STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
ROBERT CHAMBERLIN	:	DECISION DTA No. 806195
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law and under Chapter 17 of Title 11 of the Administrative Code of the City of New York for the Year 1983.	:	

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on January 10, 1991 with respect to the petition of Robert Chamberlin, 81 Columbia Street, #3C, New York, New York 10002 for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law and under Chapter 17 of Title 11 of the Administrative Code of the City of New York for the year 1983. Petitioner appeared pro se. The Division of Taxation appeared by William F. Collins, Esq. (Carroll R. Jenkins, Esq., of counsel).

Each party filed a brief on exception. The Division's request for oral argument was denied.

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

ISSUE

Whether an amount of $66,017.70 was properly deducted as a worthless debt on petitioner's income tax return.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for findings of fact "4," "5(b)," "6" and "8" which have been modified. We have also made additional findings of fact. The Administrative Law Judge's findings of fact, the modified findings of fact and the additional findings of fact are set forth below.

Petitioner, a high school teacher, was engaged in a labor strike in 1975 against the City of New York.

Petitioner was fired from his job for his strike activity.

Litigation concerning petitioner's rights resulted in awards being granted in 1980 and 1981 by the Voluntary Labor Arbitration Tribunal of the American Arbitration Association.

A memo of the Board of Education computes amounts due petitioner as a result of these awards. Petitioner has computed interest and salary due totalling $66,017.70, on these amounts according to his understanding of the rationale for those awards. The Division of Taxation at the hearing has agreed that there is nothing wrong with petitioner's rationale.

We modify findings of fact "4" of the Administrative Law Judge's determination to read as follows:

> In 1983, petitioner received an amount from the Board of Education as back pay under the awards. To do so, however, petitioner had to sign a waiver of his rights to all other financial claims against the Board of Education. Petitioner believes that by signing this release he gave up his right to the $66,017.70 in interest and salary owed to him by the Board of Education. This waiver, the Division of Taxation agrees, was signed under duress.[1]

Mr. Chamberlin filed a 1983 resident income tax return showing wages of $83,138.64, certain other income, interest income of $269.81, other income of $13,621.03, for a total

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[1] The Administrative Law Judge's finding of fact "4" read as follows:

> "4. In 1983, petitioner received an amount from the Board of Education as back pay under the awards. To do so, however, petitioner had to sign a waiver of his rights to the amounts here in dispute. This waiver, the Division of Taxation agrees, was signed under duress.

We modified this fact to reflect more details of the record.

income of $97,029.48. His deductions were interest expense of $1,557.76 and miscellaneous expenses of $89,429.85. His taxable income was $6,241.87.

We modify finding of fact "5.(b)" of the Administrative Law Judge's determination to read as follows:

> The miscellaneous expenses were union dues of $291.12, a contribution to his nephew of $5,000.00, a worthless debt from his ex-wife of $4,000.00, a worthless debt from his employer of $66,017.70, a "reserve" for litigation expenses with his employer of $13,621.03 and legal fees of $500.00. At hearing, the attorney for the Division acknowledged that petitioner provided a detailed description of the factual basis of his $66,017.70 deduction in his 1983 return by indicating to the Administrative Law Judge that the "taxpayer explains his argument in (his 1983 State return) in some considerable detail. I think it will make it very easy for you to understand where he is coming from" (transcript, p. 33). The relevant portion of petitioner's 1983 return referred to by the attorney states as follows:
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> > "In December of 1975 New York City teachers were illegally put on penalty probation as a result of a strike earlier that year. One year later 46 of these teachers, myself included, were fired. In January, 1980, an arbitrator ordered some of us reinstated. After six months, the Board of Education sent a letter to these teachers, myself included, reinstating us in one sentence, and refiring us in the next. In October, 1981, the same arbitrator once again ordered us reinstated forthwith with backpay to January, 1980. He also, however, gave the Board the right to give us new hearings based on the old charges which we would have to win in order to gain backpay back to 1976 and to justify continued employment.
> >
> > "On May 2, 1982 we were reinstated to a 'suspended status' with pay. In October, 1982, I was offered a check for about $38,000 which was represented as the entire net amount due me for the period 1/15/80 until 'reinstatement'. I was asked to sign a general release releasing them from all other obligations for that period. I calculated that the base pay they offered me was about $14,000 less than it should have been and that no interest on backpay was being offered. I refused to sign for the check, but later, in August of 1983, I signed the statement under duress. I calculate, that my losses for 1983 based on Signing [sic] that release to be about $66,000 and henceforth will be about $11,000 per year until litigation has run its course. About $52,000 is interest due for the period 1/15/80 - 12/31/83, simple annual interest calculated at 9%.
> >
> > "It should be noted that the $66,000 or so that I am declaring to be a worthless debt is only part of a general debt, the rest of which I am pursuing, and is in litigation. It should also be noted that other teachers refused to sign this release and are pursuing the entire amount owed. Since everything we are

> demanding is provided for by contract and by law, it is reasonable to expect that our combined litigation will be successful. If this occurs, then I will have forfeited some $66,000 for 1983 that would otherwise have been due me."[2]

The petitioner, at the hearing, conceded that the amounts of $5,000.00 and $13,621.03 were not deductible.

We modify finding of fact "6" of the Administrative Law Judge's determination to read as follows:

> In 1986, petitioner received $9,269.28 from the Board of Education. This amount represented a portion of the $66,017.70 petitioner deducted in 1983. On his 1986 State return, petitioner reported the $9,269.28 twice, as both wages and interest. Petitioner attached an explanation to his 1983 State return which explained that he believed such double counting was necessary to adjust for the bad debt deduction taken in 1983.[3]

A Notice of Deficiency was issued on February 11, 1987, for personal income tax for the year 1983 in the amount of $13,005.85 plus interest of $3,721.44 for a total amount due of $16,727.29. This accepts petitioner's gross income of $97,029.48 as reported, but allows only a standard deduction of $2,500.00 which with an exemption of $800.00 results in taxable income of $93,729.48. The reason stated for the deficiency is the disallowance of miscellaneous deductions. In lieu of other itemized deductions, the standard deduction was granted.

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[2]The Administrative Law Judge's finding of fact "5(b)" read as follows:

> "5.(b) The miscellaneous expenses were union dues of $291.12, a contribution to his nephew of $5,000.00, a worthless debt from his ex-wife of $4,000.00, a worthless debt from his employer of $66,017.70, a "reserve" for litigation expenses with his employer of $13,621.03 and legal fees of $500.00."

We modified this fact to explain the detail with which petitioner disclosed the nature of his $66,017.70 deduction on his 1983 return.

[3]Finding of fact "6" of the Administrative Law Judge's determination read as follows:

> "6. In later years, petitioner claims that he has included in income amounts received from the City identified as being interest and which would be the interest for which a loss is claimed in this case. I can make no finding on this assertion.

We modified this finding to more accurately reflect the record.

The Division of Taxation, at hearing, has not contested the miscellaneous deductions of $4,000.00 for the bad debt nor the $500.00 in legal fees nor the deduction of the interest expense of $1,557.76. The only item in dispute is now the $66,017.70 worthless debt of the Board of Education.

We modify finding of fact "8" of the Administrative Law Judge's determination to read as follows:

> The documents in this case contain no statements as to the basis upon which the Division of Taxation relies for its disallowance of the claimed worthless debt deduction. As noted earlier, the Statement of Audit Changes dated November 4, 1986 states only that "miscellaneous deductions of $88,638.73 are disallowed". The Division of Taxation's Answer, dated January 12, 1990, alleges in item 9 that "the Department of Taxation and Finance disallowed miscellaneous deductions claimed by petitioner in the total amount of $88,638.73". Finally, at the hearing held on May 10, 1990, the Division of Taxation was specifically requested to articulate why the miscellaneous deductions were disallowed (Tr., p. 10); however, the only explanation given was that if it was found "that Mr. Chamberlin's income for 1983 was part of a court settlement where he was awarded, it was in the terms of 'damages,' then he would not have to pay tax on damages, but if it was income--if it was salary to compensate him for salary lost then it would be income." The Division of Taxation declined to file a brief in this case with the Administrative Law Judge. Petitioner filed, with the Administrative Law Judge, a brief, copies of the two arbitration decisions and other related materials.[4]

In addition to the facts found by the Administrative Law Judge, we find the following facts.

In his petition, petitioner stated as follows:

> "At the Conciliation Conference of 6/23/88 the only issued raised by Mr. Safren was the 'Technical one that I had never actually received the interest in question.'
>
> "1. The interest in question was in fact awarded me by a combination of:
>
> a) Arbitration Award
> b) New York State Law mandating interest on back pay

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[4] We modified finding of fact "8" of the Administrative Law Judge's determination so that the last sentence of the paragraph indicated that the Division's failure to file a brief occurred at the hearing stage of the proceeding.

c) A case law finding of fact [Schacte v. US Bd of Ed.] that the Arbitrator did not bar interest.

"2. The fact that it was deducted from my pay (either by mistake or fraud) is of no more significance than taxes were also deducted from my pay and I never actually received them either."

At the hearing, the Division of Taxation conceded that petitioner was entitled to a refund of $2,554.00, plus interest, for 1982, and of $2,156.00, plus interest, for 1984.

OPINION

The Administrative Law Judge concluded that only the $66,017.70 bad debt deduction remained in dispute between the parties. The Administrative Law Judge cancelled that part of the deficiency that related to petitioner's deduction of this $66,017.70 on the basis that the Division of Taxation (hereinafter the "Division") had not stated any rationale for the denial of the deduction that the Administrative Law Judge could accept. The Administrative Law Judge stated that the Division had declined to file a brief and had not made an effective argument in any other way. The Administrative Law Judge concluded that it would be inconsistent with his role as an independent judge to adopt the role as attorney for the Division and develop the authorities and considerations supporting the Division's contentions.

On exception, the Division states that the deductions remaining in dispute are the claimed bad debt from petitioner's ex-wife in the amount of $4,000.00 and the claimed bad debt from the Board of Education in the amount of $66,017.70. With respect to these deductions, the Division contends that a presumption of correctness attaches to notices of deficiency and the burden is on the taxpayer to demonstrate that the deficiency is incorrect. The Division asserts that petitioner failed to meet his burden. Further, the Division argues that the notice of deficiency issued in this case was adequate because the documents issued informed petitioner of the amount of the deficiency asserted and the reason for the deficiency, i.e., the disallowance of the deductions. Finally, the Division states that the Administrative Law Judge impermissibly shifted the burden of proof to the Division and that such determinations call the legitimacy of the whole process into disrepute. The attorney for the Division also calls into question the

conduct of the Administrative Law Judge in raising issues and arguments for the first time in his determination. As authority for the conclusion that such conduct is not appropriate, the Division's representative cites only to his own experience, stating "[i]n nearly ten years of litigation experience in private practice and almost as many years in the public sector, I have never had this occur in any other forum" (Division's brief, p. 9). The Division also notes that at the hearing it suggested that the amounts awarded to petitioner by the Board of Education might have been damages for a tort action which are excludable from income. The Division suggests that "[w]hile this finding might require some mental gymnastics by the Administrative Law Judge, it certainly would be no more implausible than the determination ultimately rendered" (Division's brief, p. 7).

In response, petitioner argues that the determination of the Administrative Law Judge should be sustained based on the doctrine of res judicata. The essence of this argument is that the Division is raising arguments on exception that it never raised at the hearing level. Next, petitioner states that the Division conceded the $4,000.00 bad debt deduction at the hearing. Petitioner also asserts that the notice of deficiency was inadequate because it did not state reasons for the Division's disallowance of the deductions. Without these explanations, petitioner claims that he was unable to prepare a defense. Next, petitioner questions the Division's attack on the integrity of the Administrative Law Judge and on the system itself. Petitioner states that "[a]fter refusing for years to give petitioner reasons for the disallowance of his deductions so that petitioner could construct a defense, and for years, trying to beat petitioner on procedure rather than face the issues that petitioner raised, respondent is now accusing the Administrative Law Judge of bias" (Petitioner's brief, p. 11).

We begin our analysis of this case by clarifying what we believe the issue to be. First, we note that we agree with the Division that the notice of deficiency in this case was adequate. The notice informed petitioner that a deficiency of $13,005.85 was being determined for the year 1983. The attached statement of audit changes explained further that the deficiency arose from the disallowance of miscellaneous itemized deductions in the amount of $88,638.73. This

information was sufficient to inform petitioner that the basic elements of the claimed deduction, including its amount and character were in dispute (see, Matter of Reese v. Commissioner, 615 F2d 226, 80-1 USTC ¶ 9350, at 83,886, citing Sorin v. Commissioner, 29 TC 959, affd 271 F2d 741, 59-2 USTC ¶ 9789).

We also note that this is not a case where the rationality of the notice of deficiency is called into question by the Division's inability to describe its audit methodology (cf., Matter of Fokos Lounge, Tax Appeals Tribunal, March 7, 1991 [where the Division failed to identify the external index it utilized in the audit]). Here, the audit methodology is sufficiently described by the statement of audit changes which states that certain of petitioner's deductions are denied.

Finally, we agree with the Division that petitioner bore the burden to prove that he was entitled to the bad debt deduction of $66,017.70 (Tax Law § 689[e]).

Having stated the areas in which we agree with the Division, we will now address our areas of disagreement. First, we disagree with the Division that the Administrative Law Judge raised or considered the issue of the adequacy of the notice of deficiency. The Administrative Law Judge mentions the documents issued by the Division only as one of the places where the Division could have stated its reason for disallowing the deductions claimed by petitioner. The other places the Administrative Law Judge lists are the hearing itself and a post-hearing brief. Clearly, the Administrative Law Judge was not saying that the Division's rationale had to be stated in any particular document, but was instead saying that the Division did not take advantage of the numerous opportunities it had to state why the deduction was inappropriate.

Further, we do not agree with the Division that it was inappropriate for the Administrative Law Judge to look to the Division to articulate a reason why the bad debt deduction was not allowed. This is not an instance where the petitioner failed to establish the facts upon which he based his claim. Petitioner in this case, through his 1983 return, other documents, and his testimony at the hearing clearly described the nature of his claimed bad debt deduction, i.e., the deduction represented salary and interest that petitioner was owed by the Board of Education, but which petitioner relinquished when he signed a document releasing the

Board of Education of all financial claims in exchange for $38,665.12. In our view, after petitioner fully described the factual basis of his claimed deduction, the issue became a legal one: was the deduction described by petitioner one that was properly deductible as a bad debt under section 166 of the Internal Revenue Code. It was at this point that the Administrative Law Judge looked to the Division for a response, in the form of a legal argument. We think the Administrative Law Judge's expectation was wholly justified. Further, we believe that by looking to the Division's advocate to present a legal argument, the Administrative Law Judge was not shifting the burden of proof to the Division. The Division does not dispute that it did not offer any legal argument.[5]

Even in this exception, which it commenced, the Division has offered almost nothing to explain why the $66,017.70 deduction described by petitioner was not properly a bad debt deduction.[6] Our own investigation of this question indicates that the most basic reason for denying the claimed deduction is that there is a Federal income tax regulation under section 166 of the Internal Revenue Code directly on point. 26 CFR 1.166-1(e) states as follows:

> "(e) Prior inclusion in income required. Worthless debts arising from unpaid wages, salaries, fees, rents, and similar items of taxable income shall not be allowed as a deduction under section 166 unless the income such items represent has been included in the return of income for the year for which the deduction as a bad debt is claimed or for a prior taxable year."

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[5]On exception, the Division has challenged the Administrative Law Judge's statement that the Administrative Law Judge rejected the rationale offered by the Division in response to petitioner's claims, by saying "[w]hat rationale? What claims? Petitioner made no claims, and Respondent's attorney never offered a rationale" (Division's brief, p. 16).

[6]The only guidance we see in the Division's exception and brief on the specific question as to why the $66,017.70 was not a deductible bad debt is as follows: "[a]mong the deductions allowed [from federal gross income] are non-business bad debts (IRC § 166). Nonbusiness bad debts are treated as short-term capital losses subject to a $3,000 per year deduction limitation and are deductible only when totally worthless (Matter of Louis and Josephine Merola, State Tax Commn., TSB-H-81[54]I)" (Division's exception, p. 9, requested conclusion of law "A," and Division's brief, p. 10). Although it is far from clear, the legal argument we infer from this statement is that the Division believes that the amount is not deductible because the debt was not worthless in 1983; however, the Division has not further amplified its position. Rather than speculating as to why the Division would believe that there is an issue as to the worthlessness of the debt (e.g., does the Division question whether the release was in fact executed in 1983, or does the Division question whether the release rendered the debt worthless), we have determined to decide this case on the most direct basis.

That this regulation is a correct interpretation of IRC, section 166 has been established (Shapiro v. Commissioner, TC Memo 1961-118, 20 TCM 579). It has also been established that indebtedness for interest is an item of income subject to the same rule (Bush Terminal Bldgs. Co. v. Commissioner, 7 TC 793, citing Charles A. Collins, 1 BTA 305, District Bond 39 BTA 739). Thus, it seems clear to us that petitioner was not entitled to deduct his forfeited salary and interest under Federal law because he had not declared these amounts as income in 1983 or in any earlier year. Since a New York resident's deductions are his Federal deductions, with modifications not relevant here (Tax Law § 615), petitioner was not entitled to this deduction on his State return.

We are puzzled at the Division's failure to specify this regulation, or any Federal cases coming to the same conclusion (see, e.g., Gertz v. Commissioner, 64 TC 598; Seymour v. Commissioner, 14 TC 1111) as the legal reason for disallowing petitioner's bad debt deduction, because the fact that petitioner had not reported these amounts as income was apparently, as indicated by petitioner's petition, the explanation given by the Division to petitioner at his conciliation conference. Further, petitioner was aware that this was the central weakness of his claim (Tr., p. 38). On exception, instead of articulating this legal reason to support the deduction denial, the Division states "[t]here is a certain perverse logic to petitioner's position, i.e., in the same way as a person might want to take a deduction on money he did not win at the lottery, petitioner is deducting money not paid to him by the Board of Education. Appreciating the humor in it is a far cry from saying that the deductions were legal" (Division's brief, p. 16, footnote 8). We suggest that a simple citation to the relevant regulation or cases would have been more helpful both to petitioner and to this Tribunal, than is the Division's analogy and commentary. Ultimately, even the Division might have benefited from a specific legal statement because if petitioner had been aware of the Division's legal position, perhaps he would have abandoned this contest and saved the Division the resources spent at the hearing and on this exception. At the hearing petitioner did state, "[m]y big problem with the State all

along is that if they had given me a good argument I would have bought it, would not have had to go through this whole thing" (Tr., p. 39).

Although we reverse the Administrative Law Judge on the substantive question of whether petitioner was entitled to the $66,017.70 deduction, we appreciate the circumstances that led him to this conclusion, i.e., the complete failure of the Division to present a legal argument as to why petitioner was not entitled to the deduction. As stated above, even on exception the Division has given scant attention to stating a legal reason why petitioner's deduction was erroneous. Instead, the Division has gone on at length about how the notice of deficiency was adequate and has left us in the position of developing the legal rationale for concluding that petitioner's deduction was inappropriate. Apparently, it is the Division's position that throughout the hearing and exception process, it need not present any legal argument to respond to a taxpayer's proof other than to say that the notice of deficiency was issued and that the petitioner bears the burden of proof. Although we are extremely troubled by this position, we do not believe that it would be appropriate, under existing procedure, to do as the Administrative Law Judge did and refuse to formulate the arguments that respond to petitioner's factual claim. However, this case confirms the need for us to consider revising our rules of practice to ensure that in the future the Administrative Law Judges have a mechanism, and a means to enforce it, to require the petitioner and the Division to state their legal positions.

Since we have reversed the Administrative Law Judge's conclusion that petitioner was entitled to the $66,017.70 deduction, we must address the related issue raised by petitioner at the hearing regarding a set off for amounts reported in 1986. Petitioner established that in 1986 he received $9,269.28 from the Board of Education that represented a portion of the interest petitioner had deducted in 1983. Petitioner reported this amount twice on his 1986 State return, as both wages and interest. Petitioner stated on a schedule attached to his State return, that he believed such double counting was necessary in order to compensate for the deduction taken in 1983. Since the deficiency and overpayment arise out of the same transaction, petitioner's claim appears to raise an issue of equitable recoupment (see, Matter of National Cash Register Co. v.

Joseph, 299 NY 200). However, we are unable to grant any relief on such grounds in an income tax case because section 689(g) of the Tax Law specifically precludes us from determining that an overpayment was made for a year not otherwise in issue (Matter of Hemmers, Tax Appeals Tribunal, March 1, 1990). Accordingly, we must conclude that petitioner is not entitled to a reduction of the deficiency for 1983 based on the overpayments in 1986.

We believe we must also address the theory offered by the Division that the Administrative Law Judge should have found the payments by the Board of Education to be damages excludable from income. Section 104(a)(2) of the Internal Revenue Code provides that gross income does not include the amount of any damages received on account of personal injuries. For the payments made by the Board of Education to be excludable under this provision, we would have to find that they were paid based on the violation of a duty that arose by operation of law, rather than a duty that arose from an employment contract (see, Rickel v. Commissioner, 900 F2d 655, 90-1 USTC ¶ 50,200). The information before us indicates that the payments to petitioner came about as the result of the teachers' collective bargaining agreement with the Board of Education and the arbitration procedure this agreement required. Thus, we see no basis upon which to conclude that the payments were excludable from petitioner's income as damages.

Next, we address the issue of whether the Division contested petitioner's claimed bad debt deduction of $4,000 relating to a loan to his ex-wife. The Division states that it is unclear upon what the Administrative Law Judge based his finding that the Division was not contesting this deduction, as well as three others (the Division does now concede these three other deductions).[7] We find the Administrative Law Judge's conclusion based on the following exchange between the Division's representative and petitioner:

> "[Division's representative]: Worthless debts. This is a worthless debt to his ex-wife, balance due on sale to her of partnership and store, became worthless when Francine died last year.
>
> They disallowed it, didn't they?

[7]On exception, the Division has stated that it does not now contest the deductions for union dues ($291.12), legal fees ($500.00) and home mortgage interest payments ($1,557.76) (Division's brief, p. 6).

> Mr. Chamberlin: No, they just decided that when they disallowed so many that they might as well disallow all.
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> [Division's representative]: They just decided there were so many it was going to take you below the
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> minimum standard deductions, so they applied the minimum standard deductions.
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> Board of Education, City of New York, for $66,000. Once it became clear that was going to be disallowed as a deduction, that took Mr. Chamberlin to a point where he would be better off using the standard deductions, so they just disregarded it and gave him the standard deduction" (Tr., pp. 11-12).

This statement by the Division's representative clearly provided the basis for the Administrative Law Judge's finding that the Division did not contest the $4,000.00 deduction. We see no basis for disturbing the conclusion.

With respect to petitioner's arguments that the Division should be prohibited from raising arguments on exception that were not made at the hearing, we simply note that the purpose of our two stage process is to allow objections to the Administrative Law Judge's determination to be made to this Tribunal on exception (Tax Law § 2006[7]).

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is granted to the extent that petitioner's bad debt deduction in the amount of $66,017.70 is disallowed, but is otherwise denied;

2. The determination of the Administrative Law Judge is modified to the extent indicated in paragraph "1" above, but is otherwise sustained;

3. The petition of Robert Chamberlin is granted to the extent of allowing him deductions for union dues ($291.12), legal fees ($500.00), interest payments ($1,557.76) and a bad debt deduction ($4,000.00), but is otherwise denied; and

4. The Division of Taxation is directed to modify the notice of deficiency dated February 11, 1987 in accordance with paragraph "3" above, but such notice is otherwise sustained.

DATED: Troy, New York
January 30, 1992

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

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

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