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rant and establish an easement. While the facts might justify that an easement was created, the affirmance of the Court of Appeals was proper where the trier of fact made a choice which was not clearly wrong, and defendant failed to meet his burden of proving an easement.[87]

TAXATION

UNREALIZED APPRECIATION OF ASSETS EXCLUDED FROM EARNINGS AND PROFITS

Article 16 of the New York Tax law deals with "Taxes Upon And With Respect To Personal Incomes." Within that Article, Section 350(8) defines "dividends" to mean any distribution made by a corporation to its shareholders out of its earnings and profits.[1] Section 359 of the same Article defines "gross income" as including, *inter alia*, gains, profits and income from dividends, and gains, profits and income from any source whatever.[2] In the recent case of *Marks v. Bragalini*,[3] the Court of Appeals clarified the concept of "earnings and profits" for income tax purposes, particularly in its relation to unrealized appreciation of corporate assets.

Taxpayer was a stockholder in a corporation which had purchased an apartment house from the Federal Housing Administration in 1942, to whom it gave a mortgage for $1,682,000. By 1950, the value of the property had increased enough so that the corporation was able to obtain a new mortgage from an insurance company for $2,000,000, paying off the old mortgage and leaving an excess of over $800,000. In 1950, it made a distribution to shareholders of $735,000 ($700 per share) of which taxpayer received approximately $389,000. At the close of the fiscal year, the corporation had accumulated earnings of some $77,000, which was about 10.6 per cent of the distribution.

On his 1950 Federal and New York State personal income returns, taxpayer included $41,000, representing 10.6 per cent of the distribution to him, in "gross income" as a dividend subject to tax as ordinary income. Of the balance of $348,000, he treated $346,000 as "return of capital" (thus reducing his basis in the stock to zero) and the remainder as capital gain. His Federal return was accepted, but the New York authorities disallowed his treatment

87. Zeiger v. Interborough R. T. Co., 254 App. Div. 908, 5 N.Y.S.2d 527 (2d Dep't 1938), *aff'd* 280 N.Y. 516, 19 N.E.2d 922 (1939). One claiming the easement has the burden of proving it.

1. N.Y. TAX LAW § 350(8).
   The word "dividends" means any distribution made by a corporation out of its earnings and profits to its shareholders or members whether in cash or other property or in stock of the corporation, other than stock dividends as herein defined. . . .
2. N.Y. TAX LAW § 359.
   The term "gross income":
   1. includes gains, profits and income from salaries, wages . . . ; also from interest, rent . . . , dividends, securities . . . , or gains and profits and income derived from any source whatever . . . .
3. 6 N.Y.2d 322, 189 N.Y.S.2d 846 (1959).

of the distribution as "return of capital" and capital gain. They determined that the entire distribution was includible in "gross income" and subject to normal tax. The Appellate Division affirmed the Tax Commission determination taking the view that there could be no capital gain treatment since there was no sale or exchange of property; that the concept of a "return of capital" was inapplicable since in effect this was an advance of future profits to the stockholders, serving no corporate purpose; and that even if this were not a dividend, the receipt of cash was taxable under the broad definition of "gross income" as "income derived from any source whatever."[4]

In an unanimous opinion, the Court of Appeals reversed.[5] It started with the major premise that it was the intent of the New York Legislature in drafting the personal income tax provisions to follow the Federal act whenever practicable.[6] It then easily distinguished the New York cases relied upon by the Tax Commission to establish that unrealized appreciation of assets could be used for dividends, by pointing out that those cases were not concerned with income tax.[7] Having established that there was no New York case law in the income tax field covering a distribution from unrealized appreciation of assets, the Court pointed out that substantially the same wording was used in Sections 350(8) and 359 of the New York Tax Law[8] as in comparable sections of the Internal Revenue Code of 1939.[9]

The Court then proceeded to establish its minor premise, *i.e.*, the applicable Federal law on such a distribution. By the terms of both the New York Tax Law,[10] and the Internal Revenue Code of 1939,[11] distributions to stockholders of a corporation are dividends when made from "earnings and profits." A basic concept of Federal income taxation is that unrealized appreciation of corporate assets is not a part of "earnings and profits."[12] The Court pointed to a recent Federal case, *Commissioner v. Gross*,[13] which was similar in many

4. 6 A.D.2d 393, 178 N.Y.S.2d 524 (3d Dep't 1958).

5. *Supra* note 3.

6. In re Rogers' Estate, 296 N.Y. 676, 70 N.E.2d 170 (1946), interpreting N.Y. TAX LAW art. 10(c).

> There is nothing of compulsion in the rule . . . rather it should be regarded merely as a signpost.
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> . . . .
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> The rule has been applied only:
>
> (1) in cases of first impression
>
> (2) where the question involved, though previously passed on in connection with prior tax laws, is being raised for the first time under existing . . . tax laws.

7. Randall v. Bailey, 288 N.Y. 280, 43 N.E.2d 43 (1942) involved a suit brought under Section 58 of the Stock Corporation Law against a director for paying out dividends while the capital was allegedly impaired. The asset in question had been written up on the books of the corporation to provide sufficient surplus from which to declare dividends.

8. *Supra* notes 1, 2.

9. INT. REV. CODE of 1939, § 115(a)(b) (now INT. REV. CODE of 1954 § 316); INT. REV. CODE of 1939, § 22(a) (now INT. REV. CODE of 1954 § 61(a)).

10. N.Y. TAX LAW § 350(8).

11. *Supra* note 9.

12. *E.g.*, Lynch v. Turrish, 247 U.S. 221 (1918); see also MERTENS, LAW OF FEDERAL INCOME TAXATION § 5.05.

13. 236 F.2d 612 (2d Cir. 1956). In this case, the corporation borrowed money from

respects to the instant case, and in which it was held that the distribution of the proceeds of a loan, by a corporation to its stockholders, was income only to the extent of "earnings and profits." The balance was construed as a "return of capital" until the stockholder's basis was reduced to zero and the remainder as capital gain. There, the same arguments were made by the Commissioner of Internal Revenue as were made here by the New York Tax Commission, including an attempt to bring the distribution within the catch-all definition of "gross income" as constituting "income from whatever source derived." There, as here, the arguments were of no avail. The main reason given for the exclusion of unrealized appreciation of assets from "earnings and profits" as a source of taxable dividends is that a contrary rule would lead to difficulties of administration, *i.e.* each time a distribution was to be made, it would be necessary that the corporation re-evaluate all its assets.[14] As to the catch-all definition of "gross income," the argument which defeats it is that since corporate distributions are specifically covered under the "dividends" definition, the broader concept is inapplicable.

With the above premises proven, the conclusion to the syllogism follows naturally, *viz:* in the interest of uniformity of administration between the tax laws, where there is a distribution by a corporation to its stockholders of money representing an unrealized appreciation of assets, since the appreciation is not a part of "earnings and profits," the distribution is a dividend only to the extent of the stockholder's *pro rata* share of "earnings and profits." The balance is treated as a reduction of basis and in excess of basis, as capital gain.

The decision in the instant case appears to be a sound one. By bringing the New York Tax Law in this area into closer harmony with Federal tax law concepts, the Court facilitates not only the administration of the former, but makes it easier for a taxpayer, particularly a corporate stockholder, to determine his annual income taxes. One minor aspect, however, remains unsettled. Following the decision in *Gross*,[15] the Internal Revenue Code of 1954 was amended to meet that specific problem. By Section 312(j),[16] it is now provided that where there is a distribution to stockholders of the proceeds of a loan, any portion of which is guaranteed by an agency of the United States Government, the "earnings and profits" are deemed to include the excess of such loan over the adjusted basis of the property which is security for the loan. Should such a case arise in New York, the Court of Appeals would presumably be required to follow its decision in *Marks*.[17] This would be a step away from uniformity but would seem to be required on the basis of the concept of unrealized appreciation of assets being excluded from "earnings and profits."

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the F.H.A. to put up a housing project. Upon completion, it was discovered that the cost was a good deal less than had been estimated, so although the corporation had as yet earned no income, it made a distribution to stockholders of the excess of the loan.

14. See also MERTENS, *op. cit., supra* note 12.
15. *Supra* note 13.
16. INT. REV. CODE of 1954, § 312(j); Treas. Reg. § 1.312-12 (1956).
17. *Supra* note 3.

Applying a different concept would not cure the step away from uniformity as to the *ratio decidendi* in *Marks*,[18] even though it might result in uniformity *ad hoc*. As a practical matter, it is doubtful that that situation will often arise as the Federal provision will probably act as a strong deterrent. However, in the interest of uniformity, New York legislation to conform to the exception to the general rule would appear to be desireable.

NIGHT CLUB OWNER EMPLOYER FOR UNEMPLOYMENT INSURANCE TAX PURPOSES

The taxation of employers for the purpose of unemployment insurance is carried on at both the state and the federal level. The Federal Government imposes a tax of 3% for unemployment insurance, based upon all wages paid by an employer during a given tax period.[19] New York State imposes a 2.7% tax for unemployment insurance purposes on the basis of all wages paid by an employer,[20] but the Federal Government gives a 90% tax credit to any employer against his federal unemployment taxes based on all taxes paid to the state unemployment insurance fund. This credit will only be granted to the same employer who paid the state tax.[21] A difficult problem arises in the area of entertainment, specifically concerning dance bands, as to the liability of the leader for unemployment insurance taxes.

In *In re Basin St., Inc.*,[22] the Court of Appeals reversed a decision of the Appellate Division,[23] and reinstated a determination by the Industrial Commissioner that Basin Street, Inc., a night club, was the employer of certain musicians for unemployment insurance tax purposes. Basin Street, Inc. contracted with numerous bands during the years 1953 and 1954, the tax periods in question. The standard form B union contract was used with a form B rider attached. The form B contract stated that the night club operator would have complete control of the musicians and designated the operator as the employer; the band leader and the rest of the band were designated as employees. The form B rider made the band leader liable for all withholding taxes and gave him 7% above the contract price for employment tax purposes. The rider, contrary to the main contract, designated the operator as a purchaser of music, instead of an employer.

The Court of Appeals had to construe the contract and rider standing alone in order to determine whether the operator or the band leader, was the employer for unemployment insurance tax purposes, because no evidence was offered on this point before the Unemployment Insurance Appeal Board. The Court interpreted the form B contract as giving full control of the musicians and the band leader to the night club operator. It construed the form B rider

18. *Ibid.*
19. INT. REV. CODE OF 1954 § 3301.
20. N.Y. LABOR LAW § 570.
21. *Supra* note 19, §§ 3302-3306.
22. 6 N.Y.2d 276, 189 N.Y.S.2d 641 (1959).
23. 6 A.D.2d 922, 175 N.Y.S.2d 889 (3d Dep't 1958).