STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
JOHN BUCHER AND CHRISTINE ERICKSON	:	DETERMINATION DTA NO. 826978
for Redetermination of Deficiencies or for Refund of Personal Income Tax under Article 22 of the Tax Law and the New York City Administrative Code for the Years 2011 and 2012.	:	

Petitioners, John Bucher and Christine Erickson, filed a petition for redetermination of deficiencies or for refund of personal income tax under Article 22 of the Tax Law and the New York City Administrative Code for the years 2011 and 2012.

A hearing was held before Herbert M. Friedman, Jr., Administrative Law Judge, in New York, New York, on June 21, 2016, at 10:30 A.M., with all briefs to be submitted by October 17, 2016, which date began the six-month period for the issuance of this determination. Petitioners appeared by Selig & Associates, Inc. (Bradley Dorin, Esq. and David Selig, EA, of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (Linda A. Jordan, Esq. and Brian J. McCann, Esq., of counsel).

ISSUES

I. Whether petitioners have substantiated their claimed deductions for expenses incurred in the operation of their business.

II. Whether petitioners have demonstrated reasonable cause for the abatement of penalties.

FINDINGS OF FACT

1. During 2011 and 2012, petitioner John Bucher was a 95% shareholder, and petitioner Christine Erickson was a 5% shareholder in Buchermonster Inc. (Buchermonster), a New York City based subchapter S corporation pursuant to the Internal Revenue Code (IRC) and Tax Law § 660. Buchermonster provided sound design, audio engineering, and production services at live events such as corporate conferences and entertainment events. Petitioner John Bucher performed all of the services on behalf of Buchermonster.[1]

2. Petitioners filed New York State Resident Income Tax returns (Forms IT-201) for the years 2011 and 2012 (personal returns).

3. On their 2011 personal return, petitioners reported $13,351.00 in income from Buchermonster and $33,392.00 in additional wage income. The entire amount of wage income was attributable to petitioner Christine Erickson.

4. Buchermonster's 2011 federal income tax return (Form 1120S) reported total income of $115,327.00, and total deductions of $101,977.00, leaving the $13,351.00 of income reflected on petitioners' 2011 personal return.[2] Buchermonster's 2011 deductions were reported as follows:

Rents - $15,000.00
Depreciation - $7,700.00
Advertising - $254.00
Accounting - $1,339.00
Amortization - $5,000.00
Auto and truck expenses - $2,655.00
Bank charges - $34.00
Computer expense - $5,635.00
Office expense - $3,759.00
Outside service - $4,813.00
Postage - $117.00
Supplies - $4,613.00
Telephone - $1,943.00
Tools - $12,041.00
Travel - $8,715.00
Uniforms - $732.00

[1] Unless otherwise specified or required by context, references using the singular term "petitioner" shall mean petitioner John Bucher, as he solely operated Buchermonster.

[2] Buchermonster reported $13,350.00, and not $13,351.00, as its ordinary business income for 2011. Nevertheless, petitioners reported the latter figure on their personal return for that year. This discrepancy was unexplained.

Dues and subscriptions - $48.00
Entertainment and promotion - $10,928.00
Insurance - $5,644.00
Laundry and cleaning - $28.00
Miscellaneous - $1,026.00
Utilities - $2,068.00
Internet - $1,211.00
Equipment supplies - $4,944.00
Computer software - $805.00
Research - $917.00

5. On their 2012 personal return, petitioners reported no wage income and $19,531.00 in income from Buchermonster.

6. Buchermonster's 2012 federal income tax return (Form 1120S) reported total income of $115,723.00, and total deductions of $96,192.00, leaving the $19,531.00 of income reflected on petitioners' 2012 personal return. Buchermonster's 2012 deductions were reported as follows:

Rents - $8,350.00
Depreciation - $7,540.00
Advertising - $10.00
Accounting - $2,163.00
Amortization - $5,000.00
Auto and truck expenses - $1,113.00
Bank charges - $399.00
Computer expense - $482.00
Dues and subscriptions - $48.00
Entertainment and promotion - $3,903.00
Insurance - $561.00
Laundry and cleaning - $53.00
Miscellaneous - $2,450.00
Taxes and licenses - $2,317.00
Employee benefit programs - $30,000.00
Tools/hardware - $162.00
Meals - $53.00
Storage - $1,907.00
Parking fees and tolls - $294.00
Supplies - $370.00
Telephone - $1,772.00
Audio equipment - $3,678.00
Travel - $7,564.00
Uniforms - $2,391.00
Utilities - $2,058.00
Internet - $659.00
Equipment supplies - $560.00
Computer software - $207.00
Research - $537.00
Audio rental - $58.00
Audio equipment repairs - $233.00
Petty cash - $9,300.00

7. Buchermonster also filed New York S Corporation Franchise Tax Returns (Form CT-3-S) for the years 2011 and 2012. On these returns, Buchermonster reported the same ordinary income as reported on its federal income tax returns for the respective years ($13,350.00 for 2011 and $19,531.00 for 2012).

8. On December 11, 2012, the Division of Taxation (Division) commenced an audit of Buchermonster's 2009 through 2011 New York S Corporation Franchise Tax Returns. In the

initial audit letter, the Division requested that Buchermonster provide documents supporting the income and expenses claimed on its returns for the years in issue. The corporation failed to respond to the Division's letter.

9. On January 10, 2013, the Division sent another letter to Buchermonster informing it that as the requested information was not provided, the expenses claimed on its CT-3-S returns were disallowed. Moreover, the Division pointed out that any adjustments to the CT-3-S returns could result in changes to petitioners' personal income tax returns and that other years may also be reviewed.

10. On May 16, 2014, Notice of Deficiency number L-040822765 (2011 Notice) was issued to petitioners as the shareholders of Buchermonster, assessing tax of $11,473.20, penalties of $1,911.17, and interest for the year 2011. The basis for the 2011 Notice was the disallowance of all of Buchermonster's claimed expenses, thereby causing an adjustment to petitioners' claimed income from the S corporation.

11. On May 16, 2014, Notice of Deficiency number L-040822764 (2012 Notice) was issued to petitioners as the shareholders of Buchermonster, assessing tax of $9,893.00, penalties of $1,258.62, and interest for the year 2012. The basis for the 2012 Notice was the disallowance of all of Buchermonster's claimed expenses, thereby causing an adjustment to petitioners' claimed income from the S corporation.

12. The Division reviewed various records provided by petitioners subsequent to the issuances of the two statutory notices and determined that certain claimed deductions were substantiated. Consequently, the Division made adjustments to the deductions claimed by Buchermonster that had been previously disallowed.

2011 Return

13. Petitioners verified health insurance expenses of $4,633.00 paid by Buchermonster. This expense was allowed and reclassified as wages.

14. Petitioner maintained storage units in Brooklyn and Kingston, New York. Based on the receipts provided, $1,466.00 was allowed for this expense. Petitioners, however, claimed rent for the storage of equipment in their residential apartment. This expense was entirely disallowed.

15. The Division allowed $113.00 in taxes verified as paid by Buchermonster to New York State and City.

16. The Division allowed $7,309.00 of depreciation claimed on Buchermonster's equipment. It disallowed the $399.00 of depreciation claimed on petitioners' vehicle for lack of substantiation of amount of business use.

17. Based on receipts provided, the Division allowed $97.00 of the $254.00 claimed for advertising.

18. Petitioners claimed $1,339.00 in accounting fees for Buchermonster. The Division allowed $1,300.00 based on substantiation provided by petitioners.

19. Petitioners' claim of $34.00 of bank charges was allowed as reasonable.

20. Petitioners claimed $5,635.00 for computer expenses. The Division allowed $366.00 based on substantiation provided by petitioners.

21. Petitioners' claim of $48.00 for dues and subscriptions was allowed as reasonable.

22. Petitioners claimed $3,759.00 for office expenses. The Division allowed $550.00 based on receipts presented.

23. Petitioners substantiated their $117.00 expense for postage.

24. Petitioners claimed travel expenses of $8,715.00. The Division allowed $964.00, which represented the amount expended on the only trip that had a verified business purpose.

25. Petitioners claimed expenses of $4,944.00 for equipment and supplies. The Division allowed $2,791.00, which represented that amount substantiated by receipts.

26. In total, the Division allowed petitioners $19,788.00 of the $101,977.00 in claimed deductions passed through from Buchermonster on their 2011 personal return.

2012 Return

27. Petitioners verified health insurance expenses of $8,688.00 paid by Buchermonster. This expense was reclassified as wages.

28. Petitioner maintained storage units in Brooklyn and Kingston, New York. Based on the receipts provided, $2,088.00 was allowed. Additionally, petitioners claimed rent for the storage of equipment in their residential apartment. This expense was entirely disallowed.

29. The Division allowed $102.00 in taxes verified as paid by Buchermonster to New York State and City.

30. The Division allowed $7,301.00 of depreciation claimed on Buchermonster's equipment. It disallowed depreciation claimed on petitioners' vehicle for lack of substantiation of amount of business use.

31. The Division allowed all $10.00 claimed for advertising.

32. Petitioners claimed $2,163.00 in accounting fees for Buchermonster were allowed as verified.

33. The Division allowed $125.00 of petitioners' claimed bank fees based on substantiation provided by petitioners.

34. Petitioners claimed $482.00 for computer expenses. The Division allowed $79.00 based on receipts provided.

35. Petitioners' claim of $48.00 for dues and subscriptions was allowed as reasonable.

36. Petitioners did not claim a deduction for office expenses. Nevertheless, the Division allowed $36.00 based on receipts presented.

37. Petitioners claimed $294.00 for parking fees and tolls. The Division disallowed this expense entirely as there was no travel itinerary provided.

38. Petitioners claimed $560.00 for equipment and supplies expenses. Nevertheless, the Division allowed $4,706.00 based on reallocation of receipts presented.

39. In total, the Division allowed petitioners $25,465.00 of the $96,192.00 in claimed total deductions passed through from Buchermonster on their 2012 personal return.

40. At hearing, petitioner presented various documents in an attempt to further substantiate the claimed deductions. First, petitioner introduced a series of three binders with photographs of equipment and work sites, correspondence, receipts, and charts for the following projects performed by Buchermonster:

Project	Location	Dates
Aids Walk	Central Park, NY, NY	5/12 - 5/15/2011
Marriott Marquis Ballroom	New York, NY	7/2011 - 9/2011
JW Marriott Marquis Miami	Miami, FL	2/13 - 2/17/2011

The only receipts in the binders for Buchermonster's expenses for these projects were already allowed as part of the Division's post-notice adjustments.

41. Petitioners also presented a binder containing various emails that concerned solicitation of Buchermonster's services. Receipts for Buchermonster's expenses were not included in the binder.

42. Petitioner testified that he used either an American Express card in his name or a CitiBusiness account with Citibank in Buchermonster's name (Citibank Account) to pay Buchermonster's expenses. He explained that in that manner, he kept track of his business expenses. He did not keep logs or other detailed summaries of the expenses. At hearing, he introduced a binder containing bank statements from the Citibank Account for the two years at issue (bank statements). A review of the bank statements, however, evidenced that this account included a variety of personal charges, a fact confirmed by petitioner's testimony on cross-examination. Moreover, the American Express statements also contained a variety of acknowledged personal charges.

43. The bank statements also contained copies of canceled checks. Included with these were checks made out to petitioner in the amount of approximately $3,000.00 per month during the years at issue. Petitioner identified these payments as "salary."

44. Neither Buchermonster's 2011 nor 2012 federal return reported payment of salaries.

45. Petitioners reported wages of $33,392.00 on their 2011 personal return, an amount identical to Christine Erickson's wages as reflected on her Form W-2. Petitioners did not report any wage income on their 2012 personal return.

46. Petitioner owned and maintained a vehicle for both personal and business use. He did not maintain a log that reflected a breakdown between the two uses.

47. Petitioner testified that he opened a defined benefit pension account in March 2013. It was funded by a check in the amount of $30,000.00 dated March 12, 2013.

48. Sometime in 2011, petitioner and his sister unsuccessfully attempted to start a business in Iowa providing event space for private parties. Petitioner had moved some of his audio equipment to his sister's machine shed in Iowa and, in August 2011, traveled there in an attempt to remove the equipment.

49. Petitioner testified that, during the period of preparation of the returns, he visited his accountant's office, only to find the substantiating materials undisturbed.

SUMMARY OF THE PARTIES' POSITIONS

50. Petitioners maintain that their accountant, John Cisneros, deliberately failed to provide the Division with their substantiating records. Petitioners argue that, subsequently, the Division did not perform a proper audit by refusing to review and accept the records eventually provided. Finally, petitioners assert that the penalties should be canceled for reasonable cause.

51. The Division argues that petitioners have failed to show, by clear and convincing evidence, that they are entitled to any deductions beyond those referenced in Findings of Fact 12 through 39. Additionally, the Division states that reasonable cause does not exist for the abatement of penalties.

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 (***see*** Tax Law § 689(e); ***Matter of O'Reilly***, Tax Appeals Tribunal, May 17, 2004).

B. The adjusted gross income of a New York resident is federal adjusted gross income, with certain modifications not applicable in this case (Tax Law § 612[a]). IRC § 62(a)(1) defines adjusted gross income as an individual's gross income minus certain deductions. Among the

deductions permitted are expenses that are "ordinary and necessary" for the production of income in carrying on a trade or business (IRC § 162[a]). An ordinary expense is one that is common and acceptable (***see Welch v. Helvering***, 290 US 111 [1933]). A necessary expense is considered to be one that is appropriate and helpful in conducting a trade or business (***Heineman v. Commr.***, 82 TC 538 [1984]). As noted, Buchermonster made elections whereby the results of its operation flow through to petitioners and are reported on their annual personal income tax returns. In this case, then, in order to maintain the deductions for Buchermonster's business expenses, as carried over to petitioners' New York returns, petitioners have the double burden of (1) demonstrating entitlement to the deductions and (2) substantiating the amounts 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 [3d Dept 1999]).

C. As noted, Tax Law § 689(e) places the burden upon petitioners to establish entitlement to the claimed deductions for business expenses. The Cohan rule (***Cohan v. Commissioner,*** 39 F2d 540, 544 [2d Cir 1930]), permits courts to make an approximation of an allowable amount when the taxpayer is unable to substantiate the full business expense deducted (***see e.g. Lerch v. Commr.***, 877 F2d 624 [7th Cir 1989]). However, as discussed by the Tax Appeals Tribunal in ***Matter of Hamsho*** (Tax Appeals Tribunal, October 25, 1990), the Cohan rule is not obligatory, and deductions may be limited or completely disallowed where the taxpayer has provided no basis to make a reasonable estimation (***see e.g. Pfluger v. Commr.***, 840 F2d 1379 [7th Cir 1988], ***cert denied*** 487 US 1237 [1988]; IRC § 274[d]; ***see Sanford v. Commr.***, 50 TC 823, 827 [1968]).[3]

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[3] IRC § 274(d) applies a stricter substantiation requirement for certain business expenses, including, among other things, expenses for travel, tolls, and cellular telephone expenses (IRC §§ 274[d][4]; 280F[d][4][A]). As stated by the U.S. Tax Court in ***Ong v. Commissioner*** (TC Memo 2012-114 [2012]):

D. Despite failing to provide any of the requested substantiation during the audit, in the period following the audit, petitioners provided the Division with several supporting records. Upon review, the Division made adjustments to the Notices of Deficiency, as described in Findings of Fact 12 through 39. For Notice of Deficiency number L-040822765, for the year 2011, the Division increased the allowed deductions to $19,788.00, resulting in a reduction of the tax due to $9,282.00. Likewise, for Notice of Deficiency number L-040822764, for the year 2012, the Division increased the allowed deductions to $25,465.00, resulting in a reduction of the tax due to $6,900.00. These adjustments shall be made to the subject notices, along with the applicable penalty and interest.

E. As for the substance of the Division's remaining adjustments, petitioners argue that the taxable income computed by the Division, even after the post-notice allowances, was incorrect and overstated. At issue were numerous deductions claimed by Buchermonster that were contested and eventually disallowed for lack of substantiation. Unquestionably, the Division requested the necessary records by its letters of December 11, 2012, and January 10, 2013. Despite ample opportunity throughout Buchermonster's audit process, the period proceeding issuance of the notices of deficiency, the conciliation conference, and, most importantly, the

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> "To substantiate a deduction attributable to such expenses, a taxpayer must maintain adequate records or present corroborative evidence to show the following: (1) the amount of the expense; (2) the amount of each business use and total use (e.g., mileage for automobiles and time for other listed property); (3) the time (i.e., date of the expenditure or use); and (4) the business purpose of the expense or use. Sec. 274(d); sec. 1.274-5T(b)(6), Temporary Income Tax Regs., 50 Fed. Reg. 46016 (Nov. 6, 1985). In the absence of evidence establishing the elements of the expenditure or use, deductions are to be disallowed entirely. Sec. 274(d); ***Sanford v. Commr.***, 50 T.C. 823, 827 (1968), ***aff'd per curiam***, 412 F.2d 201 (2d Cir 1969); see also sec. 1.274-5T(a), Temporary Income Tax Regs., ***supra***."

The specific intent of IRC § 274 (d) and the regulations is to limit the application of the Cohan rule (***Sanford***, 50 TC at 827; ***Rodriguez v. Commissioner***, TC Memo 2009-22 [2009]). This more limited view impacts the amounts of any allowable expenses claimed herein such as travel expenses, cellular telephone expenses, and the like (***see*** Conclusion of Law I).

hearing in this matter, petitioners failed to present records clearly supporting their claimed entitlement to nearly $150,000.00 in remaining deductions.

F. Buchermonster claimed deductions for rental payments for two storage units, and a portion of petitioners' apartment. After review, the Division allowed $1,466.00 for the storage units in 2011 and $2,088.00 for 2012. As for the claimed deductions for petitioners' apartment, however, the evidence shows that the residence simply stored equipment, and there was no demonstration of a dedicated space solely for business purposes (***see*** IRC § 280A[c][1]; ***see also Matter of Jarvis***, Tax Appeals Tribunal, July 22, 2010). Thus, the Division's adjustments for these claimed deductions are appropriate.

G. Likewise, petitioners have failed to support their claims for depreciation and amortization outside of that allowed by the Division. Petitioners' attempt to depreciate their vehicle fails as it was used for both personal and business purposes without documentation of any breakdown between the two. They failed to provide a log, journal, or other document evidencing its use. No deduction is allowed for personal, living or family expenses under these circumstances (IRC § 262). Additionally, their claims for $5,000.00 in both 2011 and 2012 for goodwill was completely unsubstantiated and, thus, properly disallowed.

H. Petitioners' claim for a $30,000.00 deduction on their 2012 return for a contribution to an employee benefit program also must fail. Although petitioners were able to substantiate this expense by virtue of a check, petitioners did not clearly demonstrate what type of plan was established. Moreover, while contributions made by the due date of a return may be applied to the applicable tax year (in this case 2012), the plan must be established by the end of the taxable year in question. Petitioner made the contribution on March 12, 2013 for an account that, based

on the record, was established on or about March 18, 2013. Consequently, the deduction must be disallowed for 2012.

I. The deductions claimed for travel, entertainment, and miscellaneous expenses also suffer from a severe lack of clear proof. In order for business travel, entertainment and other ordinary and necessary business unreimbursed expenses to be deductible, the following elements must be substantiated by adequate records or evidence that corroborate the taxpayer's own statement (***see*** IRC § 274[d]; Temporary Reg § 1.274-5T[c][1]): the amount, the date of the expenditure, the place, the business purpose and the business relationship. The primary evidence proffered by petitioners in support of these claims were the credit card and bank statements. Petitioner did not dispute, however, that he used both credit cards and the bank account for both personal and business expenses, and the record lacks a detailed breakdown supporting particular expenditures. Hence, the fact that an expenditure appeared in these records was not determinative of its purpose. Indeed, petitioner's testimony highlighted the haphazard manner in which he failed to segregate and account for Buchermonster's expenses. In the few instances where petitioners were able to directly identify and prove a business expense, the Division previously agreed to make an adjustment (***see*** Conclusion of Law D). Based on the record, petitioners are not entitled to further adjustment.

J. In sum, petitioner's vague testimony and limited source records do not support the remaining claimed deductions. Contrary to petitioners' assertions, the evidence shows that the Division reviewed and considered the records provided; they simply did not support the claimed deductions. Therefore, petitioners must yield to the presumption of correctness (***see Matter of Tavolacci v. State Tax Commn.***, 77 AD2d 759 [3d Dept 1980]).

K. Petitioners also assert that an abatement of penalties is appropriate because they relied upon Mr. Cisneros, who plainly was not performing his required tasks. It is well-established that the taxpayer seeking the abatement of penalties faces an "onerous" task (***Matter of Philip Morris, Inc.***, Tax Appeals Tribunal, April 29, 1993). 20 NYCRR 2392.1 provides, in pertinent part, as follows:

> "Where any person fails to timely file a return, fails to timely pay any taxes due or fails to meet or fulfill any other act or requirement of the Tax Law, thereby subjecting such person to the additions to tax, penalties, or interest penalty imposed pursuant to sections . . . 685(a) . . . of the Tax Law . . . , the applicable additions to tax, penalties, interest penalty and/or the interest amount, as listed above, must be imposed unless it is shown that such failure was due to reasonable cause and not due to willful neglect. In the event that these amounts have been imposed and it is later determined any such failure was due to reasonable cause and not due to willful neglect, all or part of these amounts will be canceled. The absence of willful neglect is not sufficient grounds for not imposing or for canceling these amounts."

The regulation discusses reasonable cause as follows:

> "In determining whether reasonable cause and good faith exist, the most important factor to be considered is the extent of the taxpayer's efforts to ascertain the proper tax liability. In addition to any relevant grounds for reasonable cause . . ., circumstances that indicate reasonable cause and good faith with respect to the substantial understatement or omission of tax, where clearly established by or on behalf of the taxpayer, may include the following:
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> (iv) the reliance by the taxpayer on any written information, professional advice or other facts, provided such reliance was reasonable and the taxpayer had no knowledge of circumstances which should have put the taxpayer upon inquiry as to whether such facts were erroneous." (20 NYCRR 2392.1[g][2].)

Petitioners cannot shield themselves from liability, however, by claiming blind reliance on the advice or inaction of Mr. Cisneros (***see Matter of Rubin v. Tax Appeals Trib. of State of N.Y.***, 29 AD3d 1089 [3d Dept 2006]). The returns were approved by petitioners, and the remarkably low amount of taxable income and tax due on their personal income tax returns

compared with the corporation's receipts should have given rise to further inquiry. Moreover, at some point, petitioners were able to provide their records to the Division, an action that should have occurred during the audit. Hence, petitioners' oblivious reliance on Mr. Cisneros was unreasonable given the circumstances and does not give rise to reasonable cause (***see*** 20 NYCRR 2392.1[g][2][iv]).

L. The petition of John Bucher and Christine Erickson is granted to the extent indicated in Conclusion of Law D; the Division of Taxation is hereby directed to modify the Notices of Deficiency issued May 16, 2014 accordingly; and, except as so granted, the petition is in all other respects denied.

DATED: Albany, New York
April 13, 2017

/s/ Herbert M. Friedman, Jr.
SUPERVISING ADMINISTRATIVE LAW JUDGE