

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
Ronald A. & Margaret L. Capone : AFFIDAVIT OF MAILING

for Redetermination of a Deficiency or Revision :
of a Determination or Refund of NYS Personal Income :
Tax under Article 22 of the Tax Law for the Years :
1976 through 1979 and NYC Nonresident Earnings Tax :
under Chapter 46, Title U of the Administrative :
Code of the City of New York for the Years 1976 - :
1979. :

State of New York }
County of Albany } ss.:

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 9th day of July, 1984, he served the within notice of Decision by certified mail upon Ronald A. & Margaret L. Capone, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Ronald A. & Margaret L. Capone
3134 N. Piedmont St.
Arlington, VA 22207

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office 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
9th day of July, 1984.

David Parchuck

John A. [Signature]
Authorized to administer oaths
pursuant to Tax Law section 174

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

July 9, 1984

Ronald A. & Margaret L. Capone
3134 N. Piedmont St.
Arlington, VA 22207

Dear Mr. & Mrs. Capone:

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 & 1312 of the Tax Law, a proceeding in court to review an adverse decision by the State Tax Commission may be instituted only 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: Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition

of

RONALD A. AND MARGARET L. CAPONE

for Redetermination of a Deficiency or for
Refund of New York State Personal Income Tax
under Article 22 of the Tax Law for the Years
1976 through 1979 and New York City Nonresident
Earnings Tax under Chapter 46, Title U of the
Administrative Code of the City of New York for
the Years 1976 through 1979.

In the Matter of the Petition

of

RUSSELL T. AND VIRGINIA L. WEIL

for Redetermination of a Deficiency or for
Refund of New York State Personal Income Tax
under Article 22 of the Tax Law for the Years
1976 and 1977 and New York City Nonresident
Earnings Tax under Chapter 46, Title U of the
Administrative Code of the City of New York for
the Years 1976 and 1977.

In the Matter of the Petition

of

ROBERT J. AND ELEANOR L. HICKEY

for Redetermination of a Deficiency or for
Refund of New York State Personal Income Tax
under Article 22 of the Tax Law for the Years
1976 through 1979 and New York City Nonresident
Earnings Tax under Chapter 46, Title U of the
Administrative Code of the City of New York for
the Years 1976 through 1979.

DECISION

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of
Russell T. & Virginia L. Weil
Kirlin, Campbell & Keating : AFFIDAVIT OF MAILING

for Redetermination of a Deficiency or Revision :
of a Determination or Refund of NYS Personal Income :
Tax under Article 22 of the Tax Law for the Years :
1976 and 1977 and NYC Nonresident Earnings Tax :
under Chapter 46, Title U of the Administrative :
Code of the City of New York for the Years 1976 :
and 1977. :

State of New York }
County of Albany } ss.:

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 9th day of July, 1984, he served the within notice of Decision by certified mail upon Russell T. & Virginia L. Weil, Kirlin, Campbell & Keating the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Russell T. & Virginia L. Weil
Kirlin, Campbell & Keating
The Connecticut Bldg.
1150 Connecticut Ave., N.W. Suite 800
Washington, DC 20036

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office 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
9th day of July, 1984.

David Parchuck

James P. Haggard
Authorized to administer oaths
pursuant to Tax Law section 174

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

July 9, 1984

Russell T. & Virginia L. Weil
Kirlin, Campbell & Keating
The Connecticut Bldg.
1150 Connecticut Ave., N.W. Suite 800
Washington, DC 20036

Dear Mr. & Mrs. Weil:

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 & 1312 of the Tax Law, a proceeding in court to review an adverse decision by the State Tax Commission may be instituted only 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: Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
Stuart S. & Mary I. Dye : AFFIDAVIT OF MAILING

for Redetermination of a Deficiency or Revision :
of a Determination or Refund of NYS Personal Income :
Tax under Article 22 of the Tax Law for the Years :
1976 and 1977 and NYC Nonresident Earnings Tax :
under Chapter 46, Title U of the Administrative :
Code of the City of New York for the Years 1976 :
and 1977. :

State of New York }
County of Albany } ss.:

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 9th day of July, 1984, he served the within notice of Decision by certified mail upon Stuart S. & Mary I. Dye, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Stuart S. & Mary I. Dye
5511 Parkston Rd.
Bethesda, MD 20016

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office 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
9th day of July, 1984.

David Parchuck

James A. Hagedorn

Authorized to administer oaths
pursuant to Tax Law section 174

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

July 9, 1984

Stuart S. & Mary I. Dye
5511 Parkston Rd.
Bethesda, MD 20016

Dear Mr. & Mrs. Dye:

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 & 1312 of the Tax Law, a proceeding in court to review an adverse decision by the State Tax Commission may be instituted only 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: Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
Robert J. & Eleanor L. Hickey : AFFIDAVIT OF MAILING

for Redetermination of a Deficiency or Revision :
of a Determination or Refund of NYS Personal Income :
Tax under Article 22 of the Tax Law for the Years :
1976 through 1979 and NYC Nonresident Earnings Tax :
under Chapter 46, Title U of the Administrative :
Code of the City of New York for the Years 1976 - :
1979. :

State of New York }
County of Albany } ss.:

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 9th day of July, 1984, he served the within notice of Decision by certified mail upon Robert J. & Eleanor L. Hickey, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Robert J. & Eleanor L. Hickey
5601 Lambeth Rd.
Bethesda, MD 20014

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office 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
9th day of July, 1984.

David Parchuck

Anna A. Hagedorn
Authorized to administer oaths
pursuant to Tax Law section 174

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

July 9, 1984

Robert J. & Eleanor L. Hickey
5601 Lambeth Rd.
Bethesda, MD 20014

Dear Mr. & Mrs. Hickey:

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 & 1312 of the Tax Law, a proceeding in court to review an adverse decision by the State Tax Commission may be instituted only 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:

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

Very truly yours,

STATE TAX COMMISSION

cc: Taxing Bureau's Representative

In the Matter of the Petition	:	
	:	
of	:	
	:	
STUART S. AND MARY I. DYE	:	DECISION
	:	
for Redetermination of a Deficiency or for	:	
Refund of New York State Personal Income Tax	:	
under Article 22 of the Tax Law for the Years	:	
1976 and 1977 and New York City Nonresident	:	
Earnings Tax under Chapter 46, Title U of the	:	
Administrative Code of the City of New York for	:	
the Years 1976 and 1977.	:	

Petitioners Ronald A. and Margaret L. Capone, 3134 North Piedmont Street, Arlington, Virginia 22207, filed a petition for redetermination of a deficiency or for refund of New York State personal income tax under Article 22 of the Tax Law for the Years 1976 through 1979 and New York City nonresident earnings tax under Chapter 46, Title U of the Administrative Code of the City of New York for the years 1976 through 1979 (File Nos. 30420 and 30436).

Petitioners Russell T. and Virginia L. Weil, c/o Kirlin, Campbell & Keating, The Connecticut Building, 1150 Connecticut Avenue N.W., Suite 800, Washington, D.C. 20036, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the years 1976 and 1977 and New York City nonresident earnings tax under Chapter 46, Title U of the Administrative Code of the City of New York for the years 1976 and 1977 (File No. 30468).

Petitioners Robert J. and Eleanor L. Hickey, 5601 Lambeth Road, Bethesda, Maryland 20014, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the years 1976 through 1979 and New York City nonresident earnings tax under Chapter 46,

Title U of the Administrative Code of the City of New York for the years 1976 through 1979 (File Nos. 30462 and 31940).

Petitioners Stuart S. and Mary I. Dye, 5511 Parkston Road, Bethesda, Maryland 20016, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the years 1976 and 1977 and New York City nonresident earnings tax under Chapter 46, Title U of the Administrative Code of the City of New York for the years 1976 and 1977 (File No. 30592).

A formal hearing was commenced before Arthur Bray, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on October 27, 1981 at 10:30 A.M. and concluded at the same offices on October 28, 1981, with all briefs to be submitted on or before September 9, 1983. Petitioners appeared pro se. The Audit Division appeared by Ralph J. Vecchio, Esq. (Kevin A. Cahill, Esq., of counsel).

ISSUES

I. Whether it is unconstitutional to apply section 637 of the Tax Law to petitioners.

II. Whether the agreement between Kirlin, Campbell & Keating and Deputy Commissioner Donovan constituted an agreement pursuant to section 637(d) of the Tax Law; if not, whether such agreement should nonetheless be followed; and whether the failure to follow this agreement constituted an improper retroactive cancellation of the agreement.

III. Whether the incomes of the petitioners were attributable to a New York source and therefore taxable by New York State and New York City.

IV. Whether the notices of deficiency erroneously understated the ratio of Washington office net income to the net partnership income for 1976 and 1977 by

failing to consider the compensation paid to the Washington and New York junior partners as an expense.

FINDINGS OF FACT

1. On April 3, 1980, the Audit Division issued a Notice of Deficiency, accompanied by an explanatory Statement of Audit Changes to petitioners Ronald A. Capone and Margaret L. Capone, asserting a deficiency of New York State personal income tax and New York City nonresident earnings tax for the years 1976 and 1977. The Notice asserted a total deficiency of tax of \$31,029.36, plus interest of \$6,290.65, for a total amount due of \$37,320.01. On April 28, 1980, the Audit Division issued two notices of deficiency, with accompanying statements of audit changes, to petitioners Ronald A. Capone and Margaret L. Capone, asserting deficiencies of New York State personal income tax and New York City nonresident earnings tax for, respectively, the years 1978 and 1979. The Notice for the year 1978 asserted a deficiency of \$14,169.27, plus interest of \$1,247.31, for a total amount due of \$15,416.58. The Notice for the year 1979 asserted a deficiency of \$15,600.87, plus interest of \$47.26, for a total amount due of \$15,648.13.

2. On June 20, 1980, petitioners Ronald A. Capone and Margaret L. Capone, filed petitions for redetermination of the above-mentioned notices of deficiency. On December 18, 1980, they submitted payments to the Audit Division of \$39,957.51 for 1976 and 1977, \$16,620.97 for 1978 and \$16,973.77 for 1979 and they amended their petitions to claim a refund of said payments. The purpose of the payments was to stop the accrual of interest.

3. On April 14, 1980, the Audit Division issued a Notice of Deficiency, accompanied by an explanatory Statement of Audit Changes, to petitioners Russell T. Weil and Virginia L. Weil, asserting a deficiency of New York State

personal income tax and New York City nonresident earnings tax for the years 1976 and 1977. The tax asserted to be due was \$12,592.69, plus interest of \$2,600.21, for a total amount due of \$15,192.90.

4. On April 14, 1980, the Audit Division issued a Notice of Deficiency, accompanied by an explanatory Statement of Audit Changes, to petitioners Robert J. Hickey and Eleanor L. Hickey, asserting a deficiency of New York State personal income tax and New York City nonresident earnings tax for the years 1976 and 1977. The total amount of the deficiency of tax asserted was \$9,072.11, plus interest of \$1,824.41, for a total amount due of \$10,896.52. On October 1, 1980, the Audit Division issued a Notice of Deficiency, accompanied by an explanatory Statement of Audit Changes, to petitioners Robert J. Hickey and Eleanor L. Hickey, asserting a deficiency of New York State personal income tax and New York City nonresident earnings tax for the years 1978 and 1979. The total tax asserted to be due in the latter Notice was \$14,328.63, plus interest of \$1,037.97, for a total amount due of \$15,366.42.

5. On April 14, 1980, the Audit Division issued a Notice of Deficiency, accompanied by an explanatory Statement of Audit Changes, to petitioners Stuart S. Dye and Mary I. Dye, asserting a deficiency of New York State personal income tax and New York City nonresident earnings tax plus interest for the years 1976 and 1977. The total amount of tax allegedly due was \$7,167.88, plus interest of \$1,536.24, for a total of \$8,704.12.

6. The statements of audit changes which accompanied each of the foregoing notices of deficiency stated, in substance, that each of the petitioners¹ were partners in a partnership which did business both within and without the State

¹ Unless otherwise stated, references to petitioners shall be a reference to Ronald A. Capone, Russell T. Weil, Robert J. Hickey and Stuart S. Dye.

and City of New York. Accordingly, the Audit Division determined that New York State personal income tax and New York City nonresident earnings tax were due based upon an allocation percentage computed by the Audit Division and the distributive shares of partnership income reported by the partnership on its partnership returns as distributed to each partner. In determining the partnership's allocation percentage, the Audit Division did not treat the compensation of the junior partners as an expense. Instead, such compensation was added to the partnership net income and the Washington office net income.

7. Kirlin, Campbell & Keating (hereinafter "the partnership") is a partnership engaged in the full-time practice of law with offices in Washington, D.C. (the "Washington office") and New York City (the "New York City office").

8. During the years 1976 through 1979, petitioner Ronald A. Capone was a resident senior partner of the Washington office. Petitioner Russell T. Weil was a resident senior partner of the Washington office during the years 1976 and 1977. Petitioner Robert J. Hickey was a resident junior partner of the Washington office during 1976 and remained in that status until July, 1978 when he became a senior partner. Petitioner Stuart S. Dye was a resident junior partner of the Washington office during the years 1976 and 1977.

9. During the years in issue, Mr. & Mrs. Capone were residents of and filed income tax returns with the State of Virginia. Mr. and Mrs. Capone did not file New York State income tax returns or New York City nonresident earnings tax returns for the years 1976 through 1978. They did file a joint New York State Income Tax Nonresident Return for the year 1979. Mr. Capone indicated on this return, however, that he did not have any income subject to New York State tax.

10. During their respective years in issue, Russell T. Weil, Robert J. Hickey and Stuart S. Dye were residents of and filed tax returns with the State of Maryland.

11. Mr. and Mrs. Weil did not file New York State or New York City tax returns for the years 1976 and 1977.

12. Mr. and Mrs. Hickey did not file New York State or New York City tax returns for the years 1976 and 1977. They did file New York State income tax nonresident returns for the years 1978 and 1979. On the 1978 and 1979 returns, Robert J. Hickey attached a comment which stated that, based upon a determination of Deputy Commissioner Donovan, there was no New York income.

13. Mr. and Mrs. Dye did not file New York State or New York City tax returns for the years 1976 and 1977.

14. During the years in issue, each of the petitioners was a member of the District of Columbia bar and was not admitted to practice and did not practice law in New York State. All of their professional services were performed in the Washington office. None of the petitioners maintained an office or work space in New York during the years in question.

15. The status of Mr. Capone, Mr. Weil, Mr. Hickey and Mr. Dye, as partners with the Washington office, was held out to the public by the partnership's letterhead and the partnership's listing in the Martindale-Hubble Law Directory.

16. All matters handled by petitioners, during the years in issue, were the results of petitioners' activities in the Washington office, except for certain matters that generated relatively low fees compared to the total Washington income.

17. The substantive data on Washington office client matters, such as retainer agreements, time sheets and billable hours, were kept at the Washington office.

18. The partnership's Washington office maintained a bank account in the District of Columbia which was separate from the bank account maintained by the New York City office. Most of the fees generated by the Washington office were billed, collected and deposited by the Washington office into this account. There were instances, however, where services were rendered to the same client by both the New York and Washington offices. In such instances, the fees generated by the Washington office were billed and collected through the New York office based upon fees determined by the Washington office.

19. The fees and disbursements collected for the Washington office have, during the years in issue, been more than sufficient to cover all expenses in maintaining the Washington office, including compensation, rent and supplies. The records of gross receipts and expenses were maintained on an allocated basis during the years in issue between the New York and Washington offices. The net income of the Washington office was sufficient to meet all expenses and to provide a net flow of funds to the partners situated in New York. Failure to show a profit would have resulted in terminating the Washington partners' relationship with the New York firm.

20. During each of the years in issue, the income and expenses were reported to the partnership's accounting firm which, in turn, prepared the New York State partnership returns. The form IT-204A, encaptioned New York State Nonresident Partner Allocation Schedule, listed each of the petitioners as nonresident partners, during the respective years in issue, but stated that none of the petitioners' incomes was attributable to New York. Each of the

petitioners was issued a schedule K-1, Partner's Share of Income, Credits, Deductions, etc., by the partnership during the respective years in issue. The partnership did not withhold taxes or social security from any compensation received by petitioners during the respective years in issue.

21. The partnership's bookkeeping department, which was located in New York, issued all payroll checks. This office would also file all necessary federal forms. A portion of the expense of operating the bookkeeping department was allocated to the Washington office.

22. During the years in issue, it was the policy of the partnership that the compensation of the junior partners would be set at a level that was commensurate with that which attorneys of comparable skills and experience were receiving from other firms. However, the partnership did not try to meet the market price of some of the larger firms that were able to compensate attorneys at the higher levels.

23. Paragraph II of the partnership agreement, dated January 1, 1977, provided that junior partners were not required to sign the partnership agreements. However, said paragraph also provided that "...each Junior Partner shall execute an individual letter consenting to join the Firm, subject to the terms and conditions of this Agreement".

24. In accordance with the foregoing paragraph, when Mr. Hickey and Mr. Dye were invited to become junior partners with the Washington office, they were sent a letter by Mr. Capone. In each instance, the letter set a fixed rate of compensation. The letters also stated that a junior partnership "does not involve any participation in the profits or assets of the Firm".

25. Paragraph III of the partnership agreements placed all of the Firm's partners into one of two categories. Partners with 3,000 or more units were

considered class A, or senior partners, and those with 3,000 or less units were considered class B, or junior partners. This paragraph further provided:

"Each Partner shares in the joint and several liability and responsibility of all Partners regardless of their classification. It is agreed that each Class B or Junior Partner makes no contribution to the Firm's Capital Account. Each Class B or Junior Partner hereby waives any interest or right in the Firm's Capital Account, or in the Firm's name, or in the Firm's goodwill or other assets of the Firm, except as otherwise provided for in this Agreement."

26. As junior partners, Mr. Hickey and Mr. Dye were accorded fifty units. The fifty units given to each of the partnership's junior partners represented an interest of approximately .0002 percent in the partnership's net income.² The incomes of petitioners Robert J. Hickey and Stuart S. Dye, as junior partners, were not dependent on the partnership's profits and losses.

27. Paragraph V of the partnership agreements provided, in part, in regard to net income and allocation, that the compensation paid to class B or junior partners was to be treated as an expense.

28. The management of the partnership was generally placed in a "Management Committee" consisting of selected individuals. The Management Committee could delegate authority to act to a subcommittee. The junior partners waived their rights in the management and conduct of the partnership and did not participate in decision making. Similarly, they waived their right to see or inspect any of the partnership's books or financial documents and their right to a formal accounting.

29. It was expressed to petitioners Robert J. Hickey and Stuart S. Dye, as junior partners, that it was the intent of the partnership to treat the junior partners as employees.

² The actual interest of the junior partners in the partnership's net income was slightly greater. In view of the partnership's net income during the years in issue a distribution to the junior partners based upon their interest in the partnership's net income was not de minimis.

30. On May 29, 1969, Mr. Louis A. Palladino of the Unemployment Insurance Accounts Bureau of the New York State Department of Labor advised the partnership that the junior partners were employees. The partnership disagreed with the Department of Labor's conclusion and, consequently, the case was forwarded to a hearing. The outcome of this hearing is not disclosed by the record.

31. In November, 1971, the Audit Division initiated an investigation as to whether there was a deficiency of personal income tax from petitioner Ronald A. Capone for the years 1967 and 1968. The investigation also included Russell T. Weil who, at the time, was a junior partner.

32. On October 12, 1972, a conference was held in Albany between petitioners Ronald A. Capone, Russell T. Weil and a Mr. Sheehan, who was a partner associated with the New York office, and Deputy Commissioner Donovan, who at the time was the Director of the Income Tax Bureau, as well as other individuals representing the Income Tax Bureau. One portion of this conference was directed to whether the junior partners, such as Mr. Weil, should be considered employees. Another portion of the conference was directed to whether Mr. Capone, as a senior partner, should be required to pay New York income tax. At the conclusion of the hearing, Deputy Commissioner Donovan decided that further consideration was needed and he asked that the partnership agreement, as well as briefs discussing the situation of Mr. Capone and the junior partners, be filed.

33. On November 13, 1972, Deputy Commissioner Donovan advised Mr. Capone, by telephone, that Mr. Capone's file would be closed and that Mr. Capone would have no tax liability for prior years on the theory that the Washington office's income exceeded the costs of the Washington office and Mr. Capone's share of the partnership income. Deputy Commissioner Donovan also advised Mr. Capone that steps would be taken to assert tax liability if the New York partners'

deduction for Washington office income plus Mr. Capone's share exceeded the Washington office's income.

34. In a letter dated November 22, 1972, Deputy Commissioner Donovan advised Mr. Sheehan of the following decision:

"With respect to the Messrs. Weil and..., I have concluded that they were employees of Kirlin, Campbell & Keating. Since they were not residents of New York State and did not perform any services within New York State, they are not subject to tax on the salaries received from the partnership.

I have decided not to ask Mr. Capone to file returns for the years 1967 through 1971. The manner in which the nonresident partners attached to the New York office reported their distributive shares of income resulted in tax revenue to the State of New York in an aggregate amount approximating the revenue which would result if I were to insist upon Mr. Capone filing returns for the years 1967 through 1971.

For subsequent years, I must reserve the right to require a change in the method of reporting partnership income on the individual nonresident returns for any year in which the State of New York would suffer a loss in tax revenue."

35. In reliance upon the method set forth by Deputy Commissioner Donovan, petitioners did not sever their relations with the partnership or attempt to terminate or rearrange the New York office/Washington office arrangement. Moreover, petitioner Ronald A. Capone periodically advised each individual whom he invited to become a junior partner that the Washington office had to make every effort to increase net income and keep expenses down as much as possible to be certain that there would be no tax exposure arising from the New York office. The junior partners were specifically advised of Mr. Donovan's letter agreement, as well as of his telephone conversation of November 13, 1972.

36. Each of the Washington office's petitioners settled their accounts between the partners and otherwise planned their personal affairs in reliance upon Mr. Donovan's agreement. It is not possible to retroactively reorganize

the financial arrangements and settlement of accounts between petitioners and the New York partners.

37. On March 1, 1978, a letter was sent out under the name of Mr. Joseph Styno, as an employee of the Audit Division, requesting petitioners to file returns for the year 1974. Mr. Styno was not aware of the letter at the time it was sent. On March 15, 1978, Mr. Sheehan replied to the letter and, among other things, called the Audit Division's attention to the Donovan letter of November 22, 1972. In a letter dated April 20, 1978, the Audit Division replied that the agreement entered into with Deputy Commissioner Donovan did not apply to the year 1974. In addition, the Audit Division indicated that it was going to expand the scope of the audit to encompass the year 1975 and subsequent years.

38. In a letter dated April 20, 1978, Mr. Styno acknowledged that the activities of the partnership had not changed since 1972. He opined, however, that section 637 of the Tax Law precluded the method of reporting income agreed to by Deputy Commissioner Donovan.

39. On March 23, 1980, petitioners' Capone, Weil and Hickey, together with two partners of the New York office, had a conference with the Director of the Audit Division and other persons in the Audit Division. At this meeting, the Director disagreed with petitioners' contentions and, thereafter, the notices of deficiency which are the subject of this proceeding were issued.

40. In accordance with section 307(1) of the New York State Administrative Procedure Act, petitioners' proposed findings of fact have generally been accepted and the substance thereof adopted herein. However, the following major changes are noted: Proposed findings of fact 10, 14, 16, 17, 18, 19, 20, 22, 28, 31 and 34 have been rejected either in total or in part because they

are either redundant or unnecessary to the determination. It is noted that proposed finding of fact 24 is also not fully supported by the record inasmuch as Robert J. Hickey and Stuart S. Dye did, in fact, sign the partnership agreement dated September 1, 1976. Proposed finding of fact 35 is rejected as argumentative and Finding of Fact 26 is substituted in its place.

CONCLUSIONS OF LAW

A. That the constitutionality of the laws of the State of New York is presumed at the administrative level.

B. That subdivision (d) of section 637 of the Tax Law provides:

"Alternate methods. -- The tax commission may, on application, authorize the use of such other methods of determining a nonresident partner's portion of partnership items derived from or connected with New York sources, and the modifications related thereto, as may be appropriate and equitable, on such terms and conditions as it may require."

That since there is nothing in the record to suggest that an application was made to the State Tax Commission to authorize petitioners' method of reporting income and that the State Tax Commission, in turn, approved of petitioner's method of reporting income, the arrangement approved by Deputy Commissioner Donovan may not be considered an alternate method under section 637(d) of the Tax Law.

C. That the method approved by Deputy Commissioner Donovan pertained to the years 1967 to 1971 alone. It is noted that Deputy Commissioner Donovan expressly reserved the right to change the method of reporting partnership income on the individual nonresident returns for subsequent years. Accordingly, there has not been a retroactive change in the agreement entered into with Deputy Commissioner Donovan. It is noted that since the agreement is violative of other subdivisions of section 637 of the Tax Law (see Conclusion of Law "E", infra), whether or not there has been a loss of revenue to the State of New

York is irrelevant. The State Tax Commission is not bound to follow an informal agreement that is not in conformity with the Tax Law of the State of New York.

D. That section 632(a)(1) of the Tax Law provides, in substance, that the New York adjusted gross income of a nonresident individual shall include the sum of the net amount of the items of income, gain, loss and deduction entering into that individual's federal adjusted gross income which are derived from or connected with New York sources. Section 632(a)(1)(A) of the Tax Law further provides that these items include the nonresident individual's "...distributive share of partnership income, gain, loss and deduction, determined under section six hundred thirty-seven...". The income subject to the New York City nonresident earnings tax is computed in the same manner [Administrative Code of the City of New York, §§U46-1.0(f); U46-4.0(a)].

E. That section 637(a)(1) of the Tax Law, in defining the portion of income derived from New York sources, provides:

"In determining New York adjusted gross income of a nonresident partner of any partnership, there shall be included only the portion derived from or connected with New York sources of such partner's distributive share of items of partnership income, gain, loss and deduction entering into his federal adjusted gross income, as such portion shall be determined under regulations of the tax commission consistent with the applicable rules of section six hundred thirty-two."

F. That since it is acknowledged that Ronald A. Capone and Russell T. Weil were nonresident partners of a New York partnership, the Audit Division properly concluded that they were taxable upon their distributive share of partnership income which was attributable to the partnership's activities in New York (Tax Law §637(a)(1); see Matter of Weinflash v. Tully, 93 A.D.2d 369, 373).

G. That petitioners Stuart S. Dye and Robert J. Hickey are considered partners of Kirlin, Campbell & Keating for tax purposes during the respective

periods that they served as junior partners. It is recognized that said petitioners had a small interest in the profits of the partnership, received a fixed salary, and did not participate in the management of the firm. Nevertheless, since petitioners chose to be designated partners and were held out to the public as partners, they must accept the tax consequences of their decision (Matter of Weinflash v. Tully, supra; see Matter of Faulkner, Dawkins & Sullivan v. State Tax Comm., 63 A.D.2d 764).

H. That section 637(b)(1) of the Tax Law provides, in part:

"In determining the sources of a nonresident partner's income, no effect shall be given to a provision in the partnership agreement which --

(1) characterizes payments to the partner as being for services or for the use of capital,...".

I. That in view of section 637(b)(1) of the Tax Law, the Audit Division properly determined that the payments to the junior partners were distributions of partnership income which were connected with New York State and subject to New York State and New York City taxation (see Matter of Baum v. State Tax Comm., 89 A.D.2d 646, 647, mot. for lv. to app. den. 57 N.Y.2d 607; cf., Matter of Faulkner, Dawkins & Sullivan v. State Tax Comm., supra).


J. That the petitions and amended petitions of Ronald A. and Margaret L. Capone are denied and the Audit Division is directed to determine whether the payments (see Finding of Fact "2", supra) resulted in an underpayment or overpayment of the notices of deficiency which are sustained.

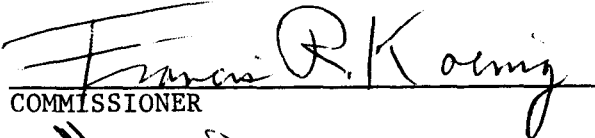
K. That the petitions of Russell T. and Virginia L. Weil, Robert J. and Eleanor L. Hickey and Stuart S. and Mary I. Dye are denied and the notices of deficiency are sustained.

DATED: Albany, New York

STATE TAX COMMISSION

JUL 09 1984


PRESIDENT


COMMISSIONER


COMMISSIONER