STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
MARTIN LASSOFF	:	DETERMINATION DTA NO. 819919
for Redetermination of a Deficiency or for Refund of New York State and New York City Personal Income Tax under Article 22 of the Tax Law and the New York City Administrative Code for the Years 1998 through 2000.	:	

Petitioner, Martin Lassoff, 429 East 52nd Street, Apt. 36C, New York, New York 10022-5478, filed a petition for redetermination of a deficiency or for refund of New York State and New York City personal income tax under Article 22 of the Tax Law and the New York City Administrative Code for the years 1998 through 2000.

A hearing was held before Frank W. Barrie, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on May 16, 2006 at 10:30 A.M., with all briefs to be submitted by December 1, 2006, which date began the six-month period for the issuance of this determination. Petitioner appeared by David J. Silverman, EA. The Division of Taxation appeared by Daniel Smirlock, Esq. (Robert A. Maslyn, Esq., of counsel, at the hearing, and Justine Clarke Caplan, Esq., of counsel, on the brief).

ISSUES

I. Whether there existed a rational basis for the Notice of Deficiency issued by the Division of Taxation to petitioner.

II. Whether petitioner has substantiated his business expenses incurred in the practice of law as a personal injury lawyer and whether canceled checks were adequate substantiation of expenses.

III. Whether petitioner has established that the Division of Taxation overestimated his income by its analysis of his bank deposits.[1]

IV. Whether penalties for negligence and for substantial underpayment of tax should be imposed.

FINDINGS OF FACT

1. Petitioner, Martin Lassoff, is a personal injury lawyer who, during the years at issue, maintained a solo practice out of offices in lower Manhattan located at 160 Broadway. According to his petition,[2] which was dated April 13, 2004,[3] Mr. Lassoff has been in legal practice for almost 50 years at this location. He shared offices with a law firm named Israel, Adler, Ronca & Gucciardo. According to the letterhead of this firm, on which amounts due from petitioner were delineated, all of the attorneys included in the name of the firm were no longer at the firm during the years at issue since the following beginning and ending dates appear after their names: Samuel Israel, 1953-1979; Sydney Adler, 1953-1985; Theodore P. Ronca, 1953-

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[1] As noted in Finding of Fact "21", petitioner, on his motion to vacate his earlier default on April 13, 2005 at a previously scheduled hearing, contended there was merit to his case on the basis that "the auditor failed to take into account that two-thirds of the money paid into the [attorney] trust account was paid out to clients and should not be considered income of petitioner." However, at the actual hearing held in this matter, petitioner's representative noted it was "not an issue any longer" (tr., p. 19) and focused on the auditor's failure to consider that certain deposits turned out to be checks with insufficient funds that did not clear and were, in fact, debited by the bank in order to cancel out the earlier deposit, as detailed in Finding of Fact "19". In addition, in his statement of issues, petitioner's representative contended that some deposits represented loan proceeds since petitioner "had borrowed heavily from a number of credit card companies" (tr., p. 18).

[2] Mr. Lassoff did not appear and testify at the hearing and no evidence was introduced providing any details concerning his legal practice. His representative, David Silverman, appeared on petitioner's behalf only after the audit in question (pursuant to a power of attorney dated March 25, 2005), and although he testified briefly concerning the documents he was offering into evidence on behalf of petitioner, he had no personal knowledge of his client's legal practice.

[3] Since his petition was received by the Division of Tax Appeals on March 17, 2004, the petition was incorrectly dated by petitioner who filed the petition on his own behalf.

1982; and Angelo C. Gucciardo, 1959-1990. The only other attorneys on the letterhead of Israel, Adler, Ronca & Gucciardo are Philip J. Rooney and Michael E. Glazer. Also named on the letterhead are two non-attorneys, Domenica Gucciardo and Angela C. Gucciardo, identified as "Licensed NYS Workers' Compensation Representatives," which may possibly explain the continued use of the firm's name since they share the Gucciardo surname. In contrast, petitioner used his own letterhead with the same lower Manhattan address of 160 Broadway with "Counselor At Law - Proctor In Admiralty" below his name. Also named on petitioner's letterhead was an individual named Christine E. Salla. An asterisk following Ms. Salla's name noted that she was "also admitted in N.J.," and a New Jersey office located in Newark at 56 Park Place appeared on petitioner's letterhead as well. Petitioner attached to his New York resident income tax return for 1998 marked into evidence copies of his W-3, "Transmittal of Wage and Tax Statements" for 1998[4] and related W-2 forms for six employees showing wages in the following amounts:

Petitioner's Employee	Wages shown on W-2
Christine Navarro	$62,400.00
Frances Mignano, Sr.	15,600.00
Fazia Mohammed	10,400.00
Andrea Michaela Lassoff	2,000.00
Joseph Barranca	20,800.00
Janet Miralla	39,000.00
Total wages paid by petitioner, as employer	150,198.00

[4] In contrast, for 1999, the return introduced into evidence did not have similar documentation attached showing petitioner's employment of any individuals. For 2000, the return in evidence includes a copy of a W-3 transmittal showing wages for 1999 totaling $179,400.00 paid by petitioner as employer, but related W-2 forms were not included.

Petitioner did not provide affidavits or statements from any of his employees or the individuals who also practiced out of the shared offices.

2. Although petitioner was married during the years at issue, on his New York personal income tax returns for 1998 and 1999, he selected the filing status of "head of household (with qualifying person)." On May 9, 2001, an audit of petitioner's income tax returns was assigned to auditor Myoung Lee,[5] and petitioner filed under a correct filing status of "married filing separate return" on his tax return for 2000 dated August 14, 2001 after the audit's commencement. Similarly, petitioner has not contested the adjustment by the Division of Taxation ("Division") of his filing status for 1998 and 1999 to "married filing separate return."

3. Petitioner apparently prepared his tax returns himself since they do not show a paid preparer, and only petitioner signed the returns. The numbers written on the returns are not easily decipherable since they are handwritten in an unclear fashion and in a number of places are unreadable. A best effort has been made to decipher these numbers. Arithmetic errors, as noted below, further reflect the sloppiness of petitioner's tax returns.

4. On his returns for the three years at issue, petitioner reported "gross receipts" from his practice of law of $653,451.21 for 1998, $676,258.07 for 1999, and $635,786.72 for 2000. Over the past few years, since the commencement of the audit in the spring of 2000 up to the current date, petitioner has never offered any books and records from which his income from his practice of law could be determined other than copies of bank statements showing deposits to his checking accounts. He apparently failed to maintain any type of bookkeeping ledger or journal for the recording of client fees. In fact, as noted in footnote "2", petitioner provided little if any

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[5] William McClellan, auditor Lee's supervisor, testified that this matter was assigned to Mr. Lee on May 9, 2000. However, given the fact that the audit encompassed the year 2000, and that by August 11, 2001, the date of auditor Lee's last entry, only 20 hours of work had been completed on the audit, the finding has been made above that the audit was commenced on May 9, 2001. As noted in Finding of Fact "15", auditor Lee died on September 11, 2001 in the terror attack on Manhattan's World Trade Center where the State's auditors maintained their offices in the south tower on the 86th floor.

evidence concerning his law practice. Most important, petitioner failed to introduce any records that support or tie in directly to the above amounts reported by him as his "gross receipts" for the years at issue.

5. Although petitioner reported substantial "gross receipts" from his practice of law as noted above, he reported a net loss in 1998 of $45,761.09, a net profit in 1999 of $95,159.39, and a net profit of $1,775.28 in 2000 on the respective Federal schedules C. Most of his gross receipts were sheltered from taxation by petitioner's substantial deductions for business expenses, in 1998 of $701,168.30, in 1999 of $581,678.88, and in 2000 of $634,031.44.

6. The business expenses claimed by petitioner on his tax returns against his gross receipts from his legal practice consisted of the following:

Item of expense	1998	1999	2000
Car and truck	$38,977.00	$32,000.00	$28,639.32
Employee benefit programs	$29,412.00	$29,312.20	$28,414.84
Insurance (other than health)	$2,000.00	$2,681.52	$2,500.00
Legal and professional services	$13,128.00	$6,000.00	$25,272.09
Office expense	$101,851.09	$29,000.00	$2,500.00
Rent or lease expenses for "other business property"	$57,005.81	$52,868.60	$55,234.71
Taxes and licenses	$39,149.31	$13,245.37	$23,441.96
50% of meals and entertainment[6]	$6,500.00	$5,000.00	$3,900.00
Utilities	$32,000.00	$8,092.90	$6,519.71
Wages	$290,328.00	$165,000.00	$179,400.00
Bank Charges	$6,449.42	-0-	-0-

[6] The Division incorrectly disallowed 100% of petitioner's expenses claimed for meals and entertainment although petitioner properly applied the 50% limitation to his claimed expenses for meals and entertainment. Such error largely explains why the totals in the Division's work papers for petitioner's claimed expenses are higher sums than shown in this table. In addition, while difficult to decipher, petitioner claimed an expense for supplies in 1999 of $5,600.00, not $5,000.00 as shown in the auditor's work papers, an error to petitioner's advantage in the way the Division calculated his deficiency.

Petty cash	$30,000.00	$18,000.00[7]	-0-
Accountant	$6,000.00	-0-	$6,000.00
Process	$5,317.07	$2,000.00	-0-
EBTs	$20,000.00	$7,682.28	$3,804.89
Stamps	$3,000.00	-0-	$2,000.00
Medical records and doctor reports	$20,000.00	$10,000.00	$11,858.46
Consultants per 1099's	$0.00	$177,950.31	$240,588.51
County Clerk	$0.00	$6,170.50	$0.00
Scan, Photostat and Paper	$0.00	$5,332.70	$0.00
Supplies	$0.00	$5,600.00	$2,000.00
Illegible description	$0.00	$5,000.00	$0.00
Calendar fees	$0.00	$0.00	$3,970.00
Bar association and dues	$0.00	$0.00	$1,000.00
Process and bank charges	$0.00	$0.00	$6,519.71
West Group	$0.00	$0.00	$3,970.24
Total	$701,117.70[8]	$580,936.38[9]	$637,534.44[10]

7. In addition, petitioner on his tax returns for the years at issue itemized his deductions on Federal schedules A in the amounts of $17,725.94 for 1998, $20,418.30 for 1999, and $35,235.31 for 2000. These itemized deductions consisted of the following:

[7] This amount also includes stamps.

[8] On his Schedule C for 1998, petitioner's total for the expenses detailed above was $701,168.30. The discrepancy perhaps might be explained by the difficulty in reading some of petitioner's handwritten numbers, which were not easily decipherable.

[9] On his Schedule C for 1999, petitioner's total for the expenses detailed above was $581,678.85. Again, the discrepancy perhaps might be explained by the difficulty in reading some of petitioner's handwritten numbers, which were not easily decipherable.

[10] On his Schedule C for 2000, petitioner's total for the expenses detailed above was $634,031.44. Like the earlier years at issue, the discrepancy perhaps might be explained by the difficulty in reading some of petitioner's handwritten numbers, which were not easily decipherable.

	1998	1999	2000
Medical and dental expenses	$12,125.94	$17,080.58	$5,312.80
State and local income taxes	1,100.00	2,342.30	23,441.96[11]
Real estate taxes	0.00	0.00	636.21
Home mortgage interest and points	0.00	0.00	2,044.44
Gifts to charity	4,500.00	3,400.00	3,700.00
Total itemized deduction	$17,725.94	$22,822.88	$35,135.31[12]

Petitioner then reported New York taxable income and taxes due as follows:

	1998	1999	2000
Taxable income	$1,845.40	$66,103.64	$(20,999.49)
New York State tax	812.00	3,965.60	0.00
City of New York resident income tax	660.00	2,378.62	0.00
Total taxes	$1,472.00	$6,344.22[13]	$0.00

8. After an audit that had commenced in the spring of 2001 and lasted until the late fall of 2003, the Division issued a separate Statement of Personal Income Tax Audit Changes dated November 13, 2003 for each of the years at issue. The statements show a substantial increase to petitioner's New York taxable income for the respective years at issue as follows:

	1998	1999	2000
New York taxable income as reported	$1,845.40	$66,103.64	$(20,999.49)
Audited New York taxable income	$787,878.95	$2,608,820.86	$895,260.78

[11] The only issue raised by the auditor concerning petitioner's Schedule A deductions for the years at issue was this deduction for "state and local income taxes" in the amount of $23,441.96, which the auditor testified was not substantiated.

[12] Although the totals for the amounts as itemized in the table for 1999 and 2000 are $22,822.88 and $35,135.31, respectively, on his return petitioner showed the total amounts as $20,625.30 and $35,235.31, respectively.

[13] The amount shown on petitioner's return was $6,344.24.

9. For 1998, the Division recalculated petitioner's New York taxable income by increasing his reported New York adjusted gross income of $44,045.26 by (i) $310,455.16 representing additional receipts per bank statements, and (ii) $443,241.50 representing Schedule C expenses disallowed, which resulted in a "corrected" New York adjusted gross income of $797,741.92. The Division subtracted (i) "corrected itemized deductions after modifications" in the amount of $8,862.97 and (ii) $1,000.00 for one exemption to arrive at petitioner's audited New York taxable income of $787,878.95. The Division then computed petitioner's corrected tax liability on such audited New York taxable income of $787,878.95 as totaling $88,939.11, consisting of a corrected New York State income tax liability of $53,969.71 and a corrected New York City resident income tax liability of $34,969.40. For 1998, the Division computed tax due of $87,467.11 plus penalties for negligence and substantial understatement of liability as follows:

	New York State	New York City	Total Liability
Corrected 1998 tax liability	$53,969.71	$34,969.40	$88,939.11
Subtract: tax previously paid	(812.00)	(660.00)	(1,472.00)
Additional 1998 tax liability	*$53,157.71*	*$34,309.40*	*$87,467.11*
Negligence penalty § 685(B)(1)	2,698.49	1,748.47	4,446.96
Negligence penalty § 685(B)(2)	9,801.88	6,351.08	16,152.96
Substantial understatement of liability penalty § 685(P)	5,315.77	3,430.94	8,746.71
Total penalties	*$17,816.14*	*$11,530.49*	*$29,346.63*

10. For 1999, the Division recalculated petitioner's New York taxable income by increasing his reported New York adjusted gross income of $88,025.64 by (i) $2,289,722.00 representing additional receipts per bank statements, and (ii) $242,385.87 representing Schedule C expenses disallowed, which resulted in a "corrected" New York adjusted gross income of $2,620,133.51. The Division subtracted (i) "corrected itemized deductions after modifications" in the amount of $10,312.65 and (ii) $1,000.00 for one exemption to arrive at petitioner's audited

New York taxable income of $2,608,820.86. The Division then computed petitioner's corrected tax liability on such audited New York taxable income of $2,608,820.86 as totaling $278,437.66, consisting of a corrected New York State income tax liability of $178,704.23 and a corrected New York City resident income tax liability of $99,733.43. For 1999, the Division computed tax due of $272,093.44 plus penalties for negligence and substantial understatement of liability as follows:

	New York State	New York City	Total Liability
Corrected 1999 tax liability	$178,704.23	$99,733.43	$278,437.66
Subtract: tax previously paid	(3,965.60)	(2,378.62)	(6,344.22)
Additional 1999 tax liability	*$174,738.63*	*$97,354.81*	*$272,093.44*
Negligence penalty § 685(B)(1)	8,935.21	4,986.67	13,921.88
Negligence penalty § 685(B)(2)	24,175.07	13,491.92	37,666.99
Substantial understatement of liability penalty § 685(P)	17,473.86	9,735.48	27,209.34
Total penalties	*$50,584.14*	*$28,214.07*	*$78,798.21*

11. For 2000, the Division recalculated petitioner's New York taxable income by increasing his reported New York adjusted gross income of $15,235.82 by (i) $665,475.70 representing additional receipts per bank statements, and (ii) $221,445.93 representing Schedule C expenses disallowed, which resulted in a "corrected" New York adjusted gross income of $902,157.45. The Division then subtracted $23,441.96 representing unsubstantiated tax expense from petitioner's itemized deductions reported on his tax return of $35,235.31, resulting in petitioner's adjusted New York itemized deductions, before modification, of $11,793.35. The Division subtracted (i) "corrected itemized deductions after modifications" in the amount of $5,896.67 and (ii) $1,000.00 for one exemption from petitioner's "corrected" New York adjusted gross income of $902,157.45 to arrive at petitioner's audited New York taxable income of $895,260.78. Petitioner's corrected tax liability on such audited New York taxable income of

$895,260.78 was then computed to be $95,038.61, consisting of a New York State income tax liability of $61,325.36 and a New York City resident income tax liability of $33,713,25. For 2000, the Division calculated tax due in the entire amount of $95,038.61 since, as noted in Finding of Fact "7", petitioner reported no New York taxes due on his 2000 tax return. Penalties totaling $22,494.05 were added to taxes due as follows:

	New York State	New York City	Total liability
Corrected 2000 tax liability	$61,325.36	$33,713.25	$95,038.61
Subtract: tax previously paid	-0-	-0-	-0-
Additional 2000 tax liability	*$61,325.36*	*$33,713.25*	*$95,038.61*
Negligence penalty § 685(B)(1)	3,066.27	1,685.66	4,751.93
Negligence penalty § 685(B)(2)	5,315.89	2,922.38	8,238.27
Substantial understatement of liability penalty § 685(P)	6,132.53	3,371.32	9,503.85
Total penalties	*$14,514.69*	*$7,979.36*	*$22,494.05*

12. As noted in Findings of Fact "9", "10" and "11", the Division increased petitioner's reported New York adjusted gross income by $310,455.16, $2,289,722.00 and $665,475.70 for 1998, 1999, and 2000, respectively, for "additional receipts per bank statements." These amounts represented the difference between gross receipts reported by petitioner on his tax returns and the Division's calculation of petitioner's receipts by its examination of his bank statements as follows:

	Per taxpayer's return	Per audit	Increase
1998	$655,451.21	$965,906.37	$310,455.16
1999	676,258.07	2,965,980.00	2,289,722.00
2000	635,786.72	1,301,262.40	665,475.90
Totals	$1,967,496.00	$5,233,148.77	$3,265,653.06

In determining gross receipts by its examination of petitioner's bank statements, both the auditor and her supervisor utilized their own calculators to add up deposits. They relied on comparing the totals from their respective and separate calculations to confirm accuracy and did not produce an adding machine tape or worksheet showing the totaling up of individual deposits. The Division introduced into evidence the bank statements which were examined as its Exhibit "J", consisting of 151 pages. This document is not in a coherent order, with months not following consecutively and duplicate copies of statements for some months. However, a close review discloses that this exhibit does include photocopies of the monthly bank statements for petitioner's business account with Republic National Bank of New York, and for the last few months of 2000 with HSBC, so that the entire three-year period at issue is covered. It is observed that this exhibit also includes photocopies of monthly bank statements for petitioner's "attorney trust account" with Republic National Bank of New York and for his "attorney trust account" with HSBC for a couple months at the end of 2000. Although photocopies are missing for some months, a review of the information on these attorney trust accounts discloses that petitioner was depositing substantial sums from his personal injury practice into his attorney trust accounts, including monthly total deposits of over $1,000,000.00 as shown on the monthly statements dated January 11, 1999 and November 10, 2000, and deposits totaling $810,748.00 as shown on the monthly statement dated January 9, 1998. A review of these statements also shows much check writing activity on the attorney trust accounts.

13. As noted in Finding of Fact "6", petitioner claimed business expenses against his gross receipts from his legal practice in the total amounts of $701,117.70, $580,936.38 and $637,534.44 for 1998, 1999 and 2000, respectively. Upon audit, as noted in Findings of Fact "9", "10" and "11", the Division disallowed expenses in the amounts of $443,241.50,

$242,385.87, and $221,445.93, for 1998, 1999 and 2000, respectively. A review of the auditor's work papers discloses that she allowed only the following few expenses on audit:

	Per taxpayer's return	Allowed per audit
1998 expense for wages	$290,929.00[14]	$265,027.80
1999 expense for wages	165,000.00	165,000.00
1999 expense for consultants	177,950.31	177,950.31
2000 expense for wages	179,400.00	179,400.00
2000 expense claimed for consultants	$240,588.51	$240,588.51

14. By the fall of 2003, the Division's auditors had become frustrated as a result of petitioner's dilatory tactics. In her report dated December 1, 2003, auditor Yvette Travis (a/k/a Yocheved Travis) summarized her frustration in explaining the issuance of the three statements of personal income tax audit changes dated November 13, 2003 (which are detailed above):

> This case was issued as a Schedule C Case. Case was reassigned to [auditor Travis] on 11/26/01. After many attempts[15] to collect documents substantiating expenses taken on both Schedules A and C. And after many extensions granted to taxpayer, auditor issued a final Statement of Audit Changes on 10/01/02. Taxpayer called and begged for another Final extension till November 15, 2002. On 12/02/03[16] [sic] received some copies of bank statements and cancelled checks. Called taxpayer and told him that need documents that add up to numbers on tax return. On 01/30/03 Taxpayer called that he hired a Rep. Rep had two meetings with team leader and I and two extensions. On October 9, 2003, we agreed that in thirty days we would assess case based on information available on

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[14] As noted in Finding of Fact "6", petitioner, in fact, claimed an expense for wages in 1998 of $290,328.00. The differing amounts perhaps explained by the difficulty in deciphering petitioner's handwritten numbers.

[15] A review of the auditor's log shows that she made at least a dozen attempts to obtain documents from petitioner to substantiate his deductions and verify his income before he hired an enrolled agent named Mark Glass to represent him on March 6, 2003. From that date until the issuance of the statements of audit changes dated November 13, 2003, the auditor provided Mr. Glass with at least five opportunities, based on a review of the auditor's log, to provide substantiation of petitioner's deductions and income. In addition, the auditor's log shows that Mr. Glass exhibited a pattern of behavior where he would make and then cancel appointments with the auditor.

[16] The year was incorrectly noted as 2003 instead of 2002, since within the context of the statement 2002 was the correct year.

> file. On 11/13/2003-after not hearing from Rep nor receiving any documents, we sent a Final Statement of Audit Changes. Rep called and said that he disagrees with our findings and I told him that I am closing it disagreed and we will take it up in appeals.

15. As noted in the auditor's summary detailed above, the audit of petitioner was assigned to auditor Travis on November 26, 2001. The audit had originally been assigned on May 9, 2001 to Myoung Lee, who died on September 11, 2001 and the matter was reassigned to Ms. Travis on November 26, 2001. In her letter dated November 26, 2001[17] to petitioner, Ms. Travis noted that "due to the September 11th tragedy, we have lost many essential documents" and requested that petitioner submit copies of all tax returns for the years at issue and documents "substantiating all deductions made on your Schedule C." This letter prompted petitioner to initially inform Ms. Travis that he had provided auditor Lee with his original documentation and as a result could no longer provide substantiation of his deductions and evidence of loan proceeds deposited in his checking accounts. In an affidavit dated May 10, 2006, petitioner "duly sworn deposes and says":

> I furnished the auditor with the above mentioned credit card statements only to be informed by letter on December 13, 2001 that these records along with other documents substantiating my deductions and income were lost in the terrorist attack of September 11, 2001.

Further, at the start of the hearing held in this matter, when petitioner's representative was provided with the opportunity to state the issues, he maintained the position that documents were provided to Mr. Lee and destroyed on September 11th and, in effect, hampered his presentation presumably because they were no longer available. Later at the hearing, the Division offered the testimony of Ms. Travis as well as her supervisor, William McClellan, who established that the Division as a policy makes copies of any documentation provided by a taxpayer and does not

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[17] This same letter was again sent (and redated) December 13, 2001 and December 26, 2001.

retain original taxpayer documents and rejected petitioner's assertions that his documents were destroyed in their offices on September 11th.

16. In conformance with the statements of audit changes dated November 13, 2003, the Division issued a Notice of Deficiency dated December 15, 2003 against petitioner which asserted total income taxes due of $454,599.16 for the years at issue, plus total penalties due of $131,302.90 and total interest due, as of December 15, 2003 (the date of the notice) of $123,193.28 as follows:

	Tax Asserted Due	Interest	Penalty
1998 New York State liability	$53,157.71	$19,475.76	$17,899.61
1998 New York City liability	34,309.40	12,570.17	11,584.36
1999 New York State liability	174,738.63	47,788.68	50,839.88
1999 New York City liability	97,354.81	26,625.24	28,356.55
2000 New York State liability	61,325.36	10,797.55	14,597.58
2000 New York City liability	33,713.25	5,935.88	8,024.92
Totals	$454,599.16	$123,193.28	$131,302.90

17. Subsequent to the issuance of the Notice of Deficiency dated December 15, 2003, auditor Travis and her supervisor provided a "courtesy conference" to petitioner and his wife to review additional documentation approximately one year later on December 13, 2004. Their further review of petitioner's documents resulted in a slight increase in taxes asserted due for 1998 and 2000, but a substantial decrease in taxes asserted due for 1999 so that the total additional tax liability asserted due by the Division was reduced from $454,599.16 to $276,290.86 as follows:

	Tax Asserted Due in Notice of Deficiency Dated 12/15/03	Revised Tax Asserted Due After Courtesy Conference
1998 New York State tax liability	$53,157.71	$55,005.90
1998 New York City tax liability	34,309.40	35,644.06
Total Additional 1998 tax liability	*$87,479.11*	*$90,649.96*
1999 New York State tax liability	174,738.63	54,609.52
1999 New York City tax liability	97,354.81	30,392.57
Total Additional 1999 tax liability	*$272,093.44*	*$85,002.09*
2000 New York State tax liability	61,325.36	64,934.45
2000 New York City tax liability	33,713.25	35,704.36
Total Additional 2000 tax liability	*$95,038.61*	*$100,638.81*
Total tax liability for three years at issue	*$454,599.16*	*$276,290.86*

Nonetheless, the courtesy conference did not result in the allowance of any additional business expenses. In addition, for 1998 and 2000, the auditors increased petitioner's receipts subject to income tax from the original audited amounts, while they decreased petitioner's receipts subject to tax for 1999 from the original audited amount. The increases for 1998 and 2000 resulted from the provision of additional bank statements for missing months. The specific adjustments were as follows:

	Original audit: Additional receipts per bank statements	After courtesy conference: Additional receipts per bank statements	Original audit: Schedule C expenses disallowed	After courtesy conference: Schedule C expenses disallowed
1998	$ 310,455.16	$ 325,582.04	$ 443,241.50	$ 443,241.50
1999	2,289,722.00	478,120.48	242,385.87	242,385.87
2000	665,475.70	718,163.12	221,445.93	221,445.93

In calculating petitioner's additional receipts per bank statements, the auditors reviewed bank statements provided by petitioner for his business checking account with Republic National

Bank of New York for 1998, 1999 and most of 2000, and, for a few months in late 2000, his business checking account with HSBC. The auditors treated petitioner's deposits to his business checking accounts as his gross receipts from his legal practice.

18. In conformance with the adjustments detailed above in Finding of Fact "17", resulting from the courtesy conference, the Division issued revised statements of audit changes, each dated March 15, 2005, asserting total corrected tax liabilities of $90,649.96, $85,002.09 and $100,638.81 for 1998, 1999 and 2000, respectively.

19. In the course of her cross-examination at the hearing in this matter, auditor Travis conceded that the Division should subtract from her totals for "additional receipts per bank statements" deposits which were later debited by the bank when they proved to be uncollectible. The auditor noted "If there was a deposit return, for whatever the reason is, it would not be in total deposits" (tr., p. 81). Deposit returns to be so subtracted are as follows:

Date of deposit (later debited by bank)	Amount
6/09/98	$5,000.00
6/11/98	6,000.00
10/02/98	3,000.00
1998 Total	*$ 14,000.00*
08/05/99	$64,170.00
09/21/99	6,500.00
6/03/99	600.00
1999 Total	*$ 71,270.00*

20. In addition, at the hearing in this matter, petitioner's representative established during his cross-examination of auditor Travis that bank statements, relied upon by the Division in

calculating petitioner's income, disclose the following electronic payments of federal payroll taxes:

Date of payment	Amount
01/14/99	$3,112.33
02/12/99	4,235.00
03/15/99	3,388.00
04/14/99	3,388.00
05/14/99	4,235.00
06/15/99	3,388.00
07/14/99	3,388.00
08/16/99	4,235.00
09/15/99	3,731.60
10/14/99	3,731.60
11/15/99	4,664.50
12/15/99	3,731.60
Total for 1999	*$45,228.63*
01/14/00	$4,664.50
02/15/00	4,247.44
03/14/00	3,847.44
04/14/00	4,809.30
05/12/00	3,847.44
06/15/00	3,847.44
07/14/00	4,809.30
08/15/00	3,847.44
09/15/00	3,847.44
10/16/00	4,809.30
11/15/00	3,847.44

12/15/00	3,847.44
Total for 2000	*$50,271.92*

Procedural Permutation

21. Petitioner argued in his petition filed on March 13, 2004 that the funds he received in contingency cases were deposited into a trust account and then disbursed two-thirds to the client and one-third to petitioner as his contingency fee. He contended that the auditor had incorrectly attributed the entire amount of the recovery as income to petitioner instead of the one-third to which he was entitled. He also disagreed with the disallowance by the auditor of many of the business deductions claimed by him on his returns for the three years at issue. On July 15, 2004, the Division of Tax Appeals mailed to petitioner and to the Division of Taxation a Notice to Schedule Hearing asking the parties to agree upon a mutually convenient date for the hearing. A response from the Division selected the date of November 18, 2004 and the location of Troy, New York. The Division's response also indicated that petitioner was in agreement as to the date but preferred New York City as the location. On October 12, 2004, the Division of Tax Appeals mailed notices of hearing advising the parties that a hearing was scheduled for the instant matter on November 18, 2004 at the offices of the Division of Tax Appeals in New York City. On October 28, 2004, the hearing scheduled for November 18, 2004 was adjourned for 90 days to allow the parties to attempt to resolve this matter without the need for a hearing.

On December 13, 2004, the Division's auditors met with petitioner and his wife in a courtesy conference to review additional substantiation supplied by petitioner which resulted in the adjustment detailed in Finding of Fact "17." Since the matter was not resolved, it was again scheduled for hearing. The new hearing date was to be March 29, 2005 in the Troy offices of the Division of Tax Appeals. This hearing was also adjourned to give the parties time to sign a

stipulation settling the case. However, petitioner refused to so stipulate and the matter was then scheduled for hearing on April 13, 2005.

On April 4, 2005, David J. Silverman, EA, made a request on behalf of petitioner for an adjournment of the April 13, 2005 hearing in order to organize petitioner's records and to make a Freedom of Information request. The request for adjournment was denied on April 4, 2005. On April 5, 2005, Mr. Silverman sent a letter indicating that it would be pointless for either Mr. Silverman or his client to appear at the hearing, and when the matter was called for hearing on April 13, 2005, petitioner did not appear, and no representative appeared on his behalf. On May 13, 2005, Administrative Law Judge Joseph Pinto issued a determination finding petitioner in default. Approximately four months later, petitioner filed an application to vacate the May 13, 2005 default determination. In his application filed on September 29, 2005, petitioner explained that he was unable to appear at his hearing because he suffers from Parkinson's disease and multiple sclerosis, as well as several other conditions. He did not address the merits of his case in any manner. On November 8, 2005, petitioner was given a second opportunity to establish that he had a reasonable excuse for his failure to appear at the hearing as well as a meritorious case. On December 1, 2005, Mr. Silverman submitted an application to vacate petitioner's default which included a letter from Dr. Leonard M. Mattesa outlining petitioner's multiple illnesses[18] which established that petitioner would not be capable of attending a hearing. Mr. Silverman explained that he failed to appear at the hearing on petitioner's behalf because he needed more time to organize petitioner's records and that petitioner's illnesses impeded his ability to organize the records in a timely fashion. However, he did not submit any evidence to

[18] In contrast, Mr. Lassoff in his letter to auditor Travis three years earlier, which was dated August 19, 2002, explained his need for additional time to supply documents based upon "my past and continuing disabilities with gout."

prove that there was merit to his arguments that (i) the auditor failed to take into account that two-thirds of the money paid into the trust account was paid out to clients and should not be considered income of petitioner and that (ii) the auditor erred in disallowing many of petitioner's business deductions.

In reviewing Mr. Silverman's application to vacate petitioner's default, Chief Administrative Law Judge Andrew F. Marchese, in his order dated March 2, 2006, rejected Mr. Silverman's suggestion that his "reorganization" of petitioner's records had any value since he did "not even allege that he has additional substantiation to submit," pointing out that petitioner had an opportunity during the audit process to submit receipts to substantiate expenses claimed on his returns and a second opportunity at the courtesy conference on December 13, 2004. Consequently, according to Judge Marchese, the reorganization of records did not rise to the level of establishing that petitioner's case had merit. Nonetheless, Judge Marchese in his order dated March 2, 2006 ordered that "the Default Determination issued on May 13, 2005 is vacated" because the Division of Taxation in its response to petitioner's request to vacate his default did not deny "the assertion that the auditor included in petitioner's income the entire amount of funds deposited into his attorney trust account rather than only the portion which would represent petitioner's contingency fee for representing his clients." Judge Marchese pointed out that Disciplinary Rule DR 9-102(B) of the Lawyer's Code of Professional Responsibility of the New York State Bar Association requires every attorney who receives funds belonging to a client to maintain such funds in a special account in a banking institution in such attorney's own name. Such special bank account shall be identified as an "Attorney Trust Account" or "Attorney Escrow Account" and shall be separate from any business or personal

account of the attorney. Judge Marchese noted that Disciplinary Rule DR 9-102 (D)(1) requires an attorney to maintain for seven years:

> 1. The records of all deposits in and withdrawals from the accounts specified in DR 9-102(B) and of any other bank account which concerns or affects the lawyer's practice of law. *These records shall specifically identify the date, source and description of each item deposited, as well as the date, payee and purpose of each withdrawal or disbursement.* (Emphasis added.)

At the hearing subsequently held in this matter on May 16, 2006, Mr. Silverman, petitioner's representative, did *not* raise as an issue[19] the very basis for Judge Marchese's finding that petitioner had established merit to his case sufficient to justify vacating the default, i.e., that the auditor included in petitioner's income the entire amount of funds deposited into his attorney trust account rather than only the portion which would represent petitioner's contingency fee for representing his clients.

22. At the hearing, petitioner's representative introduced into the record photocopies of hundreds of canceled checks for each of the three years at issue. He also brought the *original*[20] checks to the hearing for comparison. These checks had been available previously for the auditor's review. In addition, petitioner's representative prepared "recaps" of the checks, which he categorized and treated as petitioner's "outflows" on the title page of his "recaps." For example, for the year 1998, the title page of the recap showed "total outflows" of $677,358.03 as follows:

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[19] As noted at the start of this determination, although petitioner contends that the Division overestimated his income by its analysis of his bank deposits, petitioner did not continue to contend that the auditors included in his income the entire amount of funds deposited into his attorney trust account. In fact, petitioner offered no evidence concerning his attorney trust account or any of the records required to be maintained by Disciplinary Rule DR 9-102(D)(1) as detailed above.

[20] On cross-examination, petitioner's representative was forced to admit that "those weren't destroyed in the Trade Center" (tr., p. 188). He also testified that the checks were provided to him in May or June of 2005 in "packets where each one was explained as to what it was, what the category was" by petitioner's wife. Mrs. Lassoff was not present at the hearing.

Automobile	
Auto expenses	$9,163.00
Auto insurance	3,881.61
Total automobile	$13,044.61
Case & trial expenses	28,581.27
Case medical disbursements	8,717.53
Charitable contributions	6,125.00
Consultants	147,444.58
Credit card expenses	76,627.51
Dues and subscriptions	693.80
Employee benefits	27,717.90
Lien disbursements	4,771.90
Medical	150.00
Doctor	34,171.60
Hospital care	31.78
Insurance	529.00
Lab, tests	243.36
Medicine	122.18
Total Medical	35,247.92
Miscellaneous, bus	436.86
Office expenses	17,705.82
Office phone	7,171.52
Office rent	
New Jersey	6,435.79
New York	40,389.88
Total office rent	46,825.67
Payroll	117,529.41
Petty cash	15,134.00
Postage	923.47
Tax	
Employment	967.10
Local	1,041.56
State	9,238.00
Total tax	11,246.66
To credit cards for bank overdraft	111,227.96
Utilities	
Cable TV	77.67
Gas & Electric	106.97
Total Utilities	184.64
Total outflows	$677,358.03

The pages of the "recap" following the title page, which itemized the categories of "outflow" as detailed above, listed the individual checks backing up the categorized amounts. For example, for the category "auto insurance," the following checks were detailed:

Date	Check Number	Description of payee	Amount
2/19/98	19833	Liberty Mutual	$602.75
6/4/98	20174	Liberty Mutual	602.00
6/19/98	20227	Liberty Mutual	703.05
4/30/98	20068	Liberty Mutual	591.20
1/7/98	19680	Liberty Mutual	1,000.00
12/17/98	20794	Liberty Mutual	382.61
Total auto insurance			$3,881.61

Then attached to the "recap" are the photocopies of the checks. A close examination of these checks for the 1998 auto insurance expense, used as an example, show that on three of the checks, in the line on the bottom next to the word "FOR," is the same identifying number of A02-221-684832-00792 with the surname Mignano written above this number on the check dated January 7, 1998, but not on the other two dated April 30, 1998 and June 19, 1998. The check dated February 19, 1998 has a different identification number on the "FOR" line but has the name Salvatore Mignano written above it. Two checks have nothing written on the "FOR" line.

Petitioner had previously provided his cancelled checks for review during the audit and at the courtesy conference on December 13, 2004. Nonetheless, it is not known whether *all* of the checks brought out at the hearing had been provided for review by the Division on the earlier dates.

23. After the completion of the hearing, auditor Travis reviewed the recaps presented at the hearing and the checks provided in support. As noted in Footnotes "8," "9" and "10," on his tax returns, petitioner had claimed business expenses totaling $701,168.30, $581,678.85 and $634,031.44 for 1998, 1999, and 2000, respectively. On the recaps, he now claimed business expenses totaling $677,358.03, $817,364.51, and $799,988.15 for 1998, 1999, and 2000, respectively. This variation in business expenses claimed on petitioner's tax returns compared to his claim at hearing was significant:

Year	Amount claimed on tax return	Amount claimed at hearing on "recaps"	Increase or (decrease) in amount claimed as business expenses at hearing
1998	$701,168.30	$677,358.03	$ (23,810.27)
1999	581,678.85	817,364.51	235,685.66
2000	634,031.44	799,988.15	165,956.71
Total additional amount claimed at hearing for business expenses			$377,832.10

In addition, the amounts now claimed for the various categories of expenses are different from the amounts claimed on the original returns, and the categories themselves vary to some extent. For example, on the original returns there was not a category of expenses for "dues and subscription" for any of the years while there was a category for "bar association and dues" only for 2000. As detailed in Finding of Fact "13," auditor Travis had allowed very few of the expenses claimed in her original audit. After her post-hearing review, the auditor allowed the following additional expenses against petitioner's Schedule C income from his law practice:

	Rent on NYC office	Taxes	Dues and subscriptions	Totals

1998	$23,562.00	$17,783.95	-0-	$34,708.76
1999	24,375.00	17,783.95	1,041.00	43,199.95
2000	25,187.00	9,230.59	830.00	35,247.59

In her affidavit dated June 5, 2006, which set forth the results of her post-hearing review, the auditor also made the following statement, but it is not known how or even whether, in fact, it affected her recalculation:

> 7. Although the representative claimed petitioner's receipts included credit card advances, or "loans," this was not substantiated. However, since petitioner deducted amounts as repayments of these loans, such amounts of the "loans" will be deemed income and the deduction allowed against income.

24. As noted in Finding of Fact "17", the auditor, subsequent to the issuance of the Notice of Deficiency dated December 15, 2003, revised the taxes asserted due after a courtesy conference provided to petitioner on December 13, 2004. In her affidavit dated June 5, 2006, she has again revised the taxes asserted due based upon the reasons detailed in Finding of Fact "23". These adjustments in taxes asserted due may be summarized as follows:

	Tax Asserted Due in Notice of Deficiency Dated 12/15/03	Revised Tax Asserted Due After Courtesy Conference on 12/13/04	Revised Tax Asserted Due After Auditor's Post-Hearing Review
1998	$ 87,479.11	$ 90,649.96	$ 85,130.00
1999	272,093.44	85,002.09	72,773.00
2000	95,038.61	100,638.81	96,892.00
Totals	$454,611.16	$276,290.86	$254,795.00

SUMMARY OF THE PARTIES' POSITIONS

25. The Division contends that "The auditor and her supervisor did a thorough audit considering they were dealing with a difficult and uncooperative taxpayer who refused to provide the documentation as requested" (Division's brief, p. 10). With regard to the review of

deposits to petitioner's checking accounts, the Division maintains that alleged loans from relatives and credit cards "were never evidenced by any documentation" (Division's brief, p. 10). The claim that the auditors failed to follow field audit guidelines is also rejected, and the Division points out that in any event, "Audit guidelines are just that: guidelines" and have no legal force or effect (Division's brief, p. 10). With regard to substantiating the expenses claimed on petitioner's tax returns, the Division's brief does not address the pivotal issue in this matter whether canceled checks are sufficient, merely pointing out that "After five years, Petitioner has still failed to adequately substantiate his expenses and deductions and has offered no reasonable explanation for his failure to do so" (Division's brief, p. 8). At the hearing in this matter, the auditor vigorously asserted that canceled checks without invoices were inadequate to substantiate expenses. She also expressed concern that petitioner deducted various expenses from monies he paid over to clients, after the successful completion of personal injury cases, and might be deducting the same expenses from his (contingency fee) income from such cases reported on his schedules C. The Division has also reacted hostilely to petitioner's attempt to utilize the destruction of its World Trade Center offices in the terror attack of September 11th to explain his inability to document his expenses, since it was office policy never to retain original records belonging to a taxpayer: "Instead, the Department would make photocopies and keep the photocopies" (Division's brief, p. 8). The Division argues that penalties are justified "due to Petitioner's failure to cooperate and provide documentation during the audit process and for the substantial understatement of income" (Division's brief, p.12). It emphasizes that "there is no evidence that Petitioner was ill during 1998, 1999 or 2000, nor is there evidence that he was ill during the audit" (Division's brief, p. 12). It points out that he "maintained an active and lucrative law practice" and "prepared his own tax returns for all of the years in issue" (Division's

brief, p. 12). The Division maintains that petitioner's "subsequent illness" is irrelevant to the issue of penalty abatement.

26. Petitioner complains that the auditor "simply list deposits for a year and a total," without any sort of worksheet or adding machine tape to support the computation of deposits to petitioner's bank accounts (Petitioner's brief, p. 10). He maintains that this methodology was so flawed that it may not be the basis for the Division's determination of additional income or receipts. Petitioner also contends that the auditor failed to consider that Social Security benefits were included in his deposits or that he received loans from family members and credit card advances that were also deposited in his bank account. In short, petitioner contends that the Division failed to undertake an adequate investigation of petitioner's deposits to eliminate the likelihood that the deposits were from nontaxable sources of income and ignored audit guidelines for the reconstruction of income. Additionally, petitioner continues to insist that he provided original records concerning his "deposits of non-income items into his bank account" to auditor Lee and that these records were "lost in the destruction of the Towers by the terrorists" (Petitioner's reply brief, p. 10). He claims that the auditors who testified at the hearing concerning the Division's policy concerning the retention of original taxpayer records "cannot possibly know what was in the deceased auditor's file" (Petitioner's reply brief, p. 10).

With regard to the disallowance of business expenses claimed on his tax returns, petitioner invokes the rule established by the 1930 Federal court decision in ***Cohan v. Commissioner*** (39 F2d 540), which permitted "an approximation of an allowable amount" when the taxpayer is unable to substantiate the full business expense deducted. Relying on the more recent decision in ***Lerch v. Commr*** (877 F2d 624), petitioner emphasizes that the Court therein noted that if the taxpayer had produced "*even something as simple as cancelled checks showing mortgage or tax*

payments" the taxpayers would have been allowed such deductions (Petitioner's reply brief, p. 5 [emphasis in brief]). Petitioner further rejects the auditor's contention that petitioner might have deducted expenses twice, noting that petitioner would have deposited his contingency fee plus any amount equal to his reimbursement for expenses by his client:

> The petitioner is involved in settling personal injury cases . . . and say he recovered a settlement of $1,000 where he incurred court fees and other trial costs of $100.00. The net settlement after these costs was, therefore, $900 and the split would be 2/3 to the client and 1/3 to the petitioner or $600 and $300 respectfully [sic] with the $1,000 being deposited into the petitioner's escrow account . . . . A $600 check would then be issued to the client from the escrow account and the $400 balance in the account would be withdrawn by the petitioner to reimburse him for the $100 in expenses he incurred and to pay himself the $300 fee he earned. (Petitioner's brief, p. 19.)

Petitioner insists that "total deposits reflects the fee the petitioner earned and the reimbursement for case expenses that he incurred" (Petitioner's brief, p. 20). In sum, petitioner contends that the entire deficiency asserted by the Division should be vacated on the basis that the audit methodology used was "unfair and not reasonably calculated to reflect the taxes due" (Petitioner's brief, p. 25).

Petitioner argues that it is wrong for the Division to maintain that he failed to cooperate since he "furnished the Department with all the documents in his possession relating to this matter" on no less than three occasions, during the audit, at the courtesy conference and at the hearing held in this matter (Petitioner's reply brief, p. 11). In addition, petitioner argues that the assertion of penalties against petitioner was "arbitrary" especially in light of his illnesses and his attempt "to keep his practice going so he could cope with his ever-mounting medical bills long after most people in similar circumstances would have packed it in" (Petitioner's reply brief, p. 16).

CONCLUSIONS OF LAW

A. When the Division issues a Notice of Deficiency to a taxpayer, a presumption of correctness attaches to the notice, and the burden of proof is on the taxpayer to demonstrate that the deficiency assessment is erroneous by clear and convincing evidence (***Matter of O'Reilly***, Tax Appeals Tribunal, May 17, 2004). Here, petitioner argues that he has established that the audit methodology used by the Division was so arbitrary that this presumption of correctness has been rebutted, and the Notice of Deficiency dated November 13, 2003 must be vacated in its entirety. In the alternative, he contends that the Division increased the amount of the asserted deficiency after the courtesy conference, and as a result the burden of proof shifted to the Division. Both of these contentions are rejected, and it is concluded that the burden of proof remained upon petitioner to prove error in the Division's computation of additional tax for the years at issue by the introduction of clear and convincing evidence.

B. Petitioner's argument, as detailed in Paragraph "26", that the Division's methodology was so flawed that it may not be the basis for the Division's determination of additional income or receipts is, in essence, an attempt to shift the burden of proof on to the Division which is rejected. The Tax Appeals Tribunal in ***Matter of Bernstein*** (December 24, 1992), in reversing the determination of the administrative law judge, noted that, "We reiterate that the question to be asked in determining the validity of an assessment in the first instance is whether the assessment is rational, not whether it is correct." In ***Bernstein***, the administrative law judge had determined that the Notice of Deficiency issued by the Division "which failed to consider *any* portion of [subchapter S distributions] as personal service income [which at the time was taxed at a more favorable tax rate than other types of income] was arbitrary and capricious" (emphasis in original). However, since the Subchapter S corporation in ***Bernstein*** had categorized the

distributions as "contingent compensation" and not "for services," the Tribunal decided that in the first instance the Notice of Deficiency "had a proper basis," and the "Administrative Law Judge erred in determining that the assessment lacked a rational basis." Therefore, the initial question to be asked here is whether the Division had a rational basis for estimating petitioner's income from his practice as a personal injury lawyer by merely totaling up the deposits made to his business checking account during the years at issue. Given the facts and circumstances of this matter, this question must be answered in the affirmative.

C. As noted in Findings of Fact "4" and "5", although petitioner on his tax returns for the years at issue reported from his practice of law "gross receipts" of $653,451.22, $676,258.07 and $635,786.72 for 1998, 1999 and 2000, respectively, he reported a net loss in 1998 and an insignificant net profit of $1,775.28 in 2000, as well as a net profit in 1999 of $95,159.39. Such reporting would raise a red flag for any auditor reviewing these tax returns. Furthermore, as noted in Finding of Fact "2", petitioner selected a filing status which was more tax advantageous for him, but plainly incorrect and without any basis, which would also raise a flag for an auditor to take a closer look at the tax returns under review. Then, as detailed in Finding of Fact "14" and footnote "15", petitioner compounded the questions raised on the very face of his tax returns by failing to cooperate with the auditors. As noted in Finding of Fact "4", he failed to provide any type of bookkeeping ledger or journal for the recording of client fees or any records that supported or tied in directly to the amounts he reported as his "gross receipts" on his tax returns. Consequently, as noted in Finding of Fact "12", the Division resorted to a review of the bank statements eventually provided by petitioner after many requests. Totaling up deposits on such statements to calculate petitioner's "gross receipts" was indeed a rational approach given the facts and circumstances faced by the Division's auditors.

D. In addition, petitioner has contended that it was unreasonable and arbitrary for the Division to persist in its demands that he bring forward third-party documentation such as bills and invoices in support of the various expenses claimed incurred by his legal practice as a personal injury lawyer. Petitioner asserts he was a sole practitioner short on time and frail in health to respond to the demands of the auditor. He claims that his law practice had to have expenses for rent, utilities, telephone, etc., and maintains that checks in payment of expenses should have been adequate proof. However, the request for invoices and bills or some other type of third-party documentation was clearly reasonable in order for the auditors to determine whether expenses paid by check were, perhaps, personal rather than business expenses or even expenses paid on behalf of some other person, perhaps petitioner's wife or some other relative, for example. Furthermore, petitioner's inability to offer for review any particular documentation that tied into the amounts reported on his tax returns for the years at issue added to the auditors' understandable wariness in their examination of his tax returns. In short, their repeated requests that petitioner provide bills and invoices and other third-party documentation to substantiate expenses claimed on his tax returns were justified.

E. Furthermore, as noted in Finding of Fact "24", since tax asserted due by the Division has been substantially reduced from the amount asserted due in the Notice of Deficiency dated December 15, 2003, the burden of proof has not shifted to the Division on the basis that it is asserting a greater deficiency than what was asserted in the original notice.

F. Consequently, like the petitioner in ***Bernstein,*** petitioner has the "burden to prove that the assessment was erroneous," and petitioner's contention that the notice's presumption of correctness has been rebutted is rejected. In sum, there is simply no basis for throwing out the entire assessment in the first instance for lacking a rational basis.

G. As a result, a close examination of the hearing record is required to determine whether petitioner has sustained *his burden of proof* to establish (i) whether any deposits to his bank account represented loan proceeds or other nontaxable funds such as social security benefits and (ii) the amount of any business expenses deductible from his income generated by his legal practice. With regard to petitioner's Schedule A itemized deductions, as noted in Findings of Fact "9", "10" and "11", the only change made by the Division for each of the years at issue was the New York modification as required by statute. Therefore, it is unclear why the parties in their briefs seem to suggest that they are still in issue.

H. As noted in Finding of Fact "12", the Division increased petitioner's reported New York adjusted gross income by $310,455.16, $2,289,722.00 and $665,475.70 for 1998, 1999 and 2000, respectively, as a result of the auditors' review of deposits shown on petitioner's checking account for his legal practice. As noted at the hearing and conceded by the Division in its brief, certain deposits should be subtracted from the totals for "additional receipts per bank statements" as detailed in Finding of Fact "19", which total $14,000.00 in 1998 and $71,270.00 in 1999. However, other than this modest adjustment, the Division's position as specified in Finding of Fact "25" that alleged loans from relatives and credit cards were never evidenced by any documentation, either during audit or at the hearing in this matter, is a point well made. Neither was any documentation or evidence introduced to substantiate that some deposits represented social security benefits. Furthermore, as noted in Finding of Fact "21", it is observed that petitioner, in bringing his motion to vacate the default determination issued against him, argued that his case was "meritorious" because "the auditor failed to take into account that two-thirds of the money paid into the trust account was paid out to clients and should not be considered income of petitioner." In vacating the default, the supervising administrative law judge relied

upon this contention while he rejected petitioner's other contention that the "reorganization" of petitioner's documents, previously provided to the Division's auditors, established a meritorious case pointing out that petitioner had multiple opportunities to present such documents earlier. Nonetheless, at the hearing, as noted in Footnote "19", petitioner withdrew the very contention that provided the basis for the opening of the default determination and, in substance, has merely resorted to a "reorganization" of his documents as detailed above in Finding of Fact "22".

I. Turning to the other audit issue, whether petitioner has established his entitlement to additional deductions for business expenses, the legal basis for such deductions first should be noted. Under Tax Law § 612(a), the adjusted gross income of a New York resident is Federal adjusted gross income, with certain modifications not applicable in this case. Section 62(a)(1) of the Internal Revenue Code ("IRC") defines adjusted gross income as an individual's gross income minus certain deductions. Among the deductions permitted are deductions for expenses which are "ordinary and necessary" for the production of income (IRC § 162[a]).

J. The taxpayer has the double burden of (1) demonstrating entitlement to the deduction and (2) substantiating the amount of the deduction (***see***, Tax Law § 658[a]; § 689(e); 20 NYCRR 158.1; ***Matter of Macaluso***, Tax Appeals Tribunal, September 22, 1997 ***confirmed*** 259 AD2d 795, 686 NYS2d 193). Here, there is no doubt that petitioner carried on a personal injury law practice. Consequently, he was entitled to deduct from his receipts from clients of his practice his expenses which were ordinary and necessary in carrying on his trade or business. The difficulty confronting petitioner is his inadequate record keeping.

K. It must be emphasized that petitioner was *required to maintain* adequate records of his income and deductions for the years in issue from his practice of law (Tax Law § 658[a]; 20

NYCRR 158.1[a][21]). In addition, as an attorney, petitioner was further required to maintain for seven years after the events which they record, pursuant to Disciplinary Rule DR 9-102 (D)(1) of the Lawyer's Code of Professional Responsibility of the New York State Bar Association:

> 1. The records of all deposits in and withdrawals from the [Attorney's Trust Account] and of any other bank account which concerns or affects the lawyer's practice of law. These records shall specifically identify the date, source and description of each item deposited, as well as *the date, payee and purpose* of each withdrawal or disbursement. (Emphasis added.)

Petitioner failed to produce any evidence of such records. Further, as noted in Conclusion of Law "D", the Division acted reasonably in refusing to allow deductions for expenses which petitioner could not substantiate with the provision of an invoice or bill or some other type of third-party documentation.

L. Nonetheless, despite the absence of adequate documentary evidence, the Tax Appeals Tribunal has established the principle that credible testimony is sufficient as a matter of law, even without corroborating documentary evidence, to establish, for example, that a taxpayer did not spend more than 183 days in New York (***Matter of Avildsen***, Tax Appeals Tribunal, January 26, 1995). This matter concerning petitioner's entitlement to deductions for business expenses is also factual in nature. However, here petitioner offered no testimony to support his deductions, and the mere production at hearing of canceled checks (previously disclosed to the Division for the most part in the course of the audit) by a representative with no personal knowledge of petitioner's law practice is inadequate to establish entitlement to the deduction. Further, no weight can be given to petitioner's skimpy and conclusory affidavit dated May 10, 2006, as detailed in Finding of Fact "15", in light of the contrary testimony of the two auditors. As noted

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[21] This regulation provides as follows:
"Every person subject to New York State income tax . . . must keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits and other matters required to be shown by such person in any New York State income tax return . . . ."

in Finding of Fact "21", petitioner maintains that he was unable to appear at the hearing originally scheduled for the spring of 2005 because of various illnesses and was too ill to appear at the hearing subsequently held the following year on May 16, 2006. Nonetheless, pursuant to 20 NYCRR 3000.6(c), petitioner could have sought to perpetuate his testimony at an earlier date when his health was better (***see, Matter of Evans***, Tax Appeals Tribunal, June 4, 1998, ***confirmed*** 199 AD2d 340, 606 NYS2d 404). As noted in Finding of Fact "21", in December of 2004, petitioner was able to meet with the Division's auditors at a courtesy conference, approximately nine months after the filing of his petition in this matter. It is not unreasonable to presume that petitioner, in fact, did not want to testify or be deposed under oath and thereby make himself subject to cross-examination. Furthermore, unlike the situation in ***Avildsen (supra***), on cross-examination, petitioner's credibility would certainly be undermined by any questioning concerning his failure, in the face of the explicit requirements noted above, to maintain adequate records documenting his income and expenses. In contrast, in ***Avildsen***, the taxpayer lacked documents to substantiate his days spent in and out of New York.

M. In addition, petitioner's reliance on the so-called ***Cohan*** rule, that it is appropriate to estimate the deductible amount allowed even though the exact amount has not been proved (***Cohan v. Commr.***, 39 F2d 540), is misplaced. The Tax Appeals Tribunal in ***Matter of Hamsho*** (October 25, 1990) rejected a similar position pointing out that "recent decisions" have substantially limited the application of this "rule":

> Where the taxpayer has provided no basis upon which the court may make a reasonable estimate, the deduction has been denied altogether (***see, Lerch v. Commr***., 877 F2d 624, 89-1 USTC ¶ 9388; ***Pfluger v. Commr.***, 840 F2d 1379, 88-1 USTC ¶ 9921, at 83,438, ***cert denied*** 487 US 1237, 101 L ED 2d 938; ***Matter of Schneier***, Tax Appeals Tribunal, November 9, 1989). The ***Pfluger*** case dealt with a dentist who undoubtedly spent substantial sums of money on materials but completely failed to cooperate with the Tax Court in substantiating claimed deductions. The United States Court of Appeals for the Seventh Circuit

> held that there was no obligation to make an estimate under the ***Cohan*** rule (***Pfluger v. Commr., supra***). The court reasoned that the Commissioner and the Tax Court were not forced to resort to averages to estimate an allowable deduction, as the use of estimates could often result in allowance of more deductions than the taxpayer was actually entitled to take (***id.***).

Like the matter at hand, in ***Hamsho***, the taxpayer also "failed to present affidavits or other evidence supplied from the *providers* of [services]." (Emphasis added.)

N. As noted in Finding of Fact "26", petitioner persists in maintaining that he provided original records concerning his "deposits of non-income items into his bank account" to auditor Lee and that these records were "lost in the destruction of the Towers by the terrorists." It would be extremely negligent of any attorney to turn over original documents without even a transmittal letter, and petitioner has offered absolutely nothing in the nature of documentation to support his contention that he gave original records to auditor Lee. Furthermore, in light of the credible testimony of the auditor and her supervisor, as detailed in Finding of Fact "15", that the Division as a policy makes copies of any documentation provided by a taxpayer and does not retain original taxpayer documents, it is concluded that petitioner did not lose original records in the destruction of the auditors' World Trade Center offices. In any event, even if he had lost original records in the terrorist attack on September 11, 2001, there would be no shifting of the burden of proof to the Division, and petitioner would still have to shoulder the burden of proving his case (***Matter of A.V.S. Laminates***, Tax Appeals Tribunal, March 23, 2006).

O. Nonetheless, the Division has allowed certain business expenses claimed by petitioner. As noted in Finding of Fact "13", the Division allowed various expenses for wages and consultants during the audit stage. Further, as noted in Finding of Fact "23", after the completion of the hearing, upon further review, the Division also allowed expenses for rent, taxes and dues and subscriptions. In addition, it is also concluded that petitioner should be

allowed a business expense deduction for the electronic payments of Federal payroll taxes as detailed in Finding of Fact "20" since the record establishes that petitioner employed individuals in his legal practice, as noted in Finding of Fact "1". It would be irrational to allow a deduction for the wages paid and not the payroll taxes on such wages when they have been substantiated by petitioner's bank statements which show the electronic payment of such taxes.

P. Finally, it is concluded that petitioner has not established reasonable cause for the abatement of penalties. As noted in Findings of Fact "9", "10" and "11," negligence penalties and substantial understatement of liability penalties were imposed on petitioner. Pursuant to Tax Law § 685(b)(1) and (2), if any part of a deficiency is due to negligence, negligence penalties (i) equal to five percent of the deficiency and (ii) equal to 50% of the interest payable, respectively, "shall be added to the tax." Petitioner's failure to maintain adequate records of his income and expenses clearly supports the imposition of negligence penalties (***see, Matter of Eisner***, Tax Appeals Tribunal, March 22, 1990 [wherein the Tribunal noted that the "petitioner was negligent in maintaining records and, therefore, the negligence penalty was properly imposed"]). Furthermore, petitioner, failed to produce evidence that he complied with the requirements specifically imposed on attorneys pursuant to the Lawyer's Code of Professional Responsibility of the New York State Bar Association, further justifying the imposition of negligence penalties. In addition, petitioner's illnesses do not provide a basis to justify his failure to maintain adequate records. Simply stated, if petitioner was healthy enough to practice law, he was healthy enough to maintain adequate records of his income and expenses or hire a bookkeeper to do so. Finally, under Tax Law § 685(p), "[i]f there is a substantial understatement of income tax for any taxable year, there shall be added to the tax an amount equal to ten percent of the amount of any underpayment attributable to such understatement." In the case at hand, the understatement

clearly exceeded the statutory definition of "understatement" which at Tax Law § 685(p) is defined as an understatement which "exceeds the greater of ten percent of the tax required to be shown on the return for the taxable year, or two thousand dollars."

Q. The petition of Martin Lassoff is granted to the extent indicated in Conclusions of Law "H" and "O", and the Notice of Deficiency dated December 15, 2003 is to be modified to so conform, but, in all other respects, the petition is denied.

DATED: Troy, New York
May 24, 2007

/s/ Frank W. Barrie
ADMINISTRATIVE LAW JUDGE