

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
XUONG TRIEU	:	DETERMINATION
A/K/A HENRY CHAO	:	DTA NO. 807969
for Redetermination of a Deficiency or for	:	
Refund of New York State and New York City	:	
Income Taxes under Article 22 of the Tax Law	:	
and the New York City Administrative Code for	:	
the Years 1982 and 1983.	:	

Petitioner, Xuong Trieu a/k/a Henry Chao, 88-19 Justice Avenue, Elmhurst, New York 11375, filed a petition for redetermination of a deficiency or for refund of New York State and New York City income taxes under Article 22 of the Tax Law and the New York City Administrative Code for the years 1982 and 1983.

A hearing was held before Dennis M. Galliher, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on December 10, 1991 at 1:15 P.M., with all additional documents to be submitted by January 31, 1992, followed by briefs to be submitted by April 22, 1992. Petitioner submitted additional documents on December 21, 1991, and the Division of Taxation submitted additional documents on January 31, 1992. The Division submitted a letter brief on March 19, 1992, and petitioner submitted a responding brief on April 17, 1992. Petitioner appeared by Charles Becker, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Michael J. Glannon, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation properly determined additional personal income tax due from petitioner by utilizing a cash availability audit methodology.

II. Whether petitioner has established any basis warranting reduction or abatement of penalties imposed.

FINDINGS OF FACT

Petitioner, Xuong Trieu a/k/a Henry Chao, timely filed a New York State and City of New York Resident Income Tax Return (Form IT-201) for each of the years 1982 and 1983. On such returns petitioner elected filing status "3" ("Married filing separately on one return").¹

On February 3, 1989, the Division of Taxation issued to petitioner a Notice of Deficiency asserting additional New York State and New York City personal income tax due for the years 1982 and 1983 in the aggregate amount of \$153,508.01, plus penalty and interest. A Statement of Audit Changes previously issued to petitioner on June 1, 1988 separately states the amounts of tax asserted as due for each of the years in question, and also separates such yearly amounts as to New York State versus New York City amounts. This statement also indicates that penalty was imposed pursuant to Tax Law § 685(b) (negligence).

The above-described asserted deficiency results from a Division of Taxation audit of petitioner's personal income tax returns for the subject years. More specifically, this audit, consisting of an analysis of sources

and applications of funds by petitioner during the subject years, underlies the Division's claim that petitioner understated his taxable income and also had income unexplained as to source for each of the years in question, as follows:

<u>Year</u>	<u>Understatement</u>	<u>Unexplained Sources</u>	<u>Total</u>
1982	\$237,658.82	\$155,000.00	\$392,658.82
1983	344,848.26	123,000.00	467,848.26

As described hereinafter, the understatement amounts result from an analysis of deposits and withdrawals to and from petitioner's checking and savings accounts, while the unexplained sources relate to amounts received by petitioner as transfers from the Hong Kong and Shanghai Banking Corporation.

¹Petitioner's spouse, also filing separately, utilized the same form. She is not a party to this proceeding.

The Division of Taxation first conducted a cash availability analysis for each of the years in question. The Division determined petitioner's available funds (sources of funds) to consist of wages received per Forms W-2, fee income, gross rental receipts, checks to cash, tax refunds and certain checks received specifically from the Hong Kong and Shanghai Banking Corporation. In turn, the Division determined petitioner's applications or uses of funds to consist of estimated cash living expenses plus deposits to bank accounts. Comparing total funds available for each year to total funds applied for each year resulted in (or revealed) funds applied in excess of funds available. The foregoing may be presented in summary form as follows:

Funds Available

	<u>1982</u>	<u>1983</u>
Total Wages	\$ 9,631.69	\$ 2,716.56
Fee Income	1,400.00	--
Gross Rents	17,830.00	13,800.00

Checks to Cash	3,600.00	--
State tax refund	<u>215.00</u>	--
Subtotal	\$ 32,676.69	\$ 16,516.56
Checks from Hong Kong and Shanghai Bank	<u>155,000.00</u>	<u>123,000.00</u>
Subtotal	\$187,676.69	\$139,516.56
Transfers from one bank account to another: ²	Bank #5 \$ 50,000.00	Bank #4 \$ 54,823.00
	Bank #6 10,000.00	Bank #6 56,000.00
	Bank #15 <u>40,000.00</u>	Bank #7 20,000.00
		Bank #12 <u>10,000.00</u>
Total Available Funds:	\$287,676.69	\$280,339.56

- less -
Funds Applied

Estimated Cash living expenses	\$ 15,150.00	\$ 16,750.00
Deposits to bank accounts ²	<u>510,185.51</u>	<u>608,437.82</u>
Total Applications:	\$525,335.51	\$625,187.82

- equals -
Funds Applied in
Excess of Funds Available

Understated Taxable Income	\$237,658.82	\$344,848.26
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The Division treated the above-determined excess of funds applied over funds available for each year as unreported income subject to tax. In addition, the Division treated the checks received from the Hong Kong and Shanghai Banking Corporation for each year as additional taxable income. These funds were allowed in the Division's cash availability analysis as a

source of available funds, thereby reducing the difference between cash available and cash

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Bank deposits and interbank transfers were determined from the Division's analysis of some 18 different bank accounts held by petitioner. Review of the audit workpapers reveals one mathematical error, to wit, that for 1983 applications of funds were overstated by \$7,000.00. More specifically, addition of all deposits to Lincoln Savings Bank account number 14770000951-6 (Bank #7 per auditor's workpapers) reveals the correct total of deposits (treated as applications of funds) to be \$142,423.39 rather than \$149,423.39 as shown on the workpaper. Other than this math error, noted by petitioner's representative at hearing, petitioner conceded to the mathematical accuracy of the bank account analysis made by the Division.

applied. Such treatment, in effect, decreased the amount of understated income held subject to tax. However, such funds were deemed additional taxable income in their own right for lack of adequate substantiation of nontaxability (i.e., that such available funds were derived from nontaxable sources).

Review of the audit workpapers and comments therein indicates the Division's recognition that the difference or excess of funds applied over funds available might have been explained or attributed to other transfers of funds which the auditors were unable to trace, to loans not shown in petitioner's documents, or to other nontaxable sources of funds undisclosed to the auditors. However, absent such information, the Division treated as additional taxable income the excess of funds applied plus the amounts received from the Hong Kong and Shanghai Banking Corporation for each year as determined upon audit.

Petitioner did not appear at hearing to provide testimony, nor did petitioner offer an affidavit on his own behalf. Submitted into evidence on petitioner's behalf were certain documents including affidavits and summary sheets, and also certain cancelled checks including those from the Hong Kong and Shanghai Banking Corporation.

According to petitioner's representative, petitioner was a successful businessman in South Vietnam prior to 1975, being involved in the match manufacturing business. Petitioner left Vietnam by United States military plane in May 1975 as a refugee immediately prior to the takeover of South Vietnam. Petitioner settled thereafter in the United States.

According to an affidavit made by one Yin Kwok, the amounts received from the Hong Kong and Shanghai Banking Corporation represent repayments of loans made by petitioner to Mr. Kwok during 1972 and 1973 in the aggregate sum of \$278,000.00. These loans were allegedly repaid via the checks drawn on the Hong Kong and Shanghai Banking Corporation between September 25, 1982 and December 2, 1983. According to Mr. Kwok's affidavit, the "precipitate" nature of his departure from Saigon made it impossible for him to take personal and/or business records with him upon departure, including

evidence of the debt owed to petitioner. The affidavit claims that Mr. Kwok was required by honor to repay the amount to petitioner and therefore he did the same as evidenced by the drafts to petitioner drawn on the Hong Kong and Shanghai Banking Corporation. Other than the drafts drawn on said bank, no records or other information surrounding the circumstances of the alleged loans and their repayments were offered in evidence. The bank drafts themselves do not carry Mr. Kwok's name or any reference to him on their faces or reverse sides.

With respect to the excess applications of funds, petitioner submitted a one-page summary sheet entitled "source of funds", totalling some \$232,649.85 and listing monies received in 1971, 1974, 1975, 1976 and 1979. According to affidavits submitted by, inter alia, petitioner's aunt, some of these funds allegedly involved remittances from a trading company in Hong Kong to petitioner's sister in the United States to be held for safekeeping and future investment purposes. With respect to these and other monies, petitioner maintains that certain withdrawals from various of his 18 bank accounts were not treated as sources of income unless the same were nearly immediately redeposited into other banks. Petitioner's representative noted that such withdrawals should be allowed in "narrowing the gap between available funds and expended funds". Petitioner's representative alleged that funds could have been accumulated over a number of years, and thus would not necessarily represent funds received from taxable sources during the years in question. Petitioner's representative also alleged that petitioner was a "respected elder" within his community, and that petitioner often served as a "stakeholder", under which petitioner would hold monies for other Vietnamese refugees or persons in the community and repay the same to those persons when needed. Such monies were, in essence, allegedly being held "in trust". No documentation pertaining to this claim, or showing evidence of amounts held for particular individuals, was offered in evidence. Petitioner alleged that the Division bears the burden of showing some reasonable source of income in order to conclude that petitioner's excess applications of funds were derived from taxable income sources as opposed to nontaxable cash sources such as an accumulated cash hoard, repayment of loans or stakeholding of monies.

In response to the foregoing, the Division noted that withdrawals which could not be tied to deposits were not considered sources of income since such withdrawals were "more likely spent on personal expenses or asset acquisitions and were not redeposited". The Division's auditor (via workpaper entries and an affidavit) expressed doubt over the claim that petitioner kept a substantial accumulated cash hoard rather than depositing money in interest-earning bank accounts because petitioner "clearly used bank accounts as evidenced by his multiple accounts with various banks."

CONCLUSIONS OF LAW

A. The Tax Appeals Tribunal has recognized the validity of a source and application of funds audit (also known as a cash availability audit) to determine unreported taxable income (Matter of Lee, Tax Appeals Tribunal, October 11, 1990). In fact, in income tax matters, it is not even necessary that the taxpayer's books and records be deemed inadequate before a source and application of funds audit may be conducted. (Matter of R & J Automotive, Inc., Tax Appeals Tribunal, June 15, 1989.) In Matter of Lee (*supra*), the Tribunal noted that:

"[I]n Matter of Giuliano v. Chu (135 AD2d 893, 521 NYS2d 883)...the court determined that '[a]n initial consideration of inadequate or incomplete books and records before employing an indirect method is normally only required in sales and use tax cases where the tax is imposed upon verifiable receipts evidenced by statutorily required books and records' [citation omitted]."

This matter thus devolves to whether petitioner has established error in the audit calculations, proven the existence of additional (nontaxable) sources of funds or substantiated that sources of funds deemed taxable were, in fact, from nontaxable sources. The evidence presented is not sufficient to establish any of such points.

B. Treated first are the funds received from the Hong Kong and Shanghai Banking Corporation. Petitioner's only explanation as to the source of such income was a single affidavit from an alleged borrower making repayments on monies allegedly loaned nearly 10 years prior to the years in question. It is certainly possible that such monies received by petitioner represented repayments of loans. However, the evidence is insufficient to sustain such a

conclusion. First, there is no documentation evidencing any such loans. The allegation that all records were of necessity abandoned in Vietnam must be weighed against the fact that petitioner did not appear at hearing to offer testimony nor did petitioner even offer an affidavit as to the facts and circumstances surrounding this matter, including specifically the alleged loans. As to the alleged repayments of loans, there is no indication that any interest was included in the amounts repaid. On this score, petitioner's representative commented, by brief, that:

"[p]etitioner was only too happy to receive the repayment. He was overjoyed that Mr. Yin Kwok was honorable enough to honor a long overdue debt and was happy with only receiving the principal."

Such comment, represents simply a bare unsworn allegation, unsupported and unpersuasive on the issue of the existence and repayment of loans. Further, there is no correspondence between the alleged borrower and petitioner detailing the nature or purposes of the payments being made or linking the same to the alleged loans. As noted, the alleged borrower's name (Yin Kwok) does not appear on any of the drafts allegedly representing loan repayments. Accordingly, and unfortunately, the evidence submitted fails to prove that the monies received from the Hong Kong and Shanghai Banking Corporation were in fact repayments of loans and therefore not subject to tax.

C. As with the foregoing, it is entirely possible that petitioner had accumulated a cash hoard of monies prior to the years in question which monies were used during the years in question. It is also possible that petitioner had additional funds derived from nontaxable sources during the years in question. However, there is no evidence presented in the record, and apparently none was presented at audit, by which the monies applied during the years in question could be traced or tied to additional nontaxable sources of income. The only two items considered applications of funds were cash living expenses (comparatively small in amounts; see, Finding of Fact "4") and deposits to bank accounts. In turn, withdrawals from bank accounts were not treated as sources of funds if they could not be traced to deposits (i.e., applications thereof). Absent some explanation as to the disposition of the withdrawn amounts, such as showing the same as later deposits (i.e., applications), there is no accounting for such

amounts as applications. Stated differently, to allow withdrawals as sources of funds, there would have to be some accounting for the same as applications. The evidence presented does not enable such an accounting (see, Matter of Lee, supra). In the same manner, the evidence is not sufficient to support allowance of an alleged accumulated cash hoard as a source of funds. In this regard, there was no tracing of such amounts to bank deposits (i.e., applications) during the subject years. Further, and as the Division points out, the claim of a cash hoard is inconsistent with petitioner's maintenance and use of some 18 bank accounts. Finally, with respect to the claim of being a "stakeholder" for others, there were no records submitted or other details as to specific instances of stakeholding or amounts of cash involved. On balance, it is concluded that petitioner has not submitted such evidence as would allow the overapplied funds in question to be reconciled to funds available from nontaxable sources. However, as described in Footnote "2", applications of funds were, as the result of mathematical error, overstated by \$7,000.00. Hence, the dollar amount of excess applications, treated as additional taxable income, must be reduced by \$7,000.00.

D. Petitioner established, via the submission of evidence including affidavits and a related publication, that he was active in Southeast Asian refugee relocation efforts, and otherwise acted in a positive manner within his community. However, as to the abatement of penalties, petitioner has offered nothing other than evidence to establish his good character. Such evidence has essentially no bearing on the particular matter at hand, i.e., the income tax deficiency in question. In turn, there is no other evidence to support abatement of penalty and the same is, therefore, sustained.³

³As the Division admits by its Answer, the audit of petitioner was originally undertaken by one Allan Berstein, who was arrested and convicted of accepting bribes on audits he conducted. The Division "re-audited" those taxpayers previously audited by Mr. Berstein "to insure that proper audit procedures had been followed." While the petition herein claims the Division erred by "invalidating the original audit for the years 1982 and 1983 which the taxpayer had agreed to", there is simply no evidence to support such claim. In fact, there is no evidence that a Notice of Deficiency was issued prior to that at issue herein, dated February 3, 1989, or that petitioner had agreed in any manner to any audit results (either prior to or after issuance of a Notice of Deficiency). So too, petitioner's representative claims, by brief, that "negative inferences may have been drawn against petitioner because of an audit of an establishment known as No. 1

E. The petition of Xuong Trieu a/k/a Henry Chao is granted to the extent indicated in Conclusion of Law "C" (reducing additional taxable income by \$7,000.00), but is otherwise denied, and the Notice of Deficiency dated February 3, 1989, reduced in accordance herewith, together with such penalty and interest as is lawfully due and owing, is sustained.

DATED: Troy, New York
June 25, 1992

/s/ Dennis M. Galliher
ADMINISTRATIVE LAW JUDGE

Chinese Restaurant, Inc." In fact, on June 1, 1982, petitioner formally resigned from "all positions being held by him" with such corporation. The audit report contains two references to such corporation, to wit, listing petitioner's business activity as "Pres #1 Chinese" and noting "#1 Chinese Rest. Inc. XN1435" under the page 2 heading "Key Case". Even though the latter reference was unexplained, such notations do not alone support a conclusion of prejudice or "negative inferences", nor do they have any apparent bearing on the results of the audit of petitioner.