

STATE OF NEW YORK
STATE TAX COMMISSION

In the Matter of the Petition :
of :
Rodney A. & Sabra J. Richards :
for Redetermination of a Deficiency or a Revision :
of a Determination or a Refund of :
Personal Income Tax :
under Article 22 of the Tax Law :
for the Year 1973. :

AFFIDAVIT OF MAILING

State of New York
County of Albany

Jay Vredenburg, 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 3rd day of October, 1980, he served the within notice of Decision by certified mail upon Rodney A. & Sabra J. Richards, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Rodney A. & Sabra J. Richards
c/o Becker, Card, Levy & Richards
141 Washington Ave.
Endicott, NY 13760

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 petitioner herein and that the address set forth on said wrapper is the last known address of the petitioner.

Sworn to before me this
3rd day of October, 1980.

J. C. Miller

J. C. Miller

STATE OF NEW YORK
STATE TAX COMMISSION

In the Matter of the Petition :
of :
Rodney A. & Sabra J. Richards :
for Redetermination of a Deficiency or a Revision :
of a Determination or a Refund of :
Personal Income Tax :
under Article 22 of the Tax Law :
for the Year 1973. :

AFFIDAVIT OF MAILING

State of New York
County of Albany

Jay Vredenburg, 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 3rd day of October, 1980, he served the within notice of Decision by certified mail upon Bruce O. Becker the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

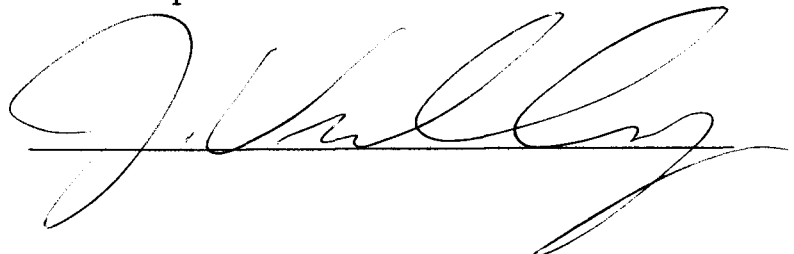
Mr. Bruce O. Becker
Becker, Card, Levy & Richards
141 Washington Ave.
Endicott, NY 13760

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 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
3rd day of October, 1980.

Frederick Bank



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

October 3, 1980

Rodney A. & Sabra J. Richards
c/o Becker, Card, Levy & Richards
141 Washington Ave.
Endicott, NY 13760

Dear Mr. & Mrs. Richards:

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 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:

NYS Dept. Taxation and Finance
Deputy Commissioner and Counsel
Albany, New York 12227
Phone # (518) 457-6240

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative
Bruce O. Becker
Becker, Card, Levy & Richards
141 Washington Ave.
Endicott, NY 13760
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
RODNEY A. RICHARDS and SABRA J. RICHARDS : DECISION :
for Redetermination of a Deficiency or :
for Refund of Personal Income Tax under :
Article 22 of the Tax Law for the Year :
1973. :

Petitioners, Rodney A. Richards and Sabra J. Richards, c/o Becker, Card, Levy, Richards, 141 Washington Avenue, Endicott, New York 13760, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the year 1973 (File No. 19480).

A small claims hearing was held before Carl P. Wright, Hearing Officer, at the offices of the State Tax Commission, Governmental Civic Center, 44 Hawley Street, Binghamton, New York, on December 5, 1979 at 9:15 A.M. Petitioners appeared by Bruce O. Becker, Esq. The Audit Division appeared by Ralph J. Vecchio, Esq. (Barry M. Bresler, Esq., of counsel).

ISSUES

I. Whether a Notice of Deficiency becomes invalid when it is later determined that a portion of the explanation accompanying the Notice is invalid.

II. Whether sections 612(b)(7), (8) and (9) of the New York State Tax Law are unconstitutional.

III. Whether petitioners are still shareholders within the meaning of section 612 of the Tax Law and, therefore, required to make modifications to their Federal adjusted gross income.

FINDINGS OF FACT

1. Petitioners, Rodney A. Richards and Sabra J. Richards, timely filed a

New York State Personal Income Tax Return for 1973. In arriving at their New York adjusted gross income, they did not increase their Federal adjusted gross income by the modifications required by sections 612(b)(7), (8) and (9) of the Tax Law in the case of a taxpayer who is a shareholder of a corporation organized under Article fifteen of the Business Corporation Law.

2. The Audit Division contended that:

Section 1511 of Article 15 of Business Corporation Law states, in part, that "No shareholder of a professional service corporation may sell or transfer his shares in such corporation except to another individual who is eligible to have shares issued to him by such corporation. Any sale or transfer in violation of such restriction shall be void."

Section 1507 of the same Article states "A Professional Service Corporation may issue shares only to individuals who are authorized by law to practice in the State a profession which such corporation is authorized to practice and who are or have been engaged in the practice of such profession in such corporation or a predecessor entity."

Accordingly, transferring to a trust or trustee is not authorized and is void.

Section 612(b)(7) of the New York State Tax Law requires a shareholder of a professional corporation to add to his Federal adjusted gross income the excess of the amount deductible by the corporation as a contribution to certain employee plans for pensions, profit sharing, annuity and bond purchase over what would have been deductible by a self-employed individual.

Section 612(b)(8) of the New York State Tax Law requires a shareholder of a professional corporation to add to his Federal adjusted gross income the amount of taxes paid by the corporation for old age, survivors and disability insurance on FICA wages for the calendar year of the shareholder. This does not include payment for hospital (medicare) insurance.

Section 612(b)(9) of the New York State Tax Law requires a shareholder of a professional corporation to add to his Federal adjusted gross income the amount paid by the corporation on behalf of the shareholder employee for the purchase of life, accident or health insurance, except for amounts attributable to the purchase of insurance to reimburse the shareholder for medical expenses incurred.

Accordingly, it issued a Notice of Deficiency on April 11, 1977 against the petitioners for 1973 in the amount of \$504.29 in personal income tax, plus \$113.05 in interest, for a total due of \$617.34.

3. Mr. Bruce O. Becker is an attorney at law. On January 12, 1971, Mr. Becker with his then law partner, Philip D. Levy, organized a professional service corporation (Company) for the practice of law. The Company was then known as Becker, Card & Levy, P.C. At the time of its incorporation, Mr. Becker and Mr. Levy were the sole stockholders of the Company as well as its principal employees.

On December 2, 1971, the name of the company was changed to Becker, Card, Levy & Richards, P.C., its present name. On June 28, 1972, petitioner, Rodney A. Richards, also an attorney at law, acquired shares of the Company's stock.

On January 2, 1972, Mr. Becker transferred his shares of the Company's stock to one Mahlon H. Card, an attorney at law, pursuant to a trust agreement dated January 2, 1972. Mr. Levy and petitioner, Rodney A. Richards, also transferred their shares in trust to Mr. Card on January 2, 1972 and June 28, 1972, respectively. Mr. Card has no stock or employment interest in Company except as trustee for Becker, Levy and Richards.

Mr. Becker, Mr. Levy and petitioner, Rodney A. Richards', stock in the Company has been held in trust under the terms of the trust agreement since January 2, 1972.

4. The petitioners contended the Notice of Deficiency took the position that petitioners were responsible for the tax involved by reason of the "add back" provisions of sections 612(b)(7), (8) and (9) of the Tax Law, which require a shareholder of a professional corporation to add back to his Federal adjusted gross income for State income tax purposes the excess of the amount deductible by the corporation as a contribution to an employee benefit plan for his benefit over than which would have been allowed as a deduction by a self-employed individual; and the amount the employer's share of the social security tax paid on the shareholder's compensation; and the amount paid by

the corporation for the purchase of life and other types of insurance covering the shareholder.

The additional tax was assessed, according to the Notice of Deficiency, on the grounds that petitioners were prohibited by sections 1507 and 1511 of the Business Corporation Law from transferring their shares to a trustee.

The original provisions of the Business Corporation Law (BCL), authorizing the establishment of professional service corporations, precluded transfers of shares of a professional service corporation to anyone other than a person licensed to practice the same profession (BCL 1507). Had the trust agreement entered into between petitioner and Mr. Card been executed the forepart of 1971, then the position of the Department as set forth in the Notice of Deficiency would have been correct, and petitioners would have been liable for the add back tax.

However, effective July 2, 1971, section 1511 of the Business Corporation Law was specifically amended to authorize transfers of professional service corporation shares to another individual in trust if that individual was also a person authorized to practice the same profession.

One of the sponsoring New York State Senators for the original professional service corporation law as well as the amendment to section 1511 of the Business Corporation Law stated his reasons for the amendment in a supporting memorandum as follows:

"2. Existing Section 1507 also prohibits voting trust or other types of agreements vesting voting power in third persons, except where the third person is another shareholder. This prohibition was added to insure that a professional service corporation could not be controlled by a lay person. However, many instances may arise where it is appropriate, for business or tax reasons, to place the corporation's shares in trust. For instance, the trust approach is used in California law to avoid the serious problems which might otherwise arise upon the death of the sole shareholder in a one-man corporation. The present bill would permit such trusts to be utilized in New York, but would require the trustee to be a qualified professional, thereby assuring that lay persons would not be in a position to control the corporation." (Emphasis added.) 1971 Legislative Manual 129, 130.

The key element in the foregoing quote is that transfers in trust specifically for business or tax reasons were authorized by law.

No concomitant change was effected in subsections 7, 8 and 9 of section 612 of the Tax Law. These sections continued to relate only to shareholders of professional service corporations and were not adjusted in any way to cover trusts owning shares of such corporations.

The amendment to section 1511 of the Business Corporation Law expressly authorized the transfer of shares of a professional service corporation by a professional to another professional in trust for business or tax reasons.

Concededly, an apparent loophole has been created, and petitioners have every legal and moral right to take advantage of it. The Courts have long held that a taxpayer has the right and duty to exercise every prerogative the law grants for decreasing taxes. Gregory v. Helvering, 293 US 465, 469.

5. The petitioners further argued the add back provisions of section 612 of the Tax Law are unconstitutional because they deny shareholders of professional service corporations equal protection of the law because if a professional is engaged in private practice as an employee-shareholder of a professional service corporation, he is then subject to the add back tax provisions. If that same professional is engaged in the practice of his profession as an employee of a conventional business corporation, at the same, greater or lesser pay and fringe benefits, he is not subject to the add back provisions.

6. At the hearing, the Audit Division took the position that the petitioner, Rodney A. Richards, should be treated as the owner of the trust since he had general power of appointment over the trust property, reversionary interest in either the corpus or the income therefrom and power to control beneficial enjoyment of the corpus or the income therefrom. The Audit Division also pointed out the trust agreement gave the petitioner, Rodney A. Richards, administrative powers and power to revoke.

CONCLUSIONS OF LAW

A. That the Notice of Deficiency does not become invalid even though a portion of the explanation accompanying the Notice is incorrect. Therefore, the State Tax Commission is not estopped from making a claim against petitioners.

B. That the constitutionality of the laws of the State of New York is presumed at the administrative level of the New York State Tax Commission. There is no jurisdiction at the administration level to declare such laws unconstitutional. Therefore, it must be presumed that the Tax Law is constitutional to the extent that it relates to the imposition of income tax liability on the petitioner. That, accordingly, sections 612(b)(7), (8) and (9) of the Tax Law are constitutional.

C. That where petitioners remain the owner of the stock, even though the trust acquired possession, for all substantial and practical purposes after looking at all the controlling circumstances, the petitioners shall be considered "a taxpayer who is a shareholder of a corporation organized under article fifteen of the business corporation law" and are required to make the modifications provided in sections 612(b)(7), (8) and (9) of the Tax Law.


D. That the petition of Rodney A. Richards and Sabra J. Richards is denied and the Notice of Deficiency issued April 11, 1977 is sustained, together with such additional interest as may be lawfully owing.

DATED: Albany, New York

OCT 03 1980

STATE TAX COMMISSION


PRESIDENT


COMMISSIONER


COMMISSIONER