

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
Ignatz & Belle Eichler :
: AFFIDAVIT OF MAILING
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 :
1972.

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 July, 1981, he served the within notice of Decision by certified mail upon Ignatz & Belle Eichler, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Ignatz & Belle Eichler
18 Dubnov St.
Tel Aviv, ISRAEL

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 July, 1981.

Gennice P. Hagelund

J. Vredenburg

STATE OF NEW YORK
STATE TAX COMMISSION

In the Matter of the Petition :

of

Ignatz & Belle Eichler :

: AFFIDAVIT OF MAILING

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 :
1972.

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 July, 1981, he served the within notice of Decision by certified mail upon Herbert Hauser the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Herbert Hauser
673 E. 79th St.
Brooklyn, NY 11236

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 July, 1981.

Connie A. Haglund

J. Vredenburg

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

July 3, 1981

Ignatz & Belle Eichler
18 Dubnov St.
Tel Aviv, ISRAEL

Dear Mr. & Mrs. Eichler:

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
Herbert Hauser
673 E. 79th St.
Brooklyn, NY 11236
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition	:	
of	:	
IGNATZ EICHLER and BELLE EICHLER	:	DECISION
for Redetermination of a Deficiency	:	
or for Refund of Personal Income Tax	:	
under Article 22 of the Tax Law for the	:	
Year 1972.	:	

Petitioners, Ignatz Eichler and Belle Eichler, 18 Dubnov Street, Tel Aviv, Israel 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 1972 (File No. 17829).

On June 26, 1980, petitioners advised the State Tax Commission, in writing, that they desired to waive a small claims hearing and to submit the case to the State Tax Commission based on the entire record contained in the file.

ISSUE

Whether certain payments derived from the sale of a business, which were specifically allocated to a covenant not to compete, are taxable as ordinary income.

FINDINGS OF FACT

1. Petitioners, Ignatz Eichler and Belle Eichler, timely filed a New York State Combined Income Tax Return for the year 1972 whereon Ignatz Eichler (hereinafter petitioner) reported an installment capital gain derived from the sale of his interest in a partnership known as Eichler Brothers, an electrical appliance retail store located in New York City.

2. On July 11, 1975, the Audit Division issued a Statement of Audit Changes to petitioner wherein \$12,500.00, which represented petitioner's share of the gain on the sale of the partnership, which was allocated to a covenant not to compete, was held taxable as ordinary income rather than capital gain, as reported by petitioner. Additionally, said statement included various other adjustments and modifications, but since the record shows no indication of petitioner contesting such other adjustments and modifications, they are therefore not at issue herein. Accordingly, a Notice of Deficiency was issued against petitioners on December 20, 1976 asserting additional personal income tax of \$1,535.38, plus interest of \$424.01, for a total due of \$1,959.39. Said notice was timely issued since on December 17, 1975 petitioners executed a form extending the period of limitation upon assessment of personal income tax to April 15, 1977.

3. Although the sales agreement is not part of the record, analysis of the file revealed the following breakdown of the sales price:

assets	\$ 5,000.00
goodwill	10,588.00
covenant not to compete	25,000.00
total sales price	<u>\$40,588.00</u>

4. Petitioner realized that generally a gain derived from the sale of a covenant not to compete is taxable as ordinary income, but he argued that due to the circumstances surrounding the sale at issue, such gain should properly be considered as part of the goodwill, and as such it qualifies for capital gains treatment.

5. Petitioner contended that the business was sold with the intention that both he and his brother, the other partner, would then retire to Israel, which they subsequently did. Accordingly, he argued that the covenant not to

compete is valueless. Additionally, he argued that the covenant, which he contended was a ten year restrictive covenant throughout the continental United States, had no independent significance or economic reality when applied to the seller (petitioner).

6. Petitioner further argued that the gain from sale should properly be treated entirely as a capital gain since the agreement not to compete accompanied the transfer of goodwill and it was apparent that the covenant had the primary function of assuring to the purchaser the beneficial enjoyment of the goodwill he has acquired. Accordingly, he claimed the agreement is regarded as non-severable and as being, in effect, a contributing element to the assets transferred.

7. Petitioner did not submit, and the record does not contain any documentary evidence with respect to the sales agreement or covenant not to compete. Further, the record is void of information concerning the manner in which Eichler Brothers conducted business.

CONCLUSIONS OF LAW

A. That where the parties to a transaction involving the sale of a business have entered into an agreement spelling out the precise amount to be paid for a covenant not to compete, a party can challenge the tax consequences of this agreement only by adducing proof which in an action between the parties to the agreement would be admissible to alter that construction or to show its unenforceability because of mistake, undue influence, fraud, duress and like reasons. (C. L. Danielson, (CA-3) 67-1 USTC 9423, 378 F.2d 771. cert. denied, 389 U.S. 858.)

B. That even though the buyer knew that the sellers had no intentions to compete with the transferred business, the valuation of the covenant was

binding on the sellers for tax purposes, since they were not induced by fraud or undue influence to accept the covenant (A. A. Proulx, CtCls, 77-2 USTC 9758).

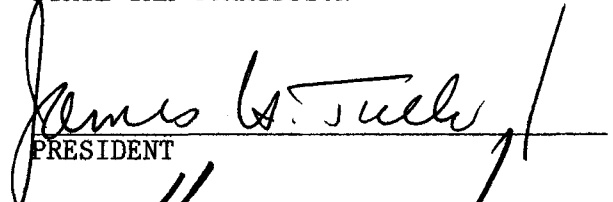
C. That petitioner has failed to sustain his burden of proof required pursuant to section 689(e) of the Tax Law to show that he was induced by fraud, undue duress or like reasons to accept the covenant. Accordingly, the valuation is binding and the amount realized which was allocated in the contract for the purchase of the covenant is taxable as ordinary income.

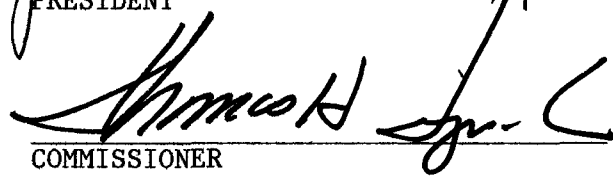
D. That the petition of Ignatz Eichler and Belle Eichler is denied and the Notice of Deficiency dated December 20, 1976, is sustained together with such additional interest as may be lawfully owing.

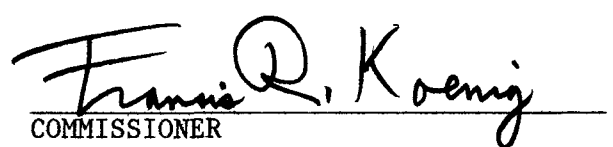
DATED: Albany, New York

JUL 03 1981

STATE TAX COMMISSION


PRESIDENT


COMMISSIONER


COMMISSIONER