STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
SALVATORE J. RIZZO	:	DECISION DTA No. 809015
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Year 1986.	:	

Petitioner Salvatore J. Rizzo, Overlook Road, Poughkeepsie, New York 12603, filed an exception to the determination of the Administrative Law Judge issued on September 17, 1992. Petitioner appeared by Raymond M. Pezzo, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Carroll R. Jenkins, Esq., of counsel).

Both parties filed briefs on exception. Petitioner also filed a reply brief which was received on December 24, 1992 and began the Tax Appeals Tribunal's six-month time period to issue this decision. Oral argument was not requested.

The Tax Appeals Tribunal renders the following decision per curiam.

ISSUES

I. Whether the money forfeited by petitioner to the State pursuant to the Assets Forfeiture Law (CPLR 1311), was includible in his New York adjusted gross income for 1986 without the allowance of a corresponding business expense deduction or loss deduction.

II. Whether, if the first issue is decided against petitioner, the proceeds from illegal gambling constituted compensation for personal services subject to the maximum tax benefit under Tax Law former § 603-A.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

The Division of Taxation issued a Statement of Personal Income Tax Audit Changes dated February 16, 1989 against petitioner, Salvatore J. Rizzo, asserting additional income tax due for the year 1986 of $51,583.30 plus penalty and interest. The statement showed "unexplained cash" of $518,000.00, which was deemed taxable in the year found (1986) because petitioner "could not establish the source of funds." The statementcalculated a net adjustment of $382,773.00, with a revised net New York income of $536,083.00, as follows:

Unexplained Cash	$ 518,000.00
Gambling Winnings reported	(135,227.00)
Net Adjustment	$ 382,773.00
Taxable Income Previously Stated	153,310.00
Net New York Income	$ 536,083.00

The Division of Taxation then issued a Notice of Deficiency dated September 5, 1989 against petitioner asserting income tax due of $51,583.30 plus penalty and interest for 1986.

Petitioner has had several run-ins with the law for illegal gambling activities. Included in petitioner's exhibits is a two-page schedule showing petitioner's record of convictions:

Year and File Numbers	Crime	Disposition
1976 #477	Possession of gambling records 1st degree and promoting gambling 1st degree	unknown
1975 #165(2)	Unknown	concurrent 1 yr. county jail sentences
1972 #744, 720-723	Promoting gambling 2nd degree	3 years probation and two $1,000 fines
1970 #134-137, 251	Unknown	3 years probation and four $1,000 fines
1965 #901, 107	Possession of bookmaking, poolselling records	two $300 fines

On May 23, 1986, the New York State Police executed eight search warrants apparently related to petitioner's illegal gambling activities and arrested petitioner. The respective New York State Police Search and Seizure Receipt and Inventory Statements, introduced into evidence by petitioner, show the following seized property:

Location Searched	Property Seized
I. Petitioner' residence on Overlook Road, Poughkeepsie	(1) U.S. Currency $51,050.00 (from dresser in ground floor bedroom), (2) U.S. Currency $140,450.00 (from closet in ground floor bedroom), (3) 1 32 caliber semi automatic pistol, (4) Papers showing property ownership, (5) Papers showing sports gambling, (6) Safe deposit box key #404, First National Bank, Highland, New York, (7) Safe deposit box key #498, Poughkeepsie Savings Bank, Poughkeepsie
II. Safe Deposit box #404 First National Bank, Highland, New York (maintained in the name of Sandra Rizzo, petitioner's wife)[1]	(1) $32,000.00 U.S. Currency ($100 denominations) (2) $20,000.00 U.S. Currency ($50.00 & $100.00 denominations) (3) $20,000.00 U.S. Currency ($100.00 denominations) (4) $20,100.00 U.S. Currency ($100.00 denominations) (5) $20,000.00 U.S. Currency ($100.00 denominations) (6) $20,000.00 U.S. Currency ($100.00 denominations) (7) $10,000.00 U.S. Currency ($50.00 denominations) (8) $7,000.00 U.S. Currency ($50.00 denominations)

[1]Petitioner testified that he did not maintain a safe deposit box in his own name. Rather, he utilized the safe deposit boxes maintained in the name of his wife and daughter, respectively.

	Total Amount: $149,100.00
III. Safe deposit box #498 Poughkeepsie Savings Bank, Poughkeepsie (maintained in the name of Traciann Rizzo, petitioner's daughter)	$160,100.00 U.S. Currency
IV. Queen Car Wash 600 Main Street, Poughkeepsie (petitioner's car wash business)	(1) $520.00 cash with policy[2] and horse wagers (in cardboard box), (2) $2,002.00 cash in paper bag, (3) $2,374.00 on petitioner, (4) $520.10 cash (in brown bank folder), (5) 3 calculators (6) $9,620.00 cash found in petitioner's attache, (7) 1 package of baseball line sheets, (8) Miscellaneous gambling records, papers and receipts Total cash: $15,036.10
V. 11 DuBois Avenue, Poughkeepsie (home of an unspecified friend of petitioner's)	(1) 1 telephone, (2) Assorted papers with sports and horse wagers, (3) Assorted papers with numbers bets, (4) $2,340.00 U.S. Currency, (5) $37.00 U.S. Currency
VI. 25 Collegeview, Poughkeepsie (petitioner testified that he did not know "what that [address] is")	(1) 1 telephone, (2) Telephone book with notations, (3) Yellow legal pad with wagering, (4) 2 Gary Austin line sheets - 1 football and 1 baseball/hockey

[2]The record does not include any explanation of this term.

VII. 1979 Chevrolet License 235-UA6 (petitioner testified he had "no idea at all" concerning this seizure)	$300.00 U.S. Currency
VIII. 1983 Buick 5006-AGG	Nothing seized - warrant not executed

Petitioner and his wife, Sandra Rizzo, filed separately on one Form IT-201, New York State Resident Income Tax Return, for 1986. Petitioner reported the following income:

Interest income	$ 237.00
Dividends	26.00
Business income	30,852.00
Capital gain	7,143.00
Other income	137,727.00
	$175,985.00

Petitioner's business income of $30,852.00 was from the operation of a car wash known as Queen Car Wash in Poughkeepsie, New York. Petitioner reported the following income and deductions from the operation of this business:

Gross receipts	$147,599.00
Cost of operations	(27,438.00)
Gross income	$120,161.00
Total deductions	(89,309.00)
	$ 30,852.00

Petitioner treated his business income of $30,852.00 as personal service income and computed a maximum tax benefit on such income.[3] The tax return did not explain the nature of petitioner's "other income" of $137,727.00. It is observed that the Division of Taxation, in adjusting petitioner's income for 1986, as noted above, subtracted gambling winnings reported of $135,227.00[4] from unexplained cash of $518,000.00.

[3]Although petitioner testified that Queen Car Wash was his wife's business, on his tax return petitioner reported income from the car wash as his income.

[4]On the tax return, this lesser amount of $135,227.00 was reported under the column heading for "federal amount" while $137,727.00 was shown under "Column A" where petitioner allocated his income, separate from his wife's. The difference of $2,500.00 ($137,727.00 less $135,227.00) was not explained in the record, although it is noted that petitioner calculated New York income tax due on the larger amount.

Petitioner testified that he did not visit or have access to the safe deposit box #498 at the Poughkeepsie Savings Bank maintained in the name of Traciann Rizzo, his daughter, during the year 1986. The record of visits for this box show the following stamped dates:

April 11, 1984
July 25, 1984
April 5, 1985
April 26, 1985
October, 1985[5]
May 23, 1986[6]

Petitioner did not introduce into evidence a record of visits with respect to the safe deposit box #404 at the First National Bank maintained in his wife's name. Petitioner testified that the cash kept in this safe deposit box represented "monies that I made . . . that my wife made from the business and other things, and legal gambling and things like that."

Petitioner introduced into evidence the following letter dated January 6, 1988 of Alfred T. Tallakson, Assistant District Attorney, Bureau Chief of the Office of the District Attorney of Dutchess County, to a Poughkeepsie attorney, Herbert Wallace, who apparently represented petitioner in the criminal prosecution related to the New York State Police seizure of assets on May 23, 1986:

> "[a]t your request, I am providing the following information to you:
>
> 1. The defendant [Salvatore Rizzo] entered a plea of guilty to Possession of Gambling Records in the Second Degree, a Class A Misdemeanor, in full satisfaction of all charges pending against him and received, as a sentence, a period of probation for 3 years.
>
> 2. As part of the disposition of the charges pending against the defendant, it was agreed that the sum of $212,650.05 would constitute assets forfeited to the State pursuant to the Assets Forfeiture Law. As per the agreement, that sum was forfeited by Mr. Rizzo but was not, of course, a part of any sentence imposed by the Court and cannot be construed as a fine, which can only be imposed by a court."

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[5]The day is not readable and the month is a best guess.

[6]This is the date that the State Police seized the contents of the safe deposit box.

At the hearing, petitioner reserved time to submit two additional documents: (1) a stipulation and assignment entered into by petitioner and the office of the Dutchess County District Attorney apparently related to the resolution of petitioner's 1986 criminal matter and (2) a release also apparently executed by the office of the Dutchess County District Attorney and petitioner. However, these documents were never submitted by petitioner.

Petitioner testified that he did not save money in banks:

> "[M]y father had bad experiences with banks. My father did not believe in saving money in banks . . . . I understood his feelings and I felt the same way."

Petitioner claims that the cash seized by the State Police represented his accumulation of cash from legal gambling, gifts from his father and his mother-in-law and business savings.

As detailed above, the State Police seized a total of $518,413.10 in cash currency upon execution of eight search warrants. This total amount is comprised of cash seized from the following locations:

Petitioner's residence	$191,500.00
First National Bank safe deposit box	149,100.00
Poughkeepsie safe deposit box	160,100.00
Car wash	15,036.10
1979 Chevy	300.00
11 DuBois Avenue home of petitioner's unspecified friend	2,377.00
	$518,413.10[7]

Petitioner testified that approximately $300,000.00 of the cash seized was returned to him for the following reason:

> "[t]he district attorney's office in conference with my attorney gave us an opportunity to justify these funds and they were sufficiently convinced that this amount of money did not constitute anything illegal."

[7]Petitioner's representative questioned petitioner concerning "the $526,000-odd that was found by the New York State Police." The difference between this larger amount and the total above of $518,413.10 is unexplained.

It would seem that if the $300,000.00 returned to petitioner was not considered "anything illegal", the $212,650.05[8] forfeited to the State, in contrast, was considered proceeds from illegal activities

The Division of Taxation conceded in its brief that:

> "[T]he assessment in dispute in this proceeding should be reduced by so much of the tax, penalty and interest as is attributable to this $160,100.00 [cash seized from the Poughkeepsie Savings Bank safe deposit box, which showed no entry during 1986]."

Therefore, the Division asserts that tax is due on the reduced amount of unexplained cash of $222,673.00 ($382,773.00 less $160,100.00). It is observed that this reduced amount of $222,673.00 is $10,022.95 greater than the amount petitioner forfeited to the State of $212,650.05.[9]

OPINION

In the determination below, the Administrative Law Judge held that: 1) petitioner failed to meet his burden of overcoming a deficiency assessment by clear and convincing evidence, by showing that both the method used to arrive at the assessment and the assessment itself are erroneous; 2) petitioner has not established his entitlement to a business expense deduction or loss deduction for the amount forfeited as a result of the criminal investigation; and 3) petitioner's gambling winnings were properly denied treatment as "personal service income." In addition, the Administrative Law Judge denied the Division's request that a penalty for a frivolous petition be imposed.

On exception, petitioner argues that: 1) because the income contained in the assessment represented monies seized by the police as a result of an illegal search and seizure, they are

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[8]As noted above, $518,413.10 was seized by the State Police. If $212,650.05 was forfeited, then the difference of $305,763.05 was returned to petitioner ($518,413.10 less $212,650.05). It is unknown if, in fact, $2,377.00 was returned to petitioner's DuBois Avenue friend and $300.00 to the owner of the 1979 Chevy. If so, $303,086.05 was returned to petitioner ($305,763.05 less $2,677.00).

[9]As noted in footnote "4," petitioner calculated New York income tax on gambling proceeds of $137,727.00. Consequently, the reduced amount of unexplained cash is more accurately determined to be $220,173.00, or $7,522.95 greater than the amount petitioner forfeited to the State of $212,650.05.

"fruits of the poisonous tree" and cannot be taxed; 2) because the $212,650.05 forfeited does not constitute a fine, penalty or part of a sentence, it is a bona fide business expense deduction or, alternatively, a loss deduction. In making this argument, petitioner asserts that: a) Internal Revenue Code § 162(f)[10] does not prohibit a deduction for the forfeiture because CPLR § 1311.1, which governed the forfeiture in question, states that "such a forfeiture is not deemed to be a penalty or criminal forfeiture for any purpose"; and b) petitioner "was an active trader engaged in a trade or business" (Petitioner's brief, p. 28). Thus, he contends that his 1986 income should have been reduced by this amount. In the alternative, petitioner argues that this forfeited amount should be taxed as personal service income.

In response, the Division of Taxation (hereinafter the "Division") makes the following arguments: 1) petitioner did not meet his burden of proving that the assessment was erroneous; 2) the legality of the seizure of petitioner's money is not an issue in this case; and 3) the $212,650.05 forfeited by petitioner cannot be allowed as a business expense deduction or loss deduction because petitioner failed to establish that he was engaged in a trade or business (citing Commissioner v. Groetzinger, 480 US 23, 87-1 USTC ¶ 9191).

We affirm the determination of the Administrative Law Judge. We will separately address two issues raised by petitioner on exception: 1) whether petitioner's money was illegally seized, and 2) whether petitioner was entitled to a deduction for the amount of the forfeiture. With respect to the issue of whether the forfeited amount should be treated as personal service income, we affirm the determination of the Administrative Law Judge for the reasons stated in the Opinion.

Seizure of Petitioner's Money

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[10]Internal Revenue Code § 162(f) states that:

> "[n]o deduction shall be allowed under [162(a)] for any fine or similar penalty paid to a government for the violation of any law" (emphasis added).

Petitioner asserts that income contained in the assessment represented monies seized by the police as a result of an illegal search and seizure, and as "fruits of the poisonous tree" cannot be taxed. However, as petitioner has offered no evidence to demonstrate the illegality of the search and seizure, or even allege facts supporting this assertion, we conclude that petitioner has failed to challenge the rational basis underlying the assessment (Matter of Tavolacci v. State Tax Commn., 77 AD2d 759, 431 NYS2d 174; Matter of Leogrande, Tax Appeals Tribunal, July 18, 1991, affd Matter of Leogrande v. New York State Tax Appeals Tribunal, ___ AD2d ___, 589 NYS2d 383, lv denied 81 NY2d 704, 595 NYS2d 398 [the presumption of correctness raised by the issuance of the assessment, in itself, provides that rational basis, so long as no evidence is introduced challenging the assessment]).

Deductibility of Forfeited Amount

Petitioner contends that he is entitled to a deduction under either section 162 or section 165 of the Internal Revenue Code. Tax Law § 612(a) states that: "[t]he New York adjusted gross income of a resident individual means his federal adjusted gross income as defined in the laws of the United States for the taxable year . . . [with certain modifications not relevant here]." Because both of these deductions would be included in arriving at Federal adjusted gross income (26 USC § 62[a][1]), Federal law is the controlling authority in deciding this question.

Petitioner's payment is deductible, if at all, under either section 162(a) or section 165(c)(1) of the Internal Revenue Code.[11] Both of these sections require that the expense be incurred by

[11]Section 165(c)(2) allows a deduction for "losses incurred in any transaction entered into for profit, though not connected with a trade or business" (emphasis added). Section 165(d) allows a deduction for "[l]osses from wagering transactions . . . to the extent of the gains from such transactions" (emphasis added). Because the loss took the form of a forfeiture consented to as part of an agreement with the District Attorney of Dutchess County, this loss was neither a "wagering transaction" nor "entered into for profit."

the taxpayer in the course of his carrying on a "trade or business."[12] The United States Supreme Court has recently defined this term, stating that:

> "to be engaged in a trade or business, the taxpayer must be involved in the activity with continuity and regularity and . . . the taxpayer's primary purpose for engaging in the activity must be for income or profit. A sporadic activity, a hobby, or an amusement diversion does not qualify" Commissioner v. Groetzinger, supra, 87-1 USTC ¶ 9191 at 87,287 [1987]).

In Groetzinger, as in this case, the taxpayer was a gambler. It was established that the taxpayer, upon losing his job, devoted 60 to 80 hours per week to parimutuel wagering on dog racing for 48 weeks during 1978, the year at issue, with a view to earning a living from such activity. During this period he had no other employment and gambled solely for his own account. He generated gross winnings of $70,000.00 on bets of $72,032.00, for a net gambling loss of $2,032.00. In finding that the petitioner's gambling activities constituted a "trade or business,"[13] the Court stated that:

> "we conclude that if one's gambling activity is pursued full time, in good faith, and with regularity, to the production of income for a livelihood, and is not a mere hobby, it is a trade or business within the meaning of the statutes with which we are here concerned. Respondent Groetzinger satisfied that test in 1978. Constant and large-scale effort on his part was made. Skill was required and was applied. He did what he did for a livelihood, though with a less than successful result. This was not a hobby or a passing fancy or an occasional bet for amusement" (Commissioner v. Groetzinger, supra, 87-1 USTC ¶ 9191 at 87,287).

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[12]Internal Revenue Code § 162(a) states that:

> "[t]here shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business . . . ."

Internal Revenue Code § 165(c)(1) states that:

> "[i]n the case of an individual, the deduction under subsection (a) shall be limited to . . . losses incurred in a trade or business."

[13]The statute interpreted by the Supreme Court in Groetzinger was former section 56(a) of the Internal Revenue Code, containing the phrase "attributable to a trade or business carried on by the taxpayer." However, it is clear that the focus of the Court's analysis was the words "trade or business," which it noted were present in over 50 sections of the Internal Revenue Code (Commissioner v. Groetzinger, supra, 87-1 USTC ¶ 9191 at 87,284).

The Court further stated that the determination of whether a taxpayer is engaged in a trade or business "'requires an examination of the facts in each case'" (Commissioner v. Groetzinger, supra, 87-1 USTC ¶ 9191 at 87,287 citing Higgins v. Commissioner, 312 US 212, 41-1 USTC ¶ 9233, at 109).

In his brief, petitioner undertakes a lengthy discussion of Groetzinger and other Federal tax cases dealing with the deductibility of gambling losses. Petitioner also recognizes that there is "factual inquiry necessary to establish the status [sic] of an active trade or business" (Petitioner's brief, p. 28). Despite this acknowledgement, the record in this case is devoid of any evidence tending to establish that petitioner continuously and regularly engaged in gambling activities which rose to a level which was more than a mere "sporadic activity, a hobby, or an amusement." Petitioner points to the Division's depiction of petitioner as a "repeater," as well as his criminal record, which includes gambling-related offenses occurring prior to 1977, as evidence that he was engaged in the business of gambling (Petitioner's reply brief, p. 5). However, this evidence of petitioner's past activities is not relevant to petitioner's task, i.e., establishing that he was engaged in the business of gambling during the year 1986. Thus, we conclude that petitioner has failed to meet his burden of proving his entitlement to a deduction under either section 162 or 165(c)(2) of the Internal Revenue Code (Tax Law § 689[e]).

Because petitioner has failed to establish this "trade or business" element required to claim the deductions at issue, it is unnecessary to address whether a forfeiture under CPLR § 1311.1 would otherwise be deductible under Internal Revenue Code sections 162 and 165.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of petitioner Salvatore J. Rizzo is denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petition of Salvatore J. Rizzo is granted to the extent indicated in conclusion of law "L" of the Administrative Law Judge's determination, but is otherwise denied; and

4. The Division of Taxation is directed to modify the Notice of Deficiency dated September 5, 1989 in accordance with paragraph "3" above, but such Notice is otherwise sustained.

DATED: Troy, New York
June 3, 1993

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

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

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