

New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-87 (10) I
Income Tax
December 15, 1987

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. I870901C

On September 1, 1987, a Petition for Advisory Opinion was received from Zalman C. and Elaine K. Bernstein, c/o Seidman & Seidman, 15 Columbus Circle, New York, New York 10023.

The issue raised is whether Petitioners' personal service income for purposes of computing their maximum tax pursuant to section 603-A of the Tax Law is limited to the amount paid to Petitioner Zalman Bernstein and designated by his employer as salary.

While the Petition for Advisory Opinion was received from Zalman C. and Elaine K. Bernstein, the income here at issue is that of Petitioner Zalman C. Bernstein.

For taxable years 1984 and 1985, Petitioner Zalman C. Bernstein was the chief executive officer, chairman of the board of directors and chief financial officer of Sanford C. Bernstein & Co., Inc. (hereinafter "SCB"). SCB is an "S" corporation for federal and New York State tax purposes and a registered stockbroker/investment advisor.

Petitioner states that SCB generates substantially all of its income through the personal services of its key employees, rather than through the employment of capital and that SCB derives nearly all of its income from fees and commissions, rather than trading profits.

Petitioner states that he serves as SCB's chief financial officer. In this capacity, he approves all significant SCB expenditures. His other responsibilities include: (1) serving on SCB's Investment Policy Committee; (2) developing and implementing SCB's investment banking activities; (3) maintaining and developing existing business and attracting new business to SCB; and (4) approving all professional personnel decisions. Additionally, Petitioner directs SCB's Institutional Management and Investment Management activities, and also is responsible for formulating SCB's strategic plan for the future.

For taxable years 1984 and 1985, Petitioner received compensation from SCB, which amounts were reported on W-2 forms furnished to him by SCB. Petitioner also reported as income for taxable years 1984 and 1985 his share of the income of SCB, whether or not distributed, which was reported on K-1 forms furnished to him by SCB.

In computing his personal service income for purposes of the maximum tax under section 603-A of the Tax Law for taxable years 1984 and 1985, Petitioner included as personal service income the amounts reported on his W-2 forms plus the amounts of ordinary income reported on his K-1 forms less amounts characterized as "net investment income." Amounts reported on such K-1

forms as "dividends", "long term capital gain" and "short term capital gain" were not included as personal service income by Petitioner. Petitioner does not describe in his Petition how the "net investment income" figures were determined.

Upon audit of Petitioner, Petitioner's personal service income for purposes of section 603-A was limited by the Audit Division to the amounts reported on Petitioner's W-2 forms.

Section 603-A of the Tax Law provided for a maximum tax rate on New York personal service income for taxable years 1984 and 1985. Section 603-A(b)(1) defines "New York personal service income", in part, as:

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.

For the taxable years at issue, the personal income tax regulations of the State Tax Commission provided that "[i]f an individual performs personal services for a corporation (including an electing small business corporation), personal service income generally is only the portion of income received from the corporation that represents a reasonable allowance for salaries and other compensation for personal services actually rendered." 20 NYCRR 100.4(c)(2)(iii). (Emphasis supplied).

The regulations of the State Tax Commission specify no test to determine the portion of income received from a corporation that represents a reasonable allowance for salaries and other compensation for personal services actually rendered. Nor do the regulations contain any provisions restricting "New York personal service income" to amounts reported on W-2 forms.

The determination of what represents a reasonable allowance for salaries and other compensation for personal services actually rendered is a factual question which must be answered on a case by case basis based upon a careful review of the relevant facts and circumstances of each case. Factors which may be taken into account in arriving at a reasonable allowance include: the nature, extent and scope of Petitioner's work, Petitioner's qualifications, the size and complexities of the trade or business, a comparison of Petitioner's compensation to the compensation of other employees, a comparison of Petitioner's income from the corporation to the income of other shareholders of the corporation and the prevailing rates of compensation for comparable positions in comparable companies. However, the above list is not intended to be an exhaustive list.

The burden of proving that income received from SCB by Petitioner represents a reasonable allowance for compensation for personal services actually rendered falls upon Petitioner. Antonio and Frances Coppola, Joseph and Marie Coppola, Decision of the State Tax Commission, February

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18, 1986, TSB-H-86(44)I; Migliore v. Commissioner, 36 TCM 1004 (1977) (applying the provisions of Internal Revenue Code section 1348); Paula Construction, Co. v. Commissioner, 58 T.C. 1055 (1972).

Accordingly, the Audit Division is justified in limiting Petitioner's personal service income to the amount designated by SCB as salary if such amount represents a reasonable allowance for personal services actually rendered. Petitioner bears the burden of proving that any amount of income included on his K-1 forms is also personal service income. Inasmuch as any such proof will entail a question of fact, such proof must be presented in the context of the audit performed by the Audit Division since questions of fact cannot be resolved in an advisory opinion.

DATED: December 15, 1987

s/FRANK J. PUCCIA
Director
Technical Services Bureau

NOTE: The opinions expressed in Advisory Opinions
are limited to the facts set forth therein.