STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:
of	:
EQUILEASE CORPORATION	:DETERMINATION DTA NO. 812827
for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Periods Ended December 31, 1985, May 31, 1986 and December 31, 1986.	:

Petitioner, Equilease Corporation, 25 Sylvan Road South, Suite D, Westport, Connecticut 06880, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the periods ended December 31, 1985, May 31, 1986 and December 31, 1986.

A hearing was held before Jean Corigliano, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on January 25, 1995 at 9:15 A.M. The Division of Taxation filed a brief on March 30, 1995. Petitioner filed a reply brief on May 1, 1995 which began the six-month statutory period for the issuance of a determination. Petitioner appeared by Philip F. Meno, Director of Taxes. The Division of Taxation appeared by William F. Collins, Esq. (James Maio, Esq., of counsel).

ISSUES

I. Whether, for the year 1985, petitioner has established the correct amount of the required adjustment to Federal income for recapture of excess New York depreciation.

II. Whether petitioner proved that income allocated to New York by the Division of Taxation should have been allocated out of New York.

III. Whether penalties should be cancelled.

FINDINGS OF FACT

The Division of Taxation ("Division") issued to petitioner, Equilease Corporation ("Equilease"), six notices of deficiency, dated September 16, 1991, asserting corporation franchise tax due under Article 9-A of the Tax Law as follows:

Period Ended	Tax	Penalty	Interest
12/31/85	$ 49,915.00	$ 4,992.00	$ 34,648.00
12/31/85	395,477.00	39,548.00	274,514.00
5/31/86	82,576.00	8,258.00	51,858.00
5/31/86	10,942.00	1,094.00	6,872.00
12/31/86	16,224.00	1,622.00	8,792.00
12/31/86	2,141.00	--	1,160.00

During the audit years, Equilease was an equipment lessor. It sought out companies that needed equipment but could not purchase it because of financial constraints or companies that preferred not to purchase for other reasons. Equilease would buy the equipment and lease it to its client. Equilease claimed the attendant interest expense and tax depreciation deduction on the leased equipment. Equilease's corporate headquarters were in New York, but it had property and employees throughout the United States.

Following a conference in the Bureau of Conciliation and

Mediation Services ("BCMS"), the Division issued to petitioner a Conciliation Order recomputing tax and penalty as follows:

Year Ending	Tax	Penalty
December 31, 1985	$462,644.00[1]	$44,733.00
May 27, 1986	87,586.00	Cancelled
December 31, 1986	625.00	-0-

The notices of deficiency were issued as a result of a field audit of petitioner's corporation franchise tax returns. Adjustments were made in many areas which are no longer in dispute. Petitioner challenges only three areas of the Division's audit. The first concerns the Division's recalculation of petitioner's entire net income for the year ending December 31, 1985 based upon an addback to Federal net income for recapture of excess New York depreciation. The second area involves the Division's allocation of income to New York. The third area of dispute concerns the Division's imposition of penalties. The total amount of tax contested pursuant to the petition is $344,250.00.

Recapture of Excess New York Depreciation Deduction

Petitioner computed its corporation franchise tax liability for the years in issue based on a calculation of its New York entire net income. The starting point for determining the entire net income is Federal taxable

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[1] The Conciliation Order actually increased the tax asserted for this period. After the auditor explained the basis for the increase in his testimony, petitioner's representative stated that petitioner was aware of the assertion of additional tax and did not choose to protest it.

income with modifications to reflect New York departures from Federal law. For tax years beginning before 1981, New York followed the Federal depreciation rules with respect to most tangible personal property. In 1981, Congress adopted the Accelerated Cost Recovery System ("ACRS") which permitted a much faster write-off of such property (referred to as

"recovery property") than was previously allowed (Internal Revenue Code ["IRC"] § 168). New York declined to follow the lead of the Federal government and adopted legislation decoupling New York depreciation from ACRS. For taxable years beginning in 1982, 1983 and 1984, New York taxpayers are required to add back to Federal taxable income the amount of the depreciation deduction allowable under ACRS on recovery property placed in service in New York from 1982 through 1984 (Tax Law § 208[9][b][10]; 20 NYCRR 3.2-3[17]). However, the taxpayer is allowed a subtraction from Federal income for the amount allowable as the depreciation deduction pursuant to IRC § 167, as such section would have applied to property placed in service on December 31, 1980 (Tax Law § 208[9][j]; 20 NYCRR 3-2.4[a][11]). No modifications to the ACRS are required for property placed in service in New York in taxable years beginning after December 31, 1984 and in other special circumstances not pertinent here (Tax Law § 208[9][b][10]). Upon the retirement, sale, abandonment or other disposition of recovery property, the New York taxpayer must make adjustments to take account of the differences between ACRS and New York

depreciation (Tax Law § 208[9][b][11]; 20 NYCRR 3-2.4[a][12]). If the aggregate New York depreciation for the property disposed of exceeds the ACRS depreciation, the taxpayer must add back to Federal taxable income the excess of the New York depreciation over the Federal depreciation. This is referred to as a recapture of the excess New York depreciation.

Upon audit of petitioner's New York State corporation franchise tax report for the year ending December 31, 1985, the Division determined that petitioner had not accurately calculated the addback required for property disposed of in 1985. The allowable New York State depreciation deduction is calculated on a form CT-399, Depreciation Adjustment Schedule. The Division's auditor calculated the addback using information taken from the CT-399 filed by petitioner for 1985 and information taken from a Depreciation Expense Worksheet for May 31, 1986, provided to the Division by petitioner (hereinafter the "1986 DEW").

Column C of Schedule B of the CT-399 requires the taxpayer to list the cost or other basis of all recovery property subject to the New York adjustment. Such property is listed by the year placed in service and the life or depreciation rate. In other columns, the taxpayer must show the amount of the accumulated Federal depreciation on such property, the amount of the Federal ACRS depreciation deduction and the accumulated New York depreciation.

The 1986 DEW provided to the Division actually contains two separate schedules. The second

schedule which will be discussed in detail later is entitled Write Off of Terminations. The first schedule is entitled "5 month expense" and appears to be a calculation of the Federal and State depreciation expense accrued for the five-month period beginning January 1, 1986 and ending May 31, 1986. Similar to the Schedule B of form CT-399, it lists the year the recovery property was placed in service, the cost basis of that property, the life of the property, and the amount of the Federal and State depreciation deduction accrued during the five-month period.

To calculate the addback to Federal income, it was first necessary for the auditor to determine the cost basis of the property disposed of in 1985, by class (or year placed in service and life of the property). To make that determination, the auditor subtracted the cost basis of all recovery property as of January 1, 1986 (taken from the 1986 DEW) from the cost basis of recovery property as of January 1, 1985 (taken from column C of Schedule B of the CT-399), i.e., the difference between the cost basis of property owned on January 1, 1985 and the cost basis of property owned on January 1, 1986 was deemed to be the cost basis of the disposed of property. The auditor's calculations were as follows:

Class	1/1/85 Cost Basis Per CT-399	1/1/86 Cost Basis Per 1986 DEW	1985 Dispositions
1981 - 5 Year	$ 22,209,938.00	$ 14,982,368.00	$ 7,227,570.00
1982 - 3 Year	12,825,451.00	8,883,334.00	3,942,117.00
1982 - 5 Year	82,232,043.00	58,441,260.00	23,790,783.00
1983 - 3 Year	13,047,515.00	9,694,931.00	3,352,584.00
1983 - 5 Year	80,767,355.00	67,738,038.00	13,029,297.00

1984 - 3 Year	22,078,628.00	18,102,954.00	3,975,674.00
1984 - 5 Year	69,155,373.00	63,378,261.00	5,777,112.00
Totals	$	$	$

The cost basis of all dispositions as determined by the auditor was $61,095,137.00. The auditor calculated the value of each class of assets by subtracting the cumulative Federal and State depreciation deduction from the cost basis of the disposed of assets. From these calculations, the auditor determined that the New York State value of the dispositions was $14,587,601.00 and the Federal value of those assets was $37,633,910.00. The auditor then subtracted the New York value from the Federal value to calculate an addback to Federal income of $23,046,308.00, representing the amount of the recapture of excess New York depreciation. The excess New York depreciation deduction was added back to Federal taxable income to determine petitioner's New York taxable income.

On the 1985 CT-399 filed by petitioner, it computed the required New York adjustment for dispositions made in 1985, reporting excess New York depreciation deductions over ACRS deductions of $1,164,309.00. Petitioner concedes that this calculation is incorrect. Petitioner also concedes that the methodology employed by the auditor is correct under the New York State Tax Law. Petitioner contends, however, that the cost basis figures reported on its CT-399 were incorrect, causing the calculation of the cost basis of the dispositions to be incorrect.

On audit, petitioner was represented by a gentleman identified by the auditor as Mr. Zahn. After the notices of

deficiency were issued, petitioner was represented by David J. Power. Although Mr. Power was a certified public accountant, he identified himself on a power of attorney as a consultant for Equilease. In connection with petitioner's request for a conciliation conference, Mr. Power prepared a detailed narrative outlining petitioner's position regarding each adjustment made by the Division. He attached to this narrative various schedules, worksheets and other documents to support petitioner's position. Mr. Power died on August 25, 1992.

No one with personal knowledge of the facts testified for petitioner regarding petitioner's calculation of the disposed-of assets, the depreciation workpapers offered in evidence or the preparation of the various documents attached to Mr. Power's narrative. Accordingly, petitioner's claim that the CT-399 contains an inaccurate calculation of the cost basis of the 1985 disposed of assets must rest on inferences from a number of documents.

Petitioner placed in evidence a copy of its 1985 corporation franchise tax report with attachments. Included in the attachments are: (1) a copy of the CT-399 relied on by the auditor; (2) a worksheet entitled Depreciation on ACRS Assets, 1985, which is similar to the 1986 DEW relied on by the auditor to determine the cost basis of recovery property as of January 1, 1986 (from here on, the 1985 Depreciation worksheet will be referred to as the "1985 DEW"); and (3) a worksheet entitled State Depreciation -- 1985/Alternate to ACRS (hereinafter, 1985 State Depreciation worksheet).

The 1985 DEW, like the 1986 DEW used by the auditor, consists of two schedules. The first shows a calculation of accumulated ACRS depreciation and accumulated State depreciation calculated by class on all recovery property. The second schedule is entitled Writeoffs of Terminated Assets. It is petitioner's position that this schedule shows the cost bases of assets disposed of (or "terminations") in 1985. It is also petitioner's position that the cost bases shown on the CT-399 were erroneously calculated by adding the cost bases of the 1985 terminations to the cost bases of all recovery property, essentially counting the terminations twice. Mr. Power prepared a chart demonstrating the alleged error. The figures in column two of the chart are taken from petitioner's CT-399 (the source of the auditor's figures); columns three and four are taken from the 1985 DEW. Petitioner's chart, modified by changing the titles of the categories, is as follows:[2]

Acquisition Year 1985 Terminations	Cost Basis Per CT-399	Cost Basis Per 1985 DEW
1981 - 5 Year	$ 22,209,938.00	$ 18,253,729.00
	$ 3,956,209.00	
1982 - 3 Year	12,825,451.00	10,915,485.00
	1,909,966.00	
1982 - 5 Year	82,232,043.00	69,983,624.00
	12,248,419.00	
1983 - 3 Year	13,047,515.00	11,877,395.00
	1,170,120.00	
1983 - 5 Year	80,767,355.00	73,524,167.00
	7,243,168.00	
1984 - 3 Year	22,078,628.00	20,893,955.00

[2]Mr. Power consistently included property placed in service in 1985 in his calculations and comparisons. The Division properly included in its computation of the New York addition only recovery property placed in service before January 1, 1985. Consequently, any references in Mr. Power's discussions to property placed in service in 1985 have been eliminated.

		1,184,673.00	
1984 - 5 Year		69,155,373.00	65,444,703.00
		3,710,670.00	
Totals	$	$	$

The chart above demonstrates that the cost bases per the CT-399 are equal to the sum of the 1985 Terminations and cost bases per the 1985 DEW. Petitioner contends that this proves that the dispositions were counted twice in the calculation of cost basis of 1985 depreciable property.

The third pertinent attachment to petitioner's corporation franchise tax report is the two-page document being referred to here as the 1985 State Depreciation worksheet. On the bottom half of the workpaper are various calculations under the heading "Terminations". The schedule contains this statement: "Write off difference between accumulated depreciation and cost." For each class of assets, there is a calculation of terminations which apparently begins with the cost basis of the terminated property minus accumulated depreciation. The cost basis of each class of terminations is consistent with the amounts recorded as terminations on the 1985 DEW. For example, terminations of 1983, three-year depreciable property begins with a cost basis of $1,170,120.00 from which New York State accumulated depreciation of $909,573.00 was subtracted to calculate a New York book value of $260,547.00. Under the heading Writeoffs of Terminated Assets, the 1985 DEW shows 1983 three-year depreciable property with a cost basis of $1,170,120.00 and a book value of $260,547.00 for State purposes.

Petitioner concedes that it failed to make the necessary

addition to Federal income to recapture the excess New York depreciation. Mr. Power prepared a calculation of the required adjustment based upon petitioner's claim regarding the actual value of the 1985 dispositions. The results of his calculations (modified by eliminating 1985 recovery property) are as follows:

Cost Basis of 1985 Dispositions -- $31,423,225.00
Total New York Depreciation -- $23,231,982.00
Total Federal Depreciation -- $11,969,941.00
New York Book Value -- $8,191,243.00
Federal Book Value -- $19,453,284.00
Excess New York Depreciation -- $11,262,041.00.

In a letter to Equilease, dated January 4, 1994, the conciliation conferee noted that "Equilease's Cost & Reserve for Depreciation schedule for 1985 shows total dispositions for that year to be $64,945,904.00" and noted that the auditor calculated total dispositions for 1985 of $61,095,137.00. The conferee also pointed out that the Cost & Reserve schedule showed total depreciable assets as of January 1, 1985 of $419,540,586.00, approximately $140,000,000.00 more than petitioner's calculation of depreciable assets as shown on the 1985 DEW. The conferee gave the existence of this discrepancy as one reason for discounting Equilease's claim that dispositions for 1985 were less than the amount calculated by the Division. Mr. Meno, petitioner's representative in this proceeding, responded to the conferee's letter with his own letter of January 13, 1994, but he made no mention of the Cost & Reserve Depreciation schedule in that letter.

The Division's auditor testified at hearing that total terminations of $64,945,904.00, as shown on the Cost & Reserve schedule, added support to the Division's position that the 1985

dispositions amounted to $61,095,137.

On cross-examination of the auditor, Mr. Meno suggested that total terminations as shown on the Cost & Reserve schedule included assets not relevant to calculating the recapture of excess depreciation. He suggested that the rather large discrepancy between the total inventory of all depreciable property as shown on that schedule and the total inventory of depreciable property as claimed by petitioner results from the fact that the Cost & Reserve schedule includes assets acquired in years prior to 1981 and not subject to ACRS.

The first entries on the Cost & Reserve schedule show balances, apparently carried forward from some other journal, for various items. They appear to be summaries from other accounts. Each entry refers to a "tab run" of assets as of December 31, 1985. The entries are listed by what appears to be client accounts, although the exact nature of these entries cannot be determined. There are entries for Olivetti, Apeco, Mergenthailer, JCB, Rapoca, Savin and A.M. There is also an entry for Equilease. Additions were made to these balances from accounts categorized as 1981 Additions, 1982 Additions, 1983 Additions, 1984 Additions and 1985 Additions. None of the items are separated by life of property. A comparison of terminations in the categories of Additions for the years 1981 through 1985 with the 1985 DEW (Writeoffs of Terminated Assets) yields the following results:

Year	Cost & Reserve Terminations	1985 DEW Terminations
1981	$ 5,006,407.00	$ 5,406,007.00

1982	13,705,609.00	14,158,385.00
1983	8,054,332.00	8,413,288.00
1984	4,895,343.00	4,895,343.00

After the so-called Additions, there are eight other entries for what appear to be customer accounts. These show additional depreciable property with a cost basis of over $25,000,000.00. There are no additions to or terminations of these assets. It is not possible to determine the nature of these assets, other than they were part of the total inventory of petitioner's depreciable assets on January 1, 1985.

It is not possible to determine with confidence whether the balances identified on the Cost & Reserve schedule as coming from other journals are balances from assets acquired before 1981 (when the New York addback adjustment began) as petitioner claims. No information on the schedule identifies the year that these assets were acquired or placed in service.

Petitioner placed in evidence two schedules prepared by Mr. Meno which purport to show that:

> "if the Audit Division's adjustments are sustained . . . a permanent disallowance for New York income tax purposes of approximately $20 million in basis recovery allowed on filed and examined federal returns will result" (Letter from Mr. Meno to Mr. Robert C. Farrelly, January 13, 1994).

Apparently, the calculations shown on the schedule were based on Equilease's Federal income tax returns. Those returns were not placed in evidence. The schedules show no depreciation taken on any assets after December 31, 1986. Mr. Meno did not clearly explain how he prepared the schedules. He did not say why Equilease failed to claim depreciation deductions in the later years.

Allocation of Income to New York

The Division allocated to New York the full amount of income reported on Equilease's Federal income tax returns as "other income". The amounts and categories of income are as follows:

Title	1985	1/86-5/86	5/86-12/86
Earned Inc. Cond. Sale Contracts	$20,393,690.00	$ 6,661,734.00	$5,077,765.00
Misc. Income	659,968.00	784,457.00	2,953,902.00
Discount on Sales Tax	20,096.00	5,105.00	5,306.00
Late Payment Fees	1,027,701.00	281,073.00	761,770.00
Extension Fees	492,050.00	205,000.00	287,000.00
Vendor Fees	750.00	150.00	--
Investor Note Fee Income	294,211.00	--	--
Sale of Vessels	--	--	269,002.00
Management Fees Marketing	1,277,948.00	182,209.00	146,601.00
	$24,166,414.00	$6,535,759.00	$11,085,315.00

In his letter of December 10, 1991 to BCMS, Mr. Power stated that much of the income allocated by the Division to New York is attributable to business transactions which occurred outside of New York State. He asserted that income from conditional sales contracts was received on transactions involving boats in the Gulf of Mexico. He also stated that the income originated from the activities of personnel located in New Orleans, including loan servicing, collections and repossessions and resale of the vessels. Mr. Power stated that income from the sale of vessels is attributable to the activities of petitioner's New Orleans office. He also stated:

"Management Fees relate to services performed for subsidiaries. As such this income represents income from subsidiary capital and therefore excluded from the calculation of entire net income."

At hearing, Mr. Meno contended that the Division had accepted petitioner's property and rental receipts allocation percentages which show that over 90% of petitioner's income from leasing was properly allocated outside of New York. Petitioner claims that the conditional sales contracts involved actual leases of boats and that the income from those contracts should be treated the same as income from petitioner's other leasing activities.

CONCLUSIONS OF LAW

A. With the exception of specifically enumerated circumstances, not pertinent here, the Tax Law places the burden of proof upon petitioner to show any error in the Division's assessment of tax (Tax Law § 1089[e]). Petitioner concedes that it inaccurately calculated the New York modification for recapture of the excess of New York depreciation required by Tax Law § 208(9)(b)(11). It also concedes that the methodology employed by the Division to calculate the modification is correct. Consequently, to prevail in this proceeding, it was incumbent upon petitioner to establish the amount of all recovery property disposed of in 1985. This petitioner failed to do.

Petitioner claims that the cost basis of all recovery property placed in service in the years 1981 through December 31, 1984 was $270,893,048.00. It also claims that the cost basis of property disposed of in 1985 was $31,423,225.00.

Petitioner claims that the accuracy of its calculations is established by a number of documents which consistently show 1985 terminations of approximately the amount petitioner claims. Thus, the amounts claimed as 1985 terminations can be traced to workpapers identified by petitioner as Federal income tax worksheets, the 1985 DEW, the 1985 State Depreciation worksheet and the Cost & Reserve schedule. I do not find these documents to be clear and convincing evidence of the actual cost basis of petitioner's 1985 dispositions for the following reasons.

First, unexplained discrepancies in costs still exist. On its CT-399, petitioner listed total recovery property with a cost basis of $302,316,303.00, yet its Cost & Reserve schedule shows total inventory of depreciable property as of January 1, 1985 of $419,540,586.00. Under the categories of 1981, 1982, 1983 and 1984 Additions, the Cost & Reserve schedule shows property with a cost basis of $279,679,633.00, a figure that is almost $9,000,000.00 more than the figures on the 1985 DEW, which petitioner claims to be correct. More important than the discrepancies is the fact that petitioner has not proven that the calculation of ACRS recovery property should be confined to the categories labelled as "Additions" on the Cost & Reserve schedule.

Petitioner claims that only one group of assets (identified as 1981, 1982, 1983 and 1984 Additions) are material to calculating the 1985 modification and that the other assets shown on the schedule were acquired before 1981. Petitioner has not presented any evidence to support this assertion. The

balances shown on the Cost & Reserve schedule were posted from other journals, but petitioner did not place those journals in evidence. Petitioner did not place in evidence Federal income tax returns from prior years which might have supported its contentions. No one with personal knowledge of petitioner's recordkeeping system or tax preparation procedures testified for petitioner. Mr. Meno made inferences from the documents in evidence, but he did not introduce evidence to support those inferences. In petitioner's brief, he states:

> "Petitioner's representative went on to posit during cross-examination that [the Cost & Reserve schedule] more probably covered the entire lot of Petitioner's depreciable assets, and not just the 1981-1985 acquisitions that are relevant to this case. There are other indicators on the face of [the Cost & Reserve schedule] which support this hypothesis, and, more importantly, strongly support Petitioner's assertion as to what true 1985 dispositions were from the 1981-1985 acquired assets.
>
> "[The Cost & Reserve schedule] contains several lines. Some are names of deals/leases (Savin, Olivetti, etc.) Others reference years acquired (1981 Additions etc.). Supportive of the suspicion that the lines with deals/lease names associated with them concern only assets acquired before 1980 (and are, therefore, irrelevant to this proceeding) is the fact that the groups of assets represented on these lines are universally 90% or more depreciated as of 1/1/85 (e.g., the first grouping 'Pg 103, Per 12/31/85 Tab Run' had 1/1/85 original cost of $82,145,679 and 1/1/85 accumulated federal depreciation of $74,283,076), which would be indicative of assets acquired several years before 1985 (and, therefore, before 1981)" (Petitioner's brief, pp. 7-8).

Mr. Meno's suspicions may be correct, but there is no evidence in the record to prove that they are. The Cost & Reserve schedule does not state that the assets listed as "deals/leases" were acquired before January 1, 1981. The Reserve Depreciation portion of the schedule does not state the

year any of the assets were placed in service. No one explained why some assets were listed under particular accounts and others were labelled "Additions".

Following Mr. Meno's logic does not necessarily clarify the significance of various entries on the schedule. Take the following example, the Cost & Reserve schedule indicates that the 1981 Additions were almost fully depreciated by December 31, 1981 and that after terminations the 1981 balance was zero. But the 1986 DEW shows an inventory of 1981 assets with a cost basis of $14,982,368.00. Moreover, the consistency of information entered on the various worksheets and schedules is not proof of the accuracy of that information. It would appear that Writeoffs of Terminations, as shown on the 1985 DEW and other workpapers, had as their source the terminations listed under 1981, 1982, 1983 and 1984 Additions on the Cost & Reserve schedule. If those "Additions" contained only a portion of all ACRS property terminated in 1985, the carryover from the Cost & Reserve schedule to the other workpapers merely perpetuates an error. Without proof that the various figures and categories on the Cost & Reserve schedule are what Mr. Meno claims them to be, I cannot conclude that petitioner carried its burden of proof to establish the cost basis of its 1985 terminations.

B. The Division allocated to New York the full amount of certain income reported on petitioner's Federal income tax return as other income. It is the Division's position that income included in this category is entirely from the making and servicing of loans, from interest on loans, or from services

provided by Equilease.

Petitioner claims that income in the category of "earned income from conditional sales contracts" should be allocated to New York in the same proportion as petitioner's income from other leasing activities. According to Mr. Meno, the conditional sales contracts were equipment leases providing for a lease term which substantially consumed the useful life of the equipment. However, petitioner provided no evidence at all concerning the nature of these conditional sales contracts and no proof that the contracts were true leases rather than financing transactions. Moreover, petitioner has offered no proof that any activities relating to the contracts took place outside of New York. Therefore, petitioner has not proven that the Division was wrong when it determined that these transactions were actually financing arrangements rather than actual leases.

C. The Division assessed an addition to tax pursuant to Tax Law § 1085(k), which provides for such an addition where there is a substantial understatement of tax. A substantial understatement exists for a taxable year "if the amount of the understatement for the taxable year exceeds the greater of ten percent of the tax required to be shown on the return for the taxable year or five thousand dollars" (Tax Law § 1085[k]). The addition may be waived, in whole or part, if petitioner establishes that there was reasonable cause for the understatement and that the taxpayer acted in good faith.

Petitioner has not offered any evidence that it acted in

good faith or had reasonable cause for understating the amount of its tax liability for the years in issue. There is no basis in this record for cancelling any portion of the penalty.

D. The petition of Equilease Corporation is denied, and the Notice of Deficiency dated September 16, 1991, as modified by the Conciliation Order, is sustained.

DATED: Troy, New York
September 21, 1995

/s/ Jean Corigliano

ADMINISTRATIVE LAW JUDGE