STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :

of :

DAVID L. SIEGEL : DETERMINATION
DTA NO. 823107

for Redetermination of a Deficiency or for Refund of New York State and New York City Personal Income Tax under Article 22 of the Tax Law and the New York City Administrative Code for the Years 2002 and 2003. :

Petitioner, David L. Siegel, filed a petition for redetermination of a deficiency or for refund of New York State and New York City personal income tax under Article 22 of the Tax Law and the New York City Administrative Code for the years 2002 and 2003.

A hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on June 8, 2010 at 10:30 A.M., with all briefs due by November 22, 2010, which date began the six-month period for the issuance of this determination. By letter dated May 3, 2011, this six-month period was extended for an additional three months (Tax Law § 2010[3]). Petitioner appeared by Hodgson Russ, LLP (Timothy P. Noonan, Esq., and Elizabeth Pascal, Esq., of counsel). The Division of Taxation appeared by Mark F. Volk, Esq. (Christopher O'Brien, Esq., of counsel).

ISSUE

Whether it was appropriate for the Division of Taxation to assert that tax was due on the gain from the sale of Blimpie International, Inc., shares.

FINDINGS OF FACT

1. Petitioner, David L. Siegel, grew up in Far Rockaway, New York. He graduated from Marietta College and received a J.D. degree in 1968 and an L.L.M. degree in 1970 from New York University School of Law. In 1968, as a member of Volunteers in Service to America (VISTA) he started a program to create jobs for a community group in East Harlem that he represented. As a part of this program, he negotiated with Blimpie Corporation of America, at the time a 16-store sandwich franchise company based in Jersey City, New Jersey, to open a Blimpie franchise to be owned and run by the East Harlem group.

2. In 1970, petitioner was offered a job with the Blimpie Corporation of America as corporate counsel. He operated the Blimpie Corporation with Anthony Conza and Peter DeCarlo out of Jersey City, New Jersey. In 1976, the principals separated, and petitioner and Mr. Conza formed another company that became Blimpie International, Inc. (Blimpie). Mr. DeCarlo formed Metropolitan Blimpie. At the time of the separation, petitioner, Mr. Conza and Mr. DeCarlo divided up the approximately 40 stores between the two companies, created exclusive marketing areas throughout the United States, and signed a trademark distribution agreement.

3. In 1981, Blimpie completed a small public registration and became a public company. Stephen D. Dreyer, Esq., was hired as the company's securities lawyer. In 1981, Blimpie was controlled by four officers, one of whom was petitioner. They collectively controlled approximately 59 percent of the common stock.

4. Blimpie struggled until the early 1990s when it began selling territorial franchises. By 2000, Blimpie had approximately 2,000 franchises.

5. In 1975, petitioner married Francinelee Hand. Petitioner and his wife had a "very loving and warm relationship. . ." but maintained independent lives. Throughout their lives, they maintained separate finances, with separate bank accounts.

6. In 1994, Ms. Hand, who worked as a New York City school teacher, was diagnosed with breast cancer. Following a lumpectomy and radiation treatment, she decided to retire and move back to Florida where she had grown up. At the time, Blimpie International was finally succeeding after many years of struggle, and petitioner felt that he could not leave New York. Ms. Hand purchased a house in Boca Raton, Florida, using her own savings and money borrowed from her mother. Petitioner moved into the Boca Raton house with this wife in the fall of 1994 and commuted to New York for the next seven years.

7. In 2000, Ms. Hand decided to move from Boca Raton, Florida, to Miami Beach, Florida, where she spent her childhood. Petitioner did not want to move from the Boca Raton house. Ms. Hand offered to use her own money from the subsequent sale of the Boca Raton house and money inherited from her mother to purchase a house in Miami Beach. In January of 2001, they signed a contract for a house in Miami Beach that needed major renovation. The purchase price of the house was $1,250,000.00. Ms. Hand used $1,000,000.00 of her own money, which constituted the bulk of her savings, and petitioner provided the remaining $250,000.00 from his savings. Ms. Hand and petitioner were listed on the deed as owners of the house.

Transfer of Blimpie Shares to Francinelee Hand

8. Financial security was very important to Ms. Hand, and she was very distressed as a result of having used the majority of her savings to purchase the Miami Beach house in 2001. On July 11, 2001 petitioner presented his wife with a letter gifting 624,693 shares of Blimpie

stock to her. Petitioner gifted the shares because he loved his wife and wanted her to be happy. The letter stated, in pertinent part, that:

> Nothing could make me prouder than your trust in me by the use of your life savings to help buy our new home. I want to make sure that you do not have one moment of regret or anxiety.
>
> For that reason, I, by execution of this letter, hereby gift to you (I am unconditionally assigning and conveying to you) 624,693 shares of Blimpie stock represented by stock certificate #0956 of Blimpie International Inc. which is owned by me.
>
> If the Endervelt deal under negotiation goes thru (questionable) these shares will be worth $2.75 per share. The shares I am giving you must remain in my name and I must retain voting rights until sold so, even though they are yours, I will hold them in trust for you and I will be your agent. These shares will, after the payment of taxes, net you 1,000,000 plus; enough to cover some or all of the following; presents for many future birthdays and anniversaries, presents for me; presents for the house; presents for Halle, more presents for me. I am sure that you will figure out how to spend the $$$$ and I know you will make the correct decisions.
>
> In the future you may have to execute stock powers in my favor. I will at my expense execute any and all other documents necessary to confirm your ownership of these shares an to make sure that you will receive their proceeds if they are sold to the Endervelt group or pursuant to another transaction.
>
> If the Endervelt deal fails then I want us to take a mortgage on our home with you getting the proceeds and me paying the note.

9. He gave her the shares in the hope that a merge of Blimpie would occur but at the time of the gift, he was not certain that it would take place.

10. On August 2, 2001, petitioner wrote a second letter to clarify the legal implications of the gift of shares. The letter states that Ms. Hand was the owner of the shares, but that he would act as Ms. Hand's agent and trustee to vote the shares in her interest. The letter also explains that in order for petitioner to vote the shares, Ms. Hand would need to grant petitioner a written proxy, which she did. The letter assures Ms. Hand that he could not "sell, transfer, pledge,

encumber or otherwise dispose of" the shares that he had gifted to his wife without her express consent. In the letter, petitioner promised that Ms. Hand would become the public owner in 12 months. The letter referred to Ms. Hand as an "undisclosed principal" and stated that no one else knows that he was representing her or acting on her behalf. Ms. Hand agreed to the terms of the letter.

11. Beginning in or about September 2001, Ms. Hand began to have discussions with her investment advisor, Beverly Whitney of Prudential Securities/Wachovia Securities. Ms. Hand informed Ms. Whitney that if the Blimpie merger occurred, Ms. Hand would place most of the stock proceeds into investments. The remaining amount would be used to pay off the mortgage on the Miami Beach house, cover the costs of some of the home renovations, and pay federal taxes on the proceeds. Ms. Hand also discussed with petitioner her plans of what she would do with the stock proceeds if the merger occurred.

Stock Transfer to 5313 North Bay Road Enterprises

12. In the summer and fall of 2001, petitioner discussed with his accountant, Llyod Abrahams, CPA, the possibility of forming another company so that petitioner could go into a new business in Florida if the merger of Blimpie occurred.

13. On September 7, 2001, Mr. Abrahams wrote petitioner a letter advising him of the tax consequences of both his previous gift of Blimpie stock to his wife and his plans to create a new company for a future consulting business. Mr. Abrahams advised petitioner by phone and in the letter of September 7, 2001 that if the Blimpie sale occurred, he could, pursuant to New York law, reduce his New York State tax liability on the proceeds from the sale of the stock if he capitalized a Subchapter S corporation with some of the Blimpie stock.

14. On December 14, 2001, petitioner formed a Subchapter S corporation, 5313 North Bay Road Enterprises, Inc. (Enterprises), for federal tax purposes. Consistent with petitioner's understanding of New York law at the time, petitioner did not elect to have Enterprises taxed in New York as an S corporation. On December 21, 2001, petitioner held the organizational corporate meeting and executed all of the initial formation documents in accordance with his understanding of what is required under New York State corporate law, including holding the organization, shareholder, and directors meetings and recording the minutes from those meetings in the corporate books. At the directors meeting, petitioner subscribed for 100 shares of stock in Enterprises, which was all of the outstanding and issued shares of the company, in exchange for contributing 801,270 shares of Blimpie stock to Enterprises. On the same date, Enterprises also executed a letter of agreement in which it was agreed that petitioner would hold the Blimpie shares as agent and in trust for Enterprises and that petitioner would retain a proxy to vote the shares. Petitioner formed the corporation in order to save taxes.

Background to the Sale of Blimpie

15. In 1999 and 2000, there were unsuccessful attempts to sell Blimpie and Metropolitan Blimpie (the company owned by Mr. DeCarlo after the split in 1976) together to a single buyer.

16. In 2000, Mr. Conza, the chairman, CEO and largest stockholder of Blimpie, announced that he no longer wanted to "work the business" and instead only wanted to engage in marketing and promotion. As a result, petitioner and Mr. Conza began looking for a buyer for the company. At a franchise convention in 2000, petitioner was approached by Jeffrey Endervelt, a territorial franchisee in California, about purchasing Blimpie. By 2001, Blimpie had two potential purchasers: Mr. Endervelt and another territorial franchisee, Todd Recknagel.

17. In April and May of 2001, Blimpie engaged in negotiations with its two potential purchasers. The Endervelt Group initially offered to buy the company without specifying a price per share. The Recknagel Group then offered $1.75 per share and the Endervelt Group responded with the same offer. Thereafter, the Recknagel Group offered $4.00 per share for the manager's shares, including Mr. Siegel's. The Endervelt counter offered $2.75 per share and further offered to permit Anthony Conza to maintain an ownership interest.

18. On June 6, 2001, Blimpie's board of directors agreed to a letter of intent with the Endervelt Group. The letter of intent was a nonbinding agreement outlining the general terms of prior discussions between Mr. Endervelt and members of the board of directors.

19. Prior to signing the letter of intent, Blimpie's board of directors met with Mr. Dreyer. Mr. Dreyer advised the board members of their obligations under applicable securities laws and the necessary procedures for a sale of the company.

20. Based on Mr. Dreyer's advice, on June 8, 2001, Blimpie's board of directors appointed a special committee to negotiate the sale of the company and to "recommend it or reject it" to the shareholders. The committee consisted of three outside directors, who were not employees of the company, but did not include petitioner and Mr. Conza and the other inside directors, because they were going to receive additional compensation as officers of the company as part of the sale. The special committee had sole responsibility and authority for accepting or rejecting the purchase offer from Mr. Endervelt and remained involved in the deal until the merger was completed on January 24, 2002. As part of its responsibilities, the special committee hired Greenberg Traurig, LLP, as its independent legal counsel and hired Capitalink L.C. as its financial advisor.

21. The special committee examined the issues subject to extensions of the exclusivity periods. During its review, the special committee acknowledged that Mr. Conza and Mr. Siegel had already assented to the sale of the shares to the Endervelt Group.

22. The special committee hired Capitalink L.C. to study the proposed sale of Blimpie and produce a fairness opinion to determine whether the $2.80 per share price offered by Mr. Endervelt was a fair price to the shareholders. On October 5, 2001, Capitalink issued its report, which concluded that the $2.80 per share price was a fair price and the parties executed a definitive merger agreement. On October 8, 2001, the Blimpie board of directors approved the merger agreement. On the same date, the five Blimpie officers controlling the majority of the Blimpie stock signed a voting agreement to vote for the merger on the terms outlined in the merger agreement.

23. Despite the execution of the merger agreement and voting agreement, several conditions and contingencies remained. For instance, the merger agreement required a 30-day market check after its approval by Blimpie's board, which obligated the special committee to solicit other offers to purchase Blimpie. On or about October 8, 2001, Capitalink commenced a 30-day market check. If the committee received a superior proposal with the highest share price, and the Endervelt Group was unable or unwilling to match that proposal, Blimpie would have the right to terminate the merger agreement. The merger agreement could be terminated after the 30-day market check if a buyer approached the special committee with a superior proposal. The committee was obligated to accept that proposal and terminate the merger agreement prior to the shareholder vote scheduled for December 27, 2001.

24. Litigation also threatened the closing of the deal. On October 22, 2001, a Blimpie franchisee filed a complaint in a class action in New Jersey Superior Court challenging the

merger on the basis of grossly inadequate compensation to the shareholders and seeking an injunction to bar the merger. The lawsuit was ultimately dismissed but not until after the merger was completed. Nevertheless, the board of directors was concerned throughout the deal process that the New Jersey court would issue a restraining order to prevent the shareholder vote on December 27, 2001 or to prevent the closing of the merger on January 24, 2002.

25. Financing was also a critical aspect of the deal since, as part of the merger agreement, the Endervelt Group had represented to the seller that approximately 95 percent of the $32,000,000.00 purchase price would be financed by banks. Because of this, the merger agreement required the buyer to represent that he had the necessary financing to complete the merger at the agreed-on price. The merger agreement also gave the buyer an opportunity to arrange for alternative financing if its primary financing fell through. Most important, the buyer's failure to come through with the promised financing or arrange for alternative financing constituted a "Material Adverse Effect" and a breach of the buyer's representations under the agreement, allowing Blimpie to terminate the merger agreement and to take other legal recourse against the buyer.

26. An issue was also presented by Metropolitan Blimpie, the company formed by Mr. DeCarlo in 1976, that needed to be resolved prior to the closing. In 2001, Metropolitan Blimpie claimed that it had not consented to the transfer of the Blimpie domestic trademarks to Blimpie. The merger agreement stated that if the Metropolitan Blimpie trademark issue was not resolved by the date of the closing, the Endervelt Group had the right to terminate the merger and Blimpie would be required to pay them $600,000.00 in damages. Petitioner believed that Metropolitan Blimpie had consented to the transfer in 1999 but needed to locate the document evidencing that

transfer. Petitioner was unable to locate the document until January 20, 2002, at which time the issue was resolved to the satisfaction of the buyer.

27. On or about December 7, 2001, the shareholders of Blimpie were served with a proxy statement and notice of shareholders meeting to be held on December 27, 2001. The notice explained that the majority shareholders, consisting of the Management Group, would vote in favor of the merger. The shareholder vote on the Blimpie merger was held on December 27, 2001.

28. The Blimpie merger did not close until January 24, 2002, almost a month after the shareholder vote. The delay was due to Mr. Endervelt's inability to meet the financing provisions of the merger agreement. The issue arose soon after the shareholder vote. On December 29, 2001, Blimpie received notice from the Endervelt Group that it did not have the money to close the deal because the group was having trouble coming up with its share of the financing.

29. On January 3, 2002, Mr. Dreyer sent an e-mail to Michael Rubinger, a senior associate at the law firm representing the buyer. The e-mail outlined some of the reductions in compensation that Blimpie's current officers had agreed to in order to help resolve the buyer's financing problems, including Mr. Conza's purchase of $1,000,000.00 in stock in the new company; a $500,000.00 reduction in noncompete payments to petitioner and other Blimpie officers; and deferral of $1,000,000.00 in additional noncompete payments.

30. On January 8, 2002, Arthur Schwartz, the senior partner representing the buyer wrote a letter to Rebecca Orand, an attorney representing Blimpie's special committee, specifically noting that all of the conditions required for closing under the terms of the merger agreement had not been satisfied.

31. By January 15, 2002, the parties had still not resolved the changes to the inside director's compensation. On that date, Mr. Rubinger, an attorney for the buyer, sent an e-mail to Mr. Dreyer outlining the terms of the "Conza restructuring" and asking whether Mr. Dreyer agreed to those terms. Mr. Dreyer testified that there was "no way" the deal would have closed without the renegotiation of the purchase price and the agreement of the inside directors to reduce their compensation as part of the merger.

32. On January 23, 2002, Mr. Dreyer went to Atlanta for the closing of the Blimpie merger. On that date, he waited to finalize the merger while the buyer and his counsel took steps to satisfy the lenders.

Blimpie Stock Proceeds

33. Once the Blimpie merger occurred on January 24, 2002, the shares were to be cancelled and converted into cash to be paid to the shareholders pursuant to paragraph 1.8(b) of the merger agreement. This paragraph set forth the procedure to be followed for a shareholder to redeem his or her shares for cash. The "Special Issuance Instructions" required a beneficial owner who was not the record owner of the shares to provide the paying agent with the stock shares endorsed to the beneficial owner and a signature guarantee. Only a financial institution can provide a signature guarantee, which is a medallion or stamp officially guaranteeing the signature on the particular document.

34. On January 23, 2002, in anticipation of the completion of the merger, petitioner called the paying agent, Mr. Ken Brotz of the Register and Transfer Company, to ask how to surrender the Blimpie shares owned by Ms. Hand and Enterprises so that payment of the stock proceeds

would go directly to them as beneficial owners of the shares.[1] Petitioner informed Mr. Brotz that he was the record owner but that Ms. Hand and Enterprises were the beneficial owners. Mr. Brotz instructed petitioner to provide a letter of transmittal along with the Blimpie shares and the executed stock power assignments. Mr. Brotz also instructed petitioner that he would need to get a signature guarantee in order for the stock proceeds to be transferred to Ms. Hand and Enterprises as required by the merger agreement.

35. In compliance with those instructions, on January 24, 2002, petitioner provided Mr. Brotz as the paying agent with a letter of transmittal, along with the stock power assignments and signature guarantees from Chase Bank. Subsequent to that letter, the paying agent directly deposited $2,244,539.00 from Fleet Boston Financial (the buyer's payment agent) into Enterprises' bank account and $1,749,000.00 into Ms. Hand's individual bank account. Mr. Siegel instructed Mr. Brotz that new shares did not need to be issued and shares were never issued to Ms. Hand or Enterprises before or after the merger.

36. Petitioner delivered a letter dated February 12, 2002 to his wife outlining the transaction and providing the following instructions:

> 1. You will receive a wire transfer to your account in the amount of $1,749,140.40. From this you will owe taxes of $349,828.08 leaving a net balance of $1,399,312.40.
>
> 2. From the $1,399,312.40 the following payments are to be made:
>
> a. $248,445.08 in payment of the mortgage.
>
> b. $150,867.40 to our construction account which includes $100,000 of your money and $50,867.40 of my money.

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[1] As paying agent, Mr. Bronz's job was to collect and cancel the shares and deposit the money into the shareholder's accounts.

> c. That will leave you with a balance of $1,000,000, giving you back all of the money invested in 5313 North Bay Road except for $100,000 which is being used for construction completion.

The Division of Taxation's Audit of Enterprises

37. The Division of Taxation (Division) ascertained that, since 2003, Enterprises earned limited receipts on consulting work performed in Florida. Most of its income was derived from investments. Its clients included a radiology clinic and a franchise company called Chicken Kitchen USA, LLC. In most years, petitioner received small distributions from Enterprises and most of the assets and cash remained in the company for the years subsequent to 2003. Enterprises' federal returns for the years 2002 through 2007 report the following business income after a capitalization of $2,270,170.00:

Year	Business Income
2002	$0.00
2003	45.00
2004	(120.00)
2005	419.00
2006	3,190.00
2007	(32,308.00)

In 2003, petitioner received a distribution of $400,000.00 to pay federal taxes on the income petitioner received from Enterprises. It is common for S corporations to pay dividends to shareholders to cover the tax liabilities related to income earned by a corporation.

38. Enterprises filed a New York State corporate franchise tax return for the year 2002 reporting its gain from the sale of Blimpie shares. On June 27, 2007, after an audit of Enterprises, the Division issued a Consent to Field Audit Adjustment to Enterprises for the 2002

tax year. The Division's adjustment was based on an error made by petitioner's accountant, Mr. Abrahams, on Enterprises' 2002 return relating to the allocation percentage used for apportioning the gain on the sale of Blimpie stock owed by Enterprises. On July 12, 2007, Enterprises paid the tax assessed against it and subsequently paid the interest and penalty due. The Division believes that, due to the two-year statute of limitations for refund claims, it cannot credit or refund this payment to Enterprises.

The Division's Audit of Petitioner

39. Petitioner filed a New York State Resident Income Tax Return for the year 2002 and a Nonresident and Part-Year Resident Income Tax Return for the year 2003. On each return, petitioner elected a filing status of married, filing a separate return.

40. On his 2002 New York return, petitioner reported capital gains of $2,248,710.00, which was offset by a subtraction modification of $2,241,302.00. Part of the reported capital gain was from the sale of the stock of Blimpie, which flowed through to petitioner from Enterprises.

41. In 2005, the Division initiated an audit of petitioner for the 2002 and 2003 tax years. The Division thought that the forgoing subtraction modification on petitioner's 2002 return for capital created an "audit issue."

42. The Division issued a Notice of Deficiency to petitioner, dated May 18, 2009, asserting that New York State personal income tax was due for the year 2002 in the amount of $273,408.00 plus penalty and interest. It also asserted that New York City personal income tax was due for the year 2002 in the amount of $145,509.00 plus penalty and interest. The asserted deficiencies for the year 2002 were premised upon the Division's position that the transfers of Blimpie stock to petitioner's wife and to Enterprises were invalid under the anticipatory

assignment of income doctrine. That is, the Division found that petitioner anticipated the merger and planned for it by sending a gift letter to his wife and by incorporating Enterprises and then transferring the stock to each. The penalties were asserted pursuant to Tax Law § 685(b)(1) and (2) for negligence and Tax Law § 685(p) for substantial understatement of income. For the year 2003, the Division asserted a deficiency in the amount of $12,852.00 plus penalty and interest. However, at the hearing, the Division stipulated that it would no longer pursue this portion of the asserted deficiency.

43. In accordance with State Administrative Procedure Act § 307(1), petitioner's proposed findings of fact have been substantially adopted and incorporated herein. It is noted that a portion of proposed finding of fact 7 was deleted because the proposed finding of fact was based upon a letter, which was quoted at length. Proposed finding of fact 8 was modified to conform to the record. Proposed finding of fact 9 and a portion of proposed finding of fact 26 were rejected for being in the nature of a legal conclusion. Proposed finding of fact 35 was rejected because it is inconsistent with the tenor of letters from petitioner to his wife. Proposed finding of fact 41 was rejected as argumentative. Additional findings of fact were also made.

SUMMARY OF THE PARTIES' POSITIONS

44. Petitioner argues that the anticipatory assignment of income doctrine does not apply to petitioner's transfer of Blimpie shares because he did not have a fixed right to receive income from the Blimpie shares before the shares were transferred.

45. In response to the forgoing, the Division states that there was no economic substance to the transfers of stock and that the purpose of the transfers was the avoidance of taxation.

Therefore, the gift to petitioner's wife and the transfer to Enterprises were invalid for tax purposes. The Division also argues that the transfers were invalid as anticipatory assignments of income.

CONCLUSIONS OF LAW

A. The question presented is whether petitioner is liable for New York State personal income tax on the gain from the sale of the Blimpie shares or whether the transfer of the shares to Enterprises and Ms. Hand prevents New York from imposing tax on said gain. This issue arises because, if the transfer of the shares is not recognized, petitioner would be taxable as a resident of New York on the gain from the sale of the stock (Tax Law § 601[c]; § 611[a]).

B. In the course of examining whether income is properly reported, it is a long established practice of the Commissioner of Internal Revenue to ascertain whose efforts led to the creation of the income (***see Commissioner v. Tower***, 327 US 280 [1946]) because it is the taxpayer's command over income which is the concern of the tax laws (***id.*** at 290). Thus, income earned by one person is taxable to the individual who earned the income if it is given to another for the donor's satisfaction (***id.*** at 291). It is for this reason, that the courts have employed a "special scrutiny" when reviewing transactions between a husband and wife that are designed to reduce taxes (***id.*** at 291; ***see Commissioner v. Sunnen***, 333 US 591 [1948]).

C. Here, the clear weight of the evidence supports the Division's position that the transfers of the shares from petitioner to Ms. Hand and Enterprises were simply a conduit for shielding the gain from New York taxes. As pointed out by the Division, the letter of July 11, 2001 clearly directs Ms. Hand to use the proceeds of the stock sale for the benefit of both her and petitioner. The letter of February 12, 2002 is more revealing. In this letter, petitioner instructed his wife to pay taxes and the mortgage. Petitioner further directed his wife to deposit an additional

significant sum of money into a construction account. In essence, petitioner told his wife to use the proceeds of the sale of the stock to extinguish debt and increase equity in a home that he owned jointly with his wife. It is readily evident from the forgoing detailed instructions that petitioner did not relinquish control of the proceeds of the stock and that he continued to enjoy the benefits of the stock sale. The Division has also correctly pointed out that the failure to appoint an independent trustee shows that, as a practical matter, there was no separation of legal title from economic enjoyment arising from petitioner's appointment of himself as trustee and Ms. Hand as the beneficial owner (***see Markosian v. Commr. of Internal Revenue***, 73 TC 1235, 1244-1245 [1980]).

D. In opposition to this position, petitioner contends that he did not have control of the shares of stock because he could not vote the shares without the written consent of Ms. Hand. It is also argued that petitioner could not determine whether Blimpie would pay dividends because he was only a 17 percent shareholder. With respect to the benefit issue, petitioner maintains that the benefit that he received was minimal compared to the benefit that Ms. Hand received. Petitioner also stresses that the testimony established that petitioner did not control how Ms. Hand spent her money. Lastly, petitioner submits that the transfer of the shares of Blimpie was valid and effective as a matter of state corporate securities law.

E. The forgoing arguments are unpersuasive. As set forth above, the courts have employed a "special scrutiny" when reviewing transactions between a husband and wife (***see Commr. v. Sunnen***; ***Commr. v. Tower***). Petitioner's argument regarding control of the funds is rejected for the reasons set forth above. Further, under the circumstances presented, it is not relevant that petitioner could not direct the payment of a dividend from Blimpie by himself. It is readily evident that a benefit of this transfer was that if the sale of Blimpie were consummated,

the income therefrom would be shielded from New York taxation (***see Markosian v. Commr. of Internal Revenue***). Petitioner also received a benefit through his ability to direct the gain from the sale of the stock to the party of his choosing. Thus, petitioner enjoyed the benefit of the stock as though he had received it himself (***see Helvering v. Horst***, 311 US 112 [1940]). Petitioner's argument that the transfer of the shares to Ms. Hand was valid and effective under corporate securities law does not warrant a different conclusion. The substance of this transaction did not have any economic effect. Under the circumstances, it does not need to be recognized for tax purposes (***see e.g. Zmuda v. Commr.***, 731 F2d 1417 [9th Cir 1984]).

F. The evidence also supports the Division's argument that the transfer of Blimpie shares to Enterprises lacked economic substance and was performed for tax avoidance purposes. The record shows that Enterprises was capitalized well in excess of two million dollars in 2002 yet, in relation to the amount that it was capitalized, it had relatively modest business income and few clients. Most of its income was earned from investments. The testimony also shows that the business did not have any employees, office staff or office facilities other than in petitioner's home. When asked why he capitalized Enterprises with more than two million dollars, petitioner candidly explained "I was saving a lot of taxes." It is readily evident that the substantial capitalization of Enterprises lacked a valid business purpose and that it was intended to avoid the imposition of tax. Under these circumstances, the transfer of the stock to Enterprises may be ignored or disregarded for tax purposes (***see e.g. Commr. v. Tower***).

G. In view of the forgoing, the issue of whether the transfers of the stock should be disregarded as anticipatory assignment of income is moot and will not be addressed.

H. As set forth above, penalties were imposed for negligence (Tax Law § 685[b][1]), negligence or intentional disregard of the Tax Law (Tax Law § 685[b][2]) and substantial

understatement of income (Tax Law § 685[p]). No basis has been presented for waiving said penalties. Reliance upon professional advice without an inquiry to determine the position of the Department of Taxation and Finance does not constitute reasonable cause warranting abatement of a penalty (***Matter of CBS Corp. v. Tax Appeals Tribunal***, 56 AD3d 908 [3d Dept 2008], ***lv denied*** 12 NY3d 703 [2009]).

I. In accordance with Finding of Fact 42, the Division is directed to cancel the Notice of Deficiency with respect to the year 2003.

J. The petition of David L. Seigel is granted to the extent of Conclusion of Law I; the Division is directed to recompute the Notice of Deficiency accordingly; and, except as so granted, the petition is in all other respects denied and the Notice of Deficiency is sustained together with such penalties and interest as are lawfully due.

DATED: Troy, New York
August 18, 2011

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE