

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :
of :
RABBI MILTON BALKANY AND :
SARA BALKANY : DETERMINATION
: DTA NO. 823424
for Redetermination of a Deficiency or for Refund of New :
York State Personal Income Tax under Article 22 of the :
Tax Law and New York City Personal Income Tax under :
the Administrative Code of the City of New York for the :
Year 2005. :
:

Petitioners, Rabbi Milton Balkany and Sara Balkany, 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 and New York City personal income tax under the Administrative Code of the City of New York for the year 2005.

A hearing was held before Catherine M. Bennett, Administrative Law Judge, at the offices of the Division of Tax Appeals, New York, New York, on October 30, 2013 at 10:00 A.M, with all briefs due by May 21, 2014, the date upon which the six-month period for the issuance of this determination commenced. Petitioners appeared by Davis Ward Phillips & Vineberg, LLP (Abraham Leitner, Esq.). The Division of Taxation appeared by Amanda Hiller, Esq. (Christopher O'Brien, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation properly determined that petitioners failed to present sufficient evidence to establish that they made charitable deductions of \$500,000.00 in tax year 2005.

II. If it is determined that the charitable deductions for 2005 should be disallowed, whether petitioners can ignore the 1099 Miscellaneous income statement issued to Rabbi Balkany from Rite Care, and recompute the tax due on their personal income tax return for 2005.

FINDINGS OF FACT

1. Petitioners, Rabbi Milton Balkany and Sara Balkany, filed their 2005 federal and New York State and City resident personal income tax returns on or about November 13, 2007, reporting wages in the amount of \$180,000.00 and business income on federal schedule C in the amount of \$420,804.00, without any payment for taxes, interest and penalties due.

2. The source of the \$180,000.00 in wages, paid to Rabbi Balkany, was Bais Yaakov of Brooklyn (Bais Yaakov), a Hebrew girls school where he was employed.

3. The amount of \$420,804.00, shown as gross receipts on federal schedule C for Rabbi Balkany, was reported to him on a 2005 Miscellaneous Income form (1099-MISC) by Rite Surgical Supplies, Inc., referred to during the hearing as "Rite Care," a company 50% owned by petitioners' son, Levi Balkany. Petitioners reported the principal business activity of Rabbi Balkany on schedule C for 2005 as "rabbinical teacher."

4. Rabbi Balkany did not have a compensation arrangement with Rite Care, nor did he have any type of written or oral agreement for the payment of the \$420,804.00, as reported on the 1099-MISC. He believed that this 1099 was issued to him in error.

5. On the same personal income tax returns for 2005, petitioners claimed itemized deductions on each of the respective returns, as follows:

Itemized Deduction	Federal Return	New York Return
Taxes	\$13,349.00	\$13,349.00
Gifts to Charity	\$500,000.00	\$500,000.00
Subtotal, Itemized Deductions	\$502,670.00¹	\$502,670.00
State, local and foreign income taxes subtracted		(\$2,670.00)
Other subtraction adjustments		(\$250,000.00)
Total Itemized Deduction	\$502,670.00	\$250,000.00

6. The Division of Taxation's (Division) inquiry into this matter commenced with the late-filing of New York state personal income tax returns for 2004 and 2005.² The Division was able to verify that income items reported in petitioners' names for 2005 were, in fact, reported on their return. Upon further review of the tax return for 2005, the Division noticed a charitable deduction in the amount of \$500,000.00 and followed up with petitioners by requesting an explanation and substantiation of that deduction. According to the Division's audit report, despite repeated requests for documentation, petitioners failed to provide any supporting documents for the contributions claimed. Thereafter, the charitable deduction was disallowed and replaced by the standard deduction, a Statement of Audit Changes was issued, and upon petitioners' failure to respond to the Statement of Audit Changes, the matter was closed by the Division as disagreed.

7. The Division issued a Notice of Deficiency to petitioners, dated May 1, 2008, assessing tax in the amount of \$55,780.00, plus interest and penalties, for 2005.

¹ Itemized deductions were limited in accordance with Internal Revenue Code § 68.

² The return for 2004 was later accepted as submitted and is not in issue.

8. A conciliation conference before the Bureau of Conciliation and Mediation Services was held on May 6, 2009. On September 25, 2009, the conferee issued a Conciliation Order (CMS No. 225246) and sustained the statutory notice.

9. Petitioners submitted into evidence a listing of checks that were paid by Rite Care to Levi Balkany during 2005, totaling \$449,945.00. Levi identified the listing as representing amounts paid by Rite Care to Levi on behalf of Rabbi Balkany. Levi believed that some of these payments were reported as paid to him, which accounts for the difference between the \$449,945.00 and the \$420,804.00 reported on the 1099 issued to Rabbi Balkany. When asked why Rite Care issued the checks to Levi instead of Rabbi Balkany, Levi indicated that since the Bais Yaakov was so financially dysfunctional, this method allowed him to have some control over the funds, making sure the money was directed in the manner prescribed by Rabbi Balkany, who at times did not have a personal bank account.

10. Documentation submitted by petitioners at the hearing included a listing of checks written on the account of Levi Balkany during 2005, prepared by an attorney formerly representing petitioners, some of which were described as payments made by Levi Balkany to the creditors of Bais Yaakov. The checks were essentially presented in numerical order, but bore dates that were not close in time or in a sequence that corresponded to the numerical check sequence. According to the listing, the payees on many checks were illegible. Those that were legible were not identified, except to the extent the payment was extended into a column bearing a title that Levi explained or was self explanatory. Only a few of the columnar titles were explained by Levi during the hearing and only a portion of the corresponding checks were submitted into evidence.

The total of the checks written from Levi Balkany's account in 2005, was \$1,424,144.62. Two columns that were the subject of some discussion during the hearing are entitled "BYM/Teachers and other Payments" and "BYM Debt Service/Hilgar."³ The amounts extended into these columns totaled \$284,567.10 and \$393,908.84, respectively, and were identified as amounts paid to people or companies to whom Bais Yaakov owed money.

11. Petitioners also submitted into evidence documentation indicating that the Internal Revenue Service (IRS) reviewed petitioners' federal income tax return for tax year 2005. In correspondence dated February 11, 2008, the IRS stated that it was corresponding with petitioners because there was an error on their 2005 federal income tax return and that a change to that return was being made by the IRS. The notice stated the following: "We changed the amount claimed as total gifts to charity on your Schedule A, Itemized Deductions, because it was figured incorrectly or the amount was not limited to one-half of your adjusted gross income." Page 2 of the IRS correspondence was missing, and page 3, appearing incomplete, discussed penalties that were being imposed.

12. Petitioners had prepared their 2005 federal personal income tax return utilizing the Katrina Emergency Tax Relief Act of 2005 as it concerned charitable contribution limitations.

13. Additional correspondence from the IRS dated August 19, 2010, sent to petitioners' former representative, addressing the 2005 tax year, stated the following:

"We finished reviewing the liability issue you raised for Form 1040 tax period 12/31/2005. We found that the Philadelphia Service Center has abated the additional tax assessment based on the information you provided to the campus.

³ "BYM" was identified as Bais Yaakov of Midwood, Rabbi Balkany's employer. The school changed its name from Bais Yaakov of Brooklyn to Bais Yaakov of Midwood at some point.

Therefore, the remaining tax liability for this period was based on the Form 1040 that you filed and your request have [sic] been completed.

You have indicated on your Collection Due Process request that you are interested on [sic] an installment agreement. . . .”

14. Petitioners were permitted additional time post-hearing for a final submission of 1) documentation to support their position as it related to the IRS review of the same issues in this matter and 2) documentation that would provide proof that Bais Yaakov authorized and directed payments be made to third parties for debts owed by the school. These submissions were not made by petitioners. Inasmuch as the submission of petitioners’ post-hearing brief was beyond its due date, the brief was returned to petitioners’ representative and was not considered in this determination.

SUMMARY OF THE PARTIES’ POSITIONS

15. Petitioners contend that the \$420,804.00 paid directly to the vendors, employees and creditors of Bais Yaakov, a section 501(c)(3) organization, by petitioners’ son, Levi Balkany, should be allowed as charitable contributions by petitioners, and deductible at the federal level without regard to the usual 50% contribution base limitation, in accordance with the Katrina Emergency Relief Act of 2005.⁴ Petitioners allege that amounts deposited into Levi’s account, part of which represented amounts that were paid to the vendors, employees and creditors of Bais Yaakov, were payments directed by Rabbi Balkany for the benefit of Bais Yaakov in its struggling financial condition. Although Rabbi Balkany never received the moneys, Levi Balkany claimed that Rite Care was compensating Rabbi Balkany for his business connections that resulted in a great deal of revenue for Rite Care. Levi also testified that Rite Care was not

⁴ New York State did not recognize this brief departure from the contribution base limitation.

“comfortable” paying such money to the third parties (creditors of Bais Yaakov), but would rather give the money to him. Levi in turn did not pay Rabbi Balkany the same \$420,804.00 because, allegedly, the Rabbi did not always have a bank account in which to deposit the money.

16. Petitioners claim that of the \$180,000.00 in salary attributed to Rabbi Balkany from Basi Yaakov during tax year 2005, \$80,000.00 of that amount, though still owed to him, was foregone for the payment of school debts. Petitioners claimed this \$80,000.00 as a charitable deduction to the school, as part of the \$500,000.00.

17. Petitioners also argue that the Rite Care payments should not have been included in petitioners’ gross income, though they admit the payments were properly included in income based upon the form 1099 issued to Rabbi Balkany. Petitioners believe this issue should be addressed in this matter as well, and maintain that the charitable contributions should be found to be properly deductible if it is determined that the Rite Care payments were properly included in petitioners’ income.

18. The Division maintains that petitioners have failed to provide adequate substantiation of the \$500,000.00 in charitable contributions by petitioners during the tax year in issue. The Division contends it received nothing substantive to prove that petitioners had made contributions. According to the Division, the check register from which checks were identified were from an account of Levi Balkany and his wife, not petitioners. The register covers far more than the deductions taken, but many of the checks are unidentified, and there is no trail to connect Rabbi Balkany to the payments. Adding further to the lack of proof, the record was not contemporaneously prepared with the payments, all but two of the checks are made out to

persons or businesses other than Bais Yaakov, and there is no proof that this is where the payments actually went, or that the payments were in satisfaction of debts of the school. In addition, the Division argues that the \$80,000.00 of foregone salary, characterized as a charitable deduction to Bais Yaakov, is also absent any substantiation and should be denied.

CONCLUSIONS OF LAW

A. Tax Law § 615 provides that the New York itemized deductions of a resident individual are the same as the itemized deductions allowed for federal income tax purposes, with certain modifications not relevant herein. Accordingly, it is appropriate to look to the provisions of the Internal Revenue Code (IRC), federal regulations and federal case law to determine the deductibility of an item.

B. IRC § 170 allows a deduction for charitable contributions that meet specific criteria, and Treas Reg § 1.170A-13 sets forth the record-keeping requirements for such deductions, in pertinent part, as follows:

“(a) Charitable contributions of money made in taxable years beginning after December 31, 1982

(1) **In general.**—If a taxpayer makes a charitable contribution of money in a taxable year beginning after December 31, 1982, the taxpayer shall maintain for each contribution one of the following:

(i) A cancelled check.

(ii) A receipt from the donee charitable organization showing the name of the donee, the date of the contribution, and the amount of the contribution. A letter or other communication from the donee charitable organization acknowledging receipt of a contribution and showing the date and amount of the contribution constitutes a receipt for purposes of this paragraph (a).

(iii) In the absence of a canceled check or receipt from the donee charitable organization, other reliable written records showing the name of the donee, the date of the contribution, and the amount of the contribution.

(2) *Special Rules*

(i) Reliability of records.—The reliability of records described in paragraph (a)(1)(iii) of this section is to be determined on the basis of all of the facts and circumstances of a particular case. In all events, however, the burden shall be on the taxpayer to establish reliability. Factors indicating that the written records are reliable include, but are not limited to:

(A) The contemporaneous nature of the writing evidencing the contribution.

(B) The regularity of the taxpayer's record keeping procedures. For example, a contemporaneous diary entry stating the amount and the date of the donation and the name of the donee charitable organization made by a taxpayer who regularly makes such diary entries would generally be considered reliable.

(C) In the case of a contribution of a small amount, the existence of any written or other evidence from the donee charitable organization evidencing receipt of a donation that would not otherwise constitute a receipt under paragraph (a)(1)(ii) of this section (including an emblem, button or other token traditionally associated with a charitable organization and regularly given to persons make cash donations).”

C. On September 23, 2005, in response to the hurricane disasters along the Gulf coast, President Bush signed the Katrina Emergency Tax Relief Act of 2005 (Pub L 109-73), which temporarily modified the rules relating to charitable deductions by both individuals and corporations. As the Act relates to this matter, qualified contributions, i.e., cash contributions to a charitable organization described in IRC § 170(b)(1)(A) made between August 28, 2005 and December 31, 2005, by individuals were allowed to be made in a manner unimpeded by the usual 50 percent contribution base limitation. Petitioners took advantage of this federal provision

when filing their 2005 personal income tax returns, asserting that the \$500,000.00 charitable deduction was permitted by the Act, though it did not affect their New York State return.

D. When the Division issues notices of deficiency to a taxpayer, a presumption of correctness attaches to the notices, and the burden of proof is on the taxpayer to demonstrate by clear and convincing evidence that the deficiency is erroneous (*Matter of Atlantic & Hudson Ltd. Partnership*, Tax Appeals Tribunal, January 30, 1992). Petitioners thus had the burden to show entitlement to the deductions claimed on their federal schedule A and to substantiate the amount of the deductions (*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 [1999]). Furthermore, petitioners were required under the Tax Law to maintain adequate records of their items of deductions for the year in issue (Tax Law § 658[a]; 20 NYCRR 158.1[a]).

E. Petitioners maintain that if it is established that payments came out of the funds that were held on behalf of them by their son, Levi, then although the contributions to Bais Yaakov were not paid directly by petitioners, the payments should be identified as made by petitioners. In other words, petitioners assert that where a third party (in this case Rite Care) owes money to a taxpayer, payments made by the third party (in this case the third party's designee, i.e., Levi Balkany) that are debited to the taxpayer's account and that reduce the amount owed to the taxpayer are treated for income tax purposes as having been made by the taxpayer. Petitioners cite to *Jergens v. Commissioner* (17 TC 806 [1951]), wherein the taxpayer was president of Andrew Jergens Company, the corporation that paid several personal liabilities of the taxpayer,

charging the taxpayer's personal account as offsets to the salary and dividends to which he was otherwise entitled. Although the IRS disallowed the taxpayer's claimed deductions for these payments on the basis that the petitioner had not suffered a cash detriment, the Tax Court rejected the IRS's decision observing that the taxpayer's ability to withdraw cash from his account held by the corporation is considered a payment by a cash basis taxpayer, so long as the charges do not exceed the credits included in income. Contrasted with this matter, the corporation in *Jergens* unequivocally owed the taxpayer the money, and this fact was not in question. In this case, however, there was conflicting testimony throughout the hearing concerning whether Rite Care legally owed anything to Rabbi Balkany, and whether or not the \$420,804.00 represented money available to petitioners, such that they could even make or direct payments to any source with such funds. More importantly, however, the corporation in *Jergens* was paying a liability of the taxpayer directly to the taxpayer's creditors.

The Division argues that even if the payments made by Levi are treated as having been made on behalf of petitioners, the payments would not be deductible because they were not made directly to Bais Yaakov. Petitioners contend this is not necessarily true, particularly where charitable and other gifts are concerned, and I agree. Petitioners rely upon Revenue Ruling 81-110, where an individual (X) made a binding pledge to a charitable organization that was honored by a third party (Y). The IRS held that Y was considered to have made a gift to X at the time the pledge was honored by Y, and at the time of payment, X was entitled to a charitable deduction, but Y was not. The IRS explained that the payment of money or property in satisfaction of an individual's (X's) legal obligation is equivalent to a payment directly to the

individual (X) (by Y), and Y's payment to X was characterized as a taxable gift (IRC § 2511; Treas Reg § 2511-1). There are a couple of distinguishable facts in this case. First, Bais Yaakov was not a creditor of petitioners, but at best a donee. The payments to the creditors of Bais Yaakov were not in satisfaction of any binding legal obligation of Rabbi Balkany to them. The payments were purely gratuitous. The payments in this case did not go from Rite Care to petitioners' creditors, they went to Levi. Levi did not pay Bais Yaakov, the intended donee, but rather paid people to whom Bais Yaakov allegedly owed money. Lastly, petitioners are not suggesting that Levi made a gift to them of \$420,804.00 (though it may be construed as such), and although Levi allegedly did not take charitable deductions for the payments to the creditors of Bais Yaakov, this testimony was not supported by any documentation. However, despite these differences, even if the indirect payments are attributed to petitioners on a constructive payment or agency theory, there still exists the enormous gap in substantiation that would establish charitable contributions to Bais Yaakov by petitioners. The cancelled checks offered into evidence were insufficient on their own to substantiate the payments as charitable contributions. Since the cancelled checks were not sufficient, the law requires a receipt from Bais Yaakov or any other reliable written records supporting the contributions, none of which was provided. Furthermore, there are no acknowledgments from Bais Yaakov that it received these donations, no documentation showing that Bais Yaakov directed payments to particular creditors, no substantiation that these amounts were even owed to such vendors and employees, and insufficient proof that such payments were actually made. Accordingly, the overwhelmingly scant documentation does not satisfy the record-keeping requirements required by law for the

deductibility of the charitable donations allegedly made by Levi on behalf of petitioners (Treas Reg § 1.170A-13).

As to the \$80,000.00 of salary that Rabbi Balkany claims to have foregone, there is simply no evidence that petitioners did not receive this money. There is no agreement between petitioners and Bais Yaakov, there are no minutes from the board of directors referring to any arrangement, and there are no documents or acknowledgments by the school that would support the explanation provided by petitioners. In this case, the testimony alone is simply insufficient to substantiate the \$80,000.00 charitable deduction. Accordingly, the Division properly disallowed the charitable deductions for 2005 in the amount of \$500,000.00.

F. Petitioners believe that another issue that must be addressed is the question of whether the \$420,804.00 should be properly reported as income of Rabbi Balkany in 2005. Petitioners argue that the Rite Care payments should not have been included in petitioners' gross income, though petitioners' return as filed did include such amounts as reported on the 2005 Form 1099 issued to Rabbi Balkany. One would think that the company paying such substantial sums would not be doing so without a valid reason. When Levi was questioned as to whether his father had a contract with Rite Care, Levi indicated that he was unaware of a contract but he believed that Rabbi Balkany had "an arrangement" with the company. Levi's description of the nature of the understanding was that if Rabbi Balkany procured business on a corporate level for Levi, Rabbi Balkany would be given a certain percentage of the profits against revenue. Levi described Rabbi Balkany's assistance in making contacts that resulted in securing over \$10,000,000.00 in business for Rite Care that Levi would not have been able to acquire on his

own. Consistent with Levi's explanation, Rite Care issued a 1099 to Rabbi Balkany for the income associated with the business connections he fostered. Nonetheless, Rabbi Balkany claims not to have an understanding with Rite Care as to specific dollar amounts or percentages he was to receive. What he had expressed to Rite Care is that if the company wanted to give Rabbi Balkany anything for what he had done on its behalf, it should go straight to the school. Initially, Rite Care was writing individual checks covering the expenses of Bais Yaakov that had nothing to do with the business of Rite Care. Levi's business partner believed that it would be best to instead place the funds into Levi's account. Levi then issued the checks to the creditors of Bais Yaakov as previously described. At the end of the year, Levi did not want to report the income since he was merely the conduit. The form 1099 was consequently issued to Rabbi Balkany for 2005 in the amount of \$420,804. This amount was not shown to tie into any particular listing of checks written by Levi, but general testimony indicated that most of the checks were to teachers and in satisfaction of debt service owed by Bais Yaakov.

G. It was impossible to discern additional facts in favor of petitioners since the credibility of the primary witness, Rabbi Balkany, was completely unreliable, and his lack of records for such a significant level of charitable contributions grossly incomplete. Even when petitioners were called upon to support their position with documentation that Rabbi Balkany claimed to have in his possession or available to him, and petitioners were given additional time to submit such evidence, none was provided. Examples include the alleged favorable handling of

this issue by the IRS, the alleged receipts and acknowledgments of the amounts and payments to the creditors and vendors of Bais Yaakov and substantiation of the foregone salary from Bais Yaakov by the school administrator. Likewise, Levi made characterizations of some of the payments he made as teachers' salaries. Later testimony revealed that if a payment was made to a woman, i.e., made out to "Mrs.," he assumed it was payment to a teacher without referring to or producing any supporting documentation.

It appears that at the end of a tax year with poor records at best, someone attempted to become creative with large sums of income and expenses, and take advantage of the charitable deduction limitation waiver under Hurricane Katrina legislation. Attributing income to petitioners who were the likely donors of money to the school, resulted in the potential to shelter a great deal of income. But the record-keeping was, at best, done after the fact, and grossly inadequate. That coupled with the unreliable and conflicting testimony of the father and son, left too much doubt and confusion to characterize the transactions in the deductible format that petitioners sought. Furthermore, there is an insufficient basis to ignore the form 1099 reported to petitioners for 2005, and declare it other than income attributable to petitioners in that tax year. The validity of the income reporting pursuant to the form 1099 stands separate and apart from a determination of any charitable deduction that may have been granted for 2005.

Petitioners were required under the Tax Law to maintain adequate records of their items of deductions for the year in issue (Tax Law § 658[a]; 20 NYCRR 158.1[a]), and failed to do so. Consequently, petitioners have not carried their burden of proof that they were entitled to these charitable deductions. Accordingly, the Division properly disallowed the charitable deduction, included the form 1099 income as reported by Rite Care and recomputed the tax due accordingly.

H. The petition of Rabbi Milton and Sarah Balkany is hereby denied. The Division of Taxation's Notice of Deficiency dated May 1, 2008, for tax year 2005 is sustained.

DATED: Albany, New York
November 13, 2014

/s/ Catherine M. Bennett
ADMINISTRATIVE LAW JUDGE