

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
David H. & Kathleen C. Dibble :
for Redetermination of a Deficiency or Revision :
of a Determination or Refund of Personal Income :
& Unincorporated Business Taxes under Articles 22 :
& 23 of the Tax Law for the Years 1978 & 1979. :

AFFIDAVIT OF MAILING

State of New York :

ss.:

County of Albany :

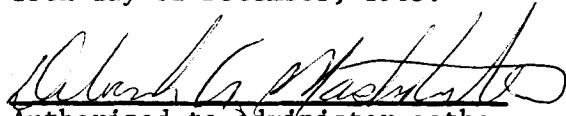
Connie A. Hagelund, being duly sworn, deposes and says that she is an employee of the State Tax Commission, that she is over 18 years of age, and that on the 13th day of December, 1985, she served the within notice of Decision by certified mail upon David H. & Kathleen C. Dibble, the petitioners in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

David H. & Kathleen C. Dibble
737 Main St.
Vestal, NY 13850

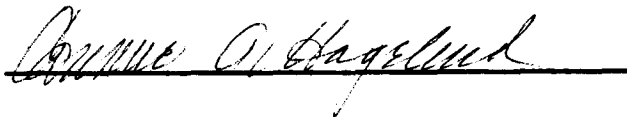
and by depositing same enclosed in a postpaid properly addressed wrapper in a post office under the exclusive care and custody of the United States Postal Service within the State of New York.

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
13th day of December, 1985.



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 H. & Kathleen C. Dibble :
for Redetermination of a Deficiency or Revision :
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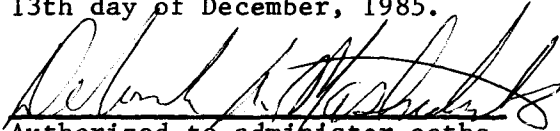
Connie A. Hagelund, being duly sworn, deposes and says that she is an employee of the State Tax Commission, that she is over 18 years of age, and that on the 13th day of December, 1985, she served the within notice of Decision by certified mail upon Fred DeRado, the representative of the petitioners in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Fred DeRado
16 Tremont Ave.
Binghamton, NY 13903

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
13th day of December, 1985.


Authorized to administer oaths
pursuant to Tax Law section 174



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

December 13, 1985

David H. & Kathleen C. Dibble
737 Main St.
Vestal, NY 13850

Dear Mr. & Mrs. Dibble:

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 & 722 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
Fred DeRado
16 Tremont Ave.
Binghamton, NY 13903
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition	:	
of	:	
DAVID H. AND KATHLEEN C. DIBBLE	:	DECISION
for Redetermination of a Deficiency or for	:	
Refund of Personal Income and Unincorporated	:	
Business Taxes under Articles 22 and 23 of the	:	
Tax Law for the Years 1978 and 1979.	:	

Petitioners, David H. and Kathleen C. Dibble, 737 Main Street, Vestal, New York 13850, filed a petition for redetermination of a deficiency or for refund of personal income and unincorporated business taxes under Articles 22 and 23 of the Tax Law for the years 1978 and 1979 (File No. 35482).

A hearing was held before James J. Morris, Jr., Hearing Officer, at the offices of the State Tax Commission, State Office Building, 164 Hawley Street, Binghamton, New York, on May 22, 1985 at 9:15 A.M. Petitioner appeared by Fred DeRado. The Audit Division appeared by John P. Dugan, Esq. (Deborah J. Dwyer, Esq., of counsel).

ISSUE

Whether petitioner David Dibble properly reported 100 percent of his business net profit as personal service income in computing the maximum tax on personal service income for the year 1979.

FINDINGS OF FACT

1. David H. Dibble (hereinafter "petitioner") timely filed a New York State Income Tax Resident Return with his wife, Kathleen C. Dibble, for the year 1979 under filing status "married filing joint return." On such return, petitioner reported business income (net profit) of \$104,877.28 derived from

the operation of his unincorporated business, Dibble's Chevron. In computing the maximum tax on personal service income for the year 1979, petitioner reported 100 percent of the aforesaid business net profit as personal service income.

2. On April 24, 1981, the Audit Division issued to petitioner a "Statement of Unincorporated Business Tax Audit Changes" asserting additional unincorporated business tax of \$62.87 for the year 1978 and \$54.81 for the year 1979.

3. On April 24, 1981, the Audit Division issued to petitioner a "Statement of Personal Income Tax Audit Changes" asserting additional personal income tax of \$112.65 for the year 1978 and \$1,579.23 for the year 1979.

4. On July 23, 1981, the Audit Division issued to petitioner a Notice of Deficiency asserting additional tax due of \$1,809.60, together with penalty and interest to the date of the issuance of such notice, for the years 1978 and 1979.

5. The total tax due of \$1,809.56 pursuant to the statements does not equal the total tax due of \$1,809.60 pursuant to the Notice of Deficiency because of a subtraction error with respect to personal income tax claimed due for 1979, the correct total figure being that asserted on the Notice of Deficiency.

6. Petitioner conceded the accuracy of the audit changes with respect to asserted personal income tax due for the year 1978 and asserted unincorporated business tax due for the years 1978 and 1979.

7. Petitioner challenges the accuracy of the audit changes with respect to asserted additional personal income tax due for the year 1979 only insofar as such changes relate to the determination that only 30 percent of his business net profit was considered personal service income in computing the maximum tax

on personal service income rather than the 100 percent of his business net profit claimed as personal service income on his return for such period.

8. For the year 1979, petitioner's unincorporated business, Dibble's Chevron, operated an automobile service station from two locations. The secondary location only sold gasoline. The primary location sold gasoline and had four service bays for performing repairs to automobiles. Petitioner claims that at the primary location, his "main income is derived from the repair business." Petitioner does not do repair work, but rather supervises the work at the primary location and performs which might be best called "customer relations."

9. Petitioner's Schedule C, Profit or (Loss) from Business or Profession, for the year 1979 reflected gross receipts (less returns and allowances) of \$1,462,126.60 and cost of goods sold of \$1,200,581.73, for a gross profit of \$261,544.87. Schedule C-1, Cost of Goods Sold and/or Operations, thereto reflected purchases of \$1,214,160.10 for the year which, when reconciled with opening inventory and closing inventory, results in the \$1,200,581.73 cost of goods sold. The record does not reflect to what extent, if any, said cost of goods sold relates to parts used in the service aspect of the business as opposed to the gasoline sales aspect of the business for such year. Schedule C-2, Depreciation, thereto reflected \$21,671.84 of depreciable property and equipment based upon cost or other basis. In arriving at net profit per said Schedule C, petitioner deducted, inter alia, wages of \$86,307.00.

10. Petitioner's income increased in 1979 in his own words, "...primarily because of gasoline... There was a shortage. Gasoline was priced high. And then it inflated my income, no question about it. That plus the two locations. The one location was strictly a gasoline-only operation."

11. In the year prior to the year at issue (1978), petitioner's net profit from his business, albeit operating from only the primary location, was approximately \$17,000.00. In the year after the year at issue (1980), petitioner's net profit from his business decreased to approximately \$35,000.00. Such estimated (by petitioner) figure is, again, due to operations at the primary location only, since petitioner's operations at the secondary location ceased sometime during the year 1980. Petitioner's testimony, however, was that his income decreased as his gas volume decreased.

12. Petitioner paid the manager of his secondary location \$6.00 an hour, which approximates to roughly \$12,000.00 to \$13,000.00 as an annual salary.

13. The statements of audit adjustment dated April 24, 1981 do not assert imposition of penalty, but they do assert interest of \$171.68 as owing to said date. The Notice of Deficiency dated July 23, 1981, however, showed penalty due of \$173.14 and only \$33.51 of interest owing to the date of such notice.

14. Petitioner asserts that he had increased his customer base vis-a-vis the service operations from 1,000 customers when he purchased the business in 1977 to 2,500 service customers in 1985; that it is his personal service and relationships with his customers that has caused the business to grow; and that, therefore, 100 percent of the business income should be considered personal service income.

CONCLUSIONS OF LAW

A. That section 603-A of the Tax Law provides for a maximum tax rate on New York personal service income.

B. That section 603-A(b)(1) of the Tax Law for the period at issue, in pertinent part, provided:

"...the term 'New York personal service income' means items of income includible as personal service income for purposes of section one thousand three hundred forty-eight of the internal revenue code..."

C. That section 1348(b)(1)(A) of the Internal Revenue Code, in pertinent part, provides:

"[t]he term 'personal service income' means any income which is earned income within the meaning of section 401(c)(2)(C) or section 911(b)... For purposes of this subparagraph, section 911(b) shall be applied without regard to the phrase 'not in excess of 30 percent of his share of the net profits of his trade or business'."

D. That section 911(b) of the Internal Revenue Code for the periods at issue provided:

"(b) Definition of Earned Income. -- For purposes of this section, the term 'earned income' means wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered, but does not include that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered. In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income-producing factors, under regulations prescribed by the Secretary, a reasonable allowance as compensation for the personal services rendered by the taxpayer, not in excess of 30 percent of his share of the net profits of such trade or business, shall be considered as earned income."

E. That Treasury Regulation 1.1348-3(a)(3), in part, provides:

"(i) If an individual is engaged in a trade or business...in which both personal services and capital are material income-producing factors, a reasonable allowance as compensation for the personal services actually rendered by the individual shall be considered earned income..."

(ii) Whether capital is a material income-producing factor must be determined by reference to all the facts of each case. Capital is a material income-producing factor if a substantial portion of the gross income of the business is attributable to the employment of capital in the business, as reflected, for example, by a substantial investment in inventories, plant, machinery, or other equipment. In general, capital is not a material income-producing factor where gross income of the business consists principally of fees, commissions, or other compensation for personal services performed by an individual."

F. That petitioner's own testimony admits that his income for the year 1979 was "inflated" due to his sales of gasoline in such year. For the year 1979, it is clear that capital in the form of petitioner's inventory was a material income-producing factor, said inventory (cost of goods sold) accounting for 83 percent of his gross sales. Likewise, for such year, it is equally obvious that sales of parts used in servicing automobiles and the labor of those who performed repair services for petitioner were in part responsible for that portion of petitioner's gross sales attributable to repairing and servicing automobiles. It is thus clear that 100 percent of petitioner's net income for the year 1979 was not "earned income" within the meaning and intent of sections 911 and 1348 of the Internal Revenue Code and, by reference thereto, section 603-A of the Tax Law.

G. That although the requirement that earned income be limited to not greater than 30 percent of an individual's share of the net profits from a trade or business was no longer applicable to the tax year at issue herein, the 30 percent of petitioner's net profit of \$104,877.28 allowed as earned income was not unreasonable. This amount itself is an increase of over 80 percent of his total income from the previous year, and 250 percent of what petitioner himself paid the manager of his secondary location as reasonable compensation. Petitioner, having failed in his burden of proof to show he was entitled to consider that greater than 30 percent of his net profit of \$104,877.28 for the year 1979 constituted earned income within the meaning of section 603-A of the Tax Law, the deficiency in such respect is sustained.

H. That based upon the discrepancy (Finding of Fact "13") as to interest claimed due as of April 24, 1981 (\$171.68) per the statements of audit changes when compared to the interest claimed due as of July 23, 1981 (\$33.51) per the

Notice of Deficiency, it is clear that a computer error was made on the Notice of Deficiency in that the penalty shown thereon (\$173.14) was interest and the interest shown thereon an updating of interest from the date of the statements to the date of the notice. That since penalty was therefore not asserted, penalty is not sustained herein.

I. That the petition of David H. and Kathleen C. Dibble is in all respects denied and, except as noted in Conclusion of Law "H", the Notice of Deficiency is sustained, together with all applicable interest as required by law.


DATED: Albany, New York

STATE TAX COMMISSION

DEC 13 1985


PRESIDENT


COMMISSIONER


COMMISSIONER