STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition of **ROBERT AND FRANCES TOSTI** for Redetermination of a Deficiency or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law for the Years 2004 through 2006.	DECISION DTA NO. 822915

Petitioners, Robert and Frances Tosti, filed an exception to the determination of the Administrative Law Judge issued on July 1, 2010. Petitioners appeared *pro se*. The Division of Taxation appeared by Mark Volk, Esq. (Kevin R. Law, Esq., of counsel).

Petitioners filed a brief in support of their exception. The Division of Taxation filed a brief in opposition. Petitioners filed a reply brief. Oral argument, at petitioners' request, was heard on November 17, 2010 in New York, New York.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision. Commissioner Nesbitt took no part in the consideration of this matter.

ISSUE

Whether petitioner, Robert Tosti, who resides and practices law exclusively in New Jersey for a law firm that does business in New York and maintains an office in New York, may be subjected to New York personal income tax by virtue of his denomination as a partner in such law firm.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

Petitioners, Robert and Frances Tosti, filed Form IT-203 (New York State Nonresident and Part-Year Income Tax Return) for each of the years 2004, 2005 and 2006 as nonresidents of New York. Petitioner also filed an amended Form IT-203 (Form IT-203-X) for the years 2004 and 2005.[1] It is undisputed that petitioner, an attorney, is a resident of New Jersey who practiced law exclusively in New Jersey on behalf of the law firm Wilson, Elser, Moskowitz, Edelman & Dicker, LLP (WEMED) during each of the years in issue. WEMED maintains offices in many locations, including at least three offices in New York State.

As is relevant to the matter at issue, petitioner received payments from WEMED in the amounts of $245,821.00 for 2004, $266,447.00 for 2005 and $266,460.00 for 2006. Petitioner treated these payments, for New York tax purposes, as follows:

> a) For 2004, petitioner reported his entire WEMED payment amount as New York source income on Form IT-203. Thereafter, petitioner removed the entire amount from New York source income on his subsequently filed Form IT-203-X.
>
> b) For 2005, petitioner reported as New York source income the portion of his entire WEMED payment resulting from the application of WEMED's New York partnership allocation percentage to such payment amount. Thereafter, petitioner removed the entire amount from New York source income on his subsequently filed Form IT-203-X.
>
> c) For 2006, petitioner reported none of his WEMED payment as New York source income.

---

[1] Petitioner Frances Tosti's name appears herein solely by virtue of the fact that she filed joint income tax returns with petitioner Robert Tosti. Mrs. Tosti filed a certification that she had no New York source income during the years in issue, and unless otherwise noted or required by context, all references to petitioner shall mean Robert Tosti.

The Division of Taxation (Division) examined petitioner's returns and concluded, in reliance on Treasury Regulation § 1.707-1(c), that the foregoing payments, denominated guaranteed payments, represented petitioner's distributive share of partnership ordinary income properly allocable to and taxable by New York to the extent of WEMED's partnership allocation percentage. Upon this basis, the Division issued the following documents to petitioner:

> a) For 2004, a Notice of Deficiency dated February 19, 2008 asserting additional personal income tax due in the amount of $8,401.37, plus interest.
>
> b) For 2005, a Notice of Disallowance dated February 8, 2008 denying the refund of personal income tax claimed on petitioner's amended Form IT-203-X in the amount of $9,130.00.
>
> c) For 2006, a Notice of Deficiency dated April 14, 2008 asserting additional personal income tax due in the amount of $7,691.98, plus interest.

Petitioner described WEMED as a large, well-known insurance defense firm interested in branching out to establish locally-based legal practices in areas of law other than insurance defense matters. Petitioner had been a partner in a small law firm in New Jersey for approximately 20 years, where his areas of practice concentration centered on labor law, including school law, municipal law and civil rights matters. WEMED approached petitioner, and or about August 2003, petitioner commenced his tenure with WEMED.

Petitioner's relationship with WEMED is memorialized in an August 12, 2003 letter addressed to petitioner from WEMED and captioned "Partnership." This letter specifies that:

> a) Petitioner's status in the firm will be as a "non-equity or limited partner as opposed to a general or capital partner." As a non-equity partner, petitioner "will not be responsible for any obligations or liabilities incurred by WEMED, LLP," and " will not have any right, title, interest or claim in any of the assets, income or files of the firm" nor "have the right or power to demand or effect an accounting or a dissolution of WEMED, LLP."
>
> b) Petitioner's compensation "will be established by the Executive

Committee of WEMED, LLP and will be in such amount as the Executive Committee in the exercise of its sole discretion may from time to time decide," and petitioner will "receive a 'draw' which has been established by the Executive Committee."

c) Petitioner, as a non-equity partner will be entitled to life insurance, disability insurance, health insurance and professional liability insurance benefits, as determined by the Executive Committee.

d) In the event of his death while the letter agreement was in effect, WEMED would pay to petitioner's estate his then current "draw for a period of one year from the date of death," and petitioner's estate and beneficiaries "shall have no other claim against WEMED, LLP or any of its partners."

e) The agreement was terminable by either party upon receipt of a 90-day written notice of termination.

f) Petitioner agreed to devote his professional and business time and attention exclusively to the business of WEMED, LLP.

g) The "Partnership Agreement and partnership relationship" shall be "interpreted, determined and controlled by" the law of New York State. The Agreement set forth provisions for the resolution of disputes and claims arising out of the Partnership Agreement and partnership relationship, included a requirement of confidentiality with respect thereto as well as a general "Confidentiality Agreement."

Petitioner had at least one, and when his work load was heavier more than one, WEMED associate attorney whose time was dedicated to working in petitioner's labor law practice at WEMED. Petitioner did not have any management role, per se, other than to make recommendations as to whether a given associate should receive a pay raise or should or should not be retained as an associate. Petitioner described these recommendations as merely his opinion to be "passed up the line." Petitioner noted that he "participated" but had no real input with regard to the hiring committee (presumably for the Newark, New Jersey, office of WEMED).

Petitioner's IT-203-X (amended return) for 2004 included the following statement:

> Taxpayer erroneously received an incorrect Form K-1 from [WEMED]. The taxpayer is a non equity partner in this firm and should not be taxed by New York State. Taxpayer works, lives and derives all income from New Jersey.

In response to the Division's letter request for a copy of petitioner's form K-1 and a statement as to where petitioner's services were performed, WEMED furnished an August 6, 2007 letter confirming that petitioner was a "Partner in our Newark, New Jersey office . . ." together with the form K-1 (Partner's Share of Income, Deductions, Credits, etc.) issued to petitioner for 2004. This form K-1 lists petitioner as an "Individual" (line K), "Domestic partner" (line J), "General partner or LLC member-manager" (line I), with "245" as petitioner's "Partner's Identifying Number" (line G). Line L lists petitioner's "Partner's share of profit, loss and capital" as "None" for each such item. Part III (Partner's Share of Current Year Income, Deductions, Credits, and Other Items) reflects WEMED's payments to petitioner as "Guaranteed payments" (Line 4) and "Self-employment earnings" (Line 14), and reflects thereafter the portion of such guaranteed payments to partners allocated to New York (Line 54) per WEMED's partnership allocation percentage.

Petitioner did not see or have access to WEMED's partnership agreement. He received his pay bi-weekly with the amount, denominated as a draw, determined by dividing his annual guaranteed payment by 24. In response to petitioner's inquiry for information as to what his salary would be based on, the managing partner in WEMED's Newark office advised petitioner that he had no information and that "it's all done in New York – I just get a piece of paper with a guy's name on it and a number and I have nothing to do with it." Petitioner stated that he completed a withholding tax form (Form W-4), but that no taxes were withheld, and he was advised that "the taxes are on you."

In order to obtain expense money, petitioner had to go to the managing partner in the Newark office to request the same. Petitioner described an instance where he did so when he needed expense money for taxicabs and incidentals in connection with client development while attending a school board convention in Atlantic City, New Jersey, and alluded to instances where the managing partner had to get authority from WEMED's New York office for expense money in excess of that which he had authority to approve.

Petitioner noted in testimony that he received a relatively small "bonus" amount of approximately $500.00 at the end of the first year in which he was with WEMED (from August 2003 through the end of 2003), and that he received substantially more in the following year.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge discussed the relevant Tax Law and cases, and concluded that petitioners were liable for the payment of New York State personal income taxes inasmuch as Robert Tosti's share of the partnership income was derived from New York sources. The Administrative Law Judge cited several cases establishing that the income of a nonresident partner of a New York law firm may be subject to tax on payments from such law firm to the extent its income is allocated to New York sources.

The Administrative Law Judge rejected petitioners' argument that they should not be liable because Robert Tosti was not a true partner, but a mere glorified associate. The Administrative Law Judge further discussed the indicia of partnership herein, concluding that petitioner agreed to be designated as a partner, which carried certain tax ramifications for which petitioner must be accountable. Accordingly, the Administrative Law Judge sustained the Notices of Deficiency and Notice of Disallowance in their entireties.

ARGUMENTS ON EXCEPTION

On exception, petitioners make the same arguments as those presented to the Administrative Law Judge below. Petitioners state that the partnership payments should not be subject to New York State personal income tax because, although Mr. Tosti was designated a partner in his agreement with WEMED, he did not exercise true partnership duties and responsibilities. Petitioners ask that we reverse precedent and hold that an individual who is designated a partner, but receives a salary untethered to gross partnership income, should not be taxed as a partner if the individual shows that he neither had nor exerted true partnership authority.

The Division presents the same arguments as those made below. The Division cites to the relevant tax laws and cases, and argues that the Administrative Law Judge properly determined that the income derived by petitioner, Robert Tosti, is properly subject to New York personal income tax to the extent allocated to New York. The Division argues that the determination should be sustained.

OPINION

New York may assert jurisdiction and apply its personal income tax on two bases: either the residence of the person, or source of the income, gain, loss or deduction (***see generally*** Tax Law § 601). New York residents are subject to tax on their worldwide income regardless of source, while nonresidents are subject to tax only on their New York source income (Tax Law § 601 [a] and [e]). As petitioner was a nonresident, it is only upon the latter basis that he may be subjected to New York personal income tax (Tax Law § 601[e]).

The New York source income of a nonresident individual includes the sum of the net

amount of income, gain, loss and deduction entering into the individual's federal adjusted gross income, derived from or connected with New York sources, including:

> (A) his distributive share of partnership income, gain, loss and deduction, determined under [Tax Law] section six hundred thirty-two . . . (Tax Law § 631[a][1]).

The New York source income of a nonresident partner includes his distributive share of all items of partnership income, gain, loss and deduction entering into his federal adjusted gross income to the extent such items are derived from or connected with New York sources (Tax Law § 632[a][1]). The New York source partnership income is determinated by calculating the percentage of partnership business activity both within and without New York, looking at partnership property, partnership payroll and partnership gross income (20 NYCRR 132.15[d], [e], and [f]).

We note that the terms "partner" and "partnership" are not explicitly defined within the Tax Law and, accordingly, we have looked to the Internal Revenue Code and relevant case law for guidance (Tax Law § 607[a]). Under the Code, a partnership for tax purposes is broader in scope than the common law meaning of partnership and may include groups not commonly called partnerships (***see*** 26 CFR § 761[a]; ***see also McManus v. Commissioner***, 583 F2d 443 [1978] ***cert denied*** 440 US 959 [1979]). Further, it does not matter whether state law classifies a venture as a partnership (***Estate of Khan v. Commissioner***, 499 F2d 1186 [1974]), because the federal tax law defines partnership and partner for tax purposes (***Cunha's Estate v. Commissioner***, 279 F2d 292 [1960], ***cert denied*** 364 US 942 [1961]). Petitioner concedes that WEMED is a partnership doing business within New York. Accordingly, the remaining issue to be determined is whether petitioner is a partner under the Tax Law.

Petitioner maintains that he was not a partner under the Tax Law because the true indicia of partnership were not present. Petitioner acknowledges that his agreement with WEMED denominated him as a "nonequity" partner, and that he received guaranteed payments and a year-end bonus from WEMED, which did business in New York. However, petitioner claims that he should not be subject to New York personal income tax because he practiced only in New Jersey, did not share in partnership profits and losses, did not participate in management of WEMED, and owned no capital in the partnership. Petitioner characterized his relationship with the firm as that of a "glorified" associate, and asserts that we treat his compensation from WEMED not as proceeds paid to a partner, but salary paid to an employee. In sum, the core of petitioner's argument is that a balancing of facts in this case leads to the conclusion that petitioner was not a partner in WEMED and that to conclude otherwise is to exalt form over substance. We do not agree with petitioner's argument and affirm the determination of the Administrative Law Judge.

It is well established that a partner of a partnership that does business within New York must pay tax to New York on the portion of the partnership income derived from New York sources (***see Matter of Heller v. New York State Tax Commn.***, 116 AD2d 901 [1986]; ***Matter of Heffron v. Chu***, 144 AD2d 729 [1988]). For federal income tax purposes, a partner is defined by his affiliation as a "member of a partnership" (IRC § 751). The Administrative Law Judge correctly noted that the decisions in ***Matter of Heller*** (***supra***) and ***Matter of Heffron*** (***supra***) are determinative of the issues herein.

Matter of Heller (***supra***) involved partnership income received by a nonresident attorney who was not required to make capital contributions to the firm, held no interest in partnership assets, shared in neither the partnership profits or losses, and did not participate in partnership

management decisions. Mr. Heller was listed as a partner on the partnership returns, his compensation was reported as partnership income, and neither Social Security nor withholding taxes were deducted from his compensation. He argued that his income should not be subject to New York tax because his partner designation in the New York partnership was merely to enhance his reputation and assist in attracting clients. The Court rejected this argument and held that Mr. Heller was a partner in a New York partnership and his distributive share of the partnership income, as allocated, was properly subject to New York tax (***see Matter of Heller***, ***supra***; see also ***Matter of Jablin v. State Tax Commn.***, ***supra***).

Matter of Heffron (***supra***) concerned a nonresident attorney working pursuant to a two-year agreement with the partnership, who received a fixed amount of compensation per year regardless of the partnership's profits or losses. The firm reported Mr. Heffron's compensation as partnership income, designating him a "nonresident partner sharing Washington office profits only," and there were no deductions for Social Security or withholding taxes. He had no capital account and possessed no interest in either the firm's assets or its management. However, Mr. Heffron was authorized to hold himself out to the public and the courts as a partner, which enabled him to attract clients and sign filings for the firm in federal court. Mr. Heffron argued that the compensation from the partnership should not be subject to New York tax because the evidence in the record negated any existence of his being a partner with the New York firm. As in ***Matter of Heller*** (***supra***), the Court rejected this argument and held that Mr. Heffron was required to pay New York tax on his distributive share of partnership income allocated to New York (***see Matter of Heffron, supra***; ***see also Matter of Weinflash v. Tully***, 93 AD2d 369 [1983]; ***Matter of Jablin v. State Tax Commn.***, 65 AD2d 891 [1978]).

We find this line of cases controlling and hold that petitioner was a partner of WEMED within the meaning of the Tax Law. Upon agreeing to join the firm, petitioner received a letter that clearly described him as a nonequity partner. WEMED treated petitioner as a partner for tax purposes and provided him with forms K-1, which designated him as such. Payments made to petitioner by the firm were reported as guaranteed payments to a partner and no taxes were withheld from such payments. During the audit period, petitioner had one or more WEMED associates to assist him with his practice. The record suggests that petitioner exerted some *de facto* management of these associates because he could recommend whether they should receive raises. The record also suggests that petitioner made use of the obvious attendant benefit derived from being designated a partner at WEMED, namely having the firm's resources, backing, and support at petitioner's disposal. This conclusion is supported by the denomination of petitioner as a partner in his agreement with WEMED, and by petitioner's description of attending a convention in Atlantic City for purposes of client development. Accordingly, we hold that petitioner was a partner of WEMED under the Tax Law and that his income for the years at issue was properly subject to New York State personal income tax as allocated.

We reject petitioner's argument that there is insufficient nexus for New York State to tax petitioner. Having determined him to be a partner at WEMED, we conclude that he bore a connection sufficient to validate the subject taxes because he was a partner in a law firm that maintained a considerable presence in New York (***see Matter of Weil v. Chu***, 120 AD2d 781 [1986], ***affd*** 70 NY2d 783 [1987], ***appeal dismissed*** 485 US 901 [1988]; ***see also Matter of Knapp v. State Tax Commn.***, 67 AD2d 1024 [1979]). The record lacks any evidence to the contrary. The Tax Law treats partners differently than employees. Having chosen to become a

partner in WEMED, which does business in New York, petitioner must bear the consequences (***see Matter of Faulkner***, ***Dawkins & Sullivan v. State Tax Commn.***, 63 AD2d 764 [1978]; ***see also Matter of Jablin v. State Tax Commn., supra***).

As such, we conclude that the portions of petitioner's payments for the years at issue, reported as New York source income on his forms K-1, were properly subject to New York taxes according to the business allocation percentage of WEMED.

We have considered the remaining arguments raised by petitioner, including that the payments bore no relationship to partnership profits and loss, and find them either without support in the record or rendered moot by the foregoing discussion.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Robert and Frances Tosti is denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petition of Robert and Frances Tosti is denied; and

4. The Notices of Deficiency, dated February 19, 2008 and April 14, 2008, and the Notice of Disallowance, dated February 8, 2008, are sustained.

DATED: Troy, New York
May 12, 2011

/s/ James H. Tully, Jr.
James H. Tully, Jr.
President

/s/ Carroll R. Jenkins
Carroll R. Jenkins
Commissioner