STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
ANTHONY AND RENATA CONTE	:	
for Redetermination of a Deficiency or for Refund of New York State and New York City Personal Income Taxes under Article 22 of the Tax Law and the New York City Administrative Code for the Year 2010.	:	DETERMINATION DTA NO. 825454

Petitioners, Anthony and Renata Conte, filed a petition for redetermination of a deficiency or for refund of New York State and New York City personal income taxes under Article 22 of the Tax Law and the New York City Administrative Code for the year 2010.

A hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, New York, New York, on April 9, 2014 at 10:30 A.M., with all briefs to be submitted by September 12, 2014 which date began the six-month period for the issuance of this determination. Petitioner Anthony Conte appeared pro se and on behalf of his wife. The Division of Taxation appeared by Amanda Hiller, Esq. (Robert A. Maslyn, Esq., of counsel).

ISSUES

I. Whether there was a rational basis for the issuance of the Notice of Deficiency.

II. Whether petitioners substantiated deductions for charitable contributions and job and miscellaneous expenses.

III. Whether the Division of Taxation properly determined that petitioner Anthony Conte was not engaged in publishing magazines for profit and therefore not entitled to the claimed losses for the years in issue.

FINDINGS OF FACT

1. Petitioners, Anthony Conte and Renata Conte, filed a joint 2010 New York State Resident Income Tax Return (Form IT-201). To the extent in issue, they claimed the following New York itemized deductions on their return:

Taxes	$ 22,690.00
Interest	$ 34,074.00
Charitable Contributions	$ 2,137.00
Job & Miscellaneous Deductions	$ 55,569.00

2. Petitioners' return included a Form IT-272, Claim for College Tuition Credit or Itemized Deduction, wherein they claimed a college tuition credit totaling $800.00 for two students, one of whom was attending a medical school. Their return also included a Schedule C, Profit or Loss From Business, for the firm I Media Company (the Company). Mr. Conte's name was listed as the proprietor of the company. According to the Schedule C, the Company did not receive any revenue and incurred a net loss of $47,923.00.

3. Nearly all of the income reported by petitioners in 2010 was wage income that was earned by Mrs. Conte. Except for relatively minor amounts, which were reported as interest income or taxable refunds, the only other source of income was unemployment insurance, which was presumably obtained by Mr. Conte.

4. By letter dated July 5, 2011, the Division of Taxation (Division) advised petitioners that their 2010 income tax return was under audit and requested documentation to substantiate their itemized deductions. The Division's letter also asked petitioners to provide substantiation from an employer verifying the job expenses claimed on the return. The Division did not inquire about the loss reported on the Schedule C.

5. Petitioners submitted documentation verifying the expense for taxes and interest. However, no documentation was submitted to verify the charitable contributions or miscellaneous job expenses.

6. The Division issued a Statement of Proposed Audit Changes, dated December 16, 2011, which stated that it disallowed the loss claimed on the Schedule C because it did not consider the business to be carried on for profit. As a result, petitioners were not permitted to use the loss to offset other income. The statement explained that the Division reached this conclusion because the business did not have any income in three of the previous five years. In the course of its review of the claimed business losses for 2010, the Division found that petitioners also reported business losses from 2006 through 2009. The Division never asked petitioners for substantiation of the business losses prior to reaching its conclusion that the business was not operated for profit. The statement also explained that the deduction for charitable contributions was disallowed because supporting documentation was not provided. The deduction for job expenses was also disallowed because the required verification was not provided. Lastly, the Division adjusted the college tuition credit because the credit only applies to tuition paid for undergraduate courses. The proposed changes to the return, resulted in a denial of a refund of $7,224.00 and a deficiency of personal income tax of $7,435.77. The statement advised petitioners that if they

disagreed with the proposed changes, they should complete the disagreement with findings section and attach a written explanation stating the reason for the disagreement.

7. In response to the Statement of Audit Changes, petitioners submitted documentation explaining the nature of the claimed business losses. However, no documentation was submitted regarding the job expenses or charitable contributions. Following its review, the Division concluded that the documentation submitted was irrelevant and did not warrant an adjustment.

8. On February 29, 2012, the Division issued a Notice of Deficiency to petitioners that asserted that tax was due in the amount of $7,435.77 plus interest for a balance due of $7,934.55.

9. In 1999, Mr. Conte developed a business plan for a TV magazine and listings guide publication with an inserted centerfold and an attached shopper publication. Mr. Conte has a background in this type of endeavor. In the 1970s and 1980s, he was employed by a 10-unit supermarket chain. Each week, the chain utilized distributors to issue hundreds of thousands of periodicals. Thereafter, he formed a business known as I Media Corporation (the Corporation) of which he was the principal owner and shareholder. At or about the end of 2003, the Corporation began operating as a publishing company that produced a magazine called TV Time Magazine. The magazine, which was offered at no cost, contained listings of local television programming and commercial advertisements. There was also an insert that was published under the name "Smart Shopper."

10. On December 22, 2003, Mr. Conte formed the Company, which operated as a sole proprietorship, to develop, print, distribute and market the publication.

11. Mr. Conte anticipated receiving revenue from two sources. One source was derived from selling advertising in the magazine and the accompanying insert. The distributors of the

magazine also paid for occupant address lists and carrier route maps that detailed the delivery route and the number of households at each individual address.

12. Through negotiation and agreement with content distributors and writers, the Corporation purchased weekly TV listings and content and promoted the advertising portion of the printed work. Initially, the Corporation planned to begin distributing the magazine in the New York City TV market, which exceeded seven million households. In time, the Corporation planned to market the magazine to more than 60 million households in more then 40 states. The Smart Shopper insert and web page were promoted and linked to the website of more than 200 retailers including Macy's, Sears, Apple, Amazon and Travelocity. Mr. Conte and the Corporation also developed rate cards, sell sheets and marketing materials to firms in the New York metropolitan area.

13. TV Time Magazine was dispensed by route distributors who operated under a contract with the Corporation to circulate the magazine on a weekly basis. The distributors were experienced home delivery agents and carriers. Ultimately, the Corporation entered into contracts with about 60 different distributors in approximately 100 different zip codes on Long Island, Queens and the New York City area. Mr. Conte signed the contracts on behalf of the Corporation. All of the contracts called for the distribution of the magazines to residences in areas designated by zip codes. Most of the contracts with the distributors were signed in 2004 and 2005 and provided for a term of 10 years with a provision that permitted them to be renewed for an additional 10 years.

14. In late November 2004, the Corporation began printing and distributing TV Time Magazine on a weekly basis to two counties on Long Island. Initially, circulation was 15,000

copies per week and by March 2005 was 200,000 copies per week. By the end of 2005, nearly three million copies of the magazine had been distributed.

15. In January 2005, Mr. Conte hired a full-time advertising sales director for the magazine who was delegated most of the advertising sales and marketing functions. The director was experienced in marketing and sales and possessed contacts with manufacturers, retailers and service companies sought by the Corporation as paid advertisers.

16. In 2005, the Corporation began to have problems with the route distributors. It was Mr. Conte's belief that the problems were caused by interference by employees of Nassau County, the Nassau County's District Attorney's Office and Newsday, Inc. (Newsday.) As a result of the alleged interference, route distributors refused to distribute the magazines and the Corporation was unable to continue in business.

17. On December 7, 2005, the Corporation received a letter from the New York State Department of Taxation and Finance advising it that the Corporation's status was administratively dissolved.[1] The letter caused Mr. Conte to begin winding up the affairs of the Corporation. Accordingly, in April 2006, the Corporation assigned all of its claims, rights, title and interests to all intellectual property and trademark rights, goodwill and causes of action against third parties to Mr. Conte.

18. In 2006, Mr. Conte commenced a lawsuit in federal district court against the County of Nassau, the Nassau County District Attorney's Office and a group of individuals who were associated with the Nassau County District Attorney's Office. He initiated a second lawsuit against Newsday, Inc. (Newsday) and certain individuals who were associated with Newsday.

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[1] The record does not disclose what prompted this letter.

Based upon the complaints, the nature of the lawsuits concerned allegations that the defendants engaged in conduct that made it impossible for Mr. Conte to continue in his business.

19. Following a jury trial, Mr. Conte was awarded total compensatory damages of $703,500.00 and total punitive damages of $678,000.00 against three individual defendants who performed services for the Nassau County District Attorney's Office based on his claim that was premised on the legal theory of tortious interference with contracts. At the time of the hearing, an appeal was pending before the Second Circuit Court of Appeals.

SUMMARY OF THE PARTIES' POSITIONS

20. With respect to the job expenses and charitable contributions, Mr. Conte contends that he submitted all of the documentation to the Division and the Division should be estopped from claiming that it did not receive them. Mr. Conte also maintains that since the Division never inquired about the business loss, there was no basis to issue a notice of deficiency. Mr. Conte takes issue with the Division's claim that the Company was operated as a hobby and that the litigation expenses incurred to collect income on business contracts were personal expenses. Mr. Conte maintains that he was in the process of liquidating valuable claims. He also notes that the Division does not deny that the Corporation was being validly liquidated. Mr. Conte further asserts that the Corporation had valuable contract claims that prompted him to bring suit in federal court. He also posits that the business deductions taken as a result of the expenses incurred in pursuing this litigation were incurred in order to recoup the lost income and were legitimate business expenses.

21. Relying upon the nine criteria set forth in Treasury Regulation § 1.183-2[b], the Division contends that Mr. Conte has not demonstrated entitlement to the business loss claimed. The Division notes that the Company was not doing any type of business in 2010 and Mr.

Conte's assertion that he intended to wind up the Corporation shows that Mr. Conte was not intending to operate the Company for profit. The Division submits that if Mr. Conte was truly winding up the Corporation's affairs, it would have done so in the name of the Corporation. The Division also argues that petitioners failed to substantiate the deductions and expenses claimed for the job and miscellaneous expenses. Lastly, the Division notes that petitioners have not presented any evidence contesting the disallowance of the charitable contributions and tuition tax credit.

22. In a reply, Mr. Conte asserts that he submitted documentation to the Division on September 12, 2011, including the documentation supporting the charitable contributions and job expenses. According to Mr. Conte, the Division simply ignored the documentation that was provided. Mr. Conte continues to take issue with the Division's characterization of the business as a hobby and the claim that the litigation expenses that were incurred to collect income were personal expenses. Mr. Conte notes that the Division has not denied petitioners' argument that a corporation that is being liquidated continues to exist for the purpose of winding up its affairs.

CONCLUSIONS OF LAW

A. At the hearing, Mr. Conte expressed his concern that the Division did not inquire about the business losses prior to issuing the Notice of Deficiency. In essence, petitioners are asserting that the Division did not have a rational basis for issuing the notice.

B. It is well established that there is a presumption of correctness of a notice of deficiency that is properly issued under the Tax Law (***Matter of Tavolacci v. State Tax Commn.***, 77 AD2d 759 [3d Dept 1980]). In certain cases, however, the government is required to first establish that the notice has a rational basis before the presumption of correctness arises (***see Matter of Fortunato***, Tax Appeals Tribunal, February 22, 1990).

C. As noted above, the Division issued a Statement of Proposed Audit Changes that, among other things, explained that it disallowed the loss claimed on the Schedule C since the Division did not think that the business was carried on for profit. The Division reached this conclusion because the business did not have any income in three of the last five years. This explanation was sufficient to put petitioners on notice of the Division's position. There is no requirement that the Division refer to a particular statute or regulation.

Second, a pattern of continuous business losses may be indicative of a lack of an intent to earn a profit (Treas Reg § 1-183-2[b][6]). In this instance, the Division examined petitioners' tax returns and found a pattern of consistent business losses. Under the circumstances, it is concluded that the Division had a rational basis for concluding that the business was not operated for profit.

D. In regard to the claimed deductions for charitable contributions and job expenses, petitioners have the burden of establishing their entitlement to the claimed expenses (Tax Law § 689(e); ***Matter of Temple***, Tax Appeals Tribunal, July 8, 2004). Here, the Division has correctly noted that petitioners did not offer any evidence to support the deductions and, therefore, it is concluded that petitioners' claim for these deductions was properly denied. It is noted that petitioners could have taken the opportunity to substantiate their position by offering the documents at the hearing.

E. The Division's argument that petitioner did not substantiate the amount of the business loss is rejected. The record shows that the Division disallowed the business loss because there were losses in three of the previous five years. The Division never raised an issue regarding the amount of the reported loss either prior to or at the hearing. Under the circumstances, the Division may not, after the hearing, raise the factual issue of substantiation of the amount of loss

for the first time in its brief because doing so deprives petitioners of the opportunity to offer evidence on the issue (***Matter of SSOV '81, Ltd.***, Tax Appeals Tribunal, January 19, 1995).

F. Preliminarily, it is noted that the number of entities involved in this matter may lead to confusion regarding which entity, if any, should be claiming the loss. The complaints, referred to earlier, make repeated references to "I Media" but were unclear as to whether the reference was to the Corporation or the Company. Therefore, the verified complaints in the civil lawsuit do not resolve whether the civil injury was suffered by the Company or the Corporation. Nevertheless, in view of the fact that it was the Corporation that assigned its cause of action to Mr. Conte, it is reasonable to conclude that it was the Corporation that had the right to pursue the tort action. The type of tort action involved in this proceeding, interference with contractual relations, is assignable (6A NY Jur 2d, Assignments § 20). It is also recognized that, although the Corporation was dissolved, it was permitted to take actions after its dissolution, such as the assignment, for the purpose of winding up its affairs (Business Corporation Law § 1006; ***Moran Enterprises, Inc. v. Hurst***, 66 AD3d 972 [2d Dept 2009]).

G. Mr. Conte chose to report the loss arising from the expenses incurred in pursuing the lawsuit on a Schedule C. Since a sole proprietorship is indistinguishable from the single owner, there is no tax consequence to reporting the loss on a Schedule C. Bearing in mind that the cause of action, that was assigned to Mr. Conte, arose from the events pertaining to the Corporation, the remaining question is whether the Corporation's activities, as a publisher of magazines, was engaged in for profit.

H. A deduction is allowed by section 162(a) of the Internal Revenue Code for "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying out any trade or business." The Corporation and its assignee are entitled to a deduction if the firm had an

actual and honest objective of making a profit (***see Annuzzi v. Commissioner,*** TC Memo 2014-233 [2014]). If an activity is "not engaged in for profit," deductions are allowable only to the extent of income from such activity (IRC § 183[b][2]; ***Matter of Temple***). Resolution of the issue of whether the Corporation's activity was engaged in for profit is properly determined based on a review of all of the surrounding facts and circumstances and in consideration of the nine factors set forth in Treas Reg § 1.183-2[b] (***see Hoag v. Commissioner***, TC Memo 1993-348 [1993]). In resolving the factual question, greater weight is given to the objective facts than to the taxpayer's statements of intention (***id***).

I. The nine factors listed in the regulations to help determine whether a taxpayer has engaged in an activity for profit are as follows: (1) the manner in which the taxpayer carries on the activity, (2) the expertise of the taxpayer or his advisors, (3) the time and effort expended by the taxpayer in carrying on the activity, (4) expectation that assets used in the activity may appreciate in value, (5) the success of the taxpayer in carrying on other similar or dissimilar activities, (6) the taxpayer's history of income or losses with respect to the activity, (7) the amount of occasional profits, if any, that are earned, (8) the financial status of the taxpayer, and (9) elements of personal pleasure or recreation (Treas Reg § 1.183-2[b]). The factors listed above are intended as guidelines and are nonexclusive. Accordingly, no single factor or combination of factors is conclusive in indicating a profit objective (***see Ranciato v. Commissioner***, 52 F3d 23 [2d Cir 1995]).

The nine factors, as applied to this case, are as follows:

The manner in which the taxpayer carries on the activity

The first factor considers whether the taxpayer engaged in the activity in a businesslike manner (Treas Reg § 1.183-2[b][1]). In determining whether the taxpayer conducted the activity

in a businesslike manner, the courts have considered whether accurate books were kept, whether the activity was conducted in a manner similar to other comparable businesses and whether changes were attempted in order to make a profit (***Dodge v. Commissioner***, TC Memo 1998-89 [1998], ***affd*** 188 F3d 507 [6th Cir 1999]). Petitioners did not offer any evidence on these points and therefore it is concluded that this factor supports the Division's position.

Expertise of the Taxpayers or their Advisors

The Division contends that Mr. Conte provided no evidence as to any experience in operating the kind of business in which the Corporation was engaged. This position is also not supported by the record. At the hearing, Mr. Conte established that in the 1970s and 1980s, he worked for a 10-unit supermarket chain that used distributors to circulate hundreds of thousands of periodicals every week. This was just a different way of doing business. Rather than rely upon newspaper companies, Mr. Conte made agreements with advertisers and distributors.

The record also shows that in January 2005, Mr. Conte hired a full-time advertising director and was delegated most of the advertising sales and marketing functions. The director was experienced in marketing and sales and possessed contacts with the manufacturers, retailers and service companies that were sought by the Corporation as paid advertisers. The regulations of the Internal Revenue Service recognize that direction from one familiar with a particular activity may show a profit motive (Treas Reg § 1.183-2[b][2]). It is concluded that this factor supports petitioners' position.

Taxpayer's Time and Effort

The Tax Court has recognized that employing substantial time and effort to an activity may be indicative of a profit motive. This is particularly true if the activity does not offer personal or recreational benefits (***Annuzzi v. Commissioner)***.

Among other things, the record shows that through negotiation and agreement with content distributors and writers, the Corporation purchased weekly TV listings and content and promoted the advertising portion of the printed work. The Smart Shopper insert and web page were promoted and linked to the website of more than 200 retailers including Macy's, Sears, Apple, Amazon and Travelocity. Mr. Conte developed rate cards, sell sheets and marketing materials to firms in the New York Metro tri-state area. In order to provide for a dependable system of home distribution, the Corporation entered into agreements with distributors who were given the right to disseminate the magazines in areas designated by zip codes. In late November 2004, the Corporation began printing and distributing TV Time Magazine on a weekly basis to two counties on Long Island. Initially, circulation was 15,000 per week and by March 2005 was 200,000 copies per week distributed by more than 24 distributors.

Given the commitment that was obviously required in order to achieve the level of distribution that was reached, it is clear that the Corporation expended substantial time and effort.

The Division argues that the Company was not engaged in a business for profit because it was inactive during the year in issue. There are two difficulties with this argument. First, as set forth above, the focus should be upon the Corporation, the firm that assigned its cause of action. Second, the cases that address this issue focus upon the entire history of the enterprise and not just the year in issue (***see e.g. Annuzzi v. Commissioner*** [where the court examined the taxpayer's enterprise from 1981 to 2010 although only the years 2009 and 2010 were in issue]). Under the circumstances, the Division's argument that the Company did not do anything to operate a business for profit is rejected and it is concluded that this factor is clearly supports petitioners' position.

Expectation that Assets May Appreciate

This factor does not appear to have any bearing on this matter and is regarded as neutral.

Taxpayer's Success in Other Activities

A prior success in turning a business from unprofitable to profitable may show that the activity in issue is engaged in for profit despite the fact that the activity is unprofitable (Treas Reg § 1.183-2(b)(5). Here, there is no history of success or failure with respect to prior business ventures and, accordingly, this factor is found to be in the Division's favor.

The Taxpayer's History of Income or Loss; *Amount of Occasional Profit*

This was the criterion that prompted the Division to issue the Notice of Deficiency and which the Division stresses in its brief. Courts have recognized that a series of losses which extend beyond the startup period may display a lack of a profit motive (***Annuzzi v. Commissioner***; Treas Reg § 1.183-2[b][6]). Nevertheless, "If [the] losses are sustained because of unforseen or fortuitous circumstances which are beyond the control of the taxpayer, such as drought, disease, fire, theft, weather damage, or other involuntary conversions, or depressed market conditions, such losses would not be an indication that the activity is not engaged in for profit" (Treas Reg § 1.183-2[b][6]).

In this instance, Mr. Conte unquestionably sustained a series of losses. However, this is not where the inquiry ends. Rather, the Regulation also requires an examination of the reason for the losses. In this instance, Mr. Conte has established that the business losses were due to an inappropriate interference with his business. Under the circumstances, it is found that this factor is neutral.

The Financial Status of the Taxpayer

The Treasury Regulations provide that an indication of a profit motive may be discerned when a taxpayer does not have substantial income or capital from sources unrelated to the activity (Treas Reg § 1.183-2[b][8]). Here, an examination of the taxpayer's return for the year 2010 shows that the source of nearly all of the income reported by petitioners for 2010 was wage income that was earned by Mrs. Conte. Except for some relatively minor amounts that were reported as interest income and taxable refunds, the only other source of income was unemployment insurance, which was presumably obtained by Mr. Conte. Since Mr. Conte had a limited source of other income, it is evident that this element favors petitioners' position.

Elements of Personal Pleasure or Recreation

The Treasury Regulations provide that the presence of recreational or personal pleasure may suggest that the activity may not be engaged in for profit (Treas Reg § 1.183-2[b][9]). In this instance, it is evident that creating and distributing millions of copies of a shopper newspaper is not the type of activity in which one would engage for a pleasant diversion or recreation. This factor also supports petitioners' position.

J. The weight of the evidence supports petitioners' position that the publication of the magazines was engaged in for profit and not as a hobby.

K. The petition of Anthony and Renata Conte is granted to the extent of Conclusion of Law J and the Division is directed to modify the Notice of Deficiency, dated February 29, 2012 accordingly; except as so granted, the petition is denied and the Notice of Deficiency is sustained.

DATED: Albany, New York
March 12, 2015

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE