

**NEW YORK CITY TAX APPEALS TRIBUNAL  
ADMINISTRATIVE LAW JUDGE DIVISION**

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**In the Matter of the Petition**

**Of**

**THE WEEKS-LERMAN GROUP, LLC**

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**DETERMINATION**

**TAT (H) 05-54 (UB)**

Murphy, A.L.J.:

Petitioner, The Weeks-Lerman Group, LLC., filed a Petition for redetermination of deficiencies of New York City ("City") Unincorporated Business Tax ("UBT") under Title 11, Chapter 5 of the City Administrative Code ("Code") for the tax years ending December 31, 2000 ("Tax Year 2000"), December 31, 2001 ("Tax Year 2001"), and December 31, 2003, ("Tax Year 2003"), and for allowance of a claim for refund of UBT for the tax year ended December 31, 2002 ("Tax Year 2002") (collectively, "Tax Years").

Robert Speilman, Esq., Jill Darrow, Esq. and Arthur S. Linker, Esq. of Katten, Muchin, Rosenman LLP, represented Petitioner and Assistant Corporation Counsel George P. Lynch. Esq., and Senior Counsel Frances Henn, Esq., represented Respondent, the City Commissioner of Finance.

On February 23, 2007, Petitioner and Respondent entered into a written Consent to Submission Without Hearing pursuant to Section 1-09(f) of the City Tax Appeals Tribunal ("Tribunal") Rules of Practice and Procedure ("Rules"), and submitted a Stipulation of Facts dated January 29, 2007, with attached Exhibits ("Stipulation

I"). The last brief was filed on November 13, 2007. On November 15, 2007, the parties submitted a Stipulation Regarding Jurisdictional Documents and Pleadings, dated October 22, 2007, with attached exhibits ("Stipulation II"). On May 15, 2008, Respondent's representative submitted a copy of the field audit narrative and workpapers and copies of relevant City UBT and Federal corporate and personal Income Tax Returns.

### **ISSUE**

Whether the compensation for services that Petitioner paid to a beneficiary of a trust that held a fifty percent (50%) interest in Petitioner was a deductible business expense under the UBT.

### **FINDINGS OF FACT**

1. Petitioner is a New York limited liability company, established by the filing of its Articles of Organization on December 15, 1995, pursuant to the provisions of the New York State ("State") Limited Liability Company ("LLC") Law.

2. Petitioner was formed by the contribution of assets of two New York corporations, Weeks Office Products, Inc. ("Weeks") and Lerman Company, Inc. ("Lerman"). Petitioner is engaged in the business of the sale of office and related products. Its principal office is located in Maspeth, New York.

3. At the time Petitioner was formed, Weeks was wholly-owned by Victoria Benalloul, who had inherited her ownership interest upon the February 1994 death of her father, Richard Karasik. Albert

Benalloul,<sup>1</sup> Victoria Benalloul's husband, was an officer but not a shareholder of Weeks prior to the Tax Years.<sup>2</sup>

4. At all relevant times, Sidney Lerman and Ilene Lerman Shotland were the sole shareholders of Lerman.

5. On January 1, 1996, Weeks and Lerman entered into an agreement entitled: "OPERATING AGREEMENT OF THE WEEKS-LERMAN GROUP, LLC" ("Operating Agreement").

6. Weeks and Lerman each held a 50% membership interest in Petitioner (Operating Agreement §3.01) and the two companies are referred to in various documents, including the Operating Agreement, as the "Members" of Petitioner. Each Member contributed certain cash and assets to Petitioner as delineated in the Operating Agreement. Section 4.01 of the Operating Agreement provides that after giving effect to certain special allocations (as set forth in a subsequent section of the Operating Agreement), Petitioner's net profit or net loss was to be allocated to the Members according to their membership interests.

7. The Operating Agreement specifically named Albert Benalloul and Sidney Lerman as Petitioner's "Managers" (Operating Agreement §1.13.), in whom the management of Petitioner was "vested exclusively." Each Manager represented a Member: Albert Benalloul represented Weeks and Sidney Lerman represented Lerman. Operating Agreement §5.01(a). The Operating Agreement provided that "the

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<sup>1</sup> See, e.g., Stip. I Ex. C. Mr. Benalloul also is known as Abraham Benalloul.

<sup>2</sup> See, Stip. I Ex. B, Operating Agreement, dated January 1, 1996, where Albert Benalloul signed as Vice President of Weeks, and Stip. I Ex. F, "Consent of the Members and Managers of the Weeks-Lerman Group LLC," dated December 22, 1999, where Mr. Benalloul signed as President of Weeks.

Managers shall have all the powers of the Company," enumerating their specific Company responsibilities which generally included administration and management of the day-to-day business and financial affairs of Petitioner. Operating Agreement §5.01(a)(ix). Albert Benalloul signed the Operating Agreement as Vice President of Weeks and Sidney Lerman signed as President of Lerman.

8. Although the Managers serve at the consent of Petitioner's Members, the Operating Agreement provided that Petitioner's actions and management decisions "shall require the prior consent or approval of both Managers and not the Members." Operating Agreement §5.01(a). A Member could terminate its representative Manager, but a replacement Manager could only be appointed with the consent of the Manager representing the other Member. Operating Agreement §5.01(b).

9. Each Manager was to be paid an "Equivalent Compensation," which was defined in the Operating Agreement to include an amount "determined by [the Managers'] mutual agreement," as well as "compensation and benefits paid by the Company to a spouse or other relative of the Manager." Operating Agreement §5.02(a).

10. The Operating Agreement provided that for each of the calendar years beginning on January 1, 1996 and ending December 31, 2000, Mr. Benalloul would receive a "bonus" of \$150,000 plus a percentage of the corporation's profits, and Mr. Lerman would receive a percentage of gross profits "generated by clients introduced or referred to the Company" by him or his corporation. Operating Agreement §5.02(c).

11. On December 20, 1999, Victoria Benalloul and Judith Connolly entered into the "Victoria Benalloul Trust Agreement"

("Trust Agreement") which created the Victoria Benalloul 1999 Family Trust ("Trust"). Victoria Benalloul was the settlor of the Trust and she and Ms. Connolly are its trustees.<sup>3</sup> Ms. Connolly, a stockbroker, is not related to either Victoria or Albert Benalloul, but is a family friend. The Trust Agreement specifically granted the Trustees the power to invest in or contribute Trust principal to a limited liability company. Trust Agreement Article SEVENTH (J) (IV).

12. Weeks was subsequently liquidated and its membership interest in Petitioner was transferred to its sole shareholder, Victoria Benalloul, by an Assignment and Acceptance Agreement dated December 22, 1999.

13. Victoria Benalloul sold her interest in Petitioner to the Trust, as of December 22, 1999, pursuant to a Membership Interest Purchase and Security Agreement, for cash of \$250,000 and a Promissory Note in the amount of \$1,000,000. The Promissory Note was secured by the Trust's Membership in Petitioner. Petitioner's Members and Managers consented to the Agreement and to the sale and the Trust agreed to be bound by all of the provisions of Petitioner's Articles of Organization and the Operating Agreement.

14. Albert Benalloul is a named contingent beneficiary of the Trust.<sup>4</sup> The other class of identified Trust beneficiaries are

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<sup>3</sup> Stip. I, Ex. C. Pursuant to Article Sixth of the Trust, Judith Connolly acts as Trustee until September 15, 2013.

<sup>4</sup> See, Stip. I, Ex. C, Article FIRST of the Trust which states:

A. During the life of the Settlor's husband, Abraham Benalloul, also known as Albert Benalloul ("Albert"), the Trustees from time to time shall (1) pay to such one or more of all of Albert and the individuals included among the Settlor's issue who shall be alive at the time of such payment  
(continued...)

Victoria's living "issue." During the Tax Years, Victoria's living issue included Benjamin Benalloul, Olivia Benalloul, Spencer Benalloul and Jake Richard Benalloul. Albert Benalloul has never been a trustee of the Trust.

15. From December 22, 1999 forward, the Trust and Lerman have each owned a 50% interest in Petitioner.

16. The Operating Agreement was amended in August 2002 to reflect the transfer to the Trust ("Amended Agreement").<sup>5</sup> Victoria

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<sup>4</sup>(...continued)

as the disinterested Trustee shall determine, and (if to more than one thereof) in such proportions as the disinterested Trustee shall determine, so much (including all) of the net income from and/or the principal of such Trust as the disinterested Trustee shall determine and (2) accumulate and add to the principle of such Trust all of said net income which shall not be so paid.

B. Upon the death of Albert, the Trustees shall (1) dispose of so much of the principal of such Trust as Albert shall, by a specific reference in his will to the power of appointment hereby granted to him, have validly directed to such individual or among such individuals included among the Settlor's issue, and (if among individuals) in such proportions, and in such manner, in trust or otherwise, as Albert shall so have validly directed and (2) dispose of so much of said principal with respect to which Albert shall not so have given such valid directions as provided in Article SECOND hereof.

C. Notwithstanding the foregoing provisions of this Article FIRST, if at any time during the life of Albert none of the Settlor's issue shall be alive, then, upon the death of the last of the individuals included among the Settlor's issue to die prior to such time (the "Last Survivor"), the Trustees shall pay to Albert all of the principal of such Trust.

Stip. I, Ex. C, pp. 1-2.

<sup>5</sup> Respondent argues that the Amended Operating Agreement is a "failed amendment." The efficacy of that Amendment is not at issue in this proceeding. In fact, as noted *infra* at Finding of Fact 19, it appears that the whole amendment may not be before me. The document submitted supports a finding that the Trust replaced Weeks as Member of Petitioner and that certain provisions of the original Operating Agreement were changed accordingly. Each party has stipulated at least to the characterization of the document as an "Amendment,"  
(continued...)

Benalloul and Judith Connolly signed the Amended Agreement for the Trust and Sidney Lerman signed the Amended Agreement for Lerman. The Amended Agreement stated that Petitioner's Members were the Trust and Lerman in equal shares. Amended Agreement §3.01. Pursuant to Section 1.13 of the Amended Agreement, Victoria Benalloul and Ilene Lerman Shotland were appointed as Managers, in addition to Albert Benalloul and Sidney Lerman. They agreed to be bound by Article V of the Amended Agreement and they signed the agreement in their capacity as the additionally appointed Managers. Albert Benalloul did not sign the Amended Agreement.

17. Section 5.01 of the Amended Agreement states that the management of the business and affairs of Petitioner is vested exclusively in the "Trust Appointees" (Victoria Benalloul and Albert Benalloul) and the "Lerman Appointees" (Ilene Lerman Shotland and Sidney Lerman). Further, the Amended Agreement provides that, except with respect to certain matters that expressly required the prior written consent of both Members, all actions to be taken by Petitioner, and all decisions relating to the management and administration of Petitioner, would require only the prior consent and approval of at least two Managers, one from the Trust Appointees and one from the Lerman Appointees. Amended Agreement §5.01(a).

18. Section 5.01(b) of the Amended Agreement specifically grants the Trust the power to terminate Albert Benalloul as a Manager and Lerman the power to terminate Sidney Lerman as Manager. The Amended Agreement requires that a Member obtain the prior consent of the other Member to replace its terminated Manager. Amended Agreement §5.01(b).

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<sup>5</sup>(...continued)  
and there is nothing in the submissions which would indicate that Respondent rejected the terms expressed in the Amended Operating Agreement in reviewing the filed UBT returns.

19. Section 5.02 of the Amended Agreement<sup>6</sup> provides that Managers for each Member receive "Equivalent Compensation" that includes "compensation and benefits paid by the Company to a spouse or other relative (including but not limited to siblings) of such Manager."

20. Petitioner filed Forms 204 NYC UBT Returns for each of the Tax Years, reporting Company income and expenses. On each filed return, Petitioner subtracted \$10,000 representing the allowed reasonable compensation paid to the two (2) active partners.

21. To compute partnership income (as reported on Forms 1065, U.S. Return of Partnership Income appended to Forms 204, and forming the basis for the reported UBT business income), Petitioner deducted salaries and wages from total partnership income. For purposes of UBT liability reported for Tax Years 2000 and 2001, salaries paid to Albert [Abraham] Benalloul, Sidney Lerman and Ilene Lerman Shotland were included in the amount deducted. For purposes of UBT liability reported for Tax year 2003, salary paid to Albert Benalloul was deducted.

22. Petitioner amended the Tax Year 2002 UBT return filed to reflect an "addback for owner compensation" and requested refund of amounts paid to Albert Benalloul. In a footnote to the return, Petitioner noted:

ONLY COMPENSATION PAID TO OWNERS SIDNEY LERMAN AND  
ILENE SHOTLAND . . . ARE REQUIRED TO BE ADDED BACK  
TO INCOME. COMPENSATION PAID TO ALBERT BENALLOUL,

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<sup>6</sup> Stip. I, Ex. H. Amended Agreement Section 5.02(s) refers to a Section 5.02(b) which was not included in the submission. Therefore, it is not possible to ascertain whether the original Operating Agreement compensation provisions were materially changed.

WHO IS NOT AN OWNER, IS NOT REQUIRED TO BE ADDED  
BACK.

23. Respondent reviewed the UBT returns filed by Petitioner for the Tax Years 2000, 2001, and 2003 and performed desk audits of these periods. The audit narrative states that an audit of the 2002 period was not performed as "the amounts paid to Abraham Benalloul, Sidney Lerman and Ilene Shotland were added back in the computation of New York City taxable income."

24. Respondent also reviewed forms W-2 which reported "Partnership Salaries" for Albert [Abraham] Benalloul, Sidney Lerman and Ilene Lerman Shotland.

25. The audit workpapers include correspondence (undated but bearing a receipt stamp dated May 28, 2002), which informed the auditor of the following Trust beneficiaries: Albert Benalloul, Benjamin Benalloul, Olivia Benalloul and Spencer Benalloul. The workpapers also include a copy of the Federal Form 1040 U.S. Individual Income Tax Return for the 2000 tax year for Abraham and Victoria Benalloul, on which joint return the Benallouls reported the Children as dependents.

26. On March 18, 2004, Respondent issued a Notice of Proposed Tax Adjustment to Petitioner asserting a UBT deficiency in the amount of \$50,276 for Tax Year 2000. On or about July 27, 2004, Petitioner paid \$13,086 of the proposed Tax Year 2000 deficiency, an amount which represents UBT computed on the payments made to Sidney Lerman and Ilene Lerman Shotland. Respondent allocated \$10,590 of this payment to the proposed total deficiency.

27. On April 8, 2005, Respondent issued a Notice of Determination to Petitioner asserting a UBT deficiency in the amount

of \$50,276 for Tax Year 2000. The Notice stated that "[P]ayments made to partners are not allowable deductions for NYC Unincorporated Business Tax purposes." A penalty for substantial understatement of tax liability (Code §11-525(j)) and a negligence penalty (Code §11-525(b)) were imposed. The Notice reflects Petitioner's July 27, 2004 payment of \$10,590 and asserts a Tax Year 2000 deficiency of \$39,686, plus interest and penalties.

28. On August 19, 2004, Respondent issued a Notice of Proposed Tax Adjustment to Petitioner asserting a UBT deficiency in the amount of \$34,363 for Tax Year 2001. On or about August 25, 2004, Petitioner paid \$17,468 of the proposed Tax Year 2001 deficiency, plus interest of \$2,767.72, an amount which represents UBT computed on payments made to Sidney Lerman and Ilene Lerman Shotland.

29. On April 8, 2005, Respondent issued a Notice of Determination to Petitioner that asserted a Tax Year 2001 UBT deficiency in the amount of \$34,363. The Notice stated that "[P]ayments made to partners are not allowable deductions for NYC Unincorporated Business Tax purposes." A penalty for substantial understatement of tax liability (Code §11-525(j)) and a negligence penalty of the deficiency (Code §11-525(b)) were imposed. The Notice reflects the August 25, 2004 payment of \$17,468 and asserts a Tax Year 2001 deficiency of \$16,895 plus interest and penalties.

30. Petitioner did not claim deductions for payments made to Sidney Lerman, Ilene Lerman Shotland and Albert Benalloul on the Tax Year 2002 UBT return. Subsequently, Petitioner filed the amended Tax Year 2002 UBT return and requested refund of UBT paid on the compensation to Albert Benalloul.

31. Petitioner did not claim deductions for payments made to Sidney Lerman and Ilene Lerman Shotland on its 2003 Tax Year UBT return, but Petitioner did claim a deduction for payments made to Albert Benalloul.

32. On April 8, 2005, Respondent issued a Notice of Determination to Petitioner that asserted a UBT deficiency in the amount of \$19,393 for Tax Year 2003. The Notice stated that "Payments made to partners are not allowable deductions for NYC Unincorporated Business Tax purposes." A penalty for substantial understatement of tax liability (Code §11-525(j)) and a negligence penalty (Code §11-525(b)) were imposed.

33. On July 20, 2005, Respondent issued a Notice of Disallowance to Petitioner with respect to its claim for a Tax Year 2002 UBT refund in the amount of \$19,205, denying the claim and stating that "[P]ayments made to partners are not allowable deductions for Unincorporated Business Tax purposes."

34. Petitioner does not dispute adjustments to UBT taxable income for payments made to Sidney Lerman and Ilene Lerman Shotland. However, Petitioner protests the asserted UBT deficiencies to the extent the adjustments deny deductions for payments made to Albert Benalloul as reflected in the following UBT deficiency amounts:

| <u>Tax Year</u> | <u>Protested Amount:</u> |
|-----------------|--------------------------|
| 2000            | \$39,686                 |
| 2001            | \$16,895                 |
| 2003            | \$19,393.                |

Petitioner also protests Respondent's disallowance of the claim for refund of UBT for the year 2002 in the amount of \$19,205.

35. A conference was held in these matters before Respondent's Conciliation Bureau on September 12, 2005. On November 1, 2005, the Conciliator issued Proposed Resolutions for each of the Tax Years. Petitioner disagreed in writing with the proposed resolutions on November 5, 2005 and on November 15, 2005 the Director of Respondent's Conciliation Bureau issued Conciliation Decisions discontinuing the conciliation proceedings.

36. On December 5, 2005, Petitioner filed a Petition requesting redetermination of the UBT deficiencies pursuant to Code §11-529 for the 2000, 2001 and 2003 Tax Years, and for allowance of the claim for refund of UBT for the 2002 Tax Year, pursuant to Code §11-527.

#### **STATEMENT OF POSITIONS**

Petitioner asserts that Albert Benalloul was neither an officer nor proprietor of Petitioner's Member, the Victoria Benalloul 1999 Family Trust, and therefore the compensation that Petitioner paid to Mr. Benalloul was a business expense which was deductible from Petitioner's unincorporated business taxable income. Respondent argues that since Mr. Benalloul was a named contingent beneficiary of the Member Trust, the compensation that Petitioner paid to him therefore constituted payments to a partner or proprietor which are not deductible from UBT income.

#### **CONCLUSIONS OF LAW**

The UBT is imposed on the taxable income of an unincorporated business which is carried on wholly or in part in the City and is not subject to the General Corporation Tax ("GCT"). Code §§11-502, 11-503(a). The taxable income of a limited liability company doing

business in the City is subject to the UBT on its unincorporated business income allocated to the City, less certain deductions and exemptions. Code §11-505.

Allowable deductions from unincorporated business income include the "items of loss and deduction directly connected with or incurred in the conduct of the business, which are allowable for federal income tax purposes for the tax year." Code §11-507. See, also, 19 RCNY §28-06. Generally, salaries paid to employees of the unincorporated business are deductible expenses. However, only \$5,000 or twenty per cent (20%) of unincorporated business taxable income for the tax year may be deducted as "reasonable compensation" paid to "partners" or "proprietors" for services rendered the unincorporated business under Code §11-509(a).<sup>7</sup>

The Code does not define the terms "partner" or "proprietor" and the decisions have taken a case-by-case approach. See, e.g., *Matter of Lazard Freres & Co.*, TAT(E)93-107(UB) (City Tax Appeals Tribunal, January 2, 2003).<sup>8</sup> The UBT Rules provide that the term "proprietor" or "partner" also includes "any . . . individual charged with performing executive duties of [a] corporation [which is the partner of the unincorporated business]." 19 RCNY §28-

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<sup>7</sup> Code §11-509(a) is an exception from the normal rule. See Code §11-507(3) which provides that "[N]o deduction shall be allowed . . . for amounts paid or incurred to a proprietor or partner for services or for use of capital."

<sup>8</sup> *Matter of Lazard Freres, supra*, involves the Code §11-510(2) Additional Exemption, which prevents multiple taxation of partnership income that also is included in corporate partners' net income subject to the City GCT. The Tribunal considered whether the term "partner" included second-tier partners. The Tribunal found that the purpose of the Additional Exemption is to avoid multiple taxation of the same income. The Tribunal did not define the term "partner," referring in a footnote to Code §11-501(a) ("unless a different meaning is clearly required, any term used in this title shall have the same meaning as when used in a comparable content[SIC] in the laws of the United States relating to federal income taxes"). The Tribunal concluded that avoiding double taxation is more important than formalistic limitation of qualifying "partners" to first-tier partners. See, also, *Matter of Weil Gotshal*, 83 NY2d 591 at 596 (1994).

06(d) (1) (ii) (B). See, *Guttman Picture Frame Associations etc., et al. v. O'Cleireacain*, 209 A.D.2d 340 (1st Dept. 1994), *affg*, FHD-92-467(UBT) (City Department of Finance Bureau of Hearings, September 4, 1992); *Matter of AGS Specialist Partners*, TAT(E)00-10(UB) (City Tax Appeals Tribunal, May 21, 2003). See, also, 19 RCNY §28-06(d) (1) (iv) which identifies the following incidents of partnership:

(A) The entity files a Federal Form 1065, Schedule K1 with respect to that person.

(B) The person is a party to the governing document of the entity (e.g., the partnership agreement;

(C) the person is liable for all or a portion of the debts or obligations of the entity;

(D) or the person has an interest in the capital or assets of the entity.

The UBT Rules also address payments to partners and proprietors for services to the unincorporated business, restating the language of Code §11-507(3). UBT Rules §28-06(d) (1) (i).<sup>9</sup> The amounts which are not deductible include salaries and other fees, even when rendered by a partner as an employee of the unincorporated business. See, e.g., UBT Rules §28-06(d) (1) (i) (B) which provides that the non-deductible amounts "include any amount paid to any person if, and to the extent that, the payment was consideration for services or capital provided by a proprietor or partner." Payments to a corporate partner for services provided the unincorporated business

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<sup>9</sup> UBT Rules §28-06(d) (1) (i) states:

(A) No deduction shall be allowed . . . for amounts paid or incurred to a proprietor or partner for services or for use of capital.

"by the corporate partner's officers . . ." also are not deductible. UBT Rules §28-06(d)(1)(ii)(B). The Rules further state that "[P]ayments made or incurred by the unincorporated business for services performed by an individual who is both an officer and an employee of the corporate partner may not be deducted . . ." UBT Rules §28-06(d)(1)(ii)(B). However, payments to employees of partners who are not also partners or proprietors are deductible business expenses. UBT Rules §28-06(d)(1)(ii)(D).

Mr. Benalloul was neither a partner nor a proprietor of Petitioner LLC during the Tax Years. The only two Member-partners of Weeks-Lerman were the Lerman Company and the Victoria Benalloul 1999 Family Trust. Nor was Mr. Benalloul a corporate partner of either Member. Petitioner compensated Albert Benalloul for services which he provided the Company during the Tax Years as one of its Managers responsible for its day-to-day operations. Generally payments for such services constitute ordinary business expenses which are deductible from unincorporated business income pursuant to Code §11-507. Only if Mr. Benalloul had provided services in a capacity which can be analogized to a partner or proprietor (as those terms are understood with respect to the relevant Code provisions and UBT Rules), would his compensation not be a deductible expense. *See, e.g., AGS, supra.*

The Trust is the entity which holds a fifty per cent (50%) membership interest in Petitioner. The Trustees, Victoria Benalloul and Judith Connolly, are responsible for Trust administration.<sup>10</sup> Albert Benalloul, on the other hand, lacked the requisite ownership interest in or control of the Trust, either individually or as

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<sup>10</sup> *See, e.g., Stipulation I, Ex. C, the Trust Agreement, Article Seventh, which states the powers and duties of the Trustees with respect to Trust income and property, and includes specific provision for the Trust to become a limited or general partner in a partnership or limited liability company.*

contingent beneficiary, to be considered a partner or proprietor of Petitioner pursuant to Code §11-509. A beneficiary has no legal title to the trust corpus, although he or she may enforce the trust instrument.<sup>11</sup> Mr. Benalloul, as a named beneficiary, did not have the authority to bind or otherwise act on behalf of the Trust. The fact that he was a contingent beneficiary of the Trust does not ensure that he could control the Member. Nor does his standing as one of the beneficiaries establish that the contingent "beneficial interest" he has in the Trust corpus was sufficient to elevate his status to an owner/proprietor of Petitioner for UBT purposes.<sup>12</sup> Accordingly the substance of Petitioner's payments to Mr. Benalloul for managing the business of the Company were not payments to a partner or proprietor, but were a deductible business expense. *Guttman, supra; AGS, supra.*

Respondent asserts that compensation paid to an individual by an unincorporated business nevertheless is not deductible from gross income if the economic substance of the payment is that it represents remuneration for services rendered the business by a partner or proprietor. *Matter of Guttman*, FHD-92-467 (UBT), September 4, 1992. In *Guttman, supra*, a hearing was held before the former Hearings Bureau of the Department of Finance regarding whether a partnership could deduct payments for services rendered by

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<sup>11</sup> See, e.g., NY Estates, Powers and Trusts Law, §7-2.1(a), Practice Commentaries: "[T]he beneficiary has no legal title, and he therefore may not dispose of the corpus [citations omitted], but his beneficial or equitable interest enables him to enforce the trust. These are venerable principles that have long applied to trusts of both real and personal property. See, e.g., *Oviatt v. Hopkins*, 20 A.D. 168 (4<sup>th</sup> Dept. 1897)."

<sup>12</sup> Respondent conflates Mr. Benalloul's executive responsibilities to Petitioner (presumably in his capacity as Manager) with an alleged executive responsibility for the Trust flowing from a hypothetical "beneficial ownership." To be a Trust beneficiary is simply to be an individual who may receive certain "benefits" (i.e., distributions) from a Trust agreement; it does not mean that the beneficiary has any control over the Trust corpus.

the officers of its corporate partners.<sup>13</sup> The Commissioner found that those individuals, who were the officers and sole shareholders of two corporate partners and officers and 50% shareholders of two other corporate partners, were "significant officers of all of petitioner's corporate partners." Therefore, the Commissioner concluded that the salary payments were nondeductible amounts paid to the taxpayer's partners for services. The Appellate Division affirmed the Commissioner's disallowance of the deduction, stating:

Tax legislation should be implemented in a manner that gives effect to the economic substance of the transaction . . . and the taxing authority may not be required to acquiesce in the taxpayer's election of a form for doing business but rather may look to the reality of the tax event and sustain or disregard the effect of the fiction in order to best serve the purposes of the tax statute. [Citations omitted.]

Respondent also relies on *AGS, supra*, where the Tribunal considered whether payments to officers of that taxpayer's corporate partners were non-deductible compensation for services rendered by a partner pursuant to Code §11-507(3). In *AGS*, the Tribunal specifically declined to consider whether the term "partner" included corporate officers *per se*. The Tribunal found that the facts presented established that the officers of *AGS'* corporate partners who, as in *Guttman*, were the corporation's sole shareholders, were the "only individuals who could act on behalf of the Corporate Partners [of the unincorporated business]."

The facts of this matter are readily distinguished from those presented in *Guttman* and *AGS*. Those cases confirm that payments to

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<sup>13</sup> In addition to four corporate shareholders, partners of that petitioner also included four irrevocable family trusts. The role of the trusts was not considered in the Commissioner's Decision.

Sidney Lerman and Ilene Lerman Shotland are not deductible expenses since those individuals were the only officers and shareholders of Petitioner's corporate Member, Lerman. Thus, payment for their services in substance was a nondeductible payment to a corporate partner. However, the analogy fails with respect to Albert Benalloul as he was not a partner of a Member-corporate partner, not a shareholder of a Member-corporate partner, and not Trustee of a Member-Trust. His beneficial interest in the Trust was wholly contingent and thus is distinguishable from the corporate officer/partners in *Guttman, supra*, and *AGS, supra*, who held vested majority ownership interests in the corporate partners of the unincorporated businesses.

Respondent references the attribution provisions of Section 318 of the Internal Revenue Code which address the Federal income tax effects of constructive ownership of stock. That provision is not relevant to this matter. By its terms, the section is specifically limited to circumstances involving corporate distribution of property, such as IRC §301. IRC §318(a). Further, the IRC has no provisions equivalent to the UBT provisions at issue and, therefore, these Code provisions have no direct bearing on this matter. The requisite ownership and control of the Trust (which is Petitioner's Member and, therefore, possibly analogous to a partner) may not be constructively attributed to Albert simply by virtue of his being a named beneficiary of the Trust.<sup>14</sup>

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<sup>14</sup> Respondent ultimately concedes that the reference to IRC §318 is not germane. See, e.g., Sur-reply Brief, p.8, where Respondent's representative states that "the above named IRC provisions lack of direct pertinence to this case is not disputed."

**ACCORDINGLY, IT IS CONCLUDED THAT** since Albert Benalloul was not a partner or proprietor of Petitioner, the compensation paid to him as Manager is an ordinary business expense which is deductible in computing Petitioner's UBT taxable income for the Tax Years. The Petition is granted, the Notices of Determination are cancelled and the Claim for Refund is granted.

DATED: June 10, 2008  
New York, New York

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ANNE W. MURPHY  
Administrative Law Judge