

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

TSB-A-91 (2) I
Income Tax
January 29, 1991

STATE OF NEW YORK

COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. I901023A

On October 23, 1990, a Petition for Advisory Opinion was received from Lionel E. and Maxine Gordon, c/o E. Parker Brown, II, Esq., Hiscock & Barclay, Financial Plaza, P.O. Box 4878, Syracuse, New York 13221-4878.

The issue raised by Petitioners, Lionel E. and Maxine Gordon, is whether payments received by a nonresident individual under a noncompetition agreement entered into with the purchaser of the assets of a New York business are New York source income.

Since the early 1980s, Petitioners have been residents of the State of Florida. Petitioner, Lionel Gordon, was the sole shareholder of Answerite, Inc. ("Answerite") and Telephone Answering Exchange of Lynbrook, Inc. ("Lynbrook"), New York corporations providing telephone answering services principally in Lynbrook, Long Beach and Woodmere, Long Island. In December of 1986, all the assets (except cash) of Answerite and Lynbrook were purchased by Telephone Answering Exchange of Hempstead, Inc. ("Hempstead"), an unrelated competitor of the selling companies. Thereafter, Answerite and Lynbrook were liquidated pursuant to section 337 of the Internal Revenue Code and cash was distributed to the shareholder, Lionel Gordon.

In connection with Hempstead's purchase of Answerite and Lynbrook, Hempstead entered into a Restrictive Covenant Agreement with the selling companies and with Lionel Gordon personally. The Agreement noted that Hempstead had purchased telephone answering service accounts and lists of customers from Answerite and Lynbrook and that Gordon had knowledge concerning these assets. Hempstead wanted to protect the confidentiality of the accounts and lists. Accordingly, it contracted with the sellers and Lionel Gordon not to disclose information, solicit or accept business from transferred accounts or compete with Hempstead for 5 1/2 years in Nassau County, New York. In consideration for Gordon's promise, Hempstead agreed to pay him a stated amount of money in 66 monthly installments.

Section 631(a) of the Tax Law provides that the New York source income of a nonresident individual shall be the sum of the net amount of items of income, gain, loss and deduction entering into the individual's federal adjusted gross income derived from or connected with New York sources.

Section 631(b)(1)(B) of the Tax Law provides that items of income, gain, loss and deduction derived from or connected with New York sources are those items attributable to a business, trade, profession or occupation carried on in New York State.

Section 131.4(a) of the Income Tax Regulations provides:

(1) The New York adjusted gross income of a nonresident individual includes items of income, gain, loss and deduction entering into his Federal adjusted gross income which are attributable to a business, trade, profession or occupation carried on in New York State.

(2) A business, trade, profession or occupation (as distinguished from personal services as an employee) is carried on within New York State by a nonresident when such nonresident occupies, has, maintains or operates desk space, an office, a shop, a store, a warehouse, a factory, an agency or other place where such nonresident's affairs are systematically and regularly carried on, notwithstanding the occasional consummation of isolated transactions without New York State. This definition is not exclusive. Business is carried on within New York State if activities within New York State in connection with the business are conducted in New York State with a fair measure of permanency and continuity.

The consideration received in exchange for a restrictive covenant constitutes income includible in gross income for federal income tax purposes. Such a covenant constitutes the surrender of an intangible asset, property right or right of value directly connected with the sale of the business. Inasmuch as the covenant derives its significance and value from the entire transaction, it follows that the payment therefor constitutes income or gain ". . . from liquidation of the business. . . ." Leon Bonfiglio, Adv Op St Tax Comm, September 16, 1980, TSB-H-80(520)I. (See, Matter of Garry J. Hearn, Dec St Tax Comm, October 5, 1984, TSB-H-84(193)I; Matter of Raymond Krinsky and Sylvia Krinsky, Dec St Tax Comm, November 9, 1979, TSB-H-79(326)I.)

Therefore, payments received with respect to a restrictive covenant entered into in connection with the sale of a business that was carried on in New York State are items of income derived from or connected with New York sources pursuant to section 631(b)(1)(B) of the Tax Law and section 131.4(a) of the Income Tax Regulations.

Herein, the payments received in consideration for the restrictive covenant agreement entered into by Lionel Gordon in connection with the sale and liquidation of Answerite and Lynbrook are income attributable to a business carried on in New York. Accordingly, pursuant to section 631(b)(1)(B) of the Tax

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Law, Petitioner, Lionel Gordon, must include in New York source income, the payments received with respect to such restrictive covenant for the taxable year in which each payment is received.

DATED: January 29, 1991

s/PAUL B. COBURN
Deputy Director
Taxpayer Services Division

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