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TAXATION

Allocation of Income of Unincorporated Businesses Operating Both Within and Without the State

Under section 386-g of the Tax Law an unincorporated firm carrying on business both within and without the state is entitled to allocate its income in computing the unincorporated business tax. When one partnership receives a share of the income of another partnership the receiving partnership must prove that it carries on its own business outside the state to be permitted to allocate income.[1] The fact that the remitting partnership carries on business without the state is irrelevant, because the two partnerships are separate taxable entities.

The New York firm in *Young v. Bragalini*[2] contended that it was entitled to allocate its income, on the ground that it carried on business outside of the state through properly licensed and authorized local agents, consisting of a Texas partnership and a Brazilian organization. The Tax Commission asserted that since the New York partnership was not licensed to engage in business in the foreign jurisdictions its business could have been conducted only in New York, and therefore all of its income was earned within New York.

The evidence showed that the three firms were engaged in the insurance business. The Houston office never acted independently of New York in dealing with their major client and from "time to time" partners and employees of New York worked on this account in Houston. Both firms always described themselves as having offices in New York and Houston and acted in conjunction with each other. A Houston partner said they considered themselves to be an agent of the New York firm. However, the Texas and Brazilian companies delivered the insurance policies, billed the insured, and collected the payments in their own names.

The Appellate Division unanimously upheld the Tax Commission and the Court of Appeals affirmed (4-3). The majority reasoned that since the New York firm was unlicensed in Texas and Brazil it had no power to make a contract of any kind in those jurisdictions, and as it could not delegate a power it did not have, the claim of carrying on business in the foreign jurisdictions could not be sustained. The dissenters were of the opinion that licensing of the principal was not a prerequisite to a valid agency relationship.

The majority refused to recognize an agency relationship for New York taxing purposes on the ground that it was not recognized by another jurisdiction

1. Cromwell v. Bates, 284 App. Div. 1001, 135 N.Y.S.2d 534 (3rd Dep't 1954).
2. 3 N.Y.2d 602, 170 N.Y.S.2d 805 (1958).

for regulatory purposes. It assumed that because the firm could not carry on business in other jurisdictions directly, it necessarily could not do so through validly licensed agents. Whether this conclusion is required by the foreign licensing laws in question was not shown.

Since the majority relied heavily upon the proposition that the burden of proof is upon the taxpayer to overcome assessments and that determinations of the Tax Commission are to be set aside only if clearly erroneous, the present case does not seem to constitute overwhelming authority against future taxpayers' contentions of this nature. If the taxpayer can clearly establish that the licensing requirements of a foreign jurisdiction, although prohibiting a business from operating directly therein, do not preclude a valid agency relationship in which only the agent is licensed, this case should not foreclose the allocation of income.

Taxation of Real Property Leased by the United States to Individuals

In *Fort Hamilton Manor v. Boyland*[3] the taxpayers leased land, located in New York State, from the federal government and erected housing projects thereon. Under the terms of the lease the improvements were to remain the property of the lessee, but if not removed at the end of the lease were to become the property of the lessor.

The Tax Commission of the City of New York attempted to tax the leasehold interest of appellants. The Supreme Court sustained the determination of the Tax Commission, the Appellate Division affirmed, and the Court of Appeals unanimously reversed.

Congress has declared that when real property owned by the federal government is leased to private interests the lessee's interest in the property is subject to state taxation.[4] While the federal government permits taxation of such a leasehold interest, however, under New York law only real property is taxed and the interest of a tenant in real estate under lease is not deemed to be real property, but rather a chattel real which is personal property.[5] It can be taxed as real property only if the lessee has an enforceable option to acquire the real property, on the theory that the lessee is the beneficial owner with the government merely holding the bare legal title.[6] In the instant case appellants had no option to

3. Fort Hamilton Manor v. Boyland, 4 N.Y.2d 192, 173 N.Y.S.2d 560 (1958).
4. Act of Aug. 5, 1947, ch. 493 §6, 61 STAT. 775 (now 10 U.S.C. §2667(e) Supp. V, 1958).
5. People ex rel. Higgins v. McAdam, 84 N.Y. 287 (1881); Matter of Althause's Estate, 63 App. Div. 252, 71 N.Y. Supp. 445 (1st Dep't 1901), *aff'd* 168 N.Y. 670, 61 N.E. 1127 (1901); Fifth Ave. Bldg. Co. v. Kernochan, 221 N.Y. 370, 117 N.E. 579 (1917); First Trust and Deposit Co. v. Syrdelco, Inc., 249 App.Div. 285, 292 N.Y.Supp. 206 (4th Dep't 1936).
6. Grumman Aircraft Eng. Corp. v. Board of Assessors, 2 N.Y.2d 500, 161 N.Y.S.2d 393 (1957).