STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition of Harry K. & Frances B. Megson	:	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 1974.	:	

State of New York
County of Albany

Connie Hagelund, 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 8th day of July, 1983, she served the within notice of Decision by certified mail upon Harry K. & Frances B. Megson, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Harry K. & Frances B. Megson
Kinney Rd.
Hebron, CT 06248

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
8th day of July, 1983.

Connie P. Hagelund

Kathy Pfaffenbach
AUTHORIZED TO ADMINISTER
OATHS PURSUANT TO TAX LAW
SECTION 174

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition of Harry K. & Frances B. Megson	:	AFFIDAVIT OF MAILING
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State of New York
County of Albany

Connie Hagelund, 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 8th day of July, 1983, she served the within notice of Decision by certified mail upon Edward Feinberg the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Edward Feinberg
Tate, Bishko & Ruthman
1698 Central Ave.
Albany, NY 12205

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
8th day of July, 1983.

Connie A. Hagelund

Kathy Kappenbach
AUTHORIZED TO ADMINISTER
OATHS PURSUANT TO TAX LAW
SECTION 174

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

July 8, 1983

Harry K. & Frances B. Megson
Kinney Rd.
Hebron, CT 06248

Dear Mr. & Mrs. Megson:

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 Law 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
Law Bureau - Litigation Unit
Building #9 State Campus
Albany, New York 12227
Phone # (518) 457-2070

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative
Edward Feinberg
Tate, Bishko & Ruthman
1698 Central Ave.
Albany, NY 12205
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition of HARRY K. AND FRANCES B. MEGSON for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Year 1974.	DECISION

Petitioners, Harry K. and Frances B. Megson, Kinney Road, Hebron, Connecticut 06248, 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 1974 (File No. 30396).

A formal hearing was held before Frank W. Barrie, Hearing Officer, at the offices of the State Tax Commission, State Campus, Building 9, Albany, New York, on July 21, 1982 at 1:15 P.M. Petitioners appeared by Tate, Bishko & Ruthman, Esqs. (Edward Feinberg, Esq., of counsel). The Audit Division appeared by Paul B. Coburn, Esq. (Harry Kadish, Esq., of counsel).

ISSUES

I. Whether a Federal-State match card (Exhibit F), page 2 of a United States form 1040 (Exhibit H), a copy of a United States form 1040 (Exhibit L), a dummy return (Exhibit G) and a copy of a United States partnership return (Exhibit J) were properly admitted into evidence.

II. Whether the burden of proof is upon the Audit Division, and, if not, whether it is unconstitutional to impose the burden of proof upon petitioners.

III. Whether petitioners were domiciled in and residents of New York State for income tax purposes during 1974 and required to file a resident New York income tax return for such year.

IV. Whether petitioner, Harry K. Megson, sold or liquidated his partnership interest in a Connecticut partnership.

V. Whether petitioners are taxable on the entire amount that petitioner, Harry K. Megson, received from the Connecticut partnership during 1974 if he was a resident of New York on the last day of 1974, the day on which the calendar year of the Connecticut partnership ended, or whether such income may be allocated between the period during 1974 that petitioner, Harry K. Megson, was a resident of Connecticut and the period during 1974 that he was a resident of New York.

VI. Whether petitioners should be allowed all of their deductions and/or credits for 1974 in lieu of a standard deduction if the 1974 partnership income is taxable by New York.

VII. Whether penalties should be waived and interest reduced.

FINDINGS OF FACT

1. Petitioners, Harry K. and Frances B. Megson, filed a joint United States income tax return for 1974. However, they did not file a New York State personal income tax return for 1974. Frances B. Megson, the wife of Harry K. Megson, is a party herein merely by reason that she filed a 1974 United States income tax return jointly with her husband. References to "petitioner" hereinafter will be to Harry K. Megson.

2. On April 18, 1978, the Audit Division issued a Statement of Audit Changes against petitioners showing personal income tax due of $11,099.30 and additions to tax under Tax Law §685(a)(1) and §685(a)(2) of $4,550.71 plus interest of $2,838.09, for a total claimed due of $18,488.10. The following explanation was provided:

> "Since you failed to reply to our two previous letters, your 1974 Personal Income Tax Liability has been computed from information

obtained from the Internal Revenue Service under authorization of Federal Law (Section 6103(d) of the Internal Revenue Code)."

The Statement of Audit Changes also showed the following computation:

Total Federal Adjusted Gross Income	$91,812.00
Maximum Standard Deduction	2,000.00
Balance	$89,812.00
Exemptions	4,550.00
New York Taxable Income	$85,262.00
PERSONAL INCOME TAX DUE	$11,099.30

3. On April 11, 1980, the Audit Division issued a Notice of Deficiency against petitioners showing a tax deficiency of $11,099.30, plus penalty and/or interest of $9,978.32, for a total balance due of $21,077.62. A copy of the Statement of Audit Changes described in Finding of Fact "2" herein was attached to the Notice of Deficiency.

4. The Audit Division prepared a 1974 New York State Income Tax Resident Return for petitioners and calculated the personal income tax due based on information furnished to it by the Internal Revenue Service on a New York State Income Tax Bureau Federal-State Match Card. Such card showed federal adjusted gross income of $91,812.00 for Harry K. and Frances B. Megson. In determining the tax due, the Audit Division utilized a standard deduction of $2,000.00. However, petitioners claimed itemized deductions of $16,053.35 for Federal tax purposes. The Audit Division also allowed petitioners seven personal exemptions.

5. Petitioner and Reino Hyyppa were equal partners, each with a one-half interest, in the Connecticut partnership of Megson and Hyyppa. Both men are professional engineers and land surveyors. The partnership, during the tax year at issue, employed fourteen employees including two other engineers. Its engineering and land surveying business was largely conducted in Hartford and Middlesex counties in Connecticut. No business was conducted in New York State and none of its income was generated from New York sources. The partnership,

which was formed on March 22, 1957, was very successful with total income before deductions of $411,645.98 and ordinary income of $217,652.56 for 1974.

6. Notwithstanding the partnership's success, petitioner determined that he wanted to withdraw from the partnership. Petitioner testified that he "was under a lot of pressure, spent a lot of time away from the family. We started to consider a different life style sometime in probably late January (of 1974)." As a result, on April 8, 1974, petitioner informed his partner, Reino Hyyppa, that he was leaving the partnership. Petitioner had decided to purchase a farm with dairy and breeding cattle, in Coopersville,[1] New York.

7. Petitioner testified that it was not until late July that his partner informed him that he intended to buy out petitioner's interest in the partnership.

8. The partnership agreement dated January 15, 1960 (hereinafter "the 1960 agreement") provided in paragraph 19 that:

> "(i)n the event that either partner desires to withdraw from the business and sell his interest in the said partnership, he shall give written notice thereof to the other partner, who shall have an option for a period of sixty days from the receipt of such written notice to purchase said interest at a price determined in accordance with the provisions of paragraph 11 and 15 hereof, payment to be made in the same manner except the entire price will be covered by the promissory note provided for in paragraph 15."

Paragraphs 11 and 15 of the 1960 agreement provided, in part, as follows:

> "11. In the event of the death of a partner, the surviving partner shall pay the deceased partner's estate for his interest in the partnership..., the net share value of the deceased partner's interest in the partnership determined by its regular accountant by adding to the capital account of the deceased partner, determined on the cash accounting basis, the deceased partner's share of the value of work in process, and accounts receivable, plus in addition the sum of Ten Thousand ($10,000.00) Dollars representing good will...".

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[1] According to petitioner, Coopersville is a section of Champlain, New York and the record, at times, refers to the farm as being located in Champlain, New York.

"15. In the event that the value of such deceased partner's interest as determined in paragraph 11 hereof exceeds the total proceeds of such policies, the surviving partner shall pay said total proceeds to the representative of the deceased partner's estate, and then concurrently with such payment...shall execute and deliver to said legal representative a promissory note carrying no interest in the amount of the excess of such value over the amount of such insurance proceeds, said notes to be paid in monthly payments of Three Hundred ($300.00) Dollars each until fully paid...".

9. No part of the 1960 agreement speaks to the concept of liquidation.

10. Although petitioner felt that "ten thousand dollars was not enough for the goodwill", on July 25, 1974, he orally accepted the terms for his withdrawal specified in the 1960 agreement described in Finding of Fact "8" herein since "the alternate choice of liquidation was not pleasing to me because some of our employees have become personal friends. I knew their families. I did not want to see the partnership liquidated and these people put out of work."

11. However, on July 26, 1974, Reino Hyyppa informed petitioner that he would agree to an additional term "which represented a percent of an amount over a fixed figure ($35,000) that he would earn and then would allocate additional monies to me." But petitioner never received any monies from Reino Hyyppa pursuant to such additional term.

12. It appears from the record that neither petitioner nor Reino Hyyppa had legal counsel in negotiating the agreement dated August 16, 1974 under which petitioner withdrew from the partnership (hereinafter, "the 1974 agreement"). David R. Lynch, a Connecticut attorney, who represented the partnership during 1967 through 1974 and who prepared the 1974 agreement testified that he was merely the "scrivener" of such agreement, "drawing the agreement that they (Reino Hyyppa and petitioner) had reached." Mr. Lynch testified that "we were involved in a sale for Mr. Megson to Mr. Hyyppa."

13. Petitioner argues that the 1974 agreement was a purchase and sale agreement between petitioner and Reino Hyyppa and points to (i) the language of purchase and sale in the recitals and sections 2, 3 and 6 of the agreement, and (ii) that the agreement established an obligor-obligee relationship between petitioner and Reino Hyyppa rather than between petitioner and the partnership. In the recitals, Reino Hyyppa is named as the acquirer of Megson's partnership interest. However, use of the words "retire" and "retiring"[2] in the recitals and section 2, respectively, of the 1974 agreement creates ambiguity whether the withdrawal by petitioner from the partnership was a sale or a liquidation.

14. David R. Lynch testified that he used the 1960 agreement as a basis for the 1974 agreement. Some of the terms of payment for petitioner's partnership interest reflect the 1960 agreement.

15. Under the 1974 agreement, Reino Hyyppa agreed to pay petitioner: (i) $10,000.00 upon execution of the agreement for petitioner's interest in partnership equipment as described in Schedule A attached to the agreement, (ii) $10,000.00 for goodwill to be paid pursuant to "a promissory note bearing no interest, payable in equal monthly principal payments of Three Hundred ($300.00) Dollars commencing on the 5th day of November 1974...", (iii) fifty percent of the accounts receivable to be collected,[3] and (iv) additional compensation as described in Finding of Fact "11" herein.

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[2] A partner whose interest in a partnership is liquidated, generally is referred to as a retiring partner.

[3] The 1974 agreement provided that "all expenses, bills for services to the partnership, debts or other obligations...shall be deducted from funds collected from accounts receivable and work in process...".

16. The 1974 agreement contained a covenant by petitioner not to compete and a provision whereby petitioner warranted that he had not contracted any debtor obligations with regard to the assets or property being transferred.

17. Petitioner testified that "(a)t the time, I had no intention of going back to Connecticut and I didn't object to it (the covenant not to compete)."

18. Petitioner received a check in the amount of $10,000.00 on August 16, 1974 from Reino Hyyppa pursuant to paragraph 4 of the August 16, 1974 agreement. On the same day, he also received a promissory note as described in Finding of Fact "15".

19. In a letter dated June 1, 1978 from petitioner to Richard E. Coffey (Exhibit N), petitioner stated that "(f)rom August 24, 1974 through December 12, 1974 I received $50,000.00 from the engineering firm all of it being money from accounts collected for work completed prior to August 2, 1974."

20. Petitioner did not perform services for the partnership after August 4, 1974, which was the effective date of the 1974 agreement, although it was executed on August 16, 1974. August 4, 1974 was chosen as the effective date since it was the Sunday nearest to the last work week in July, and according to petitioner "the intent and purpose was that the termination would be the end of July, adjusted to the end of the closest work week."

21. Petitioner testified that Reino Hyyppa continued in business under the name of Reino E. Hyyppa, d/b/a Megson and Hyyppa; that the business continued to be listed in the telephone directory under "Megson and Hyyppa"; and that a sign over the door to the business says Reino Hyyppa and immediately under it "Megson and Hyyppa".

22. David R. Lynch represented petitioners in the sale of their residence in Hebron, Connecticut. The contract for the sale of the property was entered

into on May 21, 1974. Petitioners had the right to occupy the premises until September 1, 1974, and as of August 16, 1974, petitioner was still occupying the premises.

23. On April 4, 1974, petitioner signed a contract for the purchase of a farm in Coopersville, New York. The seller of the farm, the Bechard family, did not vacate the farm until August 14, 1974. Petitioner's wife, Frances B. Megson, and three of their children preceded petitioner to the farm on August 15, 1974 with the household goods. They did not stay in the house until August 16, 1974. Petitioner left Connecticut on August 17, 1974 and stayed in the house on that night. However, the closing on the farm was not until August 19, 1974.

24. In Coopersville, New York, petitioner's farming operation included the raising of breeding and dairy cattle which petitioner testified lost money in 1974 "in the neighborhood of fifteen thousand dollars".

25. Petitioner testified that he is "not qualified to answer..." why he did not report a capital gain resulting from the sale of his partnership interest for the 1974 tax year.

26. Petitioner did not present evidence of the 1974 U.S. partnership return of income for Megson and Hyyppa or of his 1974 United States income tax return. However, Exhibit J, which is an alleged copy of such partnership return, and Exhibit L, which is an alleged copy of petitioner's 1974 United States income tax return, were introduced into evidence by the Audit Division over the objection of petitioner's representative.

27. Exhibit J shows that at the end of the partnership's 1974 calendar year, petitioner still had a capital account of $7,563.93. Exhibit L does not show a capital gain resulting from the sale by petitioner of his partnership interest. Rather petitioner reported $108,826.28 as ordinary partnership

income on Schedules E and R of his United States Individual Income Tax Return, Form 1040, and on Schedule SE, petitioner computed social security self-employment tax on such sum.

28. Petitioner testified that the reason why he did not file a New York State income tax return for 1974 "was because it was my opinion that we had not generated any taxable income in the State of New York and that we had taken a loss on our farm". In addition, he testified that he was not familiar with the procedure for filing a return since he came from a state that did not have a state income tax.

CONCLUSIONS OF LAW

A. That the State Administrative Procedure Act §306.2 provides, in part, that:

> "All evidence, including records and documents in the possession of the agency of which it desires to avail itself, shall be offered and made a part of the record, and all such documentary evidence may be received in the form of copies or excerpts, or by incorporation by reference."

Therefore, the Federal-State match card (Exhibit F), page 2 of a United States form 1040 (Exhibit H), a copy of a United States form 1040 (Exhibit L), a dummy return (Exhibit G) and a copy of a United States partnership return (Exhibit J) were properly admitted into evidence.

B. That pursuant to Tax Law §689(e), the burden of proof in this proceeding is on petitioner. There is no jurisdiction at the administrative level to determine whether §689(e) is unconstitutional since it imposes the burden of proof upon petitioner, although we note that the case cited by petitioner, People ex rel. Monjo v. S.T.C., 218 A.D.1 (3rd Dept. 1926), is not pertinent since that case involved the taxation by New York of a resident of Connecticut

while in the matter at hand, New York is seeking to tax the income of a New York resident, albeit income derived from a Connecticut source.

C. That 20 NYCRR §102.2(d)(2) provides that "(a) domicile once established continues until the person in question moves to a new location with the bona fide intention of making his fixed and permanent home there." Petitioner, Harry K. Megson, moved to the farm in Coopersville, New York, on August 17, 1974 with the intent to abandon his domicile in Connecticut and to establish a new domicile in New York. Therefore, on such date, he became a domiciliary of New York.

20 NYCRR §102.2(d)(5) provides that "(o)rdinarily a wife's domicile follows that of her husband...". Therefore, petitioner, Frances B. Megson, also became a domiciliary of New York on August 17, 1974 although she moved into the New York residence a day earlier than her husband.

D. That pursuant to Tax Law §605(a)(1), petitioners were resident individuals of New York for the period August 17, 1974 through December 31, 1974.

E. That pursuant to Tax Law §651(a)(1)(A), since petitioners were required to file a federal income tax return for 1974, they were required to file New York income tax returns for 1974.[4]

F. That Tax Law §681 provides that:

> "(i)f a taxpayer fails to file an income tax return required under this article, the tax commission is authorized to estimate the taxpayer's New York taxable income and tax thereon, from any information in its possession...".

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[4] Pursuant to Tax Law §654(a), petitioners were required to file one return as residents for the portion of the year during which they were residents, and one return as nonresidents for the portion of the year during which they were nonresidents.

Therefore, it was reasonable for the Audit Division to estimate petitioners' New York taxable income and tax thereon based on information in its possession including the Federal-State match card (Exhibit F), and pursuant to Tax Law §689(e), the burden of proving that such estimate was incorrect shifts to petitioners.

G. That petitioners have failed to sustain their burden of proof to show that the income from the Connecticut partnership of Megson and Hyyppa should be characterized and treated as a capital gain on the sale of Harry K. Megson's interest in the partnership.[5] The petitioner failed to explain why the partnership return for 1974[6] shows that at the end of the partnership's 1974 calendar year, petitioner still had a capital account since if he had sold his partnership interest pursuant to the 1974 agreement, his capital account would be reduced to zero. In addition, petitioner failed to explain why on his 1974 United States income tax return,[7] he did not report a capital gain if in fact he sold his partnership interest. We note that the economic consequences of the sale of a partnership interest and the liquidation of a partnership's interest may be indistinguishable. Finding of Fact "10" reflects petitioner's failure to understand that a liquidation of his partnership interest does not necessarily

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[5] If such income was characterized as a capital gain, it would not be taxable to New York since it would have been earned during the period that petitioner was a domiciliary of Connecticut.

[6] Petitioner objected to the introduction of the Audit Division's copy of such return. Nevertheless, it is reasonable to assume the accuracy of such copy, since if petitioner's copy of his return showed that his capital account was zero, he would have certainly introduced it into evidence.

[7] We also assume the accuracy of the Audit Division's copy of petitioner's United States income tax return which shows the failure by petitioner to report a capital gain from the sale of his partnership interest during 1974. If petitioner's copy of his return showed that he reported such capital gain, it is reasonable to assume that he would have introduced it into evidence.

mean the liquidation of the business, and that the sale of his partnership interest would not necessarily prevent the liquidation of the business. Rather, tax considerations generally control the form in which a partner's withdrawal from a partnership is cast.

H. That 20 NYCRR §148.6 provides, in part, as follows:

> "Where a member of a partnership changes his status from resident to nonresident or vice versa, his distributive share of partnership income, gain, loss and deduction shall be included in the computation of his taxable income for the portion of the taxable year in which or with which the taxable year of the partnership ends, and treatment of his distributive share for New York income tax purposes shall be determined by his status as a resident or nonresident at such time. Such distributive share of partnership income, gain, loss and deduction is not prorated between the separate resident and nonresident returns required under this Part."

Since petitioner was a resident of New York on December 31, 1974, the day on which the 1974 taxable year of the partnership ended, his distributive share from the partnership is taxable by New York pursuant to Tax Law §611 and §612. Since petitioners are taxable as resident individuals of New York, it is irrelevant that the distributive share is derived from a Connecticut partnership. In addition, we note that the case cited by petitioners, McLaughlin v. State Tax Commission, 448 N.Y.S.2d 891, is not pertinent since in that matter the taxpayer's federal adjusted gross income did not include the entire distributive share of income from a West German partnership since the controlling provisions of the Internal Revenue Code did not mandate taxation of the petitioner's entire distributive share when she was a resident of the United States for only the last month of the year at issue. In the matter at hand, however, petitioners' federal adjusted gross income, which is the starting point for calculating petitioners' New York adjusted gross income under Tax Law §612, does include petitioner's entire distributive share from the Connecticut partnership.

I. That although the Audit Division properly estimated petitioners' New York taxable income and tax thereon, it is reasonable to permit petitioners to utilize their actual deductions and/or credits for 1974 in lieu of a standard deduction as they have requested. Therefore, the Audit Division is directed to allow appropriate itemized deductions attributable to New York.

J. That petitioners' failure to file a 1974 New York State income tax return was due to reasonable cause and not willful neglect. Accordingly, the penalties asserted pursuant to Tax Law §685(a)(1) and §685(a)(2) are cancelled, and interest should be calculated as prescribed by law.

K. That the petition of Harry K. and Frances B. Megson is granted to the extent indicated in Conclusions of Law "I" and "J", supra, and that, except as so granted, the petition is in all other respects denied.

DATED: Albany, New York
JUL 08 1983

STATE TAX COMMISSION

PRESIDENT

COMMISSIONER

COMMISSIONER