

STATE TAX COMMISSION

Aaron F. Mandelbaum : AFFIDAVIT OF MAILING

State of New York }

SS.:

County of Albany }

Aaron F. Mandelbaum
411 Woodmere Blvd.
Woodmere, NY 11598

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
15th day of June, 1984.

David Parcluck

James A. Suprenant
Authorized to administer oaths
pursuant to Tax Law section 174

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition
of

Aaron F. Mandelbaum : AFFIDAVIT OF MAILING

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

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 15th day of June, 1984, he served the within notice of Decision by certified mail upon Daniel J. Guida, the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Daniel J. Guida
Fliegel & Guida
231 Vermont Ave.
Oceanside, NY 11572

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
15th day of June, 1984.

David Parchuck

Constance A. Harland
Authorized to administer oaths
pursuant to Tax Law section 174

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

June 15, 1984

Aaron F. Mandelbaum
411 Woodmere Blvd.
Woodmere, NY 11598

Dear Mr. Mandelbaum:

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: Petitioner's Representative
Daniel J. Guida
Fliegel & Guida
231 Vermont Ave.
Oceanside, NY 11572
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition	:	
	:	
of	:	
	:	
AARON F. MANDELBAUM	:	DECISION
	:	
for Redetermination of a Deficiency or for	:	
Refund of Personal Income Tax under Article 22	:	
of the Tax Law and New York City Non-Resident	:	
Earnings Tax under Chapter 46, Title U of the	:	
Administrative Code of the City of New York for	:	
the Years 1976 and 1977.	:	

Petitioner, Aaron F. Mandelbaum, 411 Woodmere Boulevard, Woodmere, New York 11598, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law and New York City non-resident 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. 31616).

A formal hearing was held before Daniel J. Ranalli, Hearing Officer at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on June 23, 1983 at 1:15 P.M., with all briefs to be submitted by September 15, 1983. Petitioner appeared by Fliegel & Guida (Daniel J. Guida, C.P.A.). The Audit Division appeared by John P. Dugan, Esq. (Anna D. Colello, Esq., of counsel).

ISSUES

I. Whether the Audit Division properly disallowed a salary expense of petitioner's corporation and correctly added said expense to petitioner's income as a constructive dividend.

II. Whether the Audit Division properly determined that a loan made by petitioner to his corporation was, in fact, a contribution to capital and,

therefore, a reduction in the corporation's loan account amounted to a constructive dividend or return on capital to petitioner.

FINDINGS OF FACT

1. For the years 1976 and 1977 petitioner, Aaron F. Mandelbaum, and his wife, Rosalie, filed New York State income tax resident returns separately on combined returns and also filed New York City non-resident earnings tax returns.

2. On September 8, 1980, as the result of a field audit, the Audit Division issued a Notice of Deficiency against petitioner in the amount of \$7,067.15, plus interest of \$1,599.93, for a total due of \$8,667.08 for the years 1976 and 1977.

3. On March 2, 1980, petitioner and his wife signed a consent fixing the period of limitation upon assessment of personal income and unincorporated business taxes for the taxable year 1976 at October 15, 1980.

4. Petitioner is the president, sole officer and, apparently, sole stockholder of Mandy of Quality, Inc. ("Mandy"), a New York corporation engaged in the operation of a home improvement contracting business. The business originally was a sole proprietorship which was incorporated on or about January 1, 1973. At the time of incorporation, Mandy carried over onto its corporate books an account entitled "Officer's Loans Payable" in the amount of \$109,989.95. There was no owner's equity account and no stock was issued upon incorporation. Mandy's assets totalled \$311,433.36 and its liabilities amounted to \$311,144.36 leaving an owner's equity of \$289.00 resulting in a debt to equity ratio of approximately 1,000 to 1. Payments were made from the officer's loans payable account either directly to petitioner or to pay petitioner's personal expenses. Mandy did not carry a capital account on its books until 1975 when \$10,000.00 in stock was issued. In 1974, Mandy obtained a loan from Bankers Trust Company

which required, as a condition of the loan, that Mandy's loans due to petitioner be subordinated to the bank's loan. Mandy complied with this requirement.

5. On audit, the auditor decided that Mandy was under-capitalized and that the approximately \$110,000.00 in loans made by petitioner to Mandy were actually contributions to capital. For 1977, Mandy's general ledger reflected a reduction in the loan account of \$16,241.74 and this figure, taken together with an unexplained difference of \$19,274.12, resulted in a total reduction in the loan account of \$35,515.86, which was deemed to be a constructive dividend or return on capital. Tax year 1977 was the only year in which Mandy's income was sufficient to establish a constructive dividend or return on capital. Petitioner's personal income tax and New York City nonresident earnings tax for 1977 was adjusted to include in his income for that year the loan repayments deemed to be constructive dividends.

6. Petitioner maintains that the loans from him to Mandy were bona fide loans which were never intended to be capital contributions and that the Audit Division should not be able to deem the loans to be such merely because Mandy did not issue any stock until two years after its formation. However, at least one of the loans in the amount of \$66,529.90 was evidenced by a written promissory note dated February 5, 1974. No explanation was offered as to why said note was issued more than a year after Mandy was incorporated. Petitioner's representative asserted that this was the amount remaining to be paid on the original loan on the books on January 1, 1973.

7. For taxable years 1976 and 1977, Mandy claimed a salary expense for Rosalie Mandelbaum, the wife of petitioner. Mandy issued wage and tax statements (Form W-2) to Mrs. Mandelbaum for each of the aforesaid years. The forms indicated that Federal and State taxes and social security taxes were withheld.

8. On audit, the auditor went to Mandy's premises on four different occasions. Mrs. Mandelbaum was not present at the place of business during any of these visits. The auditor questioned several of Mandy's employees concerning the status of Mrs. Mandelbaum as an employee. The employees' responses were either evasive, vague or conflicting, with none of the employees actually sure of what Mrs. Mandelbaum's duties were, if any. Petitioner submitted several unsworn form statements from contractors indicating that Mrs. Mandelbaum solicited various leads for them as part of her duties for Mandy. Other than the statements, petitioner presented no direct evidence either through testimony or documentation to show whether Rosalie Mandelbaum performed any duties as an employee of Mandy.¹ Mrs. Mandelbaum was not an officer or stockholder of Mandy.

9. The Audit Division disallowed the salary expense with respect to Mrs. Mandelbaum and deemed it to be a constructive dividend to petitioner. Mr. and Mrs. Mandelbaum's personal income taxes and New York City nonresident earnings taxes were adjusted accordingly for each of the years 1976 and 1977. Petitioner argues that Mandy had nothing to gain by claiming Mrs. Mandelbaum as an employee since it incurred other expenses such as social security and unemployment compensation payments by listing Rosalie Mandelbaum as an employee.

CONCLUSIONS OF LAW

A. That, with certain exceptions not applicable herein, section 689(e) of the Tax Law places the burden of proof upon the petitioner. Although Mandy may well have had nothing to gain by claiming Rosalie Mandelbaum as an employee, there was simply too little evidence produced to substantiate that she was an employee. Petitioner has not shown that Mrs. Mandelbaum performed any substantial services which were of value to the corporation. In light of this and the fact

¹ In fact, petitioner offered no testimony on either issue.

that Mr. Mandelbaum was the sole stockholder of Mandy, it was proper for the Audit Division to consider the payments to Mrs. Mandelbaum an assignment of corporate income not deductible by Mandy and taxable to petitioner as a constructive dividend.

B. That "[a] corporation's financial structure in which a wholly inadequate part of the investment is attributed to stock while the bulk is represented by bonds or other evidence of indebtedness to stockholders is lacking in the substance necessary for recognition for tax purposes, and must be interpreted in accordance with realities" (Root v. Commissioner, 220 F.2d 240, 241). "The essential difference between a stockholder and a creditor is that the stockholder's intention is to embark upon the corporate adventure, taking the risks of loss attendant upon it so that he may enjoy the chances of profit. The creditor, on the other hand, does not intend to take such risks so far as they may be avoided, but merely to lend his capital to others who do intend to take them" (United States v. Title Guarantee & Trust Co., 133 F.2d 990, 993).

C. That among the factors which are significant in deciding whether an instrument or transaction creates debt or equity are: "thin" or inadequate capitalization, identity of interest between creditor and stockholder, the ability of the corporation to obtain loans from outside lending institutions and the status of the contribution in relation to regular corporate creditors (Slappey Drive Industrial Park v. United States, 561 F.2d 572, 582).

D. That, with an owner's equity of \$289.00, a debt-equity ratio of 1000 to 1, the lack of any capital account or issuance of any stock, it is obvious that the funds supplied by petitioner to Mandy did not constitute a loan to a company with adequately existing operating capital, but represented, instead, an advance of necessary working capital. "Such a situation closely parallels

that under which an investment of equity capital is made in a new venture..." (Hippodrome Building Co. v. Commissioner, 24 TCM 113 aff'd sub nom Fellinger v. United States, 363 F.2d 826). Moreover, Banker's Trust Co. would not agree to loan money to Mandy unless all loans due to officers were completely subordinated to the bank's loan. "The complete subordination effected by [this agreement] not only tends to wipe out a most significant characteristic of the creditor-debtor relationship, the right to share with general creditors in the assets in the event of dissolution or liquidation, (citation omitted), but it also destroys another basic attribute of creditor status: i.e., the power to demand payment at a fixed maturity date" (P.M. Finance Corp. v. Commissioner, 302 F.2d 786, 790).

E. That, while no one of the aforementioned debt-equity factors necessarily indicates the existence of a capital contribution rather than a loan in this case, all of the facts taken as a whole and combined with the fact that the alleged lender, in this case, petitioner, was also the sole stockholder and officer of Mandy leads to the conclusion that the \$109,989.95 entered on Mandy's books as officer's loans payable was, in fact, an investment in the equity of the corporation and subject to tax treatment as such. Therefore, the Audit Division properly deemed the reduction in the loan account to be a constructive dividend or return on capital to petitioner.

F. That the petition of Aaron F. Mandelbaum is denied and the Notice of Deficiency issued September 8, 1980 is sustained.

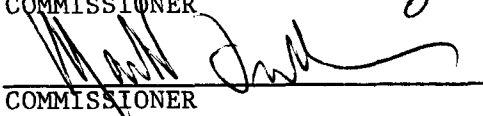
DATED: Albany, New York

JUN 15 1984

STATE TAX COMMISSION


PRESIDENT


COMMISSIONER


COMMISSIONER

REQUEST FOR BETTER ADDRESS

Requester Tax Appeals Bureau Room 107 - Bldg. #9 State Campus Albany, New York 12227	Unit Tax Appeals Bureau Room 107 - Bldg. #9 State Campus Albany, New York 12227	Date of Request <i>7/6/84</i>
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Please find most recent address of taxpayer described below; return to person named above.

Social Security Number	Date of Petition <i>Formal - Dec. 6/15/84</i>
Name <i>Aaron H. Mandelbaum</i>	
Address <i>411 Woodmere Blvd. Woodmere, N.Y. 11598</i>	

Results of search by Files

<input type="checkbox"/> New address:	
<input type="checkbox"/> Same as above, no better address	
<input checked="" type="checkbox"/> Other:	<i>Unclaimed</i>

Searched by <i>AD</i>	Section	Date of Search <i>7/6/84</i>
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PERMANENT RECORDFOR INSERTION IN TAXPAYER'S FOLDER

TA 26 (9-79)

STATE OF NEW YORK
State Tax Commission
TAX APPEALS BUREAU
STATE CAMPUS
ALBANY, N. Y. 12227

CERTIFIED

P 440977 270

MAIL

RETURNED TO SENDER

Unclaimed
Insufficient address
Forwarding order expired
Moved? Tell us address
No such number
Address not in file

CLAIM CHECK NO. **55021**

DATE

☐ FIELD

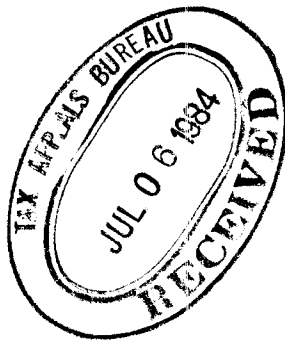
Aaron F. Mandelbaum
411 Woodmere Blvd.
Woodmere, NY 11598

1ST NOTICE

2ND NOTICE

RETURN

Detached from
PS Form 3849-A
Oct. 1980



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

June 15, 1984

Aaron F. Mandelbaum
411 Woodmere Blvd.
Woodmere, NY 11598

Dear Mr. Mandelbaum:

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: Petitioner's Representative
Daniel J. Guida
Fliegel & Guida
231 Vermont Ave.
Oceanside, NY 11572
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition	:	
	:	
of	:	
	:	
AARON F. MANDELBAUM	:	DECISION
	:	
for Redetermination of a Deficiency or for	:	
Refund of Personal Income Tax under Article 22	:	
of the Tax Law and New York City Non-Resident	:	
Earnings Tax under Chapter 46, Title U of the	:	
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which required, as a condition of the loan, that Mandy's loans due to petitioner be subordinated to the bank's loan. Mandy complied with this requirement.

5. On audit, the auditor decided that Mandy was under-capitalized and that the approximately \$110,000.00 in loans made by petitioner to Mandy were actually contributions to capital. For 1977, Mandy's general ledger reflected a reduction in the loan account of \$16,241.74 and this figure, taken together with an unexplained difference of \$19,274.12, resulted in a total reduction in the loan account of \$35,515.86, which was deemed to be a constructive dividend or return on capital. Tax year 1977 was the only year in which Mandy's income was sufficient to establish a constructive dividend or return on capital. Petitioner's personal income tax and New York City nonresident earnings tax for 1977 was adjusted to include in his income for that year the loan repayments deemed to be constructive dividends.

6. Petitioner maintains that the loans from him to Mandy were bona fide loans which were never intended to be capital contributions and that the Audit Division should not be able to deem the loans to be such merely because Mandy did not issue any stock until two years after its formation. However, at least one of the loans in the amount of \$66,529.90 was evidenced by a written promissory note dated February 5, 1974. No explanation was offered as to why said note was issued more than a year after Mandy was incorporated. Petitioner's representative asserted that this was the amount remaining to be paid on the original loan on the books on January 1, 1973.

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CONCLUSIONS OF LAW

A. That, with certain exceptions not applicable herein, section 689(e) of the Tax Law places the burden of proof upon the petitioner. Although Mandy may well have had nothing to gain by claiming Rosalie Mandelbaum as an employee, there was simply too little evidence produced to substantiate that she was an employee. Petitioner has not shown that Mrs. Mandelbaum performed any substantial services which were of value to the corporation. In light of this and the fact

¹ In fact, petitioner offered no testimony on either issue.

that Mr. Mandelbaum was the sole stockholder of Mandy, it was proper for the Audit Division to consider the payments to Mrs. Mandelbaum an assignment of corporate income not deductible by Mandy and taxable to petitioner as a constructive dividend.

B. That "[a] corporation's financial structure in which a wholly inadequate part of the investment is attributed to stock while the bulk is represented by bonds or other evidence of indebtedness to stockholders is lacking in the substance necessary for recognition for tax purposes, and must be interpreted in accordance with realities" (Root v. Commissioner, 220 F.2d 240, 241). "The essential difference between a stockholder and a creditor is that the stockholder's intention is to embark upon the corporate adventure, taking the risks of loss attendant upon it so that he may enjoy the chances of profit. The creditor, on the other hand, does not intend to take such risks so far as they may be avoided, but merely to lend his capital to others who do intend to take them" (United States v. Title Guarantee & Trust Co., 133 F.2d 990, 993).

C. That among the factors which are significant in deciding whether an instrument or transaction creates debt or equity are: "thin" or inadequate capitalization, identity of interest between creditor and stockholder, the ability of the corporation to obtain loans from outside lending institutions and the status of the contribution in relation to regular corporate creditors (Slappey Drive Industrial Park v. United States, 561 F.2d 572, 582).

D. That, with an owner's equity of \$289.00, a debt-equity ratio of 1000 to 1, the lack of any capital account or issuance of any stock, it is obvious that the funds supplied by petitioner to Mandy did not constitute a loan to a company with adequately existing operating capital, but represented, instead, an advance of necessary working capital. "Such a situation closely parallels

that under which an investment of equity capital is made in a new venture..." (Hippodrome Building Co. v. Commissioner, 24 TCM 113 aff'd sub nom Fellinger v. United States, 363 F.2d 826). Moreover, Banker's Trust Co. would not agree to loan money to Mandy unless all loans due to officers were completely subordinated to the bank's loan. "The complete subordination effected by [this agreement] not only tends to wipe out a most significant characteristic of the creditor-debtor relationship, the right to share with general creditors in the assets in the event of dissolution or liquidation, (citation omitted), but it also destroys another basic attribute of creditor status: i.e., the power to demand payment at a fixed maturity date" (P.M. Finance Corp. v. Commissioner, 302 F.2d 786, 790).

E. That, while no one of the aforementioned debt-equity factors necessarily indicates the existence of a capital contribution rather than a loan in this case, all of the facts taken as a whole and combined with the fact that the alleged lender, in this case, petitioner, was also the sole stockholder and officer of Mandy leads to the conclusion that the \$109,989.95 entered on Mandy's books as officer's loans payable was, in fact, an investment in the equity of the corporation and subject to tax treatment as such. Therefore, the Audit Division properly deemed the reduction in the loan account to be a constructive dividend or return on capital to petitioner.

F. That the petition of Aaron F. Mandelbaum is denied and the Notice of Deficiency issued September 8, 1980 is sustained.

DATED: Albany, New York

JUN 15 1984

STATE TAX COMMISSION

Roderick W. Allen
PRESIDENT

Francis D. Koernig
COMMISSIONER

Mark J. [Signature]
COMMISSIONER