

STATE OF NEW YORK
STATE TAX COMMISSION

In the Matter of the Petition

of

RICHARD V. KEARNS

AFFIDAVIT OF MAILING

For a Redetermination of a Deficiency or
a Revision of a Determination or a Refund
of Personal Income and
Unincorporated Business
Taxes under Article(s) 22 & 23 of the
Tax Law for the Year ~~(XXXXXX)~~ 1971.

State of New York
County of Albany

John Huhn, 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 6th day of October, 1978, she served the within
Notice of Decision by (certified) mail upon Richard V. Kearns

~~(representative of)~~ the petitioner in the within proceeding,

by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed
as follows:


Mr. Richard V. Kearns
11 Brycewood Drive
Dix Hills, New York 11746

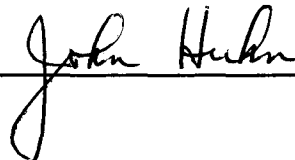
and by depositing same enclosed in a postpaid properly addressed wrapper in a
(post office or official depository) under the exclusive care and custody of
the United States Postal Service within the State of New York.

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

6th day of October, 1978.





STATE OF NEW YORK
STATE TAX COMMISSION

In the Matter of the Petition

of

RICHARD V. KEARNS

AFFIDAVIT OF MAILING

For a Redetermination of a Deficiency or
a Revision of a Determination or a Refund
of ~~Personal Income and~~
~~Unincorporated Business~~
Taxes under Article(s) 22 & 23 of the
Tax Law for the Year ~~(or any period)~~ 1971.:

State of New York
County of Albany

John Huhn, 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 6th day of October, 1978, he served the within
Notice of Decision by (certified) mail upon Paul H. Frankel

(representative of) the petitioner in the within proceeding,

by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed

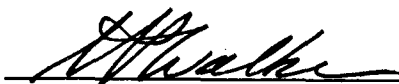
as follows: Paul H. Frankel, Esq.
19 Burnt Mill Circle
Oceanport, New Jersey 07757

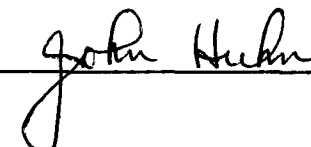
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(post office or official depository) under the exclusive care and custody of
the United States Postal Service within the State of New York.

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

6th day of October, 1978







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

JAMES H. TULLY JR., PRESIDENT
MILTON KOERNER
THOMAS H. LYNCH

October 6, 1978

Mr. Richard V. Kearns
11 Brycewood Drive
Dix Hills, New York 11746

Dear Mr. Kearns:

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) **690 and 722** 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 the Deputy Commissioner and Counsel to the New York State Department of Taxation and Finance, Albany, New York 12227. Said inquiries will be referred to the proper authority for reply.

Sincerely,

Michael Alexander
Supervising Tax
Hearing Officer

cc: Petitioner's Representative
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition
of
RICHARD V. KEARNS
for Redetermination of a Deficiency or for
Refund of Personal Income and Unincorporated
Business Taxes under Articles 22 and 23 of
the Tax Law for the Year 1971.

DECISION

Petitioner, Richard V. Kearns, 11 Brycewood Drive, Dix Hills, New York 11746, filed a petition for redetermination of a deficiency or for refund of personal income and unincorporated business taxes under Articles 22 and 23 of the Tax Law for the year 1971 (File No. 12157).

A formal hearing was held before Solomon Sies, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on May 18, 1977. Petitioner appeared by Paul H. Frankel, Esq. The Income Tax Bureau appeared by Peter Crotty, Esq. (Alexander Weiss, Esq., of counsel).

ISSUE

I. Whether petitioner may deduct as an ordinary and necessary business expense, commissions paid in accordance with two sales agreements, pursuant to which petitioner purchased two insurance agencies.

II. Whether petitioner may take a depreciation deduction in 1971, based on the value of certain insurance expirations obtained by petitioner in the purchase of two insurance agencies.

III. Whether petitioner's activities as an insurance agent and insurance broker during 1971 constituted the carrying on of an unincorporated business.

FINDINGS OF FACT

1. On October 27, 1975, the Income Tax Bureau issued a Statement of Audit Changes against petitioner, Richard V. Kearns, for unpaid personal income and unincorporated business taxes. In accordance with the aforesaid Statement, a Notice of Deficiency was issued totalling \$6,541.23. Petitioner paid \$1,000.00 to the Bureau on February 15, 1973 and subsequently sought a refund of said payment, via correspondence dated February 23, 1973. The Bureau included the \$1,000.00 payment as a credit in the computation of petitioner's deficiency.

2. During 1971 petitioner deducted "commissions" as a business expense on Schedule "C" of his Federal return in the amount of \$21,819.04. Petitioner's commission deduction represented payments made pursuant to two agreements, namely, the "McElwain Agreement" (\$7,621.03) and the "Potter Agreement" (\$14,198.01).

3. On September 1, 1967, petitioner entered into a written contract with Harold T. Potter (hereinafter "Potter"), in which petitioner agreed, inter alia, to purchase Potter's insurance

business (comprised mainly of casualty insurance), together with goodwill and insurance records and papers. Said insurance records and papers consisted primarily of "expirations". Expirations are the files on each policyholder containing daily report sheets and information contained thereon regarding the name of the insured, his address, the type of insurance, the description of the property insured, the expiration date of the policy and premium information. Petitioner was to pay for the insurance business by paying Potter or his heirs 50% of the gross commission received each month for a period of four years on all business derived from Potter's accounts. The agreement was not to become effective until Potter's retirement, incompetence or death. Because Potter was deceased in the year at issue (his accounts transferred to petitioner in accordance with the contract), 1/2 of the gross commissions on Potter's transferred accounts (\$14,198.01) was paid to Potter's heirs.

4. On April 15, 1969, before William R. McElwain (hereinafter "McElwain") moved to Florida, petitioner entered into a written agreement with McElwain, in which petitioner purchased McElwain's general insurance business (comprised mainly of casualty insurance), including the goodwill of said business. Petitioner bought primarily expirations (with the attendant goodwill) from McElwain, agreeing to remit to McElwain 50% of all the gross commissions earned from McElwain's accounts for five years from the date of the agreement. Accordingly, \$7,621.03 was paid to McElwain during the year at

issue. Part of said payment was for consultive services rendered by McElwain concerning problems on his former accounts. Also a covenant not to compete similar to the covenant negotiated with Potter was negotiated between petitioner and McElwain (McElwain agreed to retire from the insurance business).

5. Petitioner argued that if he were not allowed a business deduction for the amounts paid to McElwain and Potter's heirs during the year in question, he was entitled to a depreciation deduction based on the value of the expirations he purchased. Petitioner's insurance expert, Herbert Lapidus (hereinafter "Lapidus"), a Chartered Life Underwriter, contended that in the year 1971, 90-95% of the purchase price of the Potter and McElwain insurance agencies was attributable to the value of the expirations. He disregarded good will and the covenants not to compete in his allocation of 90-95% of the purchase price to expirations. Lapidus estimated the useful life of the expirations at issue to be 4 years for the purpose of depreciation pursuant to section 167(a) of the Internal Revenue Code of 1954. Petitioner argued that he was, therefore, entitled to a depreciation deduction equal to 1/4 the value of the expirations (\$42,000.00 - commissions derived from accounts purchased), or \$10,500.00 for the year 1971.

6. In the year in question, petitioner was both a licensed insurance broker and insurance agent. Petitioner represented the Travelers Insurance Company (hereinafter "Travelers") and Aetna Insurance (hereinafter "Aetna") in 1971. As a licensed insurance

broker, petitioner could place insurance with other insurance companies; however, he failed to do so in the year at issue.

7. Petitioner worked under a written agreement with both Travelers and Aetna. Approximately 80-90% of his work was for Travelers. Ninety percent of the insurance sold by petitioner was casualty insurance.

8. Petitioner had an office in the Travelers Insurance Company Building in Garden City, New York. For the use of said office, petitioner paid Travelers \$1,006.08 in rent in 1971. Petitioner also used the office to conduct his insurance business for Aetna.

9. Petitioner had his own telephone in his office and deducted telephone expenses incurred in connection with his insurance activities. Petitioner also deducted \$4,935.76 on Schedule C of his Federal return for "labor", which represented payment to his personal secretary. She was his full-time secretary and he accordingly remitted social security payments on her behalf. Petitioner also deducted expenses for "printing and office supplies."

10. Although Travelers had group health and life insurance plans for its employees, petitioner did not participate in said plans. Neither Travelers nor Aetna withheld taxes, social security or unemployment insurance premiums from petitioner's commissions, nor provided him with workmen's compensation coverage.

11. Although the control over petitioner's activities from Aetna and Travelers was minimal, Travelers did have an oral agreement with petitioner which gave Travelers the right to deny him office space if he did not place a certain amount of insurance with them.

CONCLUSIONS OF LAW

A. That petitioner may not deduct as an ordinary and necessary business expense under section 162(a) of the Internal Revenue Code of 1954, commissions paid pursuant to the two sales agreements. Said commissions were paid as an expense to increase petitioner's insurance business. As such, it is a capital expenditure not deductible as an ordinary and necessary business expense. (See Willcuts v. Minnesota Tribune Co., 103 F. 2d 947).

B. That petitioner may not take a depreciation deduction in 1971 pursuant to section 167(a) of the Internal Revenue Code of 1954, based on the alleged value of the expirations obtained by petitioner in the purchase of the two insurance agencies. Before a taxpayer may take a depreciation deduction based on the value of expirations or intangible assets, he must meet the heavy burden of proving the expirations (1) [have] an ascertainable value separate and distinct from goodwill, and (2) [have] a limited useful life, the duration of which can be ascertained with reasonable accuracy." (Houston Chronicle Publishing Co. v. United States, 481 F.2d 1240, 1250).
Petitioner did not prove that the expirations at issue had an ascertainable value separate and distinct from goodwill (emphasis added). Goodwill is considered to have an unascertainable useful

life and is, therefore, nondepreciable. (See Treas. Reg. §167[a]-3). Petitioner incorrectly discounted goodwill completely in his proposed computation of the value of the insurance transactions. Goodwill was an integral part of the insurance agencies purchased by petitioner. It would include "the concept of the advantage the proprietor of an existing business enjoys resulting from the probabilities that old customers would continue their patronage". (Thomas v Commissioner, 50 T.C. 247, 256). Thus, in addition to the expirations, petitioner acquired intangible factors for access to former clients of the sellers. The value of those separate goodwill factors constituted a substantial part of the transactions in question. (See Richard S. Miller v United States, 537 F.2d 446). Petitioner's failure to adequately differentiate between the value of the expirations and the goodwill involved in the two transactions precludes petitioner from taking advantage of the depreciation deduction specified in section 167(a) of the Internal Revenue Code of 1954. Additionally, petitioner's failure to delineate in the McElwain purchase between the value of the expirations (depreciable portion of the sale) and the value of McElwain's services (nondepreciable portion of the sale) also precludes petitioner from taking a depreciation deduction for said purchase.

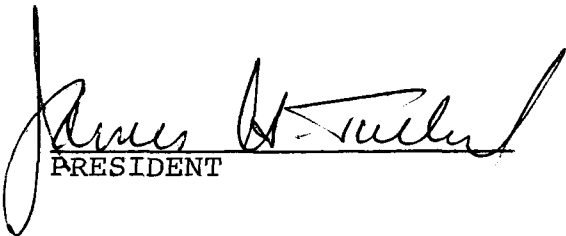
C. That Travelers Insurance Company and Aetna Insurance Company exerted insufficient control over petitioner's insurance activities to permit his designation as an employee of either company within the meaning and intent of section 703(b) of the Tax Law.

D. That petitioner's activities as an insurance broker and an insurance agent during 1971 constituted the carrying on of an unincorporated business within the meaning and intent of section 703(a) of the Tax Law.

E. That the petition of Richard V. Kearns is denied and the Notice of Deficiency issued October 27, 1975 is sustained.

DATED: Albany, New York
October 6, 1978

STATE TAX COMMISSION


PRESIDENT


COMMISSIONER


COMMISSIONER