

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

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**In the Matter of the Petition**

**of**

**MURPHY & O'CONNELL**

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**DETERMINATION**

**TAT(H) 06-18(UB)**

Hauben, D.C.A.L.J.:

Upon the motion of the Commissioner of Finance ("Respondent"), dated August 5, 2009, for summary determination that payments characterized by Petitioner, Murphy & O'Connell, as payments to a qualified pension plan for the year 2001 are nondeductible payments to partners under Section 11-507(3) of the Administrative Code of the City of New York ("Code"); and the affirmation, exhibits and supporting memoranda submitted by Andrew Lipkin, Esq., Senior Counsel, of the New York City ("City") Law Department, Respondent's representative, and the Affirmation in Opposition and cross motion for summary determination for Petitioner and accompanying documents and memoranda submitted by Patrick J. Murphy, Esq., a partner of Petitioner, Respondent's motion is granted.

**FINDINGS OF FACT**

Petitioner is a New York partnership engaged in the practice of law in New York City.

For the calendar year 2001, Petitioner claimed a deduction for Federal income tax purposes for a \$188,000 payment which it characterized as a contribution (the "Contribution") to a qualified pension plan (the "Plan"). Petitioner did not add back any part of

the Contribution to City Unincorporated Business Tax ("UBT") taxable income in reporting its UBT liability.

Petitioner's UBT Return for 2001 reflects \$50,492 of ordinary income from Federal Form 1065 and a \$5,000 allowance for each partner's active services to the partnership. After modifications, Petitioner reported taxable income of \$58,907 on which it paid UBT of \$936.

On June 3, 2005, Respondent issued a Notice of Determination asserting a UBT deficiency for 2001 in the amount of \$8,940.28, plus interest, computed to July 5, 2005 of \$2,073.09 and a penalty of \$1,341.04, for a total deficiency of \$12,354.41. The Statement of Audit Adjustments accompanying the Notice of Determination indicates that Respondent's auditor denied as a deduction and added back to taxable income the amount of the Contribution (the "Add Back"). The reason given for the Add Back was that "[p]ayments for benefit plan for partners are not allowable deductions for NYC Unincorporated Business Tax."

Petitioner filed a timely Petition with the Tribunal asserting that Respondent erred in issuing the Notice of Determination. Petitioner asserts that Code §11-507(3) relates only to payments for services or use of capital made directly to proprietors or partners and not to payments for services or use of capital made to an entity (e.g., a pension trust) on behalf of a proprietor or partner.

Petitioner and Respondent requested that the matter be placed on the Tribunal's *sine die* calendar awaiting the final outcome of two cases which concerned the tax treatment, for UBT purposes, of payments to entities on behalf of proprietors or partners: *Matter*

*of Horowitz v. Commissioner*, TAT(H)99-3(UB) (September 15, 2004), *aff'd*, TAT(E) 99-3(UB) (September 1, 2005), *aff'd*, 41 A.D.3d 101 (1<sup>st</sup> Dept. 2007), *lv. to appeal denied*, 10 N.Y.3d 710 (2008) and *Matter of Proskauer Rose LLP v. Commissioner*, TAT(H) 01-19(UB) (July 11, 2006), *aff'd*, TAT(E)01-19(UB) (November 5, 2007), *aff'd*, 57 A.D.3d 287 (1<sup>st</sup> Dept. 2008.) In both cases the Courts ruled that payments to entities on behalf of proprietors or partners were not deductible. Nevertheless, Petitioner decided to pursue the Petition. After several conferences, Respondent brought this motion.

During the conference procedure, Respondent withdrew its assertion of penalties and Petitioner withdrew its claim that it was entitled to a net operating loss.

#### **CONCLUSIONS OF LAW**

Under Section 1-05(d) (1) of the Tax Appeals Tribunal Rules of Practice and Procedure, a motion for summary determination shall be granted:

if, upon all the facts and proof submitted, the administrative law judge finds that it has been established sufficiently that no material and triable issue of fact is presented and that the administrative law judge can, therefore, as a matter of law, issue a determination in favor of any party.

However, “[t]he motion shall be denied if any party shows sufficient basis to require a hearing of any issue of fact.” *Id.*

There is no factual dispute that the Contribution, characterized by Petitioner as a contribution to a qualified pension plan was a payment to an entity for the benefit of

Petitioner's partners.<sup>1</sup> Thus, for purposes of this motion whether the Contribution was to a qualified plan or not is not a material fact that requires a trial.

Respondent's primary basis for seeking summary determination, assuming all facts in Petitioner's favor, is that the Contribution is not deductible under Code §11-507(3) as a matter of law. Respondent cites *Horowitz, supra*, and *Proskauer, supra*, as controlling precedent.

Petitioner argues that it is entitled to deduct the Contribution because payments to a third party on behalf of a partner are not required to be added back under Code §11-507(3) as "amounts paid or incurred to a proprietor or partner for services or for use of capital."

Tax deductions are a matter of "legislative grace." *Royal Indemnity Co. v. Tax Appeals Tribunal*, 75 N.Y.2d 75, 78 (1989). A taxpayer must establish entitlement to a specific tax deduction. *Mobil Oil Corp. v. Finance Admin. of City of N.Y.*, 58 N.Y.2d 95, 99 (1983); *Colt Indus. v. Dep't. of Finance*, 66 N.Y.2d 466, 471 (1985).

Code §11-507 provides, in relevant part, for unincorporated business deductions:

The unincorporated business deductions of an unincorporated business means the items of loss and deduction directly connected with or incurred in the conduct of the business, which are allowable for federal

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<sup>1</sup> Respondent's motion also sought summary determination on the grounds that Petitioner did not have a qualified plan and thus was not entitled to a deduction for Federal income tax purposes.

income tax purposes for the taxable year . . . with the following modifications:

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(3) No deduction shall be allowed (except as provided in section 11-509 of this chapter) for amounts paid or incurred to a proprietor or partner for services or for use of capital.

Code §11-509(a), provides, in relevant part:

In computing unincorporated business taxable income, there shall be allowed . . . deductions for reasonable compensation not in excess of five thousand dollars for personal services of the proprietor and each partner actively engaged in the unincorporated business . . .<sup>2</sup>

As stated above, the proper treatment under the UBT of payments to third parties (including pension plans) on behalf of proprietors or partners has been considered by the Tribunal and the courts in two recent matters: *Horowitz, supra*, and *Proskauer, supra*.

In *Horowitz*, the taxpayer deducted contributions made to a defined benefit plan arguing, as Petitioner does here, that the payment must be to the proprietor or partner to fall within the purview of Code §11-507(3). Upholding the City Department of Finance's denial of the deduction,<sup>3</sup> the Tribunal quoted *Guttman Picture Frame Associates, etc., et al. v. O'Cleireacain*, 209 A.D.2d 340 (1<sup>st</sup> Dep't 1994) *aff'g.*, FHD 92-467(UBT) (New York City Department of Finance Bureau of Hearings, September 4, 1992), that

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<sup>2</sup> Petitioner claimed the deduction allowed by Code §11-509.

<sup>3</sup> *Horowitz* also upheld the Department's disallowance of deductions for self-employed health insurance payments and payments for federal self-employment tax.

"[t]ax legislation should be implemented in a manner that gives effect to the economic substance of the transaction." In order to give effect to Code §11-507(3), the purpose of which is to disallow as deductions payments to a proprietor or partner for services or the use of capital, the Tribunal found that where a proprietorship chooses how to pay the proprietor "it cannot matter [that payments for services of the proprietor are made] directly to the proprietor or to a third party." *Guttmann, supra*. As payments to a pension plan on behalf of a proprietor or partner are payments for the services of the proprietor or partner, and it is the partnership that has chosen the form of remuneration, the economic substance of the transaction requires disallowance of the deductions. The Appellate Division upheld the Tribunal's interpretation, *Horowitz, supra*.

In *Proskauer*, The Tribunal again found no merit to the taxpayer's argument that payments to exempt trusts under the retirement plans were deductible because they were not made directly to the partners. The Appellate Division again agreed, finding the payments to be for the direct benefit of the partners:

[The] contributions to deferred compensation plans on behalf of active partners, while made not to the partners but directly to the plans, clearly are for the direct benefit of the partners and thus . . . not deductible under Administrative Code Sec. 11-507(c). *Proskauer, supra*, 57 A.D.3d at 288.<sup>4</sup>

Here, as in *Horowitz* and *Proskauer*, Petitioner's payment to the Plan was remuneration for the services of a partner or partners. *See, Horowitz, supra*, 41 A.D.3d at 102. The

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<sup>4</sup> The Tribunal and the Courts also gave no credence to arguments that the payments were deductible for UBT purposes because they were deductible for Federal income tax purposes and because the payments to the pension plans were not income to the partners in the year of the contribution to the plans.

Contributions were for the direct benefit of Petitioner's partner or partners. That the payment of such remuneration was made to an entity rather than to the partner or partners directly was the choice of the partnership and its partners. Accordingly, the payment is not deductible under Code §11-507(3). *Horowitz, supra; Proskauer, supra.*

All other arguments raised by Petitioner have been considered and are found to be without merit.

**ACCORDINGLY, IT IS CONCLUDED THAT** the Contribution is a payment on behalf of a partner or partners which is an amount "paid or incurred to a proprietor or partner for services or for use of capital" which must be added back to UBT taxable income under Code §11-507(3).

Respondent's motion for summary determination sustaining the Notice of Determination dated June 3, 2005 is granted, with the June 3, 2005 Notice of Determination amended to reflect Respondent's withdrawal of penalties. Petitioner's cross motion for summary determination is denied and the Petition is dismissed.

DATED: May 10, 2010  
New York, New York

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WARREN P. HAUBEN  
Deputy Chief Administrative Law Judge