

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
Andrew J. & Jacqueline Connelly : AFFIDAVIT OF MAILING
for Redetermination of a Deficiency or Revision :
of a Determination or Refund of Personal Income :
Tax under Article 22 of the Tax Law for the Years :
1974 & 1975.

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

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 20th day of January, 1984, he served the within notice of Decision by certified mail upon Andrew J. & Jacqueline Connelly, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:


Andrew J. & Jacqueline Connelly
6 Place De La Republique Dominicaine
75017 Paris, FRANCE

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
20th day of January, 1984.




pursuant to Tax Law section 174

Authorized to administer oaths

STATE OF NEW YORK

STATE TAX COMMISSION

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of :
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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 20th day of January, 1984, he served the within notice of Decision by certified mail upon H. John Steele, the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

H. John Steele
Dewey, Ballantine, Bushby, Palmer & Wood
101 Park Ave.
New York, NY 10178

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 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
20th day of January, 1984.




pursuant to Tax Law section 174

Authorized to administer oaths

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

January 20, 1984

Andrew J. & Jacqueline Connelly
6 Place De La Republique Dominicaine
75017 Paris, FRANCE

Dear Mr. & Mrs. Connelly:

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, 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: Petitioner's Representative
H. John Steele
Dewey, Ballantine, Bushby, Palmer & Wood
101 Park Ave.
New York, NY 10178
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

| | | |
|------------------------------------------------|---|----------|
| In the Matter of the Petition | : | |
| of | : | |
| ANDREW J. AND JACQUELINE CONNELLY | : | DECISION |
| for Redetermination of a Deficiency or for | : | |
| Refund of Personal Income Tax under Article 22 | : | |
| of the Tax Law for the Years 1974 and 1975. | : | |

Petitioners, Andrew J. and Jacqueline Connelly, 6 Place De La Republique Dominicaine, 75011 Paris, France, 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 1974 and 1975 (File No. 26532).

A formal hearing was held before James Hoefer, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on March 10, 1983 at 1:15 P.M., with all briefs to be submitted by May 27, 1983. Petitioners appeared by Dewey, Ballantine, Bushby, Palmer & Wood, Esqs. (H. John Steele, Esq., of counsel). The Audit Division appeared by John P. Dugan, Esq. (William Fox, Esq., of counsel).

ISSUE

Whether the Audit Division properly treated amounts designated as "guaranteed payments" and "cost of living allowances" received by a non-resident partner of a New York partnership as taxable to New York.

FINDINGS OF FACT

1. On December 15, 1977, the Audit Division issued a Statement of Audit Changes against petitioners, Andrew J. Connelly and Jacqueline H. Connelly,¹

¹ Jacqueline Connelly is a party to this proceeding for the sole reason that she filed joint tax returns with her husband for the years at issue. Accordingly, hereinafter the term "petitioner" refers solely to Andrew J. Connelly.

alleging a personal income tax deficiency of \$3,775.29 plus interest and \$6,646.46 plus interest for the 1974 and 1975 tax years, respectively. The following explanation was provided:

"Schedule A-1, allocation of wage and salary income to New York State, may not be used to allocate a distribution of partnership income.

A distribution of partnership income may be allocated only on the basis of the partnership allocation percentage. Since the partnership of Dewey, Ballantine, Bushby, Palmer and Wood did not allocate its income, your full distributive share of such partnership income is reportable for New York State tax purposes.

Further, payments to a partner constitutes a distribution of partnership ordinary income and may not be treated as salary income for New York State tax purposes."

2. The Audit Division computed the alleged tax deficiencies noted in Finding of Fact "1", supra, as follows:

| | <u>1974</u> | <u>1975</u> |
|--------------------------------------------------|--------------------|--------------------|
| Partnership income per return | \$44,651.00 | \$47,150.00 |
| Payments to partners | <u>27,500.00</u> | <u>45,355.00</u> |
| Corrected total income | \$72,151.00 | \$92,505.00 |
| Add: Unincorporated business tax modification | <u>4,028.00</u> | <u>4,855.00</u> |
| Total New York income | \$76,179.00 | \$97,360.00 |
| New York itemized deductions | <u>3,945.00</u> | <u>2,728.00</u> |
| Balance | \$72,234.00 | \$94,632.00 |
| Personal exemptions | <u>3,226.00</u> | <u>3,218.00</u> |
| Taxable income | \$69,008.00 | \$91,414.00 |
| New York tax on income | \$ 8,661.20 | \$12,022.10 |
| Add: Tax surcharge | | 300.55 |
| Total tax due | <u>\$ 8,661.20</u> | <u>\$12,322.65</u> |
| Less: Tax previously stated | <u>4,885.91</u> | <u>5,676.19</u> |
| Additional personal income tax due | \$ 3,775.29 | \$ 6,646.46 |

3. On April 4, 1978, the Audit Division issued a Notice of Deficiency against petitioners alleging a tax deficiency of \$10,421.75 plus interest for the tax years at issue. A copy of the Statement of Audit Changes described in Finding of Fact "1", supra, was attached thereto.

4. Petitioners filed a Form IT-203, New York State Income Tax Nonresident Return, for each of the years at issue and reported New York taxable income of \$43,839.40 and \$48,185.00 for 1974 and 1975, respectively. They allocated none of petitioner Andrew J. Connelly's "wages" of \$27,500.00 and \$45,355.00 to New York for 1974 and 1975, respectively. Such "wages" consisted of guaranteed payments and cost of living allowances² received by petitioner from the law firm of Dewey, Ballantine, Bushby, Palmer & Wood (hereinafter "the partnership") of which petitioner was a partner.

5. Petitioner practiced law in the partnership's Paris, France office and, during each of the years at issue, received remuneration from the partnership consisting of a guaranteed payment, a cost of living allowance and a distributive share of partnership ordinary income. The record is unclear whether petitioner's right to receive guaranteed payments and cost of living allowances was pursuant to the partnership agreement, a collateral written agreement, or merely a verbal arrangement.

6. The partnership allocated one hundred percent of its income to New York sources³ and petitioner concedes that his entire distributive share of partnership ordinary income is taxable to New York. However, petitioners contend that the guaranteed payment and cost of living allowance for each year at issue are not taxable to New York as New York source income.

² The partnership apparently paid additional remuneration to petitioner due to the added expense of maintaining a residence in Paris, France.

³ The record is unclear why a New York partnership which apparently maintained office(s) outside of New York State would nevertheless allocate one hundred percent of its income to New York. However, petitioner did not contest the propriety of such allocation or introduce any evidence to show that it was incorrect.

7. Petitioners argue that their rights under the United States Constitution would be violated if the Audit Division may include guaranteed payments and cost of living allowances in their New York taxable income. They also contend that pursuant to Tax Law §637(d), "The cost of living allowance and guaranteed payment should appropriately and equitably be characterized as non-New York source income."

8. Petitioners, in their brief filed subsequent to the hearing herein, noted that they claimed the I.R.C. §911 exclusion for foreign source income for New York income tax purposes for the years at issue.

CONCLUSIONS OF LAW

A. That Tax Law §637(a)(1) provides, in part, as follows:

"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..."

B. That Tax Law §637(b) provides, in part, as follows:

"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, or

(2) allocates to the partner, as income or gain from sources outside New York, a greater proportion of his distributive share of partnership income or gain than the ratio of partnership income or gain from sources outside New York to partnership income or gain from all sources, except as authorized in subsection (d), or..."

C. That since petitioner was a partner in the law partnership, all payments by the partnership to him must be treated as distributions of partnership income and may not be characterized as payments for services rendered in the form of guaranteed payments or cost of living allowances. See Baum v. State

Tax Commission, 89 A.D.2d 646 and Jablin v. State Tax Commission, 65 A.D.2d

891. Since the partnership allocated one hundred percent of its income to New York, the Audit Division properly treated the payments at issue as income connected with a New York source and subject to New York State income taxation.

D. That we reject petitioner's application under Tax Law §637(d) to exclude the payments at issue from his income subject to New York personal income tax. In particular, we note that petitioner claimed the I.R.C. §911 exclusion for foreign source income for New York income tax purposes. In addition, if the partnership maintained a bona fide office in Paris, France, it would have been entitled during the years at issue to allocate a portion of its income outside of New York. Petitioner is bound by the decision of his partnership to allocate one hundred percent of its income to New York. Therefore, we conclude that the well-settled law noted in Conclusion of Law "C", supra, should not be ignored in this instance.

E. That Tax Law §637(b) is presumed to be constitutionally valid at the administrative level of the New York State Tax Commission.

F. That the petition of Andrew J. and Jacqueline Connelly is denied in all respects.

DATED: Albany, New York

JAN 20 1984

STATE TAX COMMISSION

Roderick W. Allen
PRESIDENT

Francis R. Koehn
COMMISSIONER

Mark J. Sullivan
COMMISSIONER