STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
DREW AND LORI CASS	:	DETERMINATION DTA NO. 818802
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Years 1995, 1996 and 1997.	:	

Petitioners, Drew and Lori Cass, 12 Lily Drive, Centereach, New York 11720, 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 1995, 1996 and 1997.

A hearing was commenced before Thomas C. Sacca, Administrative Law Judge, at the offices of the Division of Tax Appeals, 250 Veterans Memorial Highway, Hauppauge, New York, on October 18, 2002 at 11:15 A.M., and continued to conclusion at the same location on December 11, 2002, with all briefs to be submitted by February 7, 2003, which date began the six-month period for the issuance of this determination. Petitioners appeared by Thomas Mulryan, CPA. The Division of Taxation appeared by Barbara G. Billet, Esq. (Jennifer L. Hink, Esq., of counsel).

ISSUE

Whether petitioners have substantiated certain claimed business deductions and the reduction of additional rental income for the years 1995, 1996 and 1997.

FINDINGS OF FACT

1. On June 15, 1998, the Division of Taxation ("Division") sent to petitioners, Drew and Lori Cass, an appointment letter advising that an audit of their records for the years 1995, 1996 and 1997 was to be performed and requested that they provide to the auditors the following records: copies of Federal and New York State income tax returns; all books, records, worksheet schedules and other documents pertinent to the preparation of their tax returns, including a general ledger, disbursements journal, payroll ledger, and a sales receipts journal; bank records including business and personal savings and checking account statements and canceled checks for the period of the audit; all credit card statements covering the audit period; and documentation supporting business and itemized deductions claimed.

2. At the initial meeting with the auditor, petitioners presented bank statements for the year 1995, documents which supported claimed telephone expenses, some of the claimed supply expenses and some of the other claimed miscellaneous expenses. The auditor was at first concerned with the year 1997, where petitioners reported approximately $500,000.00 in sales and cost of goods sold in the amount of $290,000.00. The auditor wanted to review petitioners' actual expense documents and actual income supporting statements, but was never supplied with either. Petitioners' accountant at the time informed the auditor that petitioners did not keep any formal accounting books.

3. During the course of the audit, petitioners executed three consents extending period of limitation for assessment of personal income tax under Article 22 of the Tax Law, effectively extending the period of assessment for the years 1995 and 1996 to April 15, 2001.

4. On March 13, 2000, the Division issued to petitioners a Notice of Deficiency of personal income tax due in the amount of $46,092.07, plus penalties pursuant to Tax Law § 685(b) (negligence) and Tax Law § 685(p) (substantial understatement of liability) and interest.

5. During the hearing which commenced on October 18, 2002, petitioners presented additional receipts and documentation which had not previously been provided to the auditor during the audit. At the conclusion of the first day of the hearing, the matter was continued to December 11, 2002 and petitioners were provided with additional time by the administrative law judge, prior to the continued date of the hearing, to submit receipts and substantiation documentation to the Division in an auditable form.

The Division's auditor reviewed the additional documentation provided by petitioners at the first day of hearing and recomputed the amount of tax due. Based upon the additional documentation which petitioners provided, the auditor allowed additional Schedule C expenses. There remains at issue subcontractor expenses and advertising expenses claimed as business deductions by petitioners for three separate business entities which each reported income on a Federal Schedule C during the audit period and Freon storage expenses claimed by petitioners as a business deduction on the Schedule C for the business Wholesale Sales for the year 1997. In addition, the Division increased petitioners' rental income from property located in the Town of Bay Shore, claiming that the amount of income indicated by petitioners was too low.

6. The amounts at issue, and the business they relate to, for each of the categories mentioned above, are as follows:

Year	Expense	Business	Amount Disallowed
1995	Subcontractor	Active Contracting	$10,400.00
1995	Subcontractor	Active Appliance Repairs	$9,515.00
1995	Advertising	Active Appliance Repairs	$8,950.00
1995	Subcontractor	Active Appliance Sales	$17,515.00
1995	Advertising	Active Appliance Sales	$15,625.00
1996	Subcontractor	Active Contracting	$15,400.00
1996	Subcontractor	Active Appliance Repairs	$15,691.00
1996	Advertising	Active Appliance Repairs	$10,400.00
1996	Subcontractor	Active Appliance Sales	$19,500.00
1996	Advertising	Active Appliance Sales	$16,120.00
1997	Subcontractor	Active Contracting	$16,950.00
1997	Subcontractor	Active Appliance Repairs	$20,122.00
1997	Advertising	Active Appliance Repairs	$31,050.00
1997	Subcontractor	Active Appliance Sales	$10,400.00
1997	Advertising	Active Appliance Sales	$31,050.00
1997	Freon Storage	Wholesale Sales	$20,250.00

In addition, the Division increased petitioners's income relating to the Bay Shore rental property by $10,000.00 for each of the years at issue.

SUMMARY OF THE PARTIES' POSITIONS

7. Petitioners claim that they have submitted sufficient documentation to substantiate the expenses claimed and disallowed by the Division. In an effort to substantiate the subcontracting expenses, petitioners submitted copies of total yearly receipts statements obtained from and signed by the subcontractors for the purpose of this hearing and copies of the subcontractors' tax returns. The signed statements were not notarized. A review of the tax returns revealed that the only income reported on the returns were the amounts claimed to have been paid by petitioners, in amounts between $3,400.00 and $10,400.00. According to petitioners, all payments were made in cash.

To establish the payment of the advertising expenses, petitioners submitted a copy of the front of a check in the amount of $41,937.00 claimed to have been paid to Verizon in December 1997 for Yellow Pages advertising. The check is generally unreadable except for the amount of the check and the memo section which states "1998-1999." Petitioners also introduced a copy of a letter from the Account Manager of Verizon Information Services which states that the records of Verizon indicate receipt of check number 2390, drawn on bank account number 8876220702390 with the Chase Bank in the amount of $41,397.00[1] and dated December 18, 1997. The letter further states that the check represents payment in the entirety for the NYNEX Suffolk County Yellow Pages series of publications for the year 1998. Petitioners state that the amounts claimed on the returns for advertising may also include other expenses, such as utility expenses.

[1] No explanation was provided as to the difference between the amount shown on the check and the amount in the Verizon letter.

For the Freon charges totaling $20,250.00, petitioners submitted signed, unnotarized statements from the residential owner of the garage where it is claimed that the Freon was stored during the years at issue. Five statements were provided: one covering the second six months of 1993, three each covering a year period from 1994 through 1996 and the final statement covering the first three months of 1997. The three statements which relate to the years at issue total $12,150.00, and the $20,250.00 figure is reached only by adding to the total for years at issue the amounts shown on the statements for the years 1993 and 1994. Again, petitioners claim that all payments were made in cash.

No documentation was submitted by petitioners with regard to the increase in the income earned by the rental property, although petitioners did offer testimony that the property was located in an economically depressed area, that the amount of rental income claimed by the Division to have been earned by petitioners through their ownership of this property was unrealistic and that petitioners would often offer the property for rent below the market rate in order to have a tenant there to watch over the property to avoid it from being continuously vandalized. Petitioners stated that the tenant in the Bay Shore property did not have a lease, but was a month-to-month tenant.

8. The Division has taken the position that petitioners have failed to substantiate entitlement to the remaining expenses at issue, as well as to a reduction in the amount of rental income earned, as determined by the Division. As to the subcontracting expenses, the Division states that the statements provided are summary in nature, that the business should have receipts showing daily or weekly payments and that there is no source documentation which establishes that these payments were actually made. The Division argues that the check and letter submitted to establish the advertising expenses are insufficient to establish entitlement as the memo on the

check states it is for the years 1998 and 1999, that the amount on the check matches neither the amounts claimed on the returns nor the amount of $30,000.00 now claimed by petitioners to be advertising expenses paid in the years at issue. As for the Freon storage expense, the Division again states that the statements provided by the owner of the garage where it is alleged that the Freon was stored are summary in nature, generally representing one-year periods and that no checks or other source documentation were provided establishing that the payments were made. The Division claims that the amount of rental income should not be reduced as no lease or other documentation was provided to support the amount of the claimed rental income.

CONCLUSIONS OF LAW

A. A properly issued Notice of Deficiency is presumed to be correct and the taxpayer has the burden of demonstrating the incorrectness of such an assessment (***Matter of Leogrande v. Tax Appeals Tribunal*** , 187 AD2d 768, 589 NYS2d 383, ***lv denied*** 81 NY2d 704, 595 NYS2d 398; ***Matter of Kourakos v. Tully*** , 92 AD2d 1051, 461 NYS2d 540, ***appeal dismissed*** 59 NY2d 967, 466 NYS2d 1030, ***lv denied*** 60 NY2d 556, 468 NYS2d 1026, ***cert denied*** 464 US 1070, 79 L Ed 2d 215; ***Matter of Tavolacci v. State Tax Commn***., 77 AD2d 759, 431 NYS2d 174). Tax Law § 689(e) provides that in any matter brought before the Division of Tax Appeals under Article 22 of the Tax Law, the burden of proof is upon the petitioner. Accordingly, it is necessary to ascertain whether petitioners have sustained their burden of proof in showing that they are entitled to additional Schedule C expense deductions over and above those already allowed by the Division, and a reduction in the Schedule E rental income from the amount determined by the Division.

Each item in question for the years at issue shall hereinafter be considered separately.

B. SUBCONTRACTORS - Petitioners did not prove entitlement to the claimed subcontractor expenses. The signed statements, which were not notarized, were not contemporaneous with the payment of the claimed expenses. All of the tax returns indicate that the only income earned by the subcontractors was that paid by petitioners. No receipts showing daily or weekly payments were provided, and there is no source documentation which establishes that these payments were actually made.

C. ADVERTISING - Petitioners have not proved entitlement to the claimed advertising expenses. The copy of the check is unreadable for the most part and therefore cannot be used to substantiate the information contained in the Verizon letter. The amount on the check, which is one of the few items that can be read, matches neither the amount of advertising expenses claimed by petitioners on their tax returns nor the amount claimed by petitioners at the hearing. Finally, it is noted that petitioners stated at the hearing that the amounts claimed on the tax returns may also include other expenses.

D. FREON STORAGE - Petitioners have not established entitlement to the claimed expenses for the Freon storage. The statements obtained from the owner of the garage where it is alleged that the Freon was stored are summary in nature and unnotarized. Only by adding the amounts claimed to have been paid in years not at issue can the total amount claimed be reconciled. No checks or other source documentation was provided which prove that the payments were actually made.

E. RENTAL INCOME - Petitioners are entitled to the reduction in rental income of $10,000.00 for each of the years at issue. No explanation was provided by the Division to explain how or why the increase of $10,000.00 was determined. In addition, petitioners presented credible testimony to support their contention that the increase was unreasonable in

light of the location of the Bay Shore property and their need to often rent to a watchful tenant at a low rate to insure that the property was not vandalized.

F. The petition of Drew and Lori Cass is granted to the extent indicated in Finding of Fact "5" and Conclusion of Law "E"; the Division of Taxation is hereby directed to modify the Notice of Deficiency issued to petitioners on March 13, 2000 accordingly; and, except as so granted, the petition is all other respects denied.

DATED: Troy, New York
July 24, 2003

/s/ Thomas C. Sacca
ADMINISTRATIVE LAW JUDGE