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

TSB-A-90 (10) I
Income Tax
August 14, 1990

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. I900418C

On April 18, 1990, a Petition for Advisory Opinion was received from Barry N. Wish and Judith Wish, c/o Oxford Financial Group, Northbridge Tower I, 515 North Flager Drive, West Palm Beach, Florida 33401.

The issue raised by Petitioner, Barry N. Wish and Judith Wish, is whether certain income of Petitioner, Barry N. Wish, for 1986 constitutes personal service income for purposes of computing New York State Maximum Tax on Form IT-250.

Mr. Wish was a founding partner of 880 Associates, a partnership involved in the merchant banking and security dealer/trader business. In 1986, Mr. Wish's personal services were a significant factor in the profit of the business as he was heavily involved in the day to day operations of the business. 880 Associates participates in security dealer/trader transactions and Mr. Wish claims total personal service income of the following:

Self employment income from 880 Associates	$991,262
Keogh contributions	(30,000)
Other consulting income	4,810
Total	$966,072

Included in the $991,262 of self employment income from 880 Associates were the following items:

Ordinary (loss)	$(186,675)
Guaranteed payments	50,004
Dividend income	48,997
Net short term capital gains	997,982

Mr. Wish states that the self employment income from 880 Associates represented a reasonable allowance as compensation for the services rendered by Mr. Wish in connection with his work for the partnership. Mr. Wish also states that not all the gains were treated as self employment income. The gains that were treated as self employment income were from regulated future contracts as described in section 1402(i) of the Internal Revenue Code (hereinafter "IRC").

Mr. Wish contends that under the repealed section 1348 of the IRC, personal service income included "earned income" for self employed individuals and that any income subject to self employment tax would normally qualify as personal service income. Mr. Wish refers to sections 401(c)(2), 1348(b)(1) and 1402(a) of the IRC. Therefore, Mr. Wish believes that the gains from regulated futures contracts should be allowed as personal service income for New York State personal income tax purposes.

Section 617(b) of the Tax Law provides that each item of partnership income, gain, loss or deduction shall have the same character for a partner under Article 22 of the Tax Law as for federal income tax purposes. In addition, where an item is not characterized for federal income tax purposes, it shall have the same character for a partner as if realized directly from the source from which realized by the partnership or incurred in the same manner as incurred by the partnership. Therefore, earned income cannot include items of income or gain that would be characterized as unearned income if realized by the taxpayer directly from the source from which realized by the partnership.

Accordingly, a partner's distributive share of income is to be determined as "earned" or "unearned" at its source. The fact that a partner performs services for the partnership would not alter the character of income determined to be "unearned" at its source. The characterization of such income is a factual question.

Questions of fact are not susceptible of determination in an Advisory Opinion. An Advisory Opinion merely sets forth the applicability of pertinent statutory and regulatory provisions to "a specified set of facts" Tax Law, S171, subd. twenty-fourth; 20 NYCRR 901.1(a). Therefore a determination cannot be made in this advisory opinion as to whether the income in question was "earned" or "unearned" at its source.

Section 603-A of the Tax Law, prior to its repeal by Chapter 28 of the Laws of 1987, provided for a maximum rate on New York personal service taxable income. Section 603-A(b)(1), as amended by Chapter 1043 of the Laws of 1981, defined "New York personal service income" as:

> (A) 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. In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income-producing factors... a reasonable allowance as compensation for the personal services rendered by the taxpayer shall be considered as earned income,
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> (B) gains (other than any gain which is treated under any provisions of chapter one of the internal revenue code as gain from the sale or exchange of a capital asset) and net earnings derived from the sale or other disposition of, the transfer of any interest in, or the licensing of the use of property (other than good will) by an individual whose personal efforts created such property, and

> (C) any income which is an amount received as a pension or annuity which arises from an employer-employee relationship or from tax-deductible contributions to a retirement plan, to the extent such items of income are includible in New York adjusted gross income, plus the amount of the modifications which must be added to federal adjusted gross income pursuant to paragraphs seven, eight and nine of subsection (b) of section six hundred twelve. "New York personal service income" does not include any amount which would have been excludible from personal service income for federal income tax purposes for the taxable year ending December thirty-first, nineteen hundred eighty-one had the income been includable in federal gross income for such year.

When section 603-A was added to the Tax Law in Chapter 70 and amended in Chapter 729 of the Laws of 1978, "New York personal service income" was defined as items of income includible as personal service income for purposes of section 1348 of the IRC, an analogous federal maximum tax provision. Section 1348(b)(1)(A) of the IRC, prior to its repeal effective for taxable years beginning after December 31, 1981, defined "personal service income" as any income which is earned income within the meaning of section 401(c)(2)(C) of the IRC or section 911(b) of the IRC or which is an amount received as a pension or annuity which arises from an employer-employee relationship or from tax deductible contributions to a retirement plan.

After section 1348 of the IRC was repealed in 1981, section 603-A of the Tax Law was amended to incorporate substantially the same definition of earned income that was contained in section 401(c)(2)(C) of the IRC (section 603-A(b)(1)(B) of the Tax Law), section 911(b) of the IRC (section 603-A(b)(1)(A) of the Tax Law) and the pension and annuity provision of section 1348(b)(1) of the IRC (section 603-A(b)(i)(C) of the Tax Law.) Therefore, in determining whether Mr. Wish's 1986 income is New York personal service income, it is appropriate to apply precedent set under sections 1348, 401(c)(2)(C) and 911(b) of the IRC with regards to the definition of earned income as well as the provisions contained in section 603-A of the Tax Law.

Section 401(c)(2)(C) was intended to encompass the income of a self employed individual which directly resulted from the individual's efforts; for example, the income of an author, an artist or an inventor. See S. Rep. No. 1707, 89th Cong., 2d Sess., reprinted in 1966 U.S. Code Cong. & Ad. News 4446, 4507-09. Herein, Mr. Wish's personal efforts did not create property as contemplated by such section. Accordingly, Mr. Wish's income from regulated futures contracts is not earned income pursuant to section 401(c)(2)(C) of the IRC or section 603-A(b)(1)(B) of the Tax Law.

It should be noted that subparagraph (A) of section 401(c)(2) of the IRC provides that "earned income" means the net earnings from self employment, as defined in section 1402(a) of the IRC, and section 1402(i) of the IRC provides that "in determining the net earnings from self employment of any options dealer or commodities dealer, there shall not be excluded any gain or loss (in the normal course of the taxpayer's activity of dealing or trading in section 1256 contracts [regulated futures contracts]) from such section 1256 contracts or property related to such contracts." However, section 1402(i) was added to the IRC after section 1348 of the IRC was repealed and, in any event, section

1348 of the IRC does not refer to subparagraph (A) of section 401(c)(2) of the IRC but does refer to subparagraph (C) of section 401(c)(2) of the IRC, which is discussed herein.

Therefore, it is of no consequence that Mr. Wish's income from regulated futures contracts is considered net earnings from self employment for purposes of section 1402 of the IRC. Such income does not meet the definition of earned income for purposes of section 911(b) of the IRC nor section 603-A of the Tax Law.

Section 100.4(c)(1)(v) of the Personal Income Tax Regulations provides that "[w]here an individual is engaged in an unincorporated trade or business in which both personal services and capital are material income-producing factors, a reasonable allowance as compensation for the personal services actually rendered is personal service income from the trade or business." However, such allowance cannot be more than the net profits of the business.

The Personal Income Tax Regulations do not specify any test to determine the portion of income received from an unincorporated trade or business 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 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 the taxpayer's work, the taxpayer's qualifications, the size and complexities of the trade or business, a comparison of the taxpayer's compensation to the compensation of other employees, a comparison of the taxpayer's income from the partnership to the income of other partners of the partnership and the prevailing rates of compensation for comparable positions in comparable companies. However, the above list is not intended to be an exhaustive list. Zalman C. and Elaine K. Bernstein, Adv Op Comm T&F, December 15, 1987, TSB-A-87(10)I.

It should be noted that the burden of proving that income received represents a reasonable allowance for compensation for personal services actually rendered falls upon the taxpayer. Antonio and Frances Coppola, Joseph and Marie Coppola, Dec St Tax Comm, February 18, 1986, TSB-H-86(44)I; Migliore v Commissioner, 36 TCM 1004 (1977) (applying the provisions of former section 1348 of the IRC relating to the definition of "earned income" which is substantially the same as section 603-A of the Tax Law); Paula Construction, Co. v Commissioner, 58 TC 1055 (1972).

Inasmuch as the factual questions presented herein, namely: (1) the characterization of Mr. Wish's distributive share of the partnership's income, (2) whether capital is a material income-producing factor and (3) if so, the determination of what represents a reasonable allowance for salaries and other compensation for personal services actually rendered, arise within the context of an audit, the necessary factual determination must be made within such context, in accordance with the principles outlined above.

DATED: August 14, 1990

s/PAUL B. COBURN
Deputy Director
Taxpayer Services Division

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