STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition of **HAROLD SMALL AND IRENE SMALL** for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Years 1982, 1983 and 1984.	:	DECISION DTA NO. 803077

Petitioners, Harold Small and Irene Small, 5210 Winterton Drive, Fayetteville, New York 13066, filed an exception to the determination of the Administrative Law Judge issued on October 29, 1987 with respect to their petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the years 1982, 1983 and 1984 (File No. 803077). Petitioners appeared by Sheldon G. Kall, Esq. The Division of Taxation appeared by William F. Collins, Esq. (James Della Porta, Esq., of counsel).

Petitioners requested oral argument and subsequently withdrew the request. Only the Division of Taxation submitted a brief.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUES

I. Whether the Division of Taxation properly treated as compensation to petitioner, Harold Small, certain automobile expenses and entertainment expenses deducted by Harold Small, M.D., P.C.

II. Whether the petitioners may raise an issue before the Tribunal that was not raised during the hearing.

III. If a new issue may be raised, whether the petitioners are entitled to an adjustment to the additional compensation for 1982 in order to reflect the fact that the petitioners are on a calendar year and the corporation is on a fiscal year.

IV. Whether the petitioners may introduce new evidence to the Tribunal concerning an issue raised during the hearing.

FINDINGS OF FACT

We find the facts of this matter as stated in the Administrative Law Judge's determination and such facts are incorporated herein by this reference. These facts may be summarized as follows.

Harold Small filed New York State resident income tax returns with his wife, Irene Small, for each of the years 1982, 1983 and 1984. On such returns petitioner, Harold Small, reported salary income from his professional service corporation, Harold Small, M.D., P.C., of $67,028.00 in 1982, $69,003.00 in 1983 and $75,785.00 in 1984.

On December 3, 1985, the Division of Taxation issued a Statement of Personal Income Tax Audit Changes to petitioners whereon adjustments were made increasing their income by the amount of certain automobile and entertainment expenses paid by the corporation and automobile depreciation taken by the corporation. On March 7, 1986, the Division of Taxation issued a Notice of Deficiency against the petitioners asserting additional personal income tax for 1982, 1983 and 1984 in the aggregate amount of $3,535.46 plus interest of $782.76.

The adjustments reflected on the Notice of Deficiency were the result of a field audit of Harold Small, M.D., P.C. (the "corporation") for the years 1982, 1983 and 1984. These adjustments represented either unsubstantiated expenses or expenses deemed to be personal and were characterized as additional compensation to the petitioners on their personal income tax returns. No change was made to the corporation's tax returns for said years.

In 1982 the corporation owned a 1978 Cadillac. The corporation claimed 100% business use of this car and deducted all of the operating expenses related to it.

In 1983 and 1984 the petitioner, Harold Small, personally owned a Porsche automobile which he leased to the corporation. The corporation deducted 100% of the operating expenses of the Porsche in 1983 and 90% in 1984.

The petitioner, Harold Small, did not keep contemporaneous records with respect to business mileage each year. From the records available, the Division of Taxation estimated the business use of the cars to be 25%.

The entertainment expense of $3,540.00 which was disallowed for 1982 represented a portion of the cost of a dinner party given on the occasion of petitioners' son's Bar Mitzvah. The portion of the Bar Mitzvah which the corporation deducted was based on the portion claimed to be attributable to Harold Small's fellow physicians present at the affair. Petitioners submitted an invoice from Kuhns Catering, Inc. with respect to the aforesaid dinner party. No documentation was submitted at the hearing to show when the expenses related to the Bar Mitzvah were in fact paid.

The corporation claimed deductions for petitioner, Harold Small's, tennis club dues of $785.00 for 1983 and $584.00 for 1984. The corporation claimed such deduction on the basis that petitioner, Harold Small, used the tennis club primarily to entertain physicians who referred cases to him. No documentary evidence, such as a contemporaneously kept diary or log was submitted to detail and support the percentage petitioner, Harold Small, actually used the club for business purposes.

We find as an additional fact that the corporation paid the $3,540.00 Bar Mitzvah expense in calendar year 1981.

OPINION

The Administrative Law Judge's determination increased the business use of the cars from 25% to 35%, but in all other respects upheld the adjustments to petitioners' compensation for certain automobile and entertainment expenses taken by the corporation. In their exception, petitioners do not deny that the expenses at issue were personal expenses, nor do they challenge the calculation of the amounts. Instead, petitioners challenge the appropriateness of including the corporate deductions as personal compensation to the petitioners.

Since this issue first involves whether items were properly includable in gross income, it is to be resolved under Federal law (Section 612[a] of the Tax Law).

For the years in question, section 61 of the Internal Revenue Code defined gross income to include "compensation for services, including fees, commissions and similar items" (Internal Revenue Code section 61; 26 USC section 61). It is well established under Federal case law that if an employer pays an employee's personal debts or expenses, the payment must generally be included in the gross income of the employee (Old Colony v. Commissioner, 279 US 716, 729 [1924]; Clement V. Conole v. Commissioner, 30 TCM [CCH] 467, 477 [1971]).

Under this principle, the corporation's payment of car expenses attributable to the petitioners' personal use of the cars and the payment of non-business entertainment expenses were a form of compensation for services petitioner, Harold Small, rendered to the corporation. In the absence of any statute specifically exempting this benefit, the Division of Taxation was correct in assessing tax upon the petitioners additional compensation for the expenses not attributable to business use.

Petitioners assert that it is inconsistent for the Division to treat a portion of the corporation deductions as additional compensation to the petitioners while still allowing the corporation to claim these deductions. As stated above, these expenses, even though they may be classified as repair, maintenance or entertainment are in reality compensation to the petitioners. Under Internal Revenue Code section 162(a), compensation is a deductible business expense (Internal Revenue Code section 162[a]; 26 USC section 162[a]). Thus, the Division's treatment of the deductions between the petitioners and the corporation was consistent.

Petitioners' second exception is raised only for the tax year 1982. The petitioners assert that since they, as individuals, were on a calendar tax year while the corporation was on a fiscal tax year, the Division of Taxation should have made an adjustment to reflect this difference. The corporation's 1982 tax year ran from October 1, 1981 to September 30, 1982. According to the petitioners, since 25% of the corporation's tax year (October 1, 1981 to December 31, 1981) fell within the petitioners' 1981 tax year, rather than in their 1982 tax year, their additional income arising from the personal automobile expenses and depreciation deducted by the corporation attributable to 1982 should be reduced by 25%.

The Division asserts that this is a new issue which was not raised at hearing and cannot be raised on exception. It apparently urges upon the Tribunal the standard of review contained in CPLR Article 78 and cites several cases in support of its position (Fuel Boss, Inc. v. New York State Tax Commn., 128 AD2d 945; Robert Scarpulla et al v. State Tax Commn., 120 AD2d 842; Manhattan Industries, Inc. v. Tully, 88 AD2d 737; Convissar et al v. State Tax Commn., 69 AD2d 929; Malkin v. Tully, 65 AD2d 228). Further, the Division argues that the Tribunal's consideration of the issue on exception will seriously prejudice the Division.

Initially, we must disagree with the Division's assertions concerning the standard of review accorded the Tribunal by the Legislature.

The Tribunal's enabling legislation contains no statutory limitations such as those contained in Article 78 of the CPLR which are applicable to judicial review of administrative decisions (see, CPLR sections 7803[3] and [4] which limit judicial review of administrative decisions to questions of whether the administrative action was arbitrary and capricious or supported by substantial evidence).

The Tribunal's enabling legislation, in contrast, provides broadly that the Tribunal "shall issue a decision either affirming, reversing or modifying" the determination of the Administrative Law Judge or "the Tribunal may remand the case for additional proceedings before the Administrative Law Judge" (Tax Law section 2006.7). The regulations adopted by the Tribunal implement this standard by providing in pertinent part that "the Tribunal shall review the record and shall to the extent necessary or desirable, exercise all power which it could have exercised if it had made the determination" (20 NYCRR 3000.11[e][1], emphasis added).

The procedural regulations adopted by the Tribunal are designed to focus the exception process on the determination of the Administrative Law Judge by requiring the exception to state the particular findings of fact and conclusions of law with which a party disagrees, the grounds of the exception, and alternative findings of fact and conclusions of law requested (see, 20 NYCRR 3000.11).

The Tribunal has the authority to determine what issues are properly before it on exception and to take appropriate action to insure that a just decision is reached in all cases (Tax Law section

2000; 20 NYCRR 3000.0). The enabling legislation provides ample authority and flexibility to the Tribunal to achieve this result - to assure that the correct law is applied and the law is applied correctly to the facts of the case as contained in the record at hearing - whether by the Tribunal sua sponte or upon urging of the parties on exception.

In this case the issue raised by petitioners is without merit because they failed to introduce any evidence in support of their position at the hearing. The taxpayers did not prove that 25% of the personal automobile expenses were paid for by the corporation in 1981 and that 25% of the automobile depreciation was taken by the corporation in 1981.

The final issue is whether the petitioners may submit new evidence to the Tribunal to prove that the $3,540 Bar Mitzvah expense was paid in 1981 by the corporation and thus should not have been included in petitioners' 1982 income. This issue was raised at the hearing.

At the hearing, petitioners did not submit any documentary evidence that the corporation paid for the Bar Mitzvah in 1981. However on cross-examination, the Division of Taxation's auditor testified that the expense was paid for in 1981. Based on this testimony, we find that this expense was paid in 1981 and as a result additional compensation for 1982 must be reduced by $3,540.

Since we find petitioners proved payment of the Bar Mitzvah expense in 1981 at the hearing, we do not need to address petitioners' attempt to submit documentary evidence on this point to the Tribunal on exception.

Accordingly it is ORDERED, ADJUDGED and DECREED that:

1. The exception of petitioners, Harold Small and Irene Small, is granted to the extent that the $3,540.00 expense is found to have been paid in calendar year 1981 but except as so granted, is in all other respects denied;

2. The determination of the Administrative Law Judge is modified by finding that such $3,540.00 expense was paid in calendar year 1981, but except as so modified is in all other respects affirmed; and

3. The petition of Harold Small and Irene Small is granted to the extent provided in conclusions of law "A", "H" and "I" of such determination and as indicated in paragraphs "1" and "2" above, the Division of Taxation is directed to modify accordingly the Notice of Deficiency issued on March 7, 1986 but, except as so granted, the petition is in all other respects denied.

DATED: Albany, New York
August 11, 1988

/s/John P. Dugan
John P. Dugan
President

/s/Francis R. Koenig
Francis R. Koenig
Commissioner