

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petition :  
of :  
Ernst & Co., B. Aronson & Co., Inc. :  
D. Poster and G. Reicheim (Joint Venture) : AFFIDAVIT OF MAILING

for Redetermination of a Deficiency or Revision :  
of a Determination or Refund of Unincorporated :  
Business Tax under Article 23 of the Tax Law for :  
the Year 1978. :

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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 14th day of March, 1984, he served the within notice of Decision by certified mail upon Ernst & Co., B. Aronson & Co., Inc., D. Poster and G. Reicheim (Joint Venture) the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Ernst & Co., B. Aronson & Co., Inc.  
D. Poster and G. Reicheim (Joint Venture)  
c/o Ernst & Company  
100 Wall St.  
New York, NY 10005

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  
14th day of March, 1984.

David Parchuck

Commie A. H. H. H.  
Authorized to administer oaths  
pursuant to Tax Law Section 174

STATE OF NEW YORK

STATE TAX COMMISSION

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of :  
Ernst & Co., B. Aronson & Co., Inc. :  
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Business Tax under Article 23 of the Tax Law for :  
the Year 1978. :

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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 14th day of March, 1984, he served the within notice of Decision by certified mail upon Lester Cooper, the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Lester Cooper  
Frederick S. Todman & Co.  
111 Broadway, Suite 500  
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  
14th day of March, 1984.

David Parchuck

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

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

March 14, 1984

Ernst & Co., B. Aronson & Co., Inc.  
D. Poster and G. Reicheim (Joint Venture)  
c/o Ernst & Company  
100 Wall St.  
New York, NY 10005

Gentlemen:

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  
Lester Cooper  
Frederick S. Todman & Co.  
111 Broadway, Suite 500  
New York, NY 10006  
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petition	:	
of	:	
ERNST & CO., B. ARONSON & CO., INC.,	:	DECISION
D. POSTER, G. REICHELM (JOINT VENTURE)	:	
	:	
for Redetermination of a Deficiency or for	:	
Refund of Unincorporated Business Tax under	:	
Article 23 of the Tax Law for the Year 1978.	:	

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Petitioner, Ernst & Co., B. Aronson & Co., Inc., D. Poster, G. Reichelm (Joint Venture), c/o Ernst & Co., 100 Wall Street, New York, New York 10005, filed a petition for redetermination of a deficiency or for refund of unincorporated business tax under Article 23 of the Tax Law for the year 1978 (File No. 37432).

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 May 26, 1983 at 1:30 P.M., with additional evidence to be submitted by June 26, 1983. Petitioner appeared by Frederick S. Todman & Co. (Lester Cooper, C.P.A.) The Audit Division appeared by John P. Dugan, Esq. (Anna Colello, Esq., of counsel).

ISSUES

I. Whether the Audit Division properly disallowed a modification reducing petitioner's unincorporated business income by the amount of a stock transfer tax refund received.

II. Whether the Audit Division properly limited the exemption for a corporate partner's proportionate interest in petitioner's unincorporated business gross income, less deductions, to the partner's net income allocable to New York State.

FINDINGS OF FACT

1. Petitioner, Ernst & Co., B. Aronson & Co., Inc., D. Poster, G. Reichelm (Joint Venture), filed a New York State partnership return for 1978 reporting its income and deduction on the cash basis. Petitioner is a joint venture comprised of a partnership, a corporation, and two individuals. All members of the joint venture are securities dealers engaged in "market making transactions" which involve trading securities for their own accounts. All of petitioner's income was from New York State sources. On its 1978 return, petitioner subtracted \$59,544.00 from its total business income for a 1977 New York State Stock Transfer Tax refund which had been included as income on its Federal return. On the same return petitioner took a deduction for partners' services of \$942,672.00. This amount was characterized as the profit of the joint venture and was the amount distributed to the partners. Petitioner reported no unincorporated business tax due for 1978. In 1977 petitioner had also reported no unincorporated business tax due.

2. On April 14, 1982, the Audit Division issued a Notice of Deficiency against petitioner in the amount of \$3,687.15 plus interest of \$1,073.18 for a total due of \$4,760.33. A Statement of Audit Changes issued April 14, 1982 explained that the \$59,544.00 modification for stock transfer tax was being disallowed because:

"For tax years beginning before August 1, 1977 the Section 705(c)(6) modification was the lesser of (A) the amount of New York State transfer tax refund or (B) the amount of unincorporated business tax due without any stock transfer tax refund or modification included in income.

For a cash basis taxpayer, the unincorporated business tax due for the above provision is computed on the return for the year the refund applies, even though the refund and modification may be reported on a future return. Your allowable Section 705(c)(6) modification is \$-0-, which represents the lesser of A or B above."

Additionally, the Audit Division disallowed the \$942,672.00 deduction for partners' services and allowed a deduction of only \$15,000.00.

3. The Audit Division also computed an exemption from unincorporated business taxable income pursuant to section 709(2) of the Tax Law for each of the partners who were themselves subject to unincorporated business tax or corporate franchise tax. Said exemption amounted to \$908,473.00. Prior to the hearing, the Audit Division recomputed the 709(2) exemption attributable to corporate partner, B. Aronson & Co., Inc. ("Aronson") since the original computation included erroneous income figures. The recomputation increased the 709(2) exemption to \$911,250.00.

4. As to the stock transfer tax modification, petitioner maintained that, for 1977, each of the partners had erroneously added back the amount of stock transfer taxes paid on their individual returns rather than on petitioner's partnership return. Such a modification, petitioner argued, would have resulted in unincorporated business tax being due for 1977 thus allowing petitioner to modify its 1978 unincorporated business income by subtracting the stock transfer tax refund applicable to 1977. Petitioner did not show whether its individual partners had modified their 1978 returns to subtract out the 1977 refund or why, if the partners erroneously included the transfer taxes paid in 1977, they had not applied for a refund of such taxes.

5. In recomputing the 709(2) exemption, the Audit Division had limited the exemption attributable to Aronson to Aronson's net income allocable to New York State. For each of the individual partners (D. Poster and G. Reichelm), the exemption had amounted to \$204,088.00. For the partnership partner (Ernst & Co.) the exemption was \$315,408.00. Aronson's exemption as computed amounted to \$204,088.00. However, since Aronson's 1978 net taxable income allocable to

New York as reported on its 1978 Corporation Franchise Tax Report was \$187,666.00, the Audit Division limited its exemption under 709(2) to said amount. Petitioner argued that, since Aronson modified its Federal income for stock transfer taxes paid in arriving at New York taxable income, there should be no limitation for the 709(2) exemption as to Aronson.

6. Petitioner conceded that the proper allowance for partners' services was \$15,000.00 and not the \$942,672.00 originally claimed.

#### CONCLUSIONS OF LAW

A. That for taxable years commencing prior to August 1, 1977, section 705(c)(6) of the Tax Law provided that, among the items to be subtracted from Federal gross income of the business to determine unincorporated business gross income was:

"The amount of any refund or credit for overpayment of income taxes imposed by this state, or any other taxing jurisdiction, except unincorporated business income taxes imposed by any city of this state, to the extent properly included in gross income for federal income tax purposes, and except the excess of the credit allowed under subsection (e) of section seven hundred one against the tax due under this article for any taxable year over the tax due for such year computed without regard to such credit, to the extent that such excess is included in gross income for federal income tax purposes."

B. That for taxable years commencing on or after August 1, 1977, section 705(c)(6) was amended to provide that, among the items to be subtracted from Federal gross income of the business to determine unincorporated business gross income was:

"The amount of any refund or credit for overpayment of income taxes imposed by this state, or any other taxing jurisdiction, except unincorporated business income taxes imposed by any city of this state, to the extent properly included in gross income for federal income tax purposes."

C. That the amended section 705(c)(6) deleted the section of the prior law which did not allow the subtraction of the excess credit for stock transfer taxes paid by a securities dealer trading for his own account. For tax years commencing on or after August 1, 1977, a refund resulting from the stock transfer tax credit is treated as any other state income tax refund. That is, such a refund is to be subtracted from Federal gross income to the extent included in Federal gross income in order to determine unincorporated business gross income. The amended statute does not make subtraction of the refund in the year received dependent upon the amount of unincorporated business tax due for the year the refund applies. The amended statute applies to tax year 1978, the year in issue, and therefore, any state stock transfer tax refund received by petitioner in 1978 and included in Federal gross income for 1978 is to be subtracted from Federal gross income regardless of the year to which the refund applies. Nowhere in the amended statute is there a transition year provision which would allow the Audit Division to make 1978 stock transfer tax refund modifications dependent upon 1977 unincorporated business tax paid. Such dependence was eliminated by the 1977 amendment and no longer applied in 1978, the year in issue. As a result, petitioner is to be allowed to subtract from Federal gross income the \$59,544.00 in stock transfer tax refund included in 1978 Federal gross income.

In view of the foregoing, it is unnecessary to address petitioner's arguments with respect to the erroneous addback of 1977 transfer taxes paid on the individual member partners' returns.

D. That section 709(2) of the Tax Law provides, in pertinent part, that, if a partner in an unincorporated business is itself subject to unincorporated business tax or corporation franchise tax, an exemption is allowed for " the



amount of the partner's proportionate interest in the excess of the unincorporated business gross income over the deductions allowed under sections seven hundred six and seven hundred eight, but this exemption shall be limited to the amount which is included in the partner's unincorporated business taxable income allocable to this state, or included in a corporate partner's net income allocable to this state...".

E. That the Court of Appeals, in interpreting Administrative Code of the City of New York having identical language to section 709(2), has held that:

"the construction of [the statute] urged by [petitioner] would render the limitation on the exemption a nullity. The computation of allocated net income on a corporate partner's [tax] return will necessarily include its share of the unincorporated business's net income because that share must be reported as part of the partner's 'entire net income'. Thus, an unincorporated business would always be able to exempt the full amount of its distributions to corporate partners. This interpretation of the statute must be rejected...

\* \* \*

A logical interpretation of the plain words of the exemption provision indicates that the exemption is limited to the aggregate of the amounts of each corporate partner's distributive share which is not greater than its allocated net income" (Richmond Construction v. Tishelman, N.Y.L.J., December 23, 1983, p. 1, col. 6).

Since Aronson's 1978 net taxable income allocable to New York as reported on its 1978 Corporation Franchise Tax Report was \$187,666.00, the Audit Division properly limited its exemption under 709(2) to said amount.


F. That the petition of Ernst & Co., B. Aronson & Co., Inc., D. Poster, G. Reichelm (Joint Venture) is granted to the extent indicated in Conclusion of Law "C"; that the Audit Division is directed to modify the Notice of Deficiency

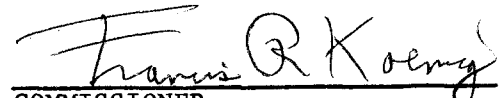
issued April 14, 1982 accordingly; and that, except as so granted, the petition is in all other respects denied.


DATED: Albany, New York

MAR 14 1984

STATE TAX COMMISSION

  
PRESIDENT

  
COMMISSIONER

  
COMMISSIONER