STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
CARDINALD AND PAULETTE T. DONALD	:	DETERMINATION DTA NO. 830593
for Redetermination of a Deficiency or for Refund of New York State and New York City Personal Income Tax under Article 22 of the Tax Law and the Administrative Code of the City of New York for the Year 2016.	: : :	

Petitioners, Cardinald and Paulette T. Donald, filed a petition for redetermination of a deficiency or for refund of New York State and New York City personal income tax under article 22 of the Tax Law and the Administrative Code of the City of New York for the year 2016.

A hearing was held before Donna M. Gardiner, Supervising Administrative Law Judge, in Brooklyn, New York, on August 22, 2023, with the final brief to be submitted by January 5, 2024, which date commenced the six-month period for the issuance of this determination. Petitioners appeared pro se. The Division of Taxation appeared by Amanda Hiller, Esq. (Maria Matos, Esq., of counsel).

ISSUE

Whether petitioners established that they are real estate professionals and are entitled to claim a deduction in the amount of $16,426.00 for losses incurred from rental real estate activities for the tax year 2016.

FINDINGS OF FACT

1. Petitioners, Cardinald and Paulette T. Donald, filed a New York State resident income tax return, form IT-201, for the year 2016 (return). Petitioners' return reflects federal

adjusted gross income of $193,030.00 and New York State adjusted gross income of $172,408.00.

2. Attached to the return was federal schedule E, of form 1040, supplemental income and loss, on which petitioners claimed a deduction in the amount of $16,426.00 for losses from rental real estate activities for three rental properties located in Brooklyn, New York: one unit located at 766 East 56th Street[1] and two units located at 65 Chester Street. The Division of Taxation (Division) conducted an audit of the return to determine whether petitioners qualified as real estate professionals and, if so, whether they were entitled to the claimed deduction.

3. By letter dated September 26, 2019, the Division requested that petitioners provide documentation demonstrating that they qualified as real estate professionals. This letter included a federal schedule E rental real estate loss questionnaire that requested information concerning petitioners' occupations such as: a description of their occupations that were NOT related to rental real estate activities, the total number of hours worked in that occupation during the tax year, the physical address of all rental properties listed on federal schedule E and the number of rental units in each property, the dates that all units were rented, and the name of the property manager. Additionally, the Division requested a list of services performed and hours attributable to those services such as: appointment books, calendars, or narrative summaries to support hours claimed, any other records to support the hours attributable to the rental activities and a copy of form 8582, passive activity loss limitations, if such form was filed with the Internal Revenue Service (IRS). Petitioners were requested to submit a response to the letter within 30 days.

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[1] Petitioners reside in a second unit in the East 56th Street property.

4. On January 22, 2020, after no documentation was submitted by petitioners, the Division issued a statement of proposed audit changes that disallowed the claimed rental real estate loss deduction and stated, in pertinent part, that:

> "Since you have not verified that you qualify as a real estate professional, and your modified adjusted gross income (MAGI) is greater than $150,000.00, the rental real estate loss claimed on line 26 of your federal schedule E is considered passive, and subject to the passive activity loss (PAL) rules. The PAL rules state that losses from passive activities are limited to any passive income and cannot offset non-passive income.
>
> Based on your federal schedule E, you had no net passive income reported. Therefore, the passive rental loss has been disallowed in full. Any unused or disallowed passive loss can be carried forward to the following tax year on Form 8582.
>
> If you feel that you meet the real estate professional qualifications and the material participation tests, please provide the following information:
> -a description of your occupation that is not related to your rental real estate activities, along with a record or summary of the total number of hours worked in that occupation during the tax year
> -a list of the services performed for each rental property and hours attributable to those services
> -a daily hour/work log, calendar, or any other records to support those hours[.]"

5. On March 9, 2020, the Division issued a notice of deficiency, assessment number L-051188566, to petitioners in the amount of $1,690.00 in total New York State and New York City taxes due plus interest for the year 2016 (notice).

6. On April 2, 2020, petitioners filed a request for conciliation conference (request) with the Division's Bureau of Conciliation and Mediation Services (BCMS) in protest of the notice.

7. At the hearing, the Division presented the testimony of Bryan Kafka, an employee of the Division. His title is Tax Technician II and he works in the personal income tax audit division in audit group 2. The auditor was assigned to the audit of petitioners.

8. The auditor explained that petitioners' tax return was flagged by audit because petitioners claimed a deduction for rental real estate losses, yet they also reported form W-2

wage income from what appeared to be full-time employment unrelated to real estate activities. The auditor explained that he focused on whether petitioners met the requirements to qualify as real estate professionals such that they could claim the loss reported on their return.

9. As stated in findings of fact 3 and 4, the auditor explained the information requested from petitioners. He testified that no documentation was received until after petitioners filed a request for conciliation conference.

10. The auditor recounted that, on May 18, 2020, petitioners submitted work logs to demonstrate that they qualified as real estate professionals. A two-page document entitled Cardinald Donald Real Estate Hours has three columns: date of service, hours and service description. With respect to the listed date of service, it simply provided month and year. The total hours reported were 1,907 broken down by a summary of hours for each listed month of service for the year, and the description of services was general in nature and referenced a particular property. The other document is two pages in length and is titled Paulette Donald Real Estate Hours. The document has three columns: date of service, hours and service description. Similarly, there is no specific day in any month listed as date of service, only the month and year. She reported many more dates of service, but only claimed 1,764 hours worked on the properties. The description of services was general in nature and referenced a particular property.

11. With respect to their form W-2 wage income employment, Mr. Donald reported that he worked as an electrician during 2016 for 1,680 hours employed by Five Star Electric Corp., located in Ozone Park, New York, and E-J Electric Installation Co., located in Long Island City, New York. Mrs. Donald reported that she worked as a dietician with the New York City Health and Hospitals Corporation during 2016 for 1,680 hours. Petitioners did not provide any

substantiation of the claimed hours worked in their non-real estate occupations and the auditor found it irregular for petitioners to both report the identical number of hours worked.

12. The auditor reviewed the work logs and determined that they lacked detailed information regarding what service was provided on which particular date. For example, he mentioned that for January, Mr. Donald claimed 218 hours for snow and garbage removal. These hours would be in addition to petitioner's full-time employment as an electrician. The auditor explained that based upon his experience, the claimed hours simply are not credible. In reviewing February and March, Mr. Donald claimed 190 hours and 211 hours, respectively, for snow and garbage removal. The auditor explained that he looked at aerial views of the properties on Google Maps and, in his assessment, the properties did not have a front yard and the backyards were tiny. The auditor determined that the number of hours claimed as service on these properties did not align with the size of the properties.

13. In reviewing the work log for Mrs. Donald, the auditor noted that she reported 182 hours of service hours for January. The auditor said that it would be highly improbable for her to work on the properties for this number of hours since she, too, had full-time employment in addition to her claimed work hours. Additionally, the auditor noted that in reviewing the months of January, February and March, petitioners failed to submit any receipts or other documentation to demonstrate what work was provided to account for service hours in the amounts reported.

14. On March 1, 2021, after a delay due to the COVID-19 pandemic, BCMS sent petitioners a letter that scheduled the conciliation conference for April 5, 2021. In response to this letter, petitioners submitted a new set of work logs for 2016.

15. The second set of work logs submitted by petitioners were each six pages in length, with the same three columns. In the second set of work logs, the date of service included the day of the month. However, the claimed service hours were drastically reduced. The second work log reported that Mr. Donald worked only 943 hours on the properties in 2016, rather than the originally reported 1,907 hours. For Mrs. Donald, her second work log indicated that she worked only 880 hours on the properties in 2016, rather than the originally reported 1,764 hours.

16. On June 11, 2021, a conciliation order, CMS No. 000319738, was issued that denied the request and sustained the notice issued to petitioners.

17. On August 6, 2021, petitioners filed a timely petition with the Division of Tax Appeals in protest of the conciliation order.

18. Both petitioners testified at the hearing. Mrs. Donald explained that she was not aware that there was a record keeping requirement. She explained that managing the properties was ongoing. She stated that her tenants often failed to pay their rent and she was forced to take legal actions which required her frequent appearance in court. Mr. Donald testified that he performed the snow and garbage removal, and he did some plumbing work. He stated that he did not create either work log. He explained that he would tell his wife how much time he spent maintaining the properties, but he did not provide any details on how this information was relayed to her and whether it was contemporaneously conveyed. Mrs. Donald confirmed that she was responsible for the paperwork.

CONCLUSIONS OF LAW

A. This case involves whether petitioners are entitled to claim a deduction for real estate activities. "Whether and to what extent deductions shall be allowed depends upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed"

(***New Colonial Ice Co. v Helvering***, 292 US 435, 440 [1934]). The taxpayers bear the burden of demonstrating that they have met all the requirements necessary to be entitled to the claimed deduction (***see Moss v Commissioner***, 135 TC 365, 368 [2010]).

B. Taxpayers are allowed deductions for certain business and investment expenses under Internal Revenue Code (IRC [26 USC]) §§ 162 and 212. Section 469 (a) of the IRC generally disallows any passive activity loss, defined as the excess of aggregate losses from all passive activities for the taxable year over the aggregate income from all passive activities for the year (***see*** IRC [26 USC] § 469 [d] [1]). A passive activity is any trade or business in which the taxpayer does not materially participate (***see*** IRC [26 USC] § 469 [c] [1]). For the purposes of section 469 and to the extent provided in regulations, a trade or business includes any activity with respect to which expenses are allowable as a deduction under section 212 (***see*** IRC [26 USC] § 469 [c] [6] [B]). Rental activity is usually treated as a per se passive activity regardless of whether the taxpayer materially participates (***see*** IRC [26 USC] § 469 [c] [2], [4]). Material participation is defined as involvement in the operations of an activity on a basis that is regular, continuous and substantial (***see*** IRC [26 USC] § 469 [h] [1]).

C. An exception to the rule that a rental activity is per se passive is found in IRC (26 USC) § 469 (c) (7). If the taxpayers qualify as real estate professionals, the taxpayers' rental real estate activity is treated as a trade or business subject to the material participation requirements of section 469 (c) (1) (***see*** Treas Reg [26 CFR] § 1.469-9 [e] [1]).

A taxpayer may qualify as a real estate professional if:

> "(i) more than one-half of the personal services performed in trades or businesses by the taxpayer during such taxable year are performed in real property trades or businesses in which the taxpayer materially participates, and
>
> (ii) such taxpayer performs more than 750 hours of services during the taxable year in real property trades or businesses in which the taxpayer materially

> participates" (IRC [26 USC] § 469 [c] [7] [B]; ***see also*** Treas Reg [26 CFR] § 1.469-5T [a]).

The regulation at 26 CFR 1.469-5T (f) (4) provides the types of proof to be used in determining the extent of an individual's participation in an activity as follows:

> "The extent of an individual's participation in an activity may be established by any reasonable means. Contemporaneous daily time reports, logs, or similar documents are not required if the extent of such participation may be established by other reasonable means. Reasonable means for purposes of this paragraph may include but are not limited to the identification of services performed over a period of time and the approximate number of hours spent performing such services during such period, based on appointment books, calendars, or narrative summaries."

D. Having ascertained the rule applicable to the question of whether petitioners qualify as real estate professionals under federal law, it is noted that a presumption of correctness attaches to a notice of deficiency issued by the Division (***see Matter of Leogrande v Tax Appeals Trib.***, 187 AD2d 768, 769 [3d Dept 1992], ***lv denied*** 81 NY2d 704 [1993]; ***Matter of Tavolacci v State Tax Commn.***, 77 AD2d 759, 760 [3d Dept 1980]). A taxpayer bears the burden of proof in showing by clear and convincing evidence that the Division's determination was incorrect or erroneous (***see Matter of Suburban Restoration Co. v Tax Appeals Trib.***, 299 AD2d 751, 752 [3d Dept 2002]; Tax Law § 689 [e]). Similarly, a taxpayer bears the burden of proof in showing entitlement to any deduction he or she claims by maintaining adequate records to substantiate the amount of each deduction (***id.***; Tax Law § 658 [a]; 20 NYCRR 158.1 [a]).

In reviewing the two sets of work logs, petitioners reported drastically different service hours worked on the properties. The first set of work logs for petitioners were each two pages in length, whereas the second set of work logs were each six pages in length. Although both sets of work logs have the same three columns, the first set of work logs used a month/year format, whereas the second set of work logs used a month/day/year format. The first work log

for Mr. Donald reported 1,970 service hours contrasted with the second work log that reported only 943 service hours. For Mrs. Donald, her first work log reported 1,764 service hours contrasted with the second work log that reported only 880 hours. For this reason, it is determined that the work logs are simply unreliable. It cannot be found that the information contained within the work logs was contemporaneously maintained. Additionally, petitioners each have full-time jobs that are unrelated to their real estate activities. In reviewing the service hours reported in the first work log, petitioners would have been working more hours on their properties than at their full-time jobs, which is deemed unrealistic considering all the facts presented.

E. In cases where the documentary evidence has not met the clear and convincing standard, the Tax Appeals Tribunal has held that a taxpayer's credible testimony can meet this evidentiary standard (***see Matter of Avildsen***, Tax Appeals Tribunal, May 19, 1994). Neither petitioner testified regarding their procedure for creating the entries in the work logs. Mr. Donald stated that it was his wife who prepared the logs. Yet, Mrs. Donald testified that she was not aware of the necessity of keeping receipts which raises doubts regarding the accuracy of the work logs, presented in 2020 and 2021, to establish services performed in 2016. There is no doubt that petitioners spent time in the maintenance of their rental properties. However, their testimony, coupled with the inconsistent work logs, failed to establish by clear and convincing evidence that they qualified as real estate professionals (***see Matter of Strachan***, Tax Appeals Tribunal, June 28, 2018). Thus, the Division properly disallowed the claimed deduction for rental real estate losses.

F. The petition of Cardinald and Paulette T. Donald is denied and the notice of deficiency, dated March 9, 2020, is sustained.

DATED: Albany, New York
July 3, 2024

/s/ Donna M. Gardiner
SUPERVISING ADMINISTRATIVE LAW JUDGE