STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
HARVEY A. AND BARRIE D. SCHNEIER	:	DECISION
for Redetermination of a Deficiency or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law and New York City Personal Income Tax under Chapter 46, Title T of the Administrative Code of the City of New York for the Year 1982.	:	

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on September 29, 1988 with respect to a petition by Harvey A. and Barrie D. Schneier, 140 Nassau Street, #15A, New York, New York 10038 for redetermination of a deficiency or for refund of New York State personal income tax under Article 22 of the Tax Law and New York City personal income tax under Chapter 46, Title T of the Administrative Code of the City of New York for the year 1982 (File No. 803519). Petitioner appeared by Frederick T. Monett, C.P.A. The Division appeared by William F. Collins, Esq. (Herbert Kamrass, Esq., of counsel).

The Division filed a brief on exception. The petitioners did not. Oral argument was heard on May 24, 1989.

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

ISSUES

I. Whether Harvey A. Schneier (hereinafter "petitioner") can deduct, under Internal Revenue Code section 212(3), 90 percent of a legal fee paid in connection with his divorce from his former wife.

II. Whether petitioner or the Division of Taxation bears the burden of proof with regard to the allowability of certain miscellaneous deductions.

III. Whether imposition of the negligence penalty pursuant to section 685(b) of the Tax Law was proper.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge and such facts are stated below.

Petitioner Harvey A. Schneier is a physician. He is on the staff of Columbia University. In 1982 he divorced his wife, Lynn. He remarried and then moved with his new wife from out of state to New York City.

(a) On his 1982 Federal return Mr. Schneier claimed an adjustment to income of $24,637.23, identified in a separate schedule as being for alimony paid. Mr. Schneier also deducted miscellaneous deductions of $9,779.92. The largest item was for $9,000.00 designated as for "tax planning re matrimonial division of assets and payment of alimony".

(b) Mr. Schneier filed a 1982 New York nonresident return (IT-203) for the first eight months of the year and a 1982 New York resident return (IT-201) for the last four months of the year. Petitioner deducted miscellaneous deductions of $6,753.28 on his nonresident return and $3,376.64 on his resident return for a total deduction of $10,129.92. This is $350.00 more than deducted on his Federal return. This $350.00 is identified by the Division of Taxation in its answer as being for tax return preparation and is not in dispute. On his nonresident return, Mr. Schneier showed that 96.99 percent of his income was from New York sources and deducted that portion of his itemized deductions. On each return Mr. Schneier checked the filing status "Single".

(c) On his New York Schedule for Change of Resident Status (IT-360), Mr. Schneier showed the adjustment for alimony paid, allocating two-thirds to his nonresident period and one-

third to his resident period. The miscellaneous deductions and casualty and theft losses were also allocated two-thirds to his nonresident period and one-third to his resident period.

The Notice of Deficiency in this case was issued on January 8, 1986 to both Harvey Schneier and Barrie Schneier and is in the amount of $1,070.03, plus penalty under Tax Law § 685(b) of $53.50 and interest of $324.22, for a total of $1,447.75. A Statement of Personal Income Tax Audit Changes issued on October 1, 1985 indicated that the deficiency was computed by disallowing "Miscellaneous Deductions: Legal Deductions" of $9,779.92 to the extent of 96.99 percent ($9,485.54) for State tax purposes and disallowing one-third of that amount ($3,149.52) for New York City tax purposes. (The one-third should actually be $3,161.84, but that has not been commented on by the parties.)

The perfected petition in this case was filed by both Mr. and Mrs. Schneier. The answer, however, designates the petitioner as only Mr. Schneier. The answer at paragraph 4 refers to the total miscellaneous deductions of $10,129.92 and states that $9,000.00 was for legal fees related to the divorce, $350.00 was a tax preparation fee and the balance was for "various deductible expenses".

The attorney that Mr. Schneier retained for his divorce, Rita K. Nadler of New Jersey, charged $100.00 an hour for 100 hours. She allocated this in her bill to "tax planning" of 90 hours with respect to the division of assets and alimony, and to court appearances of 10 hours. In a letter in 1987 she explained that Mr. Schneier had met with his adversaries alone on some occasions so a legal fee was not charged on those occasions and that her own office work was concentrated on tax planning with respect to the transfer of the family house and a life insurance policy. The attorney did not appear at the hearing.

No evidence or argument was offered at the hearing by either party with respect to the disallowance of miscellaneous deductions other than the legal fee.

The penalty imposed is for negligence under section 685(b) of the Tax Law. The Division of Taxation has specified no reason for this penalty.

OPINION

The Administrative Law Judge determined 1) that petitioner was entitled to a deduction for the portion of legal fees in the divorce proceeding which pertained to tax related matters; 2) that certain miscellaneous deductions were to be allowed, as the assertion of a deficiency for these items by the Division in its answer was a new matter which shifted the burden of proof from petitioner to the Division which had not met its burden; 3) that the imposition of the negligence penalty imposed by Tax Law § 685(b)(1) should be cancelled on the grounds that petitioner's reliance on the advice of counsel was sufficient to avoid any charge of negligence. Finally, the Administrative Law Judge concluded that the issuance of the Notice of Deficiency to Barrie D. Schneier was a mistake and cancelled the Notice as to her.

On exception, the Division contends that the estimation of the legal expense at $2,000.00 was arbitrary and capricious and not supported by any reasonably detailed evidence showing time spent on the various aspects of the divorce proceeding. Additionally, the Division argues that Tax Law §§ 689(d) and 689(e) allow for the shifting of the burden of proof only in situations where a greater deficiency is asserted. In regard to the cancellation of the negligence penalty the Division asserts that reliance on the advice of counsel is not a basis for waiver, and further, that the Division was neither required to identify an act of negligence nor present argument at the hearing because the issue of penalty was not raised by petitioner. The Division does not contest the cancellation of the Notice of Deficiency as to Barrie D. Schneier.

We modify the determination of the Administrative Law Judge.

The adjusted gross income of a New York resident is Federal adjusted gross income, with certain modifications not applicable here (Tax Law § 612[a]). Section 62(1) of the Internal Revenue Code (IRC) defines Federal adjusted gross income and provides that certain deductions may reduce gross income in the computation of adjusted gross income. Among the deductions allowed are those provided for by IRC § 212 for expenses for the production of income. In particular, IRC § 212(3) provides for the deduction of "ordinary and necessary expenses paid or incurred during the taxable year . . . in connection with the determination, collection, or refund of

any tax." Specifically, legal fees and expenses incurred by the taxpayer for advice related to matters affecting his tax liability are deductible (Treas. Reg. § 1.212-1[1]; United States v. Davis, 370 US 65; Carpenter v. United States, 338 F2d 366).

In the present case the Division takes exception to the determination that petitioner was entitled to any deduction for the legal fees related to his divorce proceedings. We agree with the Division that petitioner has failed to prove the exact amount of legal fees that pertained to tax related matters. The failure of a taxpayer to prove the exact amount of deduction at issue, however, does not necessarily preclude the allowance of the deduction claimed. The problem we are confronted with is the factual issue of whether the record is sufficient to show what portion, if any, of petitioner's legal expense is allocable to tax advice (see, Goldaper v. Commr., 36 T.C. Memo 1381). In cases involving a taxpayer's entitlement to a deduction it has been held that once such taxpayer has proved his entitlement to some amount of deduction the court may allow a portion of the deduction claimed even though the exact amount has not been proved (Cohan v. Commr., 39 F2d 540). In making the approximation of the deduction the court may bear heavily upon the taxpayer whose inexactitude is of his own making (Cohan v. Commr., supra). This is commonly known as the Cohan rule.

Current trends in case law indicate that courts in their interpretation of the Cohan rule no longer always require some amount of deduction, however small, to be given where the taxpayer has shown that he is entitled to some deduction and none has been granted (Lerch v. Commr., 877 F2d 624). Rather, in situations where the taxpayer has refused to provide evidence upon which an estimation could reasonably be based, courts have denied the deduction claimed altogether (Lerch v. Commr., supra; Pfluger v. Commr., 840 F2d 1379). In the present case we find that petitioner has failed to provide the evidence necessary for us to allow a portion of the deduction claimed. All that petitioner has supplied is a generalized bill for legal fees incurred in his divorce which claims that $9,000.00 of the $10,000.00 legal fee related to tax planning, and a letter from the divorce attorney indicating that the vast majority (90%) of such bill did pertain to tax related matters. This letter was written five years after the services were rendered and was

based on memory, not on office records. Other evidence in support of the claimed deduction has not been provided. Neither petitioner nor his attorney submitted any sort of itemized breakdown of the specific subject matter involved and the corresponding amount of time spent on such matters. Further, neither petitioner nor petitioner's divorce attorney appeared at the hearing and thus did not offer any testimony as to the specific sort of work involved and the time spent on it. We cannot simply guess as to the amount of the deduction claimed. In such a situation, where specific records and supportive testimony have not been offered, we will not provide the petitioner with an estimate of the deduction at issue (see, Lerch v. Commr., supra; cf. Matter of Coleman, Tax Appeals Tribunal, May 18, 1989 [where estimation was made when petitioners provided itemized bills and detailed, uncontroverted testimony in support of deduction claimed]). As a result, we conclude that petitioner is not entitled to any deduction for the legal fees claimed.

The next issue is the decision of the Administrative Law Judge that petitioner should be allowed the miscellaneous deductions claimed. Because the Division disallowed the deductions by asserting "lack of substantiation" in its Answer, the Administrative Law Judge concluded that this was a new issue raised by the Division compelling a shifting of the burden of proof to the Division.

Generally, a presumption of correctness attaches to notices of deficiency issued under the authority of the tax statutes, and the burden is upon the taxpayer to demonstrate the incorrectness of the deficiency (Tax Law § 689[e]; Matter of Tavolacci v. State Tax Commn., 77 AD2d 759, 431 NYS2d 174, 175). The notice procedures found in Tax Law §§ 681(a) and 685(l) were modeled after comparable Federal provisions (1962 McKinney's Session Laws of New York, Memorandum of State Department of Taxation and Finance, at 3536-3537, Executive Memoranda at 3681-3682). As a result, Federal practice may be looked to for guidance in determining whether the notice of deficiency was adequate.

The New York State and the Federal statutes do not prescribe the contents of a notice of deficiency, or 90 day letter. Under Federal law, neither an error in the deficiency notice nor a failure to adequately explain the basis of the assessment will necessarily shift the burden to the

Internal Revenue Service; a notice which provides the taxpayer with information sufficient for the preparation of his case is adequate to raise the presumption of correctness and to place the burden of proof on the petitioner (Barnes v. Commr., 408 F2d 65, 69-1 USTC ¶ 9257; Myers v. Commr., 41 T.C. Memo 962).

Here, the statement of personal income tax audit changes was issued on October 1, 1985 and indicated that the deficiency at issue was computed by disallowing "Miscellaneous Deductions: Legal Deductions" of $9,779.92 to the extent of 96.99% ($9,485.54) for State tax purposes and disallowing $3,149.52 for New York City tax purposes. The Administrative Law Judge concluded that such documents were inadequate to properly apprise petitioner of his liability for miscellaneous deductions other than the legal deductions specified, thereby shifting the burden of proof to the Division for such additional items. We disagree. We conclude that the notice of deficiency and statement of personal income tax audit changes as issued were adequate to allow petitioner to prepare a case. The statement of audit changes contained an amount which included both the legal deduction at issue and the other miscellaneous deductions. The fact that the whole amount was attributed to the legal deduction did not deprive petitioner of the opportunity to adequately prepare. The essential purpose of the documents at issue is to provide the taxpayer with notification that a deficiency in taxes has been determined (see, Mayerson v. Commr., 47 T.C. 340; Nor-Cal Adjusters v. Commr., 503 F2d 359, 74-2 USTC ¶ 9701). This purpose has been fulfilled in the present case as the taxpayer was made fully aware of the amount of the deficiency asserted. Under Federal law, the error in attributing the whole deficiency to the legal deduction would not justify the shifting of the burden as petitioner was aware of the total amount being assessed. Further, Federal case law indicates that deductions in particular may be disallowed by the Commissioner without any reason or theory for the action and even if a reason or theory is offered in the deficiency notice, though it is erroneous, the Commissioner will not be limited to such claims and the burden will remain with the taxpayer (see, Mayerson v. Commr., supra). In light of the foregoing, and in consideration of the fact that petitioner was made aware of the Division's position well before the hearing as it was outlined in the answer, we conclude

that a new matter was not raised as a result of the description given on the statement of personal income tax audit changes. As a result, we need not consider whether the rule under Federal law would apply to shift the burden from petitioner to the Division had a new matter been raised.

Having determined that petitioner must carry the burden of proving its entitlement to the additional miscellaneous deductions at issue, we must now decide whether petitioner has met this burden. Since the only proof of such deductions is a mere schedule listing each deduction and the amount claimed therefor we conclude that petitioner has not met its burden of proving its entitlement to the additional miscellaneous deductions.

The last issue is whether the negligence penalty of Tax Law § 685(b)(1) was properly imposed upon petitioner. While petitioner did not raise the issue of penalty, the Administrative Law Judge assumed that petitioner's deduction of such a large portion of the legal fee was based upon the advice of counsel and in turn the penalty was cancelled. We find nothing in the record to support the cancellation of the negligence penalty. Petitioner bears the burden of proof to overcome the Tax Law § 685(b)(1) penalty (Tax Law § 689[e]) and no evidence at all has been offered by petitioner in support of the cancellation of the penalty. As a result, we conclude that the Tax Law § 685(b)(1) penalty was properly imposed.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is granted;

2. The determination of the Administrative Law Judge is modified as indicated in paragraph "1" above;

3. The petition of Harvey A. Schneier is in all respects denied;

4. The petition of Barrie D. Schneier is in all respects granted; and

5. The Notice of Deficiency issued to petitioner, Harvey A. Schneier, on January 8, 1986 is sustained but is cancelled as to Barrie D. Schneier.

DATED: Troy, New York
November 9, 1989

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

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

/s/Maria T. Jones
Maria T. Jones
Commissioner