

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :
of :
LEELA SAGUNARTHY :
AND BRAHMANANDA SAGUNARTHY :
for Redetermination of a Deficiency or for :
Refund of Personal Income Tax under Article 22 :
of the Tax Law for the Years 1983 and 1984. :
: DETERMINATION

In the Matter of the Petition :
of :
BRAHMANANDA SAGUNARTHY :
for Revision of a Determination or for Refund :
of Sales and Use Taxes under Articles 28 and 29 :
of the Tax Law for the Periods September 1, :
1980 through November 30, 1980 and September 1, :
1983 through November 30, 1983. :

Petitioners, Leela and Brahmananda Sagunarth, 15 Crest Drive, Clifton Park, New York 12065, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the years 1983 and 1984 (File Nos. 805534, 805535 and 805536).

Petitioner Brahmananda Sagunarth, 15 Crest Drive, Clifton Park, New York 12065, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 1980 through November 30, 1980 and September 1, 1983 through November 30, 1983 (File No. 805503).

A consolidated hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, W.A. Harriman State Office Building Campus, Albany, New York on March 1, 1989 with all briefs and documents to be filed by June 9, 1989. Petitioners appeared by John G. Gilooly, C.P.A. The Division of Taxation appeared by William F. Collins, Esq. (Mark F. Volk, Esq., of counsel).

ISSUE

Whether the Division of Taxation properly concluded that petitioner Dr. Brahmananda Sagunarth received constructive dividends from the professional corporation of B. Sagunarth, P.C.

FINDINGS OF FACT

Assessments of Sales and Use Taxes

During the periods in issue, Dr. Sagunarthu was a dentist. For at least a portion of the audit period, he maintained practices in both Troy and Schenectady, New York.

On October 2, 1987, the Division of Taxation ("Division") issued two notices of determination and demands for payment of sales and use taxes due to Brahmananda Sagunarthu. The first notice assessed sales and use taxes for the period September 1, 1980 through November 30, 1980 in the amount of \$1,153.18 plus interest of \$913.71 for a total amount due of \$2,066.89. The second notice assessed sales and use taxes for the period September 1, 1983 through November 30, 1983 in the amount of \$564.34, plus interest of \$185.39 for a total amount due of \$749.73. In each instance, the amounts assessed in the notices were calculated on the basis of amounts reported on the balance sheets set forth with the New York State corporation franchise tax reports of B. Sagunarthu, P.C. for the fiscal years ended, respectively, October 31, 1981 and October 31, 1983. The tax returns were relied upon to conduct the audit after it was ascertained that other records were not available for examination. At the hearing, petitioners' representative accepted the findings of liability for sales and use taxes.

Asserted Deficiency of Personal Income Tax for the Year 1983

Petitioners filed a New York State Resident Income Tax Return for the year 1983 wherein they elected a filing status of "Married filing joint return". They attached to their return a Federal Schedule C entitled Profit or (Loss) from Business or Profession wherein Dr. Sagunarthu reported car and truck expenses of \$1,536.00. Dr. Sagunarthu also reported legal and professional services expense of \$1,692.00 and depreciation expense on an automobile of \$6,175.00.

In the course of the audit, the Division concluded that petitioners were entitled to additional legal expenses of \$268.00. However, the Division disallowed 85 percent of the claimed automobile travel expense on the basis of a lack of substantiation. Furthermore, the Division considered Dr. Sagunarthu's automobile to be used 15 percent of the time for business and adjusted the cost basis of the automobile accordingly. Thereafter, the Division recalculated petitioners' auto depreciation expense on the basis of a three-year useful life.

The audit revealed that the final corporation franchise tax report of B. Sagunarthu, P.C. contained a balance sheet account of loans to shareholders which had a reported value of \$54,448.00. Since the corporation was dissolved, the Division concluded that some activity must have occurred on this account such that the debt was paid, forgiven or written off as a bad debt. Therefore, the Division requested that Dr. Sagunarthu present evidence that the loan by the corporation had been repaid. Since no evidence was forthcoming, the Division concluded that there had been a constructive dividend arising from the forgiveness of the debt.

On the basis of the foregoing audit, the Division issued a Notice of Deficiency to petitioners which asserted a deficiency of personal income tax for the year 1983. The notice, which was issued February 11, 1987, asserted that tax was due in the amount of \$8,061.70 plus interest of \$2,417.27 for a total amount due of \$10,478.97.

Asserted Income Tax Deficiency of Leela Sagunarthu for 1984

On February 11, 1987, the Division issued a Notice of Deficiency to Leela Sagunarthu

which asserted a deficiency of personal income tax for the year 1984 in the amount of \$61.15 plus interest of \$8.96 for a balance due of \$70.11. At the hearing, petitioners' representative declined to dispute this asserted deficiency of personal income tax.

Asserted Income Tax Deficiency of Brahmananda Sagunathy for 1984

The Division conducted an audit of Dr. Sagunathy's personal income tax return for the year 1984 which resulted in the conclusion that Dr. Sagunathy was entitled to an additional deduction for legal fees of \$2,705.00. However, since Dr. Sagunathy did not have any business records, the Division disallowed 85 percent of his reported automobile travel expenses. The Division also adjusted the amount of depreciation claimed on the automobile in the same manner as that which was done for the year 1983. Moreover, the Division reduced the amount of a capital loss which had been claimed. Lastly, the Division recalculated the amount of depreciation which Dr. Sagunathy had claimed on rental property which had been acquired in 1984. Specifically, the Division calculated the depreciation on the basis of a 40-year useful life whereas petitioners computed the depreciation on the basis of a 15-year useful life.

On the basis of the foregoing audit findings, the Division issued a Notice of Deficiency to Dr. Sagunathy. The notice, which was issued February 11, 1987, asserted that personal income tax was due in the amount of \$1,238.70 plus interest of \$181.48 for a total amount due of \$1,420.18.

Following issuance of the last Notice of Deficiency, the Division reconsidered its position with respect to the depreciation of the rental property. That is, the Division concluded that Dr. Sagunathy should be permitted to depreciate the rental property over a period of 25 years rather than 40 years which had been used to calculate the last Notice of Deficiency. On the basis of the revised depreciation calculations, the Division prepared a new Statement of Personal Income Tax Audit Changes which explained that personal income tax was asserted to be due for the year 1984 in the amount of \$875.30 plus interest of \$209.09 for a total amount due of \$1,084.39.

SUMMARY OF PETITIONERS' POSITION

At the hearing, petitioners' representative either accepted or declined to dispute either of the sales tax assessments or any of the adjustments to petitioners' income except for the portion of the asserted deficiency of personal income tax for 1983 premised upon a constructive receipt of income.

Petitioners' challenge to the Division's position that there was a constructive receipt of income is based on a worksheet which their accountant prepared on November 22, 1986. This worksheet contains a listing of the assets, liabilities and owners' equity accounts which the accountant obtained from the final corporation franchise tax report of B. Sagunathy, P.C. Petitioners' accountant assumed that, as a result of its dissolution, all of the corporation's outstanding liabilities, including taxes, had been paid. Thereafter, petitioners' accountant completed the worksheet which contained columns for adjusting journal entries and final balances. This exercise revealed that the corporation did not have sufficient assets to satisfy its liabilities. Therefore, petitioners' representative submits that Dr. Sagunathy must have supplied the additional funds needed to pay the debt and this, in turn, constituted a repayment of the loan to the corporation. According to the calculation on the worksheet, Dr. Sagunathy continues to owe the corporation \$2,384.00.

Petitioners' representative argues that the worksheet must be correct because the value of

the retained earnings on it corresponds with one portion of the long-term capital gain reported on petitioners' 1983 New York State income tax return. Similarly, petitioners submit that the accuracy of the worksheet is demonstrated by the fact that the income statement portion of the document shows a net loss of \$944.00 and the same net loss was reported on the final New York State Corporation Franchise Tax Report of B. Sagunarth, P.C. Petitioners' representative maintains that if the corporation franchise tax returns are going to be accepted to support the sales tax assessments, they should be accepted to challenge the income tax assessments.

CONCLUSIONS OF LAW

A. With certain exceptions not relevant herein, the burden of proof is on the petitioner to establish that the asserted deficiency of tax is erroneous (Tax Law § 689[e]). In this instance, petitioners have not presented sufficient evidence to meet this burden. First, there is no evidence in the record that the corporation satisfied all of its outstanding liabilities. Therefore, there is no basis to conclude that the assumption underlying the calculations on the worksheet are accurate. Secondly, even if it is assumed that the liabilities of the corporation were paid, there is no evidence that Dr. Sagunarth provided the funds to pay the debts.

In reaching the conclusion that petitioners have not established that Dr. Sagunarth repaid the loan from the corporation, several points are noted. First, there is no evidence from Dr. Sagunarth either by testimony or affidavit that he, in fact, repaid the loan to the corporation. Secondly, there is no documentary evidence such as a cancelled check, corporate records, or bank records which would support an inference that the loan was repaid. Lastly, there is no inconsistency between the use of the franchise tax reports to determine the amount of sales tax due and rejecting the worksheet as proof of repayment of the loan. The use of the balance sheet on the tax returns to determine the tax due was authorized by Dr. Sagunarth's failure to present proper records for a sales tax examination (see Tax Law §§ 1135[a]; 1138[a][1]; see generally, Matter of Raemart Drugs, Inc., Tax Appeals Tribunal, July 8, 1988). On the other hand, an accountant's worksheet which is based, in part, on a tax return is not the type of original source documentation which is needed to establish the amount of income which is subject to personal income tax (see 20 NYCRR 152.1). Thus, the evidence presented falls short of that needed to support a finding that Dr. Sagunarth repaid the loan to the corporation and accordingly, there is no basis to disturb the Division's conclusion that petitioners received a constructive dividend arising from the forgiving of a loan.

B. The petitions of Leela Sagunarth and Brahmananda Sagunarth are denied. The two notices of determination and demands for payment of sales and use taxes due dated October 2, 1987 and the three notices of deficiency dated February 11, 1987 are sustained in full together with such interest as may be lawfully owing except that the Division is directed to modify the Notice of Deficiency issued to Brahmananda Sagunarth in accordance with Finding of Fact "10".

DATED: Troy, New York
November 22, 1989

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE