STATE OF NEW YORK

DIVISION OF TAX APPEALS

| | | |
|---|---|---|
| In the Matter of the Petition | : | |
| of | : | |
| **LAEL CATHEY** | : | DETERMINATION<br>DTA NO. 827909 |
| 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 Administrative Code of the City of New York for the Years 2011, 2012 and 2013. | : | |

Petitioner, Lael Cathey, 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 Administrative Code of the City of New York for the years 2011, 2012 and 2013.

On November 21, 2018, petitioner, appearing by Katz, Smith and Chwat PC (Lara R. Chwat, Esq.), and the Division of Taxation, appearing by Amanda Hiller, Esq. (Peter B. Ostwald, Esq., of counsel), waived a hearing and submitted this matter for determination based on documents and briefs to be submitted by May 23, 2019, which date commenced the six-month period for issuance of this determination. After due consideration of the documents and arguments submitted, Dennis M. Galliher, Administrative Law Judge, renders the following determination.

## *ISSUE*

Whether the Division of Taxation's imposition of tax preparer penalties against petitioner, pursuant to Tax Law § 685 (aa) (1), was proper and should be sustained.

## *FINDINGS OF FACT*

1. Petitioner, Lael Cathey, is engaged in providing the service of tax return preparation. She provides this service through her operation of LMC Professional Services LLC.

2. The Division of Taxation (Division) identified and conducted an initial review of the returns prepared by petitioner for the years 2011 through 2013 (years at issue). On 789 of such returns, or approximately 79 percent of the returns prepared by petitioner, the New York adjusted gross income reported thereon was reduced by claimed itemized deductions, including deductions for employee job expenses and charitable contributions.[1]

3. In light of the results of the foregoing initial review, the Division questioned the legitimacy of such claimed itemized deductions, including most specifically the pattern of claimed deductions for employee job expenses. The Division therefore continued its review by issuing a pre-refund audit inquiry letter to 506 of the 789 taxpayers who had filed such petitioner-prepared returns for the years at issue.

4. On February 6, 2015, the Division issued to petitioner a separate statement of proposed audit changes for each of the years at issue. These statements propose the assessment of additional tax, interest and penalty against petitioner for each of such years. Each such statement includes a detailed computation and explanation section. The computation and explanation section for the year 2011 provides as follows:

> "Based on a review of your filing history as a tax preparer, we have determined that you have repeatedly prepared returns for taxpayers reporting job expenses on Schedule IT-201-D. Audits conducted on these returns have established no proof of entitlement to these deductions.

---

[1] The Division's Case Summary (Exhibit O -1) states that petitioner prepared "at least 1,000 returns for processing years 2012-2014 for which a [sic] 79% of these returns claimed improper itemized deductions of gifts to charity and job expenses, which reduced her clients' taxable income." Given that the years at issue are 2011 through 2013, the listing of the years as 2012 - 2014 is presumably a typographical error.

> In order to claim job expenses, an individual must have an expense that was required by their employer to carry out their job that was not reimbursed. The expense must also be common and accepted in that line of work and appropriate. We have audited 105 returns prepared by you that report job expenses, but none of the audited returns conform to these established guidelines.
>
> As a preparer, you should have reasonably known the proper tax treatment for reporting job expenses as an itemized deduction.
>
> Therefore, a penalty has been imposed under [section] 685 (aa) of the New York State Tax Law. The penalty is $1,000 for each return reporting the understatement of liability based on the claim for job expenses.
>
> This penalty applies to the returns you prepared for the taxpayers on the enclosed attachment.
>
> This notice applies for the returns filed for the 2011 tax year. Separate notices will be issued for tax years 2012 and 2013. You may not receive all of the notices on the same day.
>
> In addition to the assessed penalty, it does not appear you are reporting your tax preparation income on your personal income tax returns. Based on several responses from your clients indicating that your average tax preparation fee is $425, your income for tax preparation has been calculated at 48,875. Therefore, your [federal adjusted gross income] FAGI on your 2011 return has been increased to 59,758.
>
> Interest is due for late payment or underpayment at the applicable rate. Interest is required under the New York State Tax Law."[2]

5. The computation and explanation sections for the years 2012 and 2013 are identical in content to the foregoing, with the exception of the number of petitioner-prepared returns for which pre-refund audit inquiry letters were issued for such years (173 for 2012 and 228 for 2013), and the dollar amounts of increase to petitioner's FAGI for such years ($123,250.00 for 2012, and $169,575.00 for 2013).

---

[2] The "enclosed attachment" identifying the particular taxpayers whose individual returns were audited is presumably the same listing of such taxpayers as is attached to the auditor's affidavit submitted herein (***see*** finding of fact 11).

6. On March 25, 2015, the Division issued three notices of deficiency against petitioner asserting New York State and New York City personal income tax, plus interest and penalty, computed as of the date of issuance of the notices, as follows:

| Year | Assessment ID Number | Tax | Interest | Penalty | Payments or Credits | Balance Due |
|---|---|---|---|---|---|---|
| 2011 | L-042480470 | $4,999.50 | $1,231.83 | $105,001.00 | $0.00 | $111,232.33 |
| 2012 | L-042480471 | $13,332.50 | $2,090.73 | $173,001.00 | $0.00 | $188,424.23 |
| 2013 | L-042480464 | $16,211.00 | $1,187.21 | $228,001.00 | $0.00 | $245,399.21 |
| TOTALS | ----- | $34,543.00 | $4,509/77 | $506,003.00 | $0.00 | $545,055.77 |

7. The foregoing notices of deficiency assert tax liability against petitioner upon the position that she failed to report the income she earned from her tax preparation activities for the years at issue, plus interest. The Division's notices further assert a tax preparer penalty against petitioner, pursuant to Tax Law former § 685 (aa) (1), in the amount of $1,000.00 for each of the 506 returns prepared by petitioner during the years at issue that were subjected to audit, and with respect to which the audited taxpayers were not able to substantiate the itemized deductions claimed, as described above.

8. Upon further review of its records of petitioner's own tax return filings, the Division determined that petitioner had filed general business corporation tax returns (form CT-4), reporting the income she received from her tax preparation activities during the years at issue. Accordingly, the Division advised petitioner, by a Response to Taxpayer Inquiry (form DTF 972.5), dated May 29, 2015, of its agreement and concession that petitioner was not liable for the additional personal income tax asserted as due on the notices of deficiency, and those notices were adjusted to reflect the elimination of such tax amounts.

9. Subsequent to its issuance of the foregoing notices of deficiency, the Division issued to petitioner a separate notice and demand for payment of tax due (form DTF-996F) for each of the three years at issue. These notices and demands are each dated July 10, 2015, and each assesses the individual penalty amount set forth above for the particular year to which it pertains, i.e., $105,000.00 for 2011, $173,000.00 for 2012, and $228,000.00 for 2013.

10. In support of its assessment of the tax preparer penalties, the Division submitted the affidavit of Jesse Knapp, dated January 24, 2019. Mr. Knapp is employed as a Tax Technician in the Division's group one income/franchise tax desk audit bureau. He is a member of that group's fraud analysis and selection team (FAST), and is primarily responsible for reviewing incoming personal income tax returns for unusual patterns. Mr. Knapp is the auditor who handled the initial FAST review of 789 of the returns identified as having been prepared by petitioner, and the subsequent audit examination of 506 of such returns, as described above.

11. Attached to Mr. Knapp's affidavit are partially redacted lists of the individual taxpayers whose returns were prepared by petitioner, and to whom the Division issued pre-refund audit inquiry letters, for each of the years at issue. Also attached to Mr. Knapp's affidavit is a partially redacted copy of a resident income tax return (form IT-201) for each year at issue, as prepared by petitioner and filed with the Division by an audited individual taxpayer. Mr. Knapp avers that such returns are in all ways representative as examples of the returns prepared by petitioner for the years at issue. As relevant here, these particular returns report the following information and amounts of adjusted gross income (AGI), claimed gifts to charity, and job expenses:

| Year | Occupation | NY AGI | Gifts to Charity | Job Expenses |
|---|---|---|---|---|
| 2011 | Corrections Officer | $67,443.00 | $5,000.00 | $10,536.00 |
| 2012 | Pest Control | $56,848.00 | $5,220.00 | $7,926.00 |
| 2013 | Corrections Officer | $97,213.00 | $6,610.00 | $7,669.00 |

12. Mr. Knapp states that petitioner's inclusion of claimed miscellaneous itemized deductions for job expenses and/or itemized deductions for gifts to charity on 789 of the returns she prepared over the course of the years at issue presented a questionable pattern of improperly claimed itemized deductions, and led to 506 of these returns being selected for review based upon the issuance of pre-refund audit inquiry letters requesting substantiation of the claimed expenses. The record does not include a copy of the pre-refund audit inquiry letter issued by the Division, and does not disclose why such letters were not issued with respect to the remaining 283 returns, i.e., all 789 returns, identified by the Division as having reported claimed employee job expenses and/or charitable contributions. While denominated in several instances as the conduct of an "audit" of 506 taxpayers, the record most specifically reflects that the Division issued "pre-refund audit inquiry letters," and to the extent responses thereto were received, Mr. Knapp reviewed the same. The result of Mr. Knapp's review of the responses received was that "not one of the [506 taxpayers selected for such review] was able to substantiate the itemized deductions claimed [on their return]." The record does not disclose the number of taxpayer responses to such inquiry letters, or in particular, whether the absence of a response resulted in the Mr. Knapp's conclusion that the questioned deductions were properly subject to disallowance as unsubstantiated, and were therefore properly denominated "successfully audited."

13. In particular, paragraph 14 of Mr. Knapp's affidavit states the following:

> "As a tax preparer, Petitioner should be aware that most New York State and New York City employees do not have any eligible job expenses to be claimed on their tax return because the expenses are reimbursable. Petitioner included job expenses on the returns. The tax returns were selected for pre-refund audit inquiry letters requesting substantiation for the claimed itemized deductions. Pre-refund audit inquiry letters were sent to individual taxpayers that were Petitioner's clients. Petitioner's clients requested Petitioner's assistance to resolve the audit inquiry. Petitioner created and forged fraudulent documentation to submit to the Tax Department. Petitioner's actions subjected her clients to delays in receiving an accurate refund as well as additional time and stress relating to an audit inquiry. The fraudulent documentation submitted by Petitioner on behalf of her clients exposed the clients to penalty bills under section 685 (cc) of the Tax Law."

14. Mr. Knapp noted that some 84 pieces of allegedly "forged fraudulent documentation" were submitted for more than 20 different audited taxpayers, and he included representative examples of such documentation, summarized as follows:

> a) taxpayers subject to audit review were asked to submit a letter from their employer to verify the types of expenses that would not be employer-reimbursed. Four letters in response, ostensibly from four different employers, were submitted. Review of these letters reveals the body of each of the letters to be essentially identical, and that the name, title and signature of the author (one Sadie Williams, HR Manager), is identical in each instance, notwithstanding that the logos and letterheads of the four letters indicate that they pertain to and come from three different New York City agencies (the Citywide Administrative Services, the Metropolitan Transportation Authority, and the Department of Housing Preservation and Development) and one New York State agency (New York State Correctional Services). Mr. Knapp's conclusion was that the body of the letter, including the signature, was copied, and that the city or state logo and letterhead at the top was changed to fit the client (audited taxpayer);[3]
>
> b) taxpayers subject to audit review were also asked to submit actual proof in substantiation of the amounts claimed as job expenses. In response, four photo copies of a receipt, numbered 98529, and reflecting the purchase of several items from F & J Police Equipment, were submitted. Each such receipt is identical in all respects, including receipt date, individual items purchased and their costs, and the stamped date of payment, except that a different named individual (audited taxpayer) is shown as the purchaser of the items listed on the receipt. Mr. Knapp's conclusion was that the same receipt was simply copied, and that the name of the purchaser was changed to fit the client (audited taxpayer);

---

[3] The letter indicating that it was from the New York *State* Correctional Services opens, inconsistently, with the sentence "The *City* of New York . . . ." (emphasis added)

> c) taxpayers subject to audit review whose claimed gifts to charity were questioned, were asked to submit proof in substantiation of the charitable contribution amounts claimed. In response, charitable contribution confirmation letters under the letterhead of Beth Shalom Hebrew Congregation, and United Pentecostal Deliverance Temple, as the donee organizations, were submitted. Though setting forth different dollar amounts of alleged contributions, and different (audited taxpayer) donor names, the body of each such letter is essentially identical. As above, Mr. Knapp's conclusion was that only the donor, donee, and dollar amounts, on such letters were changed by petitioner to fit the client (audited taxpayer).

15. Mr. Knapp ultimately concluded that because the level of due diligence required to determine the proper treatment of the claimed itemized deductions was low, the number of returns on which such deductions were claimed was very high, and the Division's rate of success upon auditing petitioner's clients' returns for understatement of liability based on claimed but unsubstantiated itemized deductions was 100%, the imposition of the preparer penalty under Tax Law former § 685 (aa) was warranted.

16. Petitioner submitted an affidavit in support of her claim that the Division's imposition of penalties was erroneous and unwarranted. In her affidavit, petitioner describes her experience, education and training as a tax preparer, including employment as a tax preparer at H &R Block from 1995 through 2005, and her formation, in 2006, of LMC Professional Services LLC, the entity through which petitioner prepares tax returns. Petitioner explains that over the years, she has developed a clientele based on referrals to her from friends, and from co-workers of her existing clients, and states that given the nature of the client referrals she receives, many of her clients were engaged in similar occupations, including a large percentage that were employed as corrections officers. Petitioner states that during the years at issue, she prepared between 200 and 250 personal income tax returns per year for individuals who were employees and received wage income. Petitioner claims that because most of her clients were returning clients from prior

years, and many were employed in the same industry, she was familiar with the expenses they typically incurred, and notes that the tax software she utilizes typically carries forward client information from such earlier years. Petitioner further states at the time the returns were prepared, she believed that, if necessary, her clients could substantiate any claimed expenses, notwithstanding that some of her clients may not have not shown petitioner substantiating documents at the time the returns were prepared.

17. Petitioner's affidavit also describes her general process in preparing a tax return to include meeting with her clients, in person, for approximately one hour, during which time she reviews and updates the current year's return to reflect new amounts, delete items that no longer apply, and ask if there are any new items of income or deduction that were not on the prior year's return. She also reviews any documentation brought to the meeting by the client (forms W-2, 1099, 1098, proof of charitable contributions, business expenses, and the like). Petitioner states that to the extent her clients did not have verification of an expense with them, she would advise the client that if proof was requested (by a taxing authority), the client would be obligated to provide such proof in substantiation of the claimed expense. Petitioner typically completed and reviewed the return while sitting with the client, and the client would either sign the return, or complete an e-file authorization, after which the client would leave, taking any documentation they had brought with them. Petitioner noted that she did not retain copies of such documentation. In instances where petitioner did not meet in person with her clients, she requested the clients to email or fax their information to her for use in preparing the returns, after which petitioner would return the prepared returns to the clients for their review.

18. In paragraph F of her affidavit, petitioner describes the advice she provided to her clients concerning the non-deductibility of commuting mileage incurred in traveling to an

employee's principal place of business, versus the potential deductibility of unreimbursed mileage expenses incurred in traveling to alternative work sites. She describes her specific understanding, based on conversations with her clients, that such latter mileage was neither reimbursed nor reimbursable by the City of New York. The record does not include any further specifics concerning the particular deductions in question here, or the bases, including travel mileage, upon which the same may have been claimed. Petitioner's affidavit does not discuss or describe any particular investigation or additional research she may have undertaken with, or on behalf of her clients, regarding the deductions for claimed gifts to charity and/or employee job expenses, as set forth on the returns she prepared for her clients, so as to assess the appropriate tax treatment of the information her clients provided to her.

## ***CONCLUSIONS OF LAW***

A. Tax Law former § 685 (aa) (1) provides as follows:

"(aa) Tax preparer penalty.– (1) If:

> (A) any part of any understatement of liability with respect to any return or claim for refund is due to a position for which there was not a reasonable belief that the tax treatment in that position was more likely than not the proper treatment,
>
> (B) any person who is an income tax return preparer with respect to such return or claim knew (or reasonably should have known) of such position, and
>
> (C) such position was not disclosed as provided in subsection (p) of this section or there was no reasonable basis for the tax treatment of that position, such person shall pay a penalty of up to one thousand dollars with respect to such return or claim unless it is shown that there is reasonable cause for the understatement and such person acted in good faith."

B. To determine whether the imposition of a tax preparer penalty is warranted, the Division applies three criteria: (1) the egregiousness of the improper position; (2) the audit success rate based upon that position; and (3) the total number of returns on which that position

was claimed. The penalties here rest primarily upon the Division's assertion that at the time of petitioner's preparation of the returns in question, the position she set forth on such returns, i.e., that the claimed gifts to charity and employee job expenses, or both, as reported to petitioner by her clients, was not a reporting position that petitioner could reasonably believe was more likely than not the proper tax treatment of such expenses. Most specifically, the Division seems to posit that since a significant (though unspecified) number of petitioner's clients were public sector employees, including police and corrections officers, social workers, and teachers, their job expenses were reimbursed or reimbursable by their employers, and hence were not properly deductible expenses.

C. The Division sets forth its initial criterion concerning the imposition of tax preparer penalties as consideration of the "egregiousness of the improper position." This criterion involves two determinations, to wit, whether the position taken was in fact improper, and if so, whether such position was egregiously improper. Addressed first is the propriety of a tax preparer taking a reporting position by which deductions for employee job expenses and gifts to charity are claimed. The record, and the parties' arguments, focus almost entirely on the Division's challenge to the legitimacy of employee job expenses claimed as miscellaneous itemized deductions on petitioner's clients' returns, with little to no focus or discussion concerning claimed gifts to charity also set forth as itemized deductions on some of such returns. Given this presentation, most of the analysis hereinafter will focus on the former challenge concerning claimed employee job expenses.

D. The starting point for determining New York personal income tax liability is a taxpayer's federal adjusted gross income (***see*** Tax Law § 612 [a]). In turn, a taxpayer can claim either his or her itemized deductions, or the allowable New York standard deduction, but cannot

claim both (***see*** Tax Law § 613; ***see also*** 20 NYCRR 113.1). In this case, the taxpayers for whom petitioner prepared returns claimed itemized deductions, particularly for gifts to charity and for unreimbursed employee job expenses. A taxpayer's New York itemized deductions are derived from the deductions taken from federal adjusted gross income (***see*** Tax Law § 615 [a]), with modifications not at issue herein. Tax Law § 689 provides that a taxpayer bears the burden of establishing entitlement to both the amount, and the proper deductibility, of any expenses claimed as deductions (***see Matter of Temple***, Tax Appeals Tribunal, July 8, 2004).

E. As set forth hereinafter, there can be no dispute that taxpayers are entitled to claim gifts to charity and unreimbursed employee job expenses as itemized deductions. There is likewise no dispute that, upon challenge, such claimed expenses will be allowed as deductions reducing income if the taxpayer furnishes substantiation sufficient to support both the substance of the claimed expense and the dollar amount or value thereof. Specifically, Internal Revenue Code (IRC) § 170 allows a deduction for qualified gifts to charity, and in conjunction with relevant regulations, details certain specific substantiation requirements regarding such claimed gifts to charity (***see, e.g.***, 26 USC § 170 [a] [1]; [f] [8]; Treas. Reg. § 1.170A). Similarly, IRC § 162 (a) allows a deduction for all "ordinary and necessary expenses" paid or incurred during the taxable year in carrying on any trade or business (26 USC § 162 [a]). The performance of services as an employee is considered a trade or business (***O'Malley v Commr.***, 91 TC 352, 363-364 [1988]), and thus unreimbursed ordinary and necessary employee job expenses may, generally, be deducted under IRC § 162 (a). An "ordinary expense" is one that is "common and accepted," although not necessarily "habitual" (***Welch v Helvering***, 290 US 111, 114 [1933]). A "necessary expense" is one that is "appropriate and helpful in carrying on the trade or business" (***Heineman v Commr.***, 82 TC 538, 543 [1984]). Employee job expenses are classified as miscellaneous

itemized deductions (***see*** 26 USC § 62 [a] [1]; 67 [b]), and the amount allowable as a deduction is limited to the extent such expenses, in the aggregate, exceed two percent of the taxpayer's adjusted gross income (***see*** 26 USC § 67 [a]; ***see also Alexander v Commissioner***, TC Memo 1995–51, ***affd*** 72 F3d 938 [1ST Cir 1995]). As with claimed gifts to charity, the IRC, in conjunction with relevant regulations, and several Internal Revenue Service publications, discuss numerous types of employee job expenses that may be claimed as miscellaneous itemized deductions (e.g., union dues, subscriptions to professional journals, tools and supplies, licenses and regulatory fees, travel, transportation, meals, works clothes and uniforms, work-related education expenses that maintain or improve employee job skills or are required by an employer), and detail the specific requirements regarding the substantiation necessary to support the deductibility of such claimed unreimbursed employee job expenses (***see generally*** 26 USC §§ 67, 162; Treas. Reg § 1.62-2; IRS Publications 17 [2012], 529 [2012]). Since the New York State personal income tax is patterned after the federal income tax laws, the IRC is determinative on substantive questions concerning deductibility of such expenses (***see Hunt v State Tax Commn.***, 65 NY2d 13, 16 - 17 [1985]; ***Matter of Rizzo***, Tax Appeals Tribunal, June 3, 1993, ***confirmed Rizzo v Tax Appeals Trib.***, 210 AD2d 748 [3rd Dept 1994]).[4]

F. The reporting position set forth on the returns herein at issue was not, per se, an improper position. As set forth above, taxpayers are clearly entitled to claim deductions for gifts to charity, and an employee is clearly entitled to claim a miscellaneous itemized for unreimbursed expenses related to his or her employment. In this regard, there is no argument raised that the deductions were claimed on the wrong lines of the clients' returns, and thus were

[4] Many formerly allowable itemized deductions were eliminated or reduced as part of the Tax Cuts and Jobs Act of 2017 (***see*** P.L. 115 - 97 [TCJA]). References herein to the IRC, relevant regulations thereeunder, and IRS publications are to those in effect prior to the TCJA.

not properly disclosed, or concerning the claimed employee job expenses, that petitioner's clients were not employees, or that petitioner failed to apply the appropriate income limitation (2% of AGI) in determining the amount of the claimed deduction for employee job expenses (***compare Matter of Garcia***, Tax Appeals Tribunal, December 1, 2016 [tax preparer penalties sustained where a tax preparer applied a deduction for personal property rental expenses to personal residential real estate rental expenses on her clients' returns, a patently erroneous reporting position, which the preparer considered but did not apply on her own return based on the advise of her own tax preparer]). Furthermore, a taxpayer's subsequent failure or inability to provide substantiation of such claimed expenses, upon audit, does not necessarily support the conclusion that the claimed deduction of such expenses, in the first instance, constituted an improper reporting position.

G. The Division seems to argue most specifically that the reporting position concerning her clients' claimed deductions for employee job expenses, as taken by petitioner on a large number of the returns she prepared, was improper because petitioner should have known her clients' expenses were reimbursed or were reimbursable by their employers, including in particular those clients who were employed by New York State or New York City, and therefore were not properly deductible (***see*** finding of fact 13). As such, the Division maintains that petitioner could not reasonably rely upon her clients' stated desire to claim such expenses as deductions, nor could she reasonably advise her clients to do so, including most particularly in instances where her clients verbally communicated such desire, and the dollar amounts of the expenses they wished to claim, without providing accompanying substantiation.

H. Tax Law former § 685 (aa) (1) premised imposition of the penalty thereunder upon the tax preparer knowingly taking a position regarding a particular tax treatment (here, the

deductibility of gifts to charity and employee job expenses) for which there was not a reasonable belief that such position was more likely than not the proper treatment, and for which there was no disclosure of that treatment on the return or any reasonable basis for the tax treatment of that position. Again, as detailed above, there is no question that both gifts to charity and employee job expenses are potentially viable as claimed itemized deductions, subject ultimately to the claimant's ability to substantiate the same (***see*** conclusion of law E). As such, the reporting position set forth on the returns prepared by petitioner was not, per se, improper. Furthermore, the claimed deductions were clearly identified and disclosed on the returns filed with and reviewed by the Division. While petitioner knowingly took a position that gifts to charity and employee job expenses were being reported as itemized deductions on many of the returns she prepared, the Division's imposition of tax preparer penalties nonetheless fails to meet the penalty imposition requirements under Tax Law former § 685 (aa) (1), i.e., taking an improper reporting position, coupled with non-disclosure of such position, and no reasonable basis for the particular tax treatment or reporting position.

I. As to petitioner's reliance on information verbally communicated to her by her clients, a tax preparer may reasonably, and in good faith, rely on information supplied by their client, including information provided orally, and is not under an obligation to audit, examine, or review books and records, business operations, documents or other evidence in order to independently verify such taxpayer-client provided information, absent other, contravailing information or evidence, that the client-provided information is incorrect (***see*** Treas. Reg. § 1.6694 - 1 [e]). Similarly, the Division's tax preparer regulations provide that a "tax return preparer advising a client to take a position on a return . . . or preparing or signing a return as a preparer, may generally rely, in good faith, and without verification, upon information furnished by the client,

and it is only when the information appears to be incorrect or inconsistent with other information *known to the preparer* that a duty arises upon the preparer to make further inquiries" (***see*** 20 NYCRR 2600-4.3 [h] [6]) (emphasis added). The Division's assertion that as a tax preparer, petitioner should be aware that most New York State and New York City employees do not have any eligible job expenses to be claimed on their tax return because the expenses are reimbursable, represents at best supposition, and clearly does not support a conclusion that an otherwise allowable reporting position concerning the deductibility of employee job expenses is somehow in essence patently unreasonable, much less egregiously improper. As described earlier, employees, including public sector employees, may be entitled to claim deductions for numerous unreimbursed job expenses (***see*** conclusion of law E). The subsequent failure, or inability, of a taxpayer to substantiate entitlement to such claimed expenses does not serve to convert the initial claim of deductibility into an improperly taken reporting position, absent other circumstances known to a tax return preparer.

J. While the Division also points to the significant number of returns involved that were "successfully audited," that stance alone must be balanced against the fact that while some 789 returns were initially identified as presenting the same reporting position regarding employee job expenses and/or gifts to charity, only 506 (or approximately 64%) of those 789 returns on which the same deductions were initially identified were subjected to additional review. The Division points out that its further audit review of that portion of such identified returns resulted in "audit success" based on non-substantiation of deductibility in each case. At the same time, while denominated an "audit" of those 506 returns, the Division's further review consisted solely of its issuance of, and responses received to, pre-refund audit inquiry letters. The record provides no

evidence concerning the number of those letters received by the individual taxpayers, or more importantly, the number of responses actually received by the Division (***see*** finding of fact 12).

K. Finally, it is very troubling that in response to some of her clients' requests for assistance in responding to the audit inquiry letters, petitioner submitted to the Division, on behalf of some of her clients, obviously manufactured documents, including multiple minimally altered copies of the same receipt in attempted substantiation of claimed expenses pertaining to various different individual clients (***see*** finding of fact 14). While potentially exposing petitioner to sanctions other than the preparer penalties at issue herein, however, this after-the-fact submission, relating to approximately 20 out of 506 individual taxpayers to whom audit inquiry letters were issued, is not necessarily indicative of petitioner's knowledge as to the legitimacy of her clients' claims regarding the deductibility of employee job expenses or gifts to charity at the time the returns were prepared. Moreover, it is clearly not dispositive support with respect to the statutory requirements applicable to imposition of the preparer penalties at issue herein, as set forth above.

L. Under the facts of this case, there is insufficient support for the proposition that petitioner knew, or should reasonably have known, that in claiming deductions for employee job expenses, or for gifts to charity, or both, her clients were taking an untenable, incorrect, or egregiously improper reporting position. In particular, the Division's rationale for penalty imposition here rests primarily upon the claim that petitioner should have known that the claimed employee job expenses were reimbursed or were reimbursable, and hence were not properly deductible as employee job expenses by her clients, including specifically her state and municipal clients' employers. This thin rationale advanced by the Division is simply insufficient to support imposition of the penalties herein at issue.

M. The petition of Lael Cathey is hereby granted, and the Division's notices imposing tax preparer penalties under Tax Law former § 685 (aa) (1) are canceled.

DATED: Albany, New York
November 21, 2019

/s/ Dennis M. Galliher
ADMINISTRATIVE LAW JUDGE