

STATE OF NEW YORK
STATE TAX COMMISSION

In the Matter of the Petition :
of :
Elizabeth H. Todd, as Executrix :
of the Estate of Gordon B. Todd (dec'd) : AFFIDAVIT OF MAILING
for Redetermination of a Deficiency or a Revision :
of a Determination or a Refund of :
Personal Income Tax & UBT :
under Article 22 & 23 of the Tax Law :
for the Years 1960 - 1971. :

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 2nd day of March, 1981, he served the within notice of December by certified mail upon Elizabeth H. Todd, as Executrix, of the Estate of Gordon B. Todd (dec'd), the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Elizabeth H. Todd, as Executrix
of the Estate of Gordon B. Todd (dec'd)
c/o Hawkins, Delafield & Wood
67 Wall St.
New York, NY 10005

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
2nd day of March, 1981.

Cornelia P. Hagelund

J. Vredenburg

STATE OF NEW YORK
STATE TAX COMMISSION

In the Matter of the Petition :
of
Elizabeth H. Todd, as Executrix :
of the Estate of Gordon B. Todd (dec'd) : AFFIDAVIT OF MAILING
for Redetermination of a Deficiency or a Revision :
of a Determination or a Refund of
Personal Income Tax & UBT :
under Article 22 & 23 of the Tax Law
for the Years 1960 - 1971. :

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 2nd day of March, 1981, he served the within notice of December by certified mail upon James R. Eustis 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. James R. Eustis
Hawkins, Delafield & Wood
67 Wall St.
New York, NY 10005

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
2nd day of March, 1981.

Annex A. Haglund

Jay Vredenburg

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

March 2, 1981

Elizabeth H. Todd, as Executrix
of the Estate of Gordon B. Todd (dec'd)
c/o Hawkins, Delafield & Wood
67 Wall St.
New York, NY 10005

Dear Ms. Todd:

Please take notice of the December of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 690 & 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 m 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
James R. Eustis
Hawkins, Delafield & Wood
67 Wall St.
New York, NY 10005
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition	:	
of	:	
ELIZABETH H. TODD, as Executrix of	:	DECISION
the Estate of GORDON B. TODD, Deceased	:	
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 Years 1960 through 1971.	:	

Elizabeth H. Todd, as executrix of the estate of Gordon B. Todd, c/o Hawkins, Delafield & Wood, Esqs., 67 Wall Street, New York, New York 10005, 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 years 1960 through 1971 (File No. 20310).

On February 4, 1980, petitioner, by Hawkins, Delafield & Wood, Esqs. (James R. Eustis, Jr., Esq., of counsel) and the Audit Division, by Ralph J. Vecchio, Esq. (Frank Levitt, Esq. of counsel) executed a Consent to Submission without Hearing, the matter to be determined on the basis of facts set forth in the Stipulation of Facts, submitted by petitioner and deemed stipulated by order of the State Tax Commission, December 19, 1979.

ISSUE

Whether the activities of the taxpayer in writing puts and calls, taken together with his transactions in securities, constituted engagement in an unincorporated business so as to subject his income from said activities to taxation pursuant to Article 23 of the Tax Law.

FINDINGS OF FACT

1. Gordon B. and Elizabeth H. Todd did not file any unincorporated business tax returns for the years 1960 through 1971.

2. On December 20, 1976, the Audit Division issued a Notice of Deficiency (File No. 4-53343854) which asserted against the Estate of Gordon B. Todd deficiencies in personal and unincorporated business taxes in the net amount of \$83,442.00, after reduction for overpayment of personal income tax by Gordon B. Todd in the years 1969 and 1972. Of said amount, \$1,236.00 was attributable to underpayments of personal income tax for 1964 and 1965, and \$93,527.00 was attributable to unincorporated business taxes, scheduled as follows:

<u>TAXABLE YEAR</u>	<u>UBT</u>	<u>INTEREST</u>
1960	\$ 6,110.00	\$ 4,399.20
1961	3,820.00	2,521.20
1962	5,402.00	4,141.53
1963	3,514.00	2,673.52
1964	5,431.00	4,545.52 *
1965	7,369.00	4,838.19 *
1966	8,795.00	5,108.31
1967	9,457.00	4,925.39
1968	12,141.00	5,594.82
1969	2,521.00	1,010.47
1970	11,558.00	3,939.20
1971	17,409.00	4,888.80
	<u>\$93,527.00</u>	<u>\$48,586.15</u>

* Included interest on deficiencies in personal income tax for 1964 and 1965.

The deficiencies in tax for 1969, 1970 and 1971 were reduced as a result of allowing net operating losses to be carried back from 1972, 1973 and 1974.

3. Each year until 1975, decedent and/or petitioner had executed consents extending the period of limitation for assessment of personal income and unincorporated business taxes up to and including April 15, 1977.

4. On March 14, 1977, Elizabeth H. Todd, as executrix of the estate of Gordon B. Todd, filed a petition for redetermination of the deficiencies in unincorporated business taxes for each of the years at issue and in effect, conceded the asserted personal income tax liabilities for 1964 and 1965. Petitioner subsequently filed a Demand for Hearing on September 30, 1977. As

heretofore stated, petitioner's counsel and counsel for the Audit Division thereafter consented to submission of this matter to the State Tax Commission without formal hearing.

5. Petitioner's motion to compel stipulation was granted, and the facts set forth in the Stipulation of Facts submitted by petitioner were deemed stipulated by order of the State Tax Commission, December 19, 1979. The following facts are found in accordance with said Stipulation and in accordance with other materials in the file, as presently constituted.

6. Gordon B. Todd (the "decendent") died on March 10, 1975, leaving his wife Elizabeth H. Todd who was named executrix of his estate.

7. During the taxable years at issue, decedent derived his income primarily from ownership of and transactions in securities, and during said period decedent had occasion to write put and call options, both negotiable and non-negotiable. In the brief filed on behalf of the Estate of Gordon B. Todd, it was argued that petitioner was not a dealer in options and accordingly he was not engaged in a business subject to unincorporated business tax.

8. A stock option in the securities market is

"a negotiable contract paid for in advance, in which the holder has the right to buy (in the case of a 'call' contract) or sell (in the case of a 'put' contract) a specified number of shares of stock (generally 100) at a fixed price (normally the market price at the time the contract is made) at any time within the period covered by the contract (usually 30, 60 or 90 days or 6 months)." Anthony M. Reinach, 24 T.C. Memo. 1605, 1606 (1965), aff'd, 373 F.2d 900 (2d Cir.), cert. denied, 389 U.S. 841 (1967).

9. A put and call writer is

"the individual who agrees to sell stock on or before a specific future date, at a specified price, if he issues a 'call' or to buy stock on or before a specific future date, at a specified price if he issues a 'put'." Anthony M. Reinach, supra at 1606.

10. The option writer receives a premium. In the case of a call option, if the stock price remains the same or increases, the writer's profit equals the difference between the contract price and his adjusted basis in the shares, plus the amount of the premium; if the stock price declines, any loss incurred upon subsequent disposition of the shares is lessened by the amount of the premium. In the case of a put option, the writer profits from an unexercised option if the market price of the shares remains the same or rises; if the price of the shares declines, the writer exercises the option and offsets the loss incurred with the premium received.

11. In all instances in which he wrote negotiable options, either decedent was solicited by a member of the Put and Call Brokers and Dealers Association, or he telephoned a member broker or dealer and offered to write an option. (Decedent was not a member of said Association.) Decedent then utilized the standard forms prepared by the Association. After endorsement by a member firm of the New York Stock Exchange with which decedent had an account, the options, then freely negotiable, were surrendered to the member of the Association involved in the particular transaction. The broker or dealer paid decedent a premium and thereafter retailed the option to a customer at a price which included the broker's commission.

12. Decedent's practice was never to write a call option against stock he did not own nor against stock which if called away would result in a capital loss. Nor did decedent write put options in respect of stock he had no interest in acquiring.

13. From time to time decedent also wrote non-negotiable options for a "select group," comprised of approximately twenty relatives and long-time acquaintances. Under rather informal arrangements, decedent agreed to purchase

from (a put) or sell to (a call) the individual on or before a specified date a specified number of shares at the contract price, with the tacit understanding between the parties that should the market price rise (in the case of a call) or fall (in the case of a put) in an amount sufficient to justify exercise of the option, decedent would deliver the equity in the contract (i.e., the difference between the then prevailing market price and the contract price) rather than the underlying shares. These options were not written on the standard forms of the Put and Call Brokers and Dealers Association.

14. On or about May 28, 1962, Gordon B. Todd filed an application for registration as a broker and dealer, pursuant to the Securities Exchange Act of 1934, under the name of Gordon B. Todd & Co. (a partnership). Prior to said date he operated as a sole proprietor under the name of Gordon B. Todd (a sole proprietorship). On July 6, 1962, the Securities and Exchange Commission (the "SEC") granted the application of Gordon B. Todd & Co., a partnership, succeeding to the assets of Gordon B. Todd, a sole proprietorship. Subsequently, a letter dated July 10, 1962, addressed to Gordon B. Todd d/b/a Gordon B. Todd & Co. was received from the SEC enclosing a form for the withdrawal of the registration with the SEC of Gordon B. Todd & Co., a sole proprietorship. The executed form was forwarded to the SEC under the date of July 12, 1962. The SEC acknowledged that this notice of withdrawal was filed on July 16, 1962, and that it was to become effective thirty days thereafter. In a letter addressed to the SEC, under date of July 20, 1962, petitioner stated that "In the verified statement of financial condition as of April 30, 1962, which accompanied form BD, Application for Registration of Gordon B. Todd & Co., a partnership, under the column 'Liabilities and Net Worth' it will be noted that Gordon B. Todd & Co. carried no customers' accounts... and the carrying of customers' accounts is not contemplated in the future".

15. The accounting firm of Haskins and Sells submitted to decedent on or about April 11, 1972, a review of his option activity for the years 1950 through 1968 which, among other things, showed the percentages of gross premiums on negotiable and non-negotiable options. The percentages for the years 1956 through 1961 were as follows:

<u>YEAR</u>	<u>GROSS PREMIUMS</u>	<u>PREMIUMS ON NON- NEGOTIABLE OPTIONS WRITTEN FOR OUTSIDE INDIVIDUALS</u>	<u>PERCENTAGE OF GROSS PREMIUMS ON NON- NEGOTIABLE OPTIONS</u>	<u>PERCENTAGE OF GROSS PREMIUMS ON NEGOTIABLE OPTIONS</u>
1956	\$159,778.00	\$19,107.00	11.9	88.1
1957	55,953.00	8,044.00	14.3	85.7
1958	111,787.00	12,710.00	11.4	88.6
1959	367,220.00	14,406.00	4.0	96.0
1960	201,012.00	8,767.00	4.4	95.6
1961	570,829.00	4,149.00	0.72	99.28

During 1962, decedent wrote one non-negotiable option; during 1963, he wrote two such options. Thereafter, he wrote no non-negotiable options.

16. Reports made by decedent to the Securities and Exchange Commission on his financial condition reflected the market value of shares on or against which he wrote negotiable options ("share values"), compared with the market value of all securities owned by decedent ("portfolio values"). The comparative values were as follows:

<u>YEAR</u>	<u>SHARE VALUES</u>	<u>PORTFOLIO VALUES</u>	<u>SHARE VALUES AS A PERCENTAGE OF PORTFOLIO VALUES</u>
1955	\$ 725,147.50	\$3,357,708.61	21.6
1956	956,888.85	3,662,626.81	26.1
1957	247,712.50	3,341,239.03	7.4
1958	660,287.50	4,478,211.49	14.7
1959	1,629,137.50	5,191,745.28	31.4
1960	862,713.75	4,680,986.74	18.4
1961	2,348,500.50	6,595,109.82	35.6
1962	2,227,500.00	5,726,177.00	38.8

17. On December 16, 1964, the State Tax Commission conducted a formal hearing to adduce evidence on several issues, among them, whether decedent was a "dealer" in securities in his own unincorporated business and thus subject

to unincorporated business taxes for the taxable years 1945 through 1954. On July 7, 1971, the Commission issued its determination which stated, in relevant part:

"The business activities of the taxpayer in buying and holding stocks are inseparable from his activities of using such stocks in his dealings as a writer of puts and calls and conversions.

"The business activities of the taxpayer constituted the carrying on of an unincorporated business within the meaning and intent of Article 16-A of the Tax Law."

On or about October 1, 1971, an Article 78 proceeding was initiated in the Supreme Court, County of Albany, on behalf of Gordon B. and Elizabeth H. Todd to review the aforesaid determination. The proceeding was transferred to the Appellate Division, Third Department, pursuant to a stipulation by the attorneys for the parties. Subsequent correspondence and meetings among representatives of the office of the Attorney General, representatives of the Department of Taxation and Finance and the attorneys for the petitioners resulted in a settlement and a stipulation of discontinuance of the court proceeding. Under the terms of the settlement, decedent was deemed to be subject to taxation under Article 16-A for the years 1945 through 1954, for the reason that by writing options, he was engaged in an unincorporated business.

18. By her petition herein, Elizabeth H. Todd sought redetermination of the asserted deficiencies in unincorporated business taxes for 1960 through 1971, and refund of overpayments of personal income taxes for 1964 and 1965, with interest thereon.

CONCLUSIONS OF LAW

A. That the activities of decedent Gordon B. Todd as an option writer together with his transactions in securities during the years 1960 and 1961 and up to July 16, 1962, constituted the carrying on of an unincorporated

business within the meaning and intent of section 703(a) of the Tax Law and 20 NYCRR 203.1(a) (substantially the same as the aforementioned State Tax Commission Regulation 20 NYCRR 281.2); that Mr. Todd's activities as an option writer subsequent to July 16, 1962, were those of a "trader" and did not constitute the carrying on of an unincorporated business within the meaning and intent of section 703(d) of the Tax Law.

B. That the distinction between a "dealer" and a "trader" (an individual holding and trading securities or similar property for his own account) arises essentially from Federal tax law, particularly section 1221 of the Internal Revenue Code. The current definition of dealer contained in 20 NYCRR 203.12(a) was patterned directly after Treasury Regulation section 1.471-5 and provides as follows:

"For purposes of this subdivision, a dealer in real or personal property is an individual or unincorporated entity with an established place of business, regularly engaged in the purchase of property and its resale to customers; that is, one who (as a merchant) buys property and sells it to customers with a view to the gains and profits that may be derived therefrom."

Moreover, section 702 of the Tax Law prescribes that:

"Any term used in this article shall have the same meaning as when used in a comparable context in the laws of the United States relating to federal income taxes, unless a different meaning is clearly required."

C. That the Tax Court explained the dealer/trader distinction as follows:

"Those who sell 'to customers' are comparable to a merchant in that they purchase their stock in trade, in this case securities, with the expectation of reselling at a profit, not because of a rise in value during the interval of time between purchase and resale, but merely because they have or hope to find a market of buyers who will purchase from them at a price in excess of their cost. This excess or mark-up represents remuneration for their labors as a middle man bringing together buyer and seller, and performing the usual services of retailer or wholesaler of goods. [Citations omitted.] Such sellers are known as 'dealers'.

"Contrasted to 'dealers' are those sellers of securities who perform no such merchandising functions and whose status as to the source of supply is not significantly different from that of those to whom they sell. That is, the securities are as easily accessible to one as the other and the seller performs no services that need be compensated for by a mark-up of the price of the securities he sells. The sellers depend upon such circumstances as a rise in value or an advantageous purchase to enable them to sell at a price in excess of cost. Such sellers are known as 'traders.'" George R. Kemon, 16 T.C. 1026, 1032-33 (1951), acq. 1951-2 C.B.3.

D. That in order to satisfy the definition of "dealer" the taxpayer must, at a minimum, have customers and must hold property primarily for sale. Subsequent to July 16, 1962 decedent satisfied neither of the foregoing criteria.

E. That the regulations promulgated by the Commission under Article 16-A and under Article 23 directed that, in determining whether the taxpayer's activities constituted the carrying on of an unincorporated business, consideration must be given to "the continuity, frequency and regularity of activities" as distinguished from casual or incidental transactions, and to the amount of time, energy and thought devoted to the activities. Article 4 of the Unincorporated Business Income Tax Regulations; 20 NYCRR 203.1(a) (added February 1, 1974, subsequent to the years at issue).

However, these factors were deemed to be immaterial, under the Article 16-A regulations, in the case of a taxpayer who regularly and frequently traded in securities on his own account:

"22. Q. Is an individual who devotes the greater part of his time, energy and thought to stock or commodity markets, and trades with frequency and regularity in securities and commodities, carrying on an unincorporated business? A. No, unless such transactions are connected with a business regularly carried on by the individual. This is in accord with section 386 of the Tax Law..." Article 4 of the Unincorporated Business Income Tax Regulations.

F. That subdivision (d) of section 703 of the Tax Law, as amended by Chapter 215 of the laws of 1976, specifically excludes from the definition of

activities which are deemed to comprise an unincorporated business, the purchase and sale of property by the taxpayer, or the purchase, sale or writing of stock options by the taxpayer, or both, for his own account. The purpose of said amendment was set forth in a memorandum by the Department of Taxation and Finance:

"Section 703(d) of the Unincorporated Business Tax and Section 632(d) of the Personal Income Tax were adopted principally in order to encourage individual and other unincorporated entities to trade on the New York and American Stock Exchanges and the Over the Counter markets located in this State, without concern that such activities might constitute engaging in a business in this State and thus subject to these taxes. Considering the relatively high rate of these taxes it was clear that their imposition would be a substantial deterrent to the active participation of investors in the New York securities markets...

"It is essential, if the AMEX is going to compete effectively with the CBOE that comparable provisions of the Unincorporated Business Tax and Personal Income Tax apply to options trading in the same manner as now apply to the trading of stocks and other securities...

"This legislation is intended to make it clear that all transactions in stock options, whether establishing initial positions or offsetting and cancelling existing positions and regardless of other portfolio transactions or securities positions of the investor, constitute transactions entitled to the same potentially beneficially [sic] treatment provided purchases and sales of stock, securities and other property under the amended sections." New York State Legislative Annual p.339-40 (1976).

G. That the petition of Elizabeth H. Todd, as executrix of the Estate of Gordon B. Todd, is granted to the extent shown in Conclusion of Law "A" supra; and that, except as so granted, the petition is in all other respects denied.

DATED: Albany, New York

MAR - 2 1981

STATE TAX COMMISSION
[Signature]
PRESIDENT
[Signature]
COMMISSIONER
[Signature]
COMMISSIONER