STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition of David J. (Deceased) Colton	:
	: AFFIDAVIT OF MAILING
for Redetermination of a Deficiency or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law 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.	:

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 28th day of June, 1985, he served the within notice of decision by certified mail upon David J. (Deceased) Colton, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

David J. (Deceased) Colton
c/o Katheryn Colton
37 Sunset Drive
Sarasota, FL 33577

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
28th day of June, 1985.

David Parchuck

Authorized to administer oaths
pursuant to Tax Law section 174

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of
David J. (Deceased) Colton :

AFFIDAVIT OF MAILING

for Redetermination of a Deficiency or for Refund :
of New York State Personal Income Tax under Article
22 of the Tax Law 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.

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 28th day of June, 1985, he served the within notice of decision by certified mail upon Gerald D. Groden, the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Gerald D. Groden
Whitman & Ransom
522 Fifth Ave.
New York, NY 10036

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
28th day of June, 1985.

David Parchuck

Authorized to administer oaths
pursuant to Tax Law section 174

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

June 28, 1985

David J. (Deceased) Colton
c/o Katheryn Colton
37 Sunset Drive
Sarasota, FL 33577

Dear Ms. Colton:

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
Gerald D. Groden
Whitman & Ransom
522 Fifth Ave.
New York, NY 10036
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition	:	
of	:	
DAVID J. COLTON (Deceased)	:	Decision
for Redetermination of a Deficiency or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law 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.	:	

Petitioner, David J. Colton (deceased), c/o Katheryn Colton (surviving spouse), 37 Sunset Drive, Sarasota, Florida 33577, 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 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. 41838).

A small claims hearing was held before Allen Caplowaith, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on August 21, 1984 at 9:15 A.M., with all briefs to be submitted by November 30, 1984. Petitioner appeared by Gerald D. Groden, Esq. The Audit Division appeared by John P. Dugan, Esq. (Paul Lefebvre, Esq., of counsel).

ISSUES

I. Whether David J. Colton was a nonresident partner in a New York law partnership during 1976 and 1977 thereby subjecting his guaranteed payments derived therefrom to New York State and City income taxes on the basis that such payments constituted a distributive share of partnership income.

II. Whether the penalties asserted should be abated.

FINDINGS OF FACT

1. David J. Colton (hereinafter "the decedent") did not file New York State personal income tax returns or New York City nonresident earnings tax returns for the years 1976 and 1977.

2. On September 11, 1980, the Audit Division issued a Statement of Audit Changes to the decedent wherein guaranteed payments of $29,460.00 (1976) and $29,661.00 (1977), derived from the partnership Whitman & Ransom, were determined to be distributive shares of partnership income and accordingly, held taxable for New York State and City purposes to the same extent as the partnership's New York business allocation percentages of 92.48% (1976) and 91.03% (1977). In computing the decedent's New York State tax liabilities for each of said years, the Audit Division allowed the standard deduction of $2,000.00 and one (1) exemption. These allowances were based on the fact that Federal returns were not provided for said years within which such information could have been extracted. Accordingly, on January 26, 1983, a Notice of Deficiency was issued against the decedent for 1976 and 1977 asserting New York State personal income tax of $4,037.53, New York City nonresident earnings tax of $339.59, penalties of $2,272.57, plus interest of $2,288.95, for a total due of $8,938.64. Said penalties were asserted for New York State purposes for failure to file returns, failure to pay the taxes determined to be due and failure to file declarations of estimated tax pursuant to sections 685(a)(1), 685(a)(2) and 685(c) of the Tax Law, respectively. For New York City purposes similar penalties were asserted pursuant to sections U46-35.0(a) and U46-35.0(c) of the Administrative Code of the City of New York.

3. Decedent's representative alleged during the hearing held herein that the decedent was never a partner in the law partnership Whitman & Ransom, or any predecessor firm. Accordingly, it was argued that the decedent, a nonresident of New York during the years 1976 and 1977, was not liable for New York State and New York City taxes on his income derived from Whitman & Ransom since he was not a partner and no services were rendered by him in New York during said years.

4. The decedent was a member of the New York Bar and prior to May 1, 1969, practiced law as a partner in the firm of Colton and Pinkham. By letter agreement dated May 1, 1969, Colton and Pinkham merged into the law firm Parr, Doherty, Polk & Sargent. Said agreement provided, inter alia, that:

> a. "The merged firm will be known as Parr, Doherty, Polk & Sargent, and your names will appear on the letterhead as "counsel". You will not have the status or responsibilities of a partner."
>
> b. "We will supply you with appropriate offices in space which the firm has taken on the fourth floor of this building, and at the firm's expense will provide each of you with a secretary and other customary office services. It is our understanding that you will expect to bring your present secretaries who are now receiving salaries not in excess of $150 per week with you and that they will become employees of the firm."
>
> c. "We understand that you will bring such of your present office furniture with you as you initially expect to use. Space will also be provided for such books from your library as you may wish to bring with you."
>
> d. "While it is expected that you will participate in the work on behalf of your clients to the extent that you are able to do so, we agree to make available to you for services on behalf of your clients such time of our legal staff as may be necessary to service your clients' requirements properly."
>
> e. It is our firm's policy to make all new business accepted in the office subject to the written approval of our partners and this policy will, of course, apply to the business introduced by you."
>
> f. "It is the practice of the firm to consider as income from the practice of law all directors', executors', trustees', administrators', guardians' and conservators' fees, commissions and allowances,

all salaries as an officer of a corporation, all finders' fees or other commissions or remuneration of a similar type, all fees and compensation of any public or semi-public office, all royalties from the sale of books, magazine articles and pamphlets, and all salaries, fees and honoraria for speeches and teaching engagements, together with any expense allowances in connection with any of the foregoing, to the extent these exceed the amount of expenses actually incurred, and this same rule will apply to the amounts that will be turned into the firm by you, it being the intention that all income except income from personal investments shall be considered firm income."

g. "Each of you will be entitled to receive one third (1/3) of the gross fees (excluding therefrom all disbursements) received from business introduced by him."

h. "Mr. Colton is not to receive a drawing account..."

5. In April 1970, Parr, Doherty, Polk & Sargent merged into the New York City law firm of Whitman, Ransom & Coulson, the combined practice continuing under the name of Whitman & Ransom. The decedent continued as "of counsel" to Whitman & Ransom, however, there is nothing in the record which would establish the exact nature and terms of the decedent's relationship with Whitman & Ransom commencing with the April 1970 merger until March 31, 1976.

6. On March 31, 1976, the decedent entered into an agreement with Whitman & Ransom (hereinafter "The partnership") wherein it was provided that:

"WHEREAS, Colton has been counsel and a consultant to W&R (Whitman & Ransom) and

WHEREAS, the parties desire to continue such arrangement for an additional 2 year period ending 3/31/78.

NOW, THEREFORE, the parties agree as follows:

1. Colton shall serve as counsel and a consultant to W&R for the duration of the partnership agreement dated as of April 1, 1976, to wit, until March 31, 1978.

2. For such 2 year period, Colton, during his lifetime, shall be paid:

(a) For each year 20% of the first $100,000 of fees received by W&R during such year from clients originated by Colton and 33 1/3% of the excess over $100,000 of such fees. Such amount shall be paid to Colton from time to time during the year to the extent of at least

60% of the total amount, with the balance 1/2 on April 15, 1/2 on June 15 next succeeding the end of the fiscal year for which such fees are to be paid.

(b) Such additional amounts based on exceptional contributions or profits as the W&R Management Committee, in its sole discretion, may determine.

(c) Any and all advances and disbursements to or on behalf of Colton as shown on the books of W&R shall be charged against and reduce the above amounts commencing with those first due. In addition, any charges, direct or indirect, imposed by any third party against any amount payable hereunder or on the firm income allocated to such payments shall be charged against and reduce the above amounts commencing with those first due.

3. Colton shall be available for consultation with representatives of W&R or its clients at such reasonable times and places as W&R may determine in connection with the business of the partnership shall not, directly or indirectly, alone or with any other firm or person, engage in any other law practice or related occupation without the consent of the Management Committee. Except as authorized by the Management Committee, he shall contribute to the firm all income which shall come into his hands from the practice of the law and related activities to the extent permitted by law, including fees, allowances for services rendered pursuant to court appointment, salary and honoraria for writing, speaking or teaching, commissions as administrator or executor of any decedent's estate or as personal trustee, testamentary or inter vivos, but not including fees or salary received as a director of any coporation or such other similar items of income which in the sole discretion of the Management Committee are properly not income of the firm. Colton shall make full disclosure to the firm in respect of items of income received by him from the practice of law and related activities regardless of whether they are excluded from firm income as above set forth.

4. It is contemplated by the parties hereto that the payments referred to under paragraph 2 are guaranteed payments of partnership income under §736(a) of the Internal Revenue Code and deductible by it as ordinary and necessary business expenses for federal income and other tax purposes. Colton covenants for himself and for his heirs and assigns that he will not make any claims or representation as to the income tax nature of such payments which are inconsistent with the intent expressed in this paragraph.

5. The payments provided for in paragraph 2 are to be made solely out of firm income and shall not be a liability of any partner of W&R and shall not be payable out of firm capital.

6. The payments called for in paragraph 2 may be terminated, modified or reduced prospectively upon the affirmative vote of 75% of partners in W&R, such percentage to be determined on the basis of the

respective interests of the partners in W&R income rather than a per capita basis.

7. So far as feasible, Colton shall be allowed to continue to participate in W&R's life, health and accident insurance plans, its Keogh pension plan and any other similar programs in which partners generally may participate.

8. All payments made under this agreement to Colton shall be made and accepted by him in full and complete satisfaction of any and all interest in W&R, or its income or assets in any and all claims which he may now have or in the future might have in W&R, or its income or assets.

9. In the event that any controversy or claim arising out of this agreement cannot be settled by the parties, or their legal representatives, such controversy or claim shall be settled by arbitration in accordance with the then current rules of the American Arbitration Association and judgment upon the award may be entered in any court having jurisdiction thereof."

7. Prior to 1974, the decedent was a New York resident. His services rendered for the partnership were so rendered from office space provided by the partnership at its business premises. The expenses for such office space, as well as for secretarial services provided to petitioner by the partnership, were borne by the partnership.

8. During 1974 the decedent changed his residence to Florida. All services rendered to the partnership by the decedent during 1976 and 1977 were in the nature of telephone consultations respecting clients originated by him. All actual services rendered for the decedent's clients were rendered by partners or employees of the partnership.

9. The fees derived from the decedent's clients were paid directly to the partnership.

10. During the years at issue, the decedent's compensation derived from the partnership was computed based solely on a percentage of fees received by the partnership from clients originated by the decedent. No additional amounts

were paid to the decedent. He did not share in the profits nor was he charged with the losses of the partnership.

11. The decedent's representative contended that:

a. the decedent had no voice in partnership matters

b. the decedent was not a signatory to the partnership agreement of Whitman and Ransom

c. the decedent was not required to make any contribution to partnership capital and did not make any such contribution

d. the decedent's name appeared on the partnership's letterhead as "of counsel".

Neither the partnership agreement nor a copy of the partnership's stationery was submitted into evidence.

12. In response to an Audit Division inquiry, Byrnes & Baker, the CPA firm that prepared the partnership's tax returns, submitted the following statement with respect to the taxability of the decedent's income from the partnership:

"Federal Income Tax

There is attached a copy of your Schedule K-1 of the Whitman & Ransom Federal Form 1065. It sets out your shares of partnership income and of the various deductions and credits. It also states the schedule and line of your Form 1040 on which the amount is to be entered.

New York State and City Income Tax

As the amounts you received from Whitman & Ransom were Guaranteed Payments, as defined in Section 707(c) of the Internal Revenue Code, for services rendered outside New York State, no part thereof need be reported for New York State or City income tax purposes. If you have no other New York State or City source income, you need not file returns."

13. According to the Federal partnership schedules K-1, "Partner's Share of Income, Credits, Deductions, etc.", which were issued to the decedent for the partnership's fiscal years ended March 31, 1976 and March 31, 1977, the partnership reported the decedent's compensation for each of said years as a

distributive share of partnership income. Both schedules K-1 indicated that the decedent maintained a capital account in the partnership. The Schedule K-1 for fiscal year ended March 31, 1977 shows the "date partner joined partnership" as "6-30-69". On distribution schedules attached to each of the schedules K-1, the decedent was listed as a partner and his distributions were characterized as "guaranteed payment to non-resident partner".

14. Copies of the decedent's federal returns for 1976 and 1977 were not provided at the hearing. The decedent's representative had no knowledge of how the income derived from the partnership was characterized on the decedent's returns for said years.

15. The decedent's representative argued that provision number 4 of the agreement dated March 31, 1976, with respect to the characterization of payments to the decedent as "guaranteed payments of partnership income under §736(a) of the Internal Revenue Code," was included in said agreement for the sole purpose of insuring the deductibility of such payments by the partnership (see Finding of Fact "6", supra).

16. The decedent's representative argued that the penalties asserted should properly be abated since the returns for 1976 and 1977 were not filed based on the advice of the partnership's accountants (see Finding of Fact "12", supra).

17. The decedent's proposed findings of Fact 1, 4, 5, 10 and 11 are accepted and have been incorporated into the decision herein. The decedent's proposed findings of fact 2, 3, 6, 7, 8 and 9 and rejected as they have not been supported by the evidence.

CONCLUSIONS OF LAW

A. That although the decedent did not share in the profits and losses of Whitman & Ransom during the years at issue, he was, however, compensated by a guaranteed percentage of the partnership's fees which originated from his clients. Such guaranteed income was shown on both the Federal schedules K-1 issued to him and the partnership's distribution schedules, which listed him as a partner. The decedent's argument that he was not a partner of said partnership since he did not participate in its management and because he was physically located in Florida is unpersuasive (See Matter of Weinflash v. Tully, 93 A.D.2d 369).

B. That section 736 of the Internal Revenue Code is titled "Payments to a retiring partner...". Since provision #4 of the decedent's agreement with Whitman & Ramsom states that the decedent's compensation constitutes "guaranteed payments of partnership income under §736(a) of the Internal Revenue Code", it is evident that both the decedent and the partnership considered the payments at issue to be payments to a retiring partner.

C. That Treasury Regulation section 1.736-1(ii) states that a retiring partner is treated as a partner until his interest in the partnership is completely liquidated. Since under the terms of the decedent's agreement with the partnership, his interest was not completely liquidated until March 31, 1978, the decedent is considered to have been a partner during the years at issue herein.

D. That Treasury Regulation §1.707-1(c) provides that guaranteed payments are regarded as a partner's distributive share of ordinary income. Therefore, the guaranteed payments at issue are considered to be a distribution of partnership income and accordingly, are subject to New York State personal income tax

to the extent such distribution was derived from New York sources. Therefore, the guaranteed payments at issue are taxable for New York State purposes on the basis of the partnership's New York business allocation percentages (20 NYCRR 134.2(b)).

E. That section U46-1.0(f) of the Administrative Code of the City of New York 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, since the decedent was deemed to be a partner in Whitman & Ransom for tax purposes during the years at issue herein, he is liable for New York City nonresident earnings tax on the portion of his distributive share of partnership income derived from New York City sources, which, in the instant case, is the same as that derived from New York State sources.

F. That allowance of the standard deduction and one (1) exemption in computing the decedent's tax liability is deemed proper since his Federal returns filed for the years at issue were not made available.

G. That there was reasonable cause for the decedent to have believed he was not subject to the instant taxes. Accordingly, penalties asserted pursuant to sections 685(a)(1) and 685(a)(2) of the Tax Law and section U46-35.0(a) of the Administrative Code of the City of New York are cancelled. However, the penalties asserted under section 685(c) of the Tax Law and U46-35.0(c) of the Administrative Code of the City of New York for failure to file New York State

and New York City declarations of estimated tax are sustained since reasonable cause does not constitute a proper basis for cancellation of said penalties.

H. That the petition of David J. Colton is granted to the extent provided in Conclusion of Law "G", supra, and except as so granted, said petition is, in all other respects denied.

I. That except with respect to the cancellation of certain penalties as provided in Conclusion of Law "G", supra, the Notice of Deficiency dated January 26, 1983 is sustained.

DATED: Albany, New York

JUN 28 1985

STATE TAX COMMISSION

PRESIDENT

COMMISSIONER

COMMISSIONER