New York State tax.

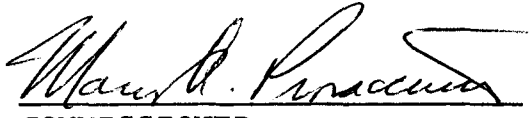
This treatment of imputed income from regulated investment companies does not seem any different in principle from the treatment of imputed income from "Sub-chapter S" corporations (see Petition of Grayck, 11-18-1970, CCH New York State Tax Rep. §99-320; Petition of Markowitz, 11-18-1970, CCH New York State Tax Rep. §99-323). That treatment has been upheld in the courts Garlin v. Murphy, App. Div. 3rd Dept. 6-7-1970).

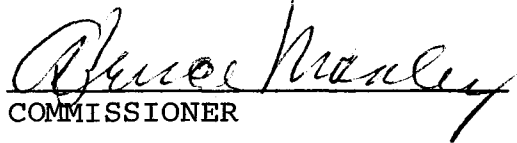
DECISION

The deficiency is found to be correct and is due together with such interest as may be computed under section 684 of the Tax Law.

DATED: Albany, New York
January 10, 1974

STATE TAX COMMISSION


COMMISSIONER


COMMISSIONER


COMMISSIONER