STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
ANTHONY B. LAWSON	:	
for Redetermination of a Deficiency or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law for the Years 1992 through 1994 and of New York City Nonresident Earnings Tax under the New York City Administrative Code for 1992 and 1993 and of New York City Personal Income Tax under the New York City Administrative Code for 1994.	:	DETERMINATION DTA NO. 816922

Petitioner, Anthony B. Lawson, P.O. Box 64395, Virginia Beach, Virginia 23467, filed a petition for redetermination of a deficiency or for refund of New York State personal income tax under Article 22 of the Tax Law for the years 1992 through 1994 and of New York City nonresident earnings tax under the New York City Administrative Code for 1992 and 1993 and of New York City personal income tax under the New York City Administrative Code for 1994.

A hearing was held before Frank W. Barrie, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on November 17, 1999 at 9:15 A.M., with all briefs to be submitted by April 6, 2000, which date began the six-month period for the issuance of this determination. Petitioner appeared *pro se*. The Division of Taxation appeared by Barbara G. Billet, Esq. (Peter T. Gumaer, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation properly disallowed petitioner's losses from his trading in German military antiques and memorabilia, as the North American representative of a

German auction house, on the basis that petitioner failed to substantiate his expenses claimed as deductions against his income from such trading.

II. Whether the Division of Taxation's assertion in its brief that petitioner's losses from his trading in German military antiques and memorabilia were not allowable because petitioner's business lacked a profit motive was an attempt to amend its answer to assert a new matter, which should have been made at or prior to the hearing, so that the Division of Taxation should be precluded from asserting such basis for the disallowance of petitioner's losses.

III. Whether, if the Division of Taxation may assert the position noted in Issue "II", petitioner's trading in German military antiques and memorabilia lacked a profit motive and was like a hobby, so that his losses from such activities may not offset his other income.

FINDINGS OF FACT

1. The Division of Taxation ("Division") issued a Notice of Deficiency dated March 24, 1997 against petitioner, Anthony B. Lawson. This notice asserted total tax due of $61,724.93 allocated to each of the years at issue as follows:

Year	Tax Asserted Due
1992	$14,002.30
1992	1,017.77
1993	13,705.97
1993	991.85
1994	20,598.24
1994	11,408.80
Total	$61,724.93

The Notice of Deficiency dated March 24, 1997 also asserted interest and penalty against petitioner.

2. Approximately, five months prior to its issuance of the Notice of Deficiency dated March 24, 1997, the Division issued three statements of personal income tax audit changes, each dated October 28, 1996, against petitioner for 1992, 1993, and 1994, respectively. The one for 1992, which treated petitioner as a nonresident of New York, asserted a "corrected taxable income or base" for New York State income tax of $177,807.00 and for New York City nonresident earnings tax of $183,807.00 computed as follows:

	Federal	New York State	New York City
Adjusted gross income per return	$ 88,485.00	$ 88,485.00	
Additional New York source income	95,322.00	95,322.00	
Net adjustments to income	95,322.00	95,322.00	
Corrected adjusted gross income	183,807.00	183,807.00	
Standard deduction allowed		(6,000.00)	
Corrected New York State taxable income		177,807.00	
Corrected taxable income or base		177,807.00	183,807.00
Corrected tax liability		$ 14,002.30	$ 1,017.77

The statement of personal income tax audit changes for 1992, in addition to interest calculated due on the corrected tax liability, also asserted three types of penalties against petitioner for (i) failure to file a tax return under Tax Law § 685(a)(1)(A), (ii) deficiency due to

negligence under Tax Law § 685(b), and (iii) substantial understatement of liability under Tax Law § 685(p).

The statement of personal income tax audit changes for 1993, which also treated petitioner as a nonresident of New York, asserted a "corrected taxable income or base" for New York State income tax of $174,044.00 and for New York City nonresident earnings tax of $180,044.00 computed as follows:

	Federal	New York State	New York City
Adjusted gross income per return	$ 89,219.00	$ 89,219.00	
Additional New York source income	90,825.00	90,825.00	
Net adjustments to income	90,825.00	90,825.00	
Corrected adjusted gross income	180,044.00	180,044.00	
Standard deduction allowed		6,000.00	
Corrected New York State taxable income		174,044.00	
Corrected taxable income or base		174,044.00	180,044.00
Corrected tax liability		$ 13,705.97	$ 991.85

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The statement of personal income tax audit changes for 1993, in addition to interest calculated due on the corrected tax liability, also asserted the same three types of penalties against petitioner which had been asserted against him for 1992 as noted above.

The statement of personal income tax audit changes for 1994, unlike the ones for 1992 and 1993, treated petitioner as a resident of New York State and City. It asserted a "corrected

taxable income or base" for both New York State and New York City personal income taxes of $261,565.00. Unlike the statements of personal income tax audit changes for 1992 and 1993, the statement of personal income tax audit changes for 1994 shows $267,565.00 as "N.Y. State adjusted gross income *per return* " (emphasis added). After allowing petitioner a standard deduction of $6,000.00, this statement shows a "corrected taxable income or base" for both New York State and New York City personal income tax of $261,565.00 and corrected tax liability for New York State personal income tax of $20,598.24 and for New York City personal income tax of $11,408.80.

Each of the three statements of personal income tax audit changes included the following explanation in the "remarks" section of the respective statements:

> The taxpayer failed to file his NY personal income tax returns. The taxpayer *did not submit any record* [sic] *to substantiate the deductions claimed*. We disallowed the business deductions claimed on the Schedule C. Applicable penalties are imposed. (Emphasis added.)

3. Attached to the three statements of personal income tax audit changes is a schedule labeled "Schedule of NY Source Income" prepared by the auditor, Jack Pu, and also dated October 22, 1996 which shows "total NY source income per audit" for 1992, 1993 and 1994 of $183,807.00, $180,044.00 and $267,565.00, respectively, calculated as follows:

	1992	1993	1994
Wages per W-2	$ 88,485.00	$ 89,219.00	$ 93,835.00
Gross receipts per Schedule C	95,322.00	90,825.00	173,730.00
Total NY source income per audit	$183,807.00	$180,044.00	$267,565.00

In addition, this schedule included a listing of the following business deductions taken by petitioner on his respective Schedules C for each of the years at issue:

	1992	1993	1994
Advertising	$ 2,698.00	$ 3,154.00	$ 8,715.00
Car/truck expense	2,317.00	3,278.00	3,876.00
Depreciation	34,028.00	34,028.00	46,667.00
Insurance	1,814.00	1,637.00	1,794.00
Other interest	19,693.00	21,957.00	23,756.00
Legal/professional	478.00	341.00	1,305.00
Office expense	5,777.00	7,233.00	9,389.00
Rent or lease	11,255.00	11,255.00	11,255.00
Supplies	985.00	1,173.00	2,243.00
Taxes	67.00	88.00	124.00
Travel	4,643.00	6,418.00	9,277.00
Meal & entertainment after allowance	2,796.00	3,338.00	2,990.00
Utilities	2,858.00	2,764.00	2,849.00
Losses from prior years[1]	50,704.00	51,314.00	0
Total expenses	$140,113.00	$ 147,978.00	$ 124,240.00

This schedule also included the following closing comment:

> The above business deductions for 1992, 1993, and 1994 were disallowed because the taxpayer *didn't submit the records to support the filing*. (Emphasis added.)

4. During the years at issue, petitioner was employed as an assistant controller by a municipal labor union's benefits fund in New York City. Petitioner's wage income from this employment by the District Council (DC) 37 Benefits Fund was $88,485.00 in 1992, $89,219.00 in 1993, and $93,835.00 in 1994. On his employee's withholding allowance certificates for

[1] The auditor's schedule listed a loss from 1991 of $50,704.00 and a loss from 1992 of $51,314.00 claimed by petitioner in 1992 and 1993, respectively. However, the auditor did not include a loss from 1993 of $67,191.00 claimed by petitioner in 1994, as noted in Finding of Fact "14", on his schedule detailed above.

1992, 1993 and 1994, petitioner claimed 48, 99 and 99 withholding allowances, respectively. As a result, no income tax was withheld from his wages from the DC 37 Benefits Fund.

5. Petitioner sheltered his wage income during the years at issue from income taxation on the Federal, state and city levels by losses he generated from his involvement in the trading of German military antiques and memorabilia as the North American representative of Hanseatisches Auktionshaus für Historica, a German auction house located near the city of Hamburg in Bad Oldsloe, Germany.

6. Petitioner provided a detailed written history of his involvement in the trading of German military antiques and memorabilia, which had been prepared for purposes of a proceeding in the United States Tax Court. While a cadet at the United States Military Academy at West Point, he organized a committee of cadets to assist the curators of the West Point Museum in maintaining their vast collections. Subsequently, while stationed in Germany on assignment to the Third Armored Division in the 1960s, he served as a liaison officer to two German divisions. The Third Armored Division's Chief of Staff, Colonel Franklin M. Davis, decided to establish a Division Museum to honor the history of the Third Armored Division, which in petitioner's words, "smash[ed] the German Wehrmacht in Central Europe in WWII." As a German speaker and liaison to German military divisions, many of whom were World War II veterans, petitioner accumulated historic materials from World War II for the museum to a degree, which in petitioner's words, were "far more than the new museum could accommodate or wanted." Petitioner ended up keeping for his own account, much of the German World War II materials he had accumulated which he eventually placed in storage in an uncle's basement in the United States. In the 1980s, petitioner started a business called The Militaria Guild after he became aware that there were collectors, in his words, "avidly looking for the items I had

brought back from Germany, and that the marketplace was quite active," and his uncle wanted him to do something with the materials stored in his basement. Because he was selling inventory in which he had virtually no cost, petitioner described his business at that early stage as small but profitable and focused upon selling to other dealers. In addition, given his knowledge of history and German, petitioner also offered services involving authenticity and certifying the historical context and background of items. By the late 1980s and early 1990s, petitioner had exhausted his initial inventory. He determined that he would raise his profile in this particular marketplace by developing "an extensive knowledge, both in breadth and depth, as to what was authentic and what was not" given the unscrupulous dealers who were selling fakes and reproductions. In addition, he decided to develop a promotional collection by acquiring "some very rare and exotic pieces to use as promotional pieces in show displays and advertisements, as well as serve as part of the '3-Dimensional' library." By having these pieces on display, he obtained publicity in various newspapers and trade papers. Petitioner also used these pieces for purposes of developing his ability to detect inauthentic pieces by comparison to these authentic materials. His expertise and self-promotion succeeded when, in October of 1991, the Hanseatisches Auktionshaus Für Historica, the largest auction house in Europe for such materials, approached petitioner and asked him to promote its business in North America, as its North American representative.

7. In December of 1991, petitioner entered into a formal contract with Dr. Wilfried Beer, the principal of Dr. Beer & Partner OHG, a German entity, which apparently operated the Hanseatisches Auktionshaus Fûr Historica. Pursuant to this agreement, petitioner became the exclusive representative and agent of the auction house in North America and agreed to pay "[a]ll costs associated with the representation and agency in North America." The agreement

specified petitioner's responsibility for "all costs of office operations, promotions and advertising." In exchange, the auction house agreed to pay to petitioner [2]:

> a commission equal to 33% of the amount received by the Auktionshaus as the sales commission paid by the consignors whose legal residence is in North America, irrespective of how or where the consigned goods are delivered to the Auktionshaus.

In addition, the auction house agreed to pay petitioner:

> a commission to [sic] 33% of the amount received by the Auktionshaus as the buyers commission paid by buyers or successful bidders whose legal residence is in North America, irrespective of how or where the purchase was made or the successful bid was delivered to the Auktionshaus.

8. Petitioner reported "gross receipts or sales" on his Schedules C for 1992, 1993 and 1994 of $95,322.00, $90,825.00, and $173,730.00, respectively. These sales apparently represented his commissions from the German auction house as well as receipts from his sales of auction catalogs, which were priced at $30 per single catalog or $160.00 for a subscription to the approximately eight yearly catalogs, and from his own personal trading. However, he reported losses from his German military antiques business of ($139,918.00), ($156,410.00) and ($117,908.00) for 1992, 1993, and 1994, respectively, on the Schedules C, and such losses were used by petitioner to offset his wage income as noted in Finding of Fact "5". Petitioner explained that the extent of his losses were unexpected since he had been incorrectly led to believe that the German auction house, Hanseatisches Auktionshaus Für Historica, had approximately 500 active clients in North America. In fact, he was provided with only 50 names for the first auction he participated in as the representative of the auction house, and of these 50, only 5 to 10 were active bidders. Petitioner over the years has increased the number of active

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[2] The agreement noted that payment would be made to Anthony B. Lawson Inc. It appears that payments, in fact, were made to petitioner as an individual since there is no evidence that petitioner operated his German military antiques business as a corporate entity.

clients from the initial 5 to 10 to approximately 500, and has developed a customer list of approximately 1,000 names, as detailed in his customer lists dated February 10, 1997 [3] which petitioner introduced into the record.

9. During the years at issue, petitioner conducted his self-employment business out of the New York City office where he performed his duties for DC 37, the municipal union. In addition, he used the premises at 100 Minnehaha Blvd. in Oakland, New Jersey, which as noted in Finding of Fact "11" was the address shown on petitioner's wage and tax statements, and which also appears to be his place of residence during the years at issue. Further, petitioner had a sales tax certificate of authority issued by the State of New Jersey which showed this address in Oakland, New Jersey as his place of business. John Casino, one of petitioner's active customers, confirmed during his testimony that auction catalogs and invoices were sent by petitioner from New Jersey and that business was transacted through New Jersey. Mr. Casino would transmit his bids and payments to the New Jersey address. However, the goods which Mr. Casino purchased through petitioner were sent from Germany directly to him, as the successful bidder.

10. The record is unclear concerning the specific way auctions were conducted by Hanseatisches Auktionshaus Für Historica, the German auction house which petitioner represented in North America. The copy of the catalog for "Auktion 19, August 1994," which was representative of the approximately eight auctions conducted each year, provides specific prices for each item noted. This catalog is a sizeable paperback book printed on high quality paper consisting of several hundred pages with 3,257 items listed. Each item is described in three or four lines and a specific price is noted. It is not known whether the price specified is a

[3] Since 1995, petitioner has conducted his business separate from the German auction house.

minimum price or the actual price at which the item would be sold. The most valuable item that petitioner was involved in auctioning off was a pilot's observer badge with diamonds that was awarded by Herman Goering to Obert Herman Graff, who petitioner described as "the highest scoring Ace" (tr., p. 43). This particular medal was sold for $30,000.00.

Petitioner's New York Income Tax Returns

11. The parties disagree as to whether or not petitioner timely filed New York tax returns for each of the years at issue. The only copies of petitioner's New York income tax returns in the record were introduced by the Division as part of its audit file, and these returns raise many unaddressed and, consequently, unanswered questions. In particular, for each of the years, there is a resident income tax return as well as a nonresident income tax return, with no explanation why mutually contradictory returns were apparently filed by petitioner. Further, all of the returns appear to have been signed by petitioner on the same date, i.e., June 18, 1996.[4] All of the tax returns show a mailing address for petitioner in New York City of 28 Vesey Street, Apartment 111, and on each of his three City of New York nonresident earnings tax returns, petitioner also used this same New York City address for his German military antiques and memorabilia "business address." However, to the contrary, petitioner's wage and tax statements (W-2s) for each of the years at issue issued by the District Counsel 37 Benefits Fund, his New York City employer, show petitioner's address as 100 Minnehaha Blvd. in Oakland, New Jersey.

12. On his 1992 resident income tax return, petitioner reported wages of $88,485.00 and a loss of ($89,214.00) as per an attached Federal Schedule C. However, the Schedule C actually

[4] However, some of the copies were made so that the year is not shown.

attached shows a greater loss of ($139,918.00).[5] In addition, petitioner claimed a loss from 1991 of ($50,704.00) on his 1992 return resulting in New York adjusted gross income of a negative $51,433.00 ($89,214.00 less $89,214.00 less $50,704.00 equals a negative $51,433.00). After taking a standard deduction of $7,000.00, petitioner reported New York taxable income of a negative $58,433.00. For 1992, the record also includes a nonresident income tax return on which petitioner also reported New York adjusted gross income of a negative $51,433.00 and New York taxable income of a negative $58,433.00. The only difference between his nonresident return and resident return, in terms of New York tax reported due, is that on the nonresident return, petitioner reported New York City nonresident earnings tax due in the amount of $398.00, calculated by applying the tax rate of .45% against wages of $88,485.00.

13. On his 1993 resident income tax return, petitioner reported wages of $89,219.00 and a loss of ($105,096.00) as per an attached Federal Schedule C. However, the Schedule C actually attached shows a greater loss of ($156,410.00).[6] In addition, petitioner claimed a carryover loss from 1992 of ($51,314.00) on his 1993 return resulting in New York adjusted gross income of a negative $67,191.00 ($89,219.00 less $105,096.00 less $51,314.00 equals a negative $67,191.00). After taking a standard deduction of $7,000.00, petitioner reported New York taxable income of a negative $74,191.00. For 1993, the record also includes a nonresident income tax return on which petitioner reported New York adjusted gross income of a negative $67,191.00 and New York taxable income of a negative $74,191.00. The only difference between his nonresident return and resident return, in terms of New York tax reported due, is

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[5] The Schedule C loss reported on the New York income tax returns for 1992 of $89,214.00 plus the carryover loss from 1991 of $50,704.00 equals this greater loss of $139,918.00 shown on the Federal Schedule C actually attached.

[6] The Schedule C loss reported on the New York income tax returns for 1993 of $105,096.00 plus the carryover loss from 1992 of $51,314.00 equals this greater loss of $156,410.00

that on the nonresident return, petitioner reported New York City nonresident earnings tax due in the amount of $401.00, calculated by applying the tax rate of .45% against wages of $89,219.00.

14. On his 1994 resident income tax return, petitioner reported wages of $93,835.00 and a loss of ($117,908.00) as per an attached Federal Schedule C. In this instance, the Schedule C actually attached shows the same amount of loss as claimed on the return of $117,908.00. Petitioner also claimed a carryover loss from 1993 of ($67,191.00) on his 1994 return resulting in New York adjusted gross income of a negative $91,264.00 ($93,835.00 less $117,908.00 less $67,191 equals a negative $91,264.00). After taking a standard deduction of $6,000.00, petitioner reported New York taxable income of a negative $97,264.00. For 1994, the record also includes a nonresident income tax return on which petitioner reported New York adjusted gross income of a negative $91,264.00 and New York taxable income of a negative $97,264.00. The only difference between his nonresident return and resident return, in terms of New York tax reported due, is that on the nonresident return, petitioner reported New York City nonresident earnings tax due in the amount of $422.00, calculated by applying the tax rate of .45% against wages of $93,835.00.

The Audit

15. The Division did not present the testimony of its auditor to explain its audit of petitioner. A review of the audit file discloses that the auditor focused upon petitioner's claiming losses from his self-employment business when he did not conduct it in New York. The auditor's narrative included the following:

> The taxpayer rented a mail box at a mail service company in NYC. The taxpayer had no physical office space in NYC. He claimed business expenses such as office expense, insurance, rents, tax, etc. We asked the taxpayer to submit the record to support his returns. *The taxpayer didn't submit any records at all*. (Emphasis added.)

An entry in the auditor's log for March 4, 1997 noted that petitioner "wrongfully applied the business deductions reported on the Schedule C preforming [sic] in NJ to offset the wages earned in NYC." As noted in Finding of Fact "11", on his New York tax returns, petitioner used an address in New York City of 28 Vesey Street, Apartment 111 as his mailing address as well as his "business address." The auditor's log contains entries concerning the auditor's visit, along with his team leader, to this Vesey Street address, in relevant part, as follows:

> 10/17/96: [Team leader asks the auditor] "to arrange a tour visit at T/P's [taxpayer's] premises 28 Vesey Street. . . . [S]ets a meeting at 2PM, 28 Vesey Street. Advise T/P that we may go to his premises for examination instead[7] that he duplicates all the records to sent in.
>
> 10/21/96: Went to meet T/P along with T/L [team leader]. Meet T/P at 28 Vesey Street where is a private mail box service and packing store. T/P rent a mail box there. T/P's only connection with this address is his mail box. . . . We find that T/P didn't conduct the self-employment business in NYC except the employment of District Council 37. T/P claimed the net operation loss on NY tax returns for 92, 93 and 94 due to the business deductions on the Schedule C. T/P should not attach the Schedule C on the NY IT-203 because he didn't retain physical equipments in NYC. We consider to disallow all of the business deductions on the Schedule C. T/P only allow to report his earned wages on the NY tax returns.

Procedural Permutations

16. At the very start of the hearing, the Division, noting that the dispute in this matter was whether petitioner could substantiate his business expenses and realizing that petitioner had brought to the hearing four cartons containing hundreds of documents, requested a continuation

[7] It is difficult to decipher the meaning of the latter part of this sentence. Petitioner complained during the course of his testimony that the English language ability of the auditor was minimal. The auditor's entries quoted in this determination include errors in the agreement of subject and verb as well as in syntax and verb tense. However, such errors have not been marked with notations of "sic."

of the hearing in order to arrange for its auditor, who was not at the hearing, to review petitioner's documents:

> Attorney Gumaer: I could only ask that . . . I be allowed to take from this hearing his substantiation back to audit and leave the record open, so he [the auditor] would have an opportunity to review these and respond. Because to do so today, I don't think would be possible.
>
> Administrative Law Judge: Why isn't the auditor here today?
>
> Attorney Gumaer: I thought it would work best for the Division of Taxation to sit down with the substantiation after the hearing and review it instead of trying to conduct the audit in the hearing room.
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> Petitioner: I would object to that. The State's had a lot of time to go through this stuff. In counsel's presentation are my letters pleading for a professional audit.
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> * * *
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> Administrative Law Judge: You [Mr. Gumaer] are making a request for a continuation of the hearing?
>
> Attorney Gumaer: I would like to, if necessary, be able to submit a response after the hearing. After the auditor has had a chance to submit [sic] documentation that hadn't been seen at this point.
>
> Administrative Law Judge: We'll hold off on that. When we're ready to close the record, I'll permit you to raise it again. I won't address it now. (Tr., pp. 24-26.)

In the course of his brief cross-examination, the Division's representative noted that he would

> be moving either now or later for some type of relief so we have an opportunity to have the Audit Department do a thorough investigation of what he's bringing into the courtroom today for the very first time. (Tr., p. 116.)

Challenging the assertion that he was providing the Division with the opportunity to review his documentation for the first time, petitioner objected to the Division's attempt to conduct another audit. In response, the administrative law judge noted that he was not going to continue the case in order to permit an audit now to be conducted by the auditor.

SUMMARY OF THE PARTIES' POSITIONS

17. The Division did not present the testimony of its auditor to explain its audit of petitioner. Rather, the audit file consisting of 189 pages was placed into the record in bulk, without explanation or elaboration by anyone with knowledge of its contents. Unfortunately, without such testimony, various entries in the audit file were not explained. The narrative section of the auditor's report included the following information concerning petitioner's New York tax returns for the years at issue:

> The taxpayer claimed to have filed NYS personal income tax returns through our central office in Albany. The taxpayer didn't file NY personal income tax returns to report the wages earned in NYC for the audit period. We examined copies of 1992, 1993 and 1994 tax returns submitted to our office.

Petitioner, in contrast, vigorously asserted in the course of his testimony that he, in fact, filed New York personal income tax returns:

> [A]t the end of their [audit] report they show gross receipts from Schedule C, and the only place you get gross receipts from Schedule C is from a return. So if it wasn't filed, how could they get it off the return?
>
> * * *
>
> They admitted they got it from the Schedule C, but they want to fine me for not filing an income tax return. (Tr., p. 61.)

18. Petitioner brought to the hearing in this matter four large cartons containing hundreds of source documents in support of his business expenses claimed on the respective Schedule C's for each of the years at issue. In addition, he introduced into the record documents which summarized the expenses claimed and testified that he had the relevant source documents in the four large cartons to support the particular expenses shown on his summary documents. During his direct testimony, the administrative law judge randomly selected an expense shown on a summary document and asked the petitioner to retrieve the source document to support the amount claimed. Petitioner quickly demonstrated his ability

to do so. On cross-examination, another expense was randomly selected for testing and petitioner again was able to retrieve the applicable source document. Other than this additional test, the cross-examination of petitioner was extremely minimal with no questions posed concerning *the nature* of any of the business expenses claimed. Neither was petitioner questioned concerning *any aspects* of his self-employment business. Furthermore, the Internal Revenue Service accepted petitioner's documentation of his Schedule C business expenses as claimed.

19. In his petition, Mr. Lawson asserted that the Division's failure to allow his business expenses against his Schedule C income for each of the years at issue was in error in light of his contention that "[t]he documentation available to prove [the expenses claimed] is overwhelming and will be presented." The Division's answer merely denied petitioner's allegations and asserted that petitioner had the burden of proof. At the hearing as well as in their prehearing memorandums, both petitioner and the Division defined the issue to be resolved as whether petitioner's business expenses from his trading in German military antiques and memorabilia had been substantiated. At the close of the hearing, the Division's representative reiterated that "I think the issue in the case is unsubstantiated business expenses" (tr., p. 142). It was not until the filing of its letter brief that the Division, for the first time, asserted that petitioner's losses from his trading in German military antiques and memorabilia should be disallowed on the basis that his self-employment business was a hobby and lacked a profit motive.

20. The Division argues in its brief that petitioner failed to establish that his self-employment business was, in fact, "a business rather than a hobby or amusement diversion" (Division's letter brief, p. 2). The Division, in its brief, also makes the following points

concerning petitioner's records: (i) No records were submitted to support the 1991 loss claimed on the 1992 Schedule C; (ii) A schedule was not submitted showing amounts claimed for depreciation and petitioner did not provide records so as to permit a determination concerning whether items were for resale and therefore not depreciable; (iii) Petitioner did not demonstrate how cost of goods sold was arrived at; (iv) Proof of payment is insufficient to establish the deductibility of travel expenses and meals and entertainment expenses; and (v) Some expenses are listed in German currency.

21. Petitioner in his letter brief [8] counters that the Division never reviewed his documentation and never provided a reasonable opportunity for his submission of records. In short, petitioner maintains that the Division failed to conduct a bona fide audit. Petitioner also emphasizes that the Internal Revenue Service accepted his tax returns as filed.

CONCLUSIONS OF LAW

A. It is well established that a presumption of correctness attaches to a properly issued statutory notice, and that the burden is then on the taxpayer to demonstrate that the basis for assessment was unreasonable or that the amount of tax assessed was incorrect (***see, Matter of Land Transport Corporation***, Tax Appeals Tribunal, June 29, 2000). However, a taxpayer must be provided with information sufficient for the preparation of his case (***see, Tavolacci v. State Tax Commn.***, 77 AD2d 759, 431 NYS2d 174; ***Matter of Schneier***, Tax Appeals Tribunal, November 9, 1989; ***Matter of Matson***, Tax Appeals Tribunal, March 10, 1988).

[8] Petitioner's letter brief included many assertions of fact which were not established by the introduction of evidence at the hearing. In addition, he appended two attachments to his letter brief which are in the nature of additional evidence. In light of the fact that the record was closed to the introduction of any additional evidence, no weight was given to these attachments.

B. As noted in Finding of Fact "15", the audit of petitioner focused upon petitioner's sheltering of his New York City-based wage income from New York State and City income tax by losses claimed from the operation of a self-employment business operated in New Jersey. Petitioner used a New York City private mail box service as his self-employment business address as well as his mailing address on his New York income tax returns. Since the evidence suggested, to the contrary, that he was a resident of New Jersey and conducted his self-employment business in New Jersey, the auditor wrote in his log that the taxpayer was "only allow[ed] to report his earned wages on the NY tax returns." This basis for the deficiency against petitioner was without merit and ignored the methodology specified by statute for computing the tax due on the taxable income of a nonresident which is derived from sources in New York (***see,*** Tax Law § 601[e]). Although petitioner had salary income in New York, his losses from his self-employment business, even if properly treated as New Jersey or out-of-state losses, were sufficiently large so that the New York tax base would be zero (***see***, Tax Law § 601[e][3]). As a result, none of his New York wage income would be subject to New York income tax if the out-of-state losses are valid. Consequently, the confusion caused by petitioner by his filing conflicting resident and nonresident income tax returns, as noted in Finding of Fact "11", and the suspicions raised by his lack of forthrightness in utilizing a New York City private mail box service as a business and personal mailing address resulted in the auditor's focusing on a red herring, which, in turn, led to very confused and confusing audit.

C. The Division justified the issuance of the Notice of Deficiency dated March 24, 1997 against petitioner on the grounds as specified in each of the three statements of personal income tax audit changes, as detailed in Findings of Fact "2" and "3", i.e., "[t]he taxpayer did not submit any record[s] to *substantiate* the deductions claimed" on the Schedules C for his

self-employment business (emphasis added). In addition, as emphasized in Findings of Fact "2", "3" and "15", the lack of records was noted by the auditor as justifying the disallowance of petitioner's expenses in his self-employment business. As noted in Finding of Fact "16", the Division at the hearing in this matter maintained that the issue was whether petitioner could substantiate his business expenses. It is fair to interpret the Division's use of the term "substantiate" as meaning whether petitioner had the source documents to support the claimed business expenses given the explanation provided in the statements of personal income tax audit changes and the auditor's notes emphasized above. The dictionary definition of "substantiate," i.e., "to establish by proof or competent evidence" (Webster's Ninth New Collegiate Dictionary 1176 [1983]), lends support to this interpretation. Furthermore, the Division's representative, in response to seeing the four cartons of records brought by petitioner to the hearing, requested a continuation of the hearing in order to permit the auditor, who was not present, to conduct a review of the documents. Moreover, at no time did the Division's representative suggest any other grounds for the deficiency against petitioner other than the lack of substantiation of expenses. No mention was made of the hobby-loss argument, which was not raised until asserted by the Division in its brief. Neither were the five specific points, noted in its brief, raised at the hearing. These five points go well beyond the issue as stated at the hearing and in the prehearing memorandums, that the issue was one of substantiation or documentation.

D. As noted, petitioner successfully satisfied the two random tests of his records performed at the hearing. He was able to produce the original source documents for the expenses tested. Further, not a single question was posed by the Division on its cross-examination of petitioner that questioned the nature of any of the expenses claimed or any

aspects of the self-employment business. No questions were posed at all concerning any of the five points raised in the Division's brief filed after the hearing. Rather, the Division's position at the hearing was merely that petitioner had failed to substantiate by the production of records the expenses claimed for his self-employment business.

E. In sum, since petitioner produced the source documents for his claimed expenses at the hearing and he successfully passed the two random tests of these records conducted at the hearing, together with the fact that the Internal Revenue Service has accepted his Schedule C business expenses as claimed, it is concluded that he has met his burden of proving the unreasonableness of the Notice of Deficiency issued against him. The late attempt in its brief to expand the basis for its assessment against petitioner cannot be countenanced (***cf., Matter of SSOV '81 Ltd.***, Tax Appeals Tribunal, January 19, 1995 [wherein the Tribunal noted that additional issues may not be raised on exception which bring up factual issues which were not addressed at the hearing stage]).

F. The petition of Anthony B. Lawson is granted, and the Notice of Deficiency dated March 24, 1997 is canceled.

DATED: Troy, New York
August 31, 2000

/s/ Frank W. Barrie
ADMINISTRATIVE LAW JUDGE