

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
Walter I. Pozen :
for Redetermination of a Deficiency or for Refund :
of Personal Income Tax under Article 22 of the Tax :
Law for the Years 1975, 1976 and 1977, and :
Earnings Tax on Nonresidents under Chapter 46, :
Title U of the Administrative Code of the City of :
New York for the Years 1976 and 1977. :
_____ :

AFFIDAVIT OF MAILING

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 6th day of July, 1984, he served the within notice of Decision by certified mail upon Walter I. Pozen, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Walter I. Pozen
3806 Klinge Pl. N.W.
Washington, DC 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
6th 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

In the Matter of the Petition :
of :
Walter I. Pozen :
AFFIDAVIT OF MAILING
for Redetermination of a Deficiency or for Refund :
of Personal Income Tax under Article 22 of the :
Tax Law for the Years 1975, 1976 and 1977, and :
Earnings Tax on Nonresidents 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 }
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 6th day of July, 1984, he served the within notice of Decision by certified mail upon Joseph L. Forstadt, the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Joseph L. Forstadt
Stroock & Stroock & Lavan
61 Broadway
New York, NY 10006

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
6th day of July, 1984.

David Parchuck

Annunzio A. Hayes
Authorized to administer oaths
pursuant to Tax Law section 174

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

July 6, 1984

Walter I. Pozen
3806 Klinge Pl. N.W.
Washington, DC 20016

Dear Mr. Pozen:

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 and Chapter 46, Title U of the Administrative Code of the City of New York, 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
Joseph L. Forstadt
Stroock & Stroock & Lavan
61 Broadway
New York, NY 10006
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition	:	
of	:	
WALTER I. POZEN	:	DECISION
for Redetermination of a Deficiency or for	:	
Refund of Personal Income Tax under Article 22	:	
of the Tax Law for the Years 1975, 1976 and	:	
1977, and Earnings Tax on Nonresidents under	:	
Chapter 46, Title U of the Administrative Code	:	
of the City of New York for the Years 1976 and	:	
1977.	:	

Petitioner, Walter I. Pozen, 3806 Klinge Place N.W., Washington, D.C. 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 1975, 1976 and 1977, and earnings tax on nonresidents under Chapter 46, Title U of the Administrative Code of the City of New York for the years 1976 and 1977 (File Nos. 25856 and 35942).

A formal hearing was held before Dennis M. Galliher, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on April 26, 1983 at 9:35 A.M., with all briefs to be submitted by July 12, 1983. Petitioner appeared by Stroock & Stroock & Lavan, Esqs. (Joseph L. Forstadt, Esq., of counsel). The Audit Division appeared by John P. Dugan, Esq. (Irwin Levy, Esq., of counsel).

ISSUES

I. Whether petitioner was a nonresident partner in the New York law firm of Stroock & Stroock & Lavan during the years at issue and, as such, subject to taxation by New York State and the City of New York.

II. Whether penalties imposed against petitioner may be waived.

FINDINGS OF FACT

1. On January 15, 1979, the Audit Division issued to petitioner, Walter I. Pozen, a Notice of Deficiency asserting additional tax due to New York State for 1975 in the amount of \$13,581.71, plus interest. On April 1, 1981, the Audit Division issued to petitioner a Notice of Deficiency asserting additional tax due to both New York State and New York City for the years 1976 and 1977 in the aggregate amount of \$28,223.52, plus interest. Penalties were also asserted pursuant to Tax Law section 685(a)(1) and (2) for the year 1976 and section 685(c) for both 1976 and 1977. The Audit Division allowed itemized deductions for the years in issue and four (4) exemptions for 1976 and 1977. Only one exemption was allowed for 1975. Validated consents had been executed by petitioner allowing the assessment of personal income tax for the years 1976 and 1977 to be made at any time on or before April 1, 1982.

2. The basic premise upon which the above deficiencies were issued was the Audit Division's assertion that petitioner was a nonresident partner in the law firm of Stroock & Stroock & Lavan (the "Firm") during the years at issue, thus subjecting petitioner to liability for New York State personal income tax and New York City nonresidents earnings tax on certain income received by him in connection with his activities for the Firm. The penalties for 1976 and 1977 were asserted pursuant to Tax Law section 685(c) [underestimation of personal income tax], while the other penalties asserted for 1976 (only) under Tax Law section 685(a)(1) and (2) were premised upon the allegation that petitioner failed to file a return and pay tax due for 1976. No penalties were asserted for 1975.

3. Petitioner was, during the years at issue, (and still is) a resident of Washington, D.C., and a member of the bar of that City and of the bar of the State of Maryland. He has never been a resident of New York State (or City) or a member of the New York bar.

4. During 1975, 1976 and 1977, Mr. Pozen practiced law in the Washington, D.C. offices of the Firm, pursuant to the terms of an agreement between Mr. Pozen and the Firm (the "employment agreement"). Mr. Pozen devoted his full working time and efforts solely to the affairs of the Firm's Washington, D.C. office.

5. Under the terms of the above agreement, Mr. Pozen was denominated a "member" of the Firm. The foregoing agreement is distinguished from an "Agreement of Partnership" (the "primary agreement") signed by twelve individuals not including petitioner. This latter agreement was alleged to have been the partnership agreement between the "true" partners of the Firm, and it referred to agreements with other persons who, "...although not admitted to the Firm, are designated as 'Partners' or 'members' of the Firm". Such other agreements, termed subsidiary agreements, presumably included the Firm's agreement with Mr. Pozen. The primary agreement also referred to its twelve signatories, at times, as "members".

6. Article III of the employment agreement, pertaining to Mr. Pozen's compensation, provided as follows:

"III. A. The Member shall be entitled to the following percentage of Net Fees on an annual basis, and to drawings on an annual basis, as follows:

Percentage of Net Fees 03.2340% for the years 1974 and 1975 and 03.2340% for the years 1976 through 1978.

Monthly drawings, at the annual rate of \$80,000.00 for the years 1974 and 1975 and \$80,000.00 for the years 1976 through 1978.

The provisions for the years after 1974 are contingent in all events upon this Agreement continuing in effect during each of such years. All such provisions are subject to the provisions of Article X [pertaining to renewal of the agreement] hereof.

B. If in the sole discretion of the Executive Committee there are special considerations which as a matter of equity entitled the Member or any other members of the Firm or non-percentage partners to receive special amounts out of the Net Fees, such special amounts so paid shall be treated as an expense of the Firm for the purpose of this Agreement and before application of the above named Member's percentage."

("Net Fees" was defined as gross revenues received by the Firm less specified expenses of the Firm.)

7. Petitioner testified that his compensation was limited to \$80,000.00 per year, plus any additional amounts granted to him as further compensation in view of his performance on behalf of the Firm. Any additional compensation would be granted by and in the sole discretion of the Firm's Executive Committee (composed of certain signatories to the primary agreement) pursuant to Article III-B of the employment agreement (the above "equity clause"). Mr. Pozen testified that although his compensation was stated in the employment agreement as a percentage, such percentage was "...just another way of stating the same sum which could not exceed \$80,000.00" (plus amounts, if any, under the equity clause).

8. The primary agreement provided for the division of 100 percent of the Firm's net fees according to various percentage amounts among the twelve signatories to that agreement, after payment of amounts to Firm members and others. Net fees, for purposes of the primary agreement, were defined as gross revenues received by the Firm less specified expenses, including operating expenses payable under, inter alia, agreements such as that between the Firm and Mr. Pozen.

The primary agreement was entitled "agreement of partnership", whereas the employment agreement was not titled but states only that it covers Mr. Pozen's "membership in the firm".

9. Mr. Pozen testified that he agreed to accept a flat \$80,000.00 compensation, plus any bonus the Executive Committee deemed was appropriate, as a show of "good faith" relative to his desire to become a partner in the Firm. In prior years, Mr. Pozen had been paid \$50,000.00, plus 50 percent of the net income of the Firm's Washington, D.C. office in excess of \$75,000.00. Mr. Pozen testified that he did not like the negotiating aspects of this original compensation arrangement and thus agreed to the changed arrangement as in effect during the years at issue.

10. Only the twelve signatories to the primary agreement, and not Mr. Pozen, held an interest in the Firm's accounts receivable, accrued and unbilled amounts due, physical property, fixtures, goodwill and name. Upon death, Mr. Pozen was entitled only to his remaining compensation for the year, unlike the twelve signatories who were entitled to their allocated share of the Firm's assets.

11. Mr. Pozen testified that even though he was in charge of the Firm's Washington, D.C. office, he was neither authorized nor did he ever borrow money for the use of the Firm, make capital expenditures for the Firm, compromise or cancel bills owed to the Firm, or add or admit partners to the Firm. Mr. Pozen was not authorized to sign checks on behalf of the Firm, did not sign legal opinions, pleadings or other court papers on behalf of the Firm, and although he could make suggestions as to hiring and firing of personnel in the Washington office, he was not authorized to hire or fire. He did not participate in meetings of the twelve signatories to the Firm's primary agreement or of its

management committee with regard to establishing Firm policies or discussing Firm business. However, Mr. Pozen was held out by the Firm as, and represented himself to the Firm's clients to be, a partner. The fees earned by petitioner on behalf of the Firm were submitted to the Firm's New York office.

12. Mr. Pozen became a signatory to the primary agreement in 1979, and commenced paying New York taxes at that time. Prior to such time, Mr. Pozen testified that he never saw the Firm's Federal or New York State tax returns, or other financial information or reports regarding the Firm's income, profits or losses or the various partners' distributive shares of partnership income, gains, losses, deductions or credits. Mr. Pozen testified that, at present, the Firm's partners do not establish or maintain capital accounts (distributive partners' consideration to the Firm). Presumably, such accounts were not established or maintained during the years at issue.

13. Schedule K-1 ("Partner's Share of Income, Credits, Deductions, etc. -") which were part of the Firm's partnership returns for 1976 and 1977, listed Mr. Pozen as a nonresident partner of the Firm and reflected distributions to him of ordinary income (profits), additional first year depreciation, contributions, tax exempt interest, political contributions, payments to a Keogh plan,¹ as well as a new jobs credit for 1977. The U.S. Partnership Returns (Form 1065) listed the names of 39 partners in 1976 and 42 partners in 1977. Petitioner's name was listed for both years. The "New York State Nonresident Partner Allocation Schedule" (Form IT-204-A) listed petitioner as a nonresident partner for the year 1975.

14. No wage and tax statements were filed with petitioner's tax returns.

¹ Payments made to a Keogh plan represent payments made by the Firm on behalf of its listed partners to a retirement plan for self-employed individuals.

15. Neither Mr. Pozen's name nor any other individual's names were reflected on the stationary used in the Firm's Washington, D.C. office. Stationary used during the years at issue by the Firm's New York office was not offered in evidence.

16. With regard to the penalty issues, Mr. Pozen testified he sought the advice of the Firm's senior tax attorney who advised Mr. Pozen that he was not a partner in the Firm and had no obligation to pay New York State or City income taxes during the years at issue. Mr. Pozen testified that he filed returns with and paid applicable taxes to Washington, D.C. Furthermore, Mr. Pozen testified that he filed timely New York income tax nonresident returns for each of the years at issue. He asserted the State must have lost his return for 1976 and upon learning that the State had no return for 1976, he immediately filed a duplicate copy of the original return (on February 20, 1979). This testimony was credible and uncontroverted and it is hereby found that the 1976 return was timely filed. Finally, petitioner points to the Matter of Walter Pozen, State Tax Comm., October 19, 1979, in support of his belief that he had reasonable cause not to consider himself liable for New York State or City income taxes.

CONCLUSIONS OF LAW

A. That sections 632(a)(1) and 637(a)(1) of the Tax Law, taken together, require inclusion in the New York adjusted gross income of a nonresident individual who is a partner in a partnership, that individual's distributive share of items of partnership income, gain, loss and deduction which are derived from or connected with New York sources. Furthermore, any allocation of such items of distribution within and without New York shall be based upon

the allocation percentage determined and reported by the partnership [see 20 NYCRR 134.2(b)].

Since Stroock & Stroock & Lavan is a partnership that does business in New York and has offices in this State, if petitioner was a partner in the Firm during the years at issue, he would be liable for New York State taxes notwithstanding the fact that he neither resided in New York nor provided any services for the Firm in New York.

B. That section U46-1.0(f) of the New York City Administrative Code defines "net earnings from self-employment", on which the New York City nonresident earnings tax is imposed, as net earnings from self-employment as defined in I.R.C. §1402(a). I.R.C. §1402(a) defines "net earnings from self-employment" as follows:

"(t)he gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this subtitle which are attributable to such trade or business, plus his distributive share (whether or not distributed) of income or loss described in section 702(a)(8) from any trade or business carried on by a partnership of which he is a member..."

Therefore, if petitioner was a partner of the Firm during the years at issue, he would be liable for New York City nonresidents earnings tax on the portion of his distributive share of partnership income, etc. from New York City sources.

C. That petitioner asserted he was not a partner in the Firm during the years at issue, and that there were twelve "true" partners in the Firm. However, petitioner received Schedules K-1 from the Firm which listed him as a partner and which reflected to petitioner a distributive share of income, contributions, additional first year depreciation, tax exempt interest, political contributions, payments to a Keogh Plan and (for 1977) new jobs credit. Although petitioner asserted that his compensation was limited to \$80,000.00

plus any added amounts under the equity clause of his agreement with the Firm, petitioner's compensation was expressed as a percentage of net fees, with monthly drawings at an annual rate of \$80,000.00. No explanation was offered in support of petitioner's assertion that although stated as a percentage of net fees, his basic remuneration calculated under such percentage was always equal to his allowable drawings of \$80,000.00. Furthermore, although petitioner asserts the Firm was comprised of twelve partners, the Firm's returns reflect a total of 39 partners in 1976 and 42 partners in 1977. Finally, both the Firm and petitioner presented Mr. Pozen to the Firm's clients and to others to be a partner in the Firm.

D. That although petitioner asserted he had no percentage interest in the profits of Stroock & Stroock & Lavan during the years in issue he was compensated, per the terms of his agreement with the Firm, on a percentage of net fees basis. This compensation was characterized as ordinary income by the partnership which also listed Mr. Pozen as a partner on its distribution schedules for the years in issue, thus indicating petitioner's status as a partner (see Matter of Harold F. Blasky v. State Tax Comm., 69 A.D.2d 940; Matter of Faulkner, Dawkins & Sullivan v. State Tax Comm., 63 A.D.2d 764). Petitioner's participation in the firm's profits (ordinary income) and/or net fees (Finding of Fact "6", supra), taken together with his listing as a partner by Stroock & Stroock & Lavan on its returns, leads to the conclusion that petitioner was in fact a partner of said firm (see Matter of Alfred R. McCauley v. State Tax Comm., 67 A.D.2d 51). Petitioner's claim that he was not a partner of Stroock & Stroock & Lavan since he did not participate in the management of said firm and because he was based in the Washington, D.C. office is not determinative (see Matter of Weinflash v. Tully, 93 A.D.2d 369; Matter of Axel Baum et al v. State Tax Comm., 89 A.D.2d 646). Accordingly, petitioner was properly taxable as a nonresident

partner of the New York City firm during the years in issue. His adjusted gross income as a nonresident partner should include his distributive share of all items of partnership income, gain, loss and deduction entering into his federal adjusted gross income to the extent that such items were derived from or connected with New York State sources (section 637(a) of the Tax Law and 20 NYCRR 134.1) and New York City sources (section U46-1.0(f) of the New York City Administrative Code).

E. That petitioner is entitled to four (4) exemptions for tax year 1975; however, said exemptions are required to be allocated pursuant to section 636(a) of the Tax Law.

F. That in view of Finding of Fact "16", the 1976 return was timely filed and there was reasonable cause for Mr. Pozen to have believed he was not subject to the instant taxes. Accordingly, penalties asserted pursuant to section 685(a)(1) and (a)(2) of the Tax Law are cancelled. However, the penalties asserted under section 685(c) of the Tax Law for underestimation of personal income tax are sustained since petitioner did not show that he qualified for the exception therefrom provided for in section 685(d) of the Tax Law, and since reasonable cause does not constitute a proper basis for cancellation of said penalty.

G. That the petition of Walter I. Pozen is hereby granted to the extent indicated in Conclusions of Law "E" and "F", but is in all other respects denied and the notices of deficiency dated January 15, 1979 and April 1, 1981, as modified in accordance herewith, are sustained.

DATED: Albany, New York

JUL 06 1984

STATE TAX COMMISSION


PRESIDENT


COMMISSIONER


COMMISSIONER