

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
SALVATORE J. RIZZO	:	DETERMINATION
	:	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 a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the year 1986.

A hearing was held before Frank W. Barrie, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on October 11, 1991 at 1:15 P.M., with all briefs to be submitted by May 29, 1992. Petitioner filed a brief on February 6, 1992. The Division of Taxation's answering brief was filed on March 3, 1992, and petitioner's reply brief on May 29, 1992. Petitioner appeared by Raymond M. Pezzo, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Carroll R. Jenkins, Esq., of counsel).

ISSUES

I. Whether petitioner's proceeds from illegal gambling, which were forfeited to the State pursuant to the Assets Forfeiture Law (CPLR 1311), were includible in his income subject to income tax, without the allowance of a corresponding business expense or business 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.

III. Whether the petition was filed merely for purposes of delay and is frivolous so that a penalty under Tax Law § 2018 should be imposed.

FINDINGS OF FACT

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 statement calculated 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	<u>(135,227.00)</u>
Net Adjustment	\$ 382,773.00
Taxable Income Previously Stated	<u>153,310.00</u>
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:

<u>Year and File Numbers</u>	<u>Crime</u>	<u>Disposition</u>
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:

<u>Location Searched</u>	<u>Property Seized</u>
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)

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
policy² 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,

¹Petitioner 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.

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

	(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
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	<u>137,727.00</u>
	\$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	<u>(27,438.00)</u>
Gross income	\$120,161.00
Total deductions	<u>(89,309.00)</u>
	\$ 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 in Finding of Fact "1", subtracted gambling winnings reported of \$135,227.00⁴ from unexplained cash of \$518,000.00.

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, 1985⁵
May 23, 1986⁶

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

³Although 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.

⁴On 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.

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

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

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:

"At 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."

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 in Finding of Fact "4", 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	<u>2,377.00</u>

\$518,413.10⁷

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

"The 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."

It would seem that if the \$300,000.00 returned to petitioner was not considered "anything illegal", the \$212,650.05⁸ 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

⁷Petitioner'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.

⁸As noted in Finding of Fact "11", \$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).

⁹As 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.

SUMMARY OF THE PARTIES' POSITIONS

Petitioner contends that the cash returned to him by the State Police represented savings, gifts and cash from legal gambling previously reported as income. The \$212,650.05 forfeited to the State should be treated as a business expense, thereby cancelling out any corresponding

increase in petitioner's income. If his income is increased based upon proceeds from illegal gambling, such additional income should be treated as personal service income subject to the maximum tax benefit.

The Division of Taxation counters that the \$212,650.05 forfeited to the State by petitioner cannot be allowed as a business expense or business loss since there is a strong State policy against illegal gambling. Petitioner has been given credit for \$135,227.00 reported on his tax return, and in its brief the Division of Taxation conceded that petitioner should be given credit for \$160,100.00 which was seized from the Poughkeepsie Savings Bank safe deposit box, which showed no entry during 1986. Therefore, such monies could not be treated as income in 1986. However, petitioner failed to shoulder his burden of proving that the assessment was in error with regard to the remaining unexplained cash of \$222,673.00 which was properly treated as additional income in 1986.

CONCLUSIONS OF LAW

A. The Tax Appeals Tribunal has recognized the validity of reconstructing a taxpayer's income by an analysis of cash availability (Matter of Lee, Tax Appeals Tribunal, October 11, 1990). In Lee, the Division of Taxation determined additional income by calculating the amount by which the taxpayer's "application of income" exceeded "sources of income". The excess available cash so computed was treated as income subject to tax.

B. In the matter at hand, the Division of Taxation has utilized a variation on a cash availability methodology to determine additional income. As noted in Finding of Fact "1", unexplained cash "found" in 1986 was treated as additional income in 1986 because the

taxpayer "could not establish the source of funds." The Division, in effect, determined that the "found" cash represented an "application of income" which exceeded the "sources of income" disclosed on petitioner's tax return.

C. The situation here is similar to that in Giuliano v. Chu (135 AD2d 893, 521 NYS2d 883, 886) where the taxpayer failed "to present any substantiating evidence other than Giuliano's own, rather nonspecific testimony [citation omitted]." In Giuliano, the taxpayer testified as to the sources of certain unexplained large personal deposits including claims that he owned and sold two businesses, sold his home and that prior to the years audited he had funds available of between \$280,000.00 and \$350,000.00. In the matter at hand, as noted in Finding of Fact "10", petitioner explained the sources of the cash seized by the State Police as gifts, business savings and the accumulation of cash from legal gambling. However, as in Giuliano, such testimony without any substantiating evidence was inadequate for petitioner to meet his "burden of overcoming a deficiency assessment by clear and convincing evidence showing that both the method used to arrive at the assessment and the assessment itself are erroneous [citations omitted]" (Giuliano v. Chu, supra, 521 NYS2d at 886). It is observed that the letter of Alfred T. Tallakson described in Finding of Fact "8" can be given minimal weight in light of petitioner's failure to submit the documents described in Finding of Fact "9" which would have provided details concerning the plea which petitioner worked out with the District Attorney's Office with regard to the 1986 criminal matter (cf., Capital District Better TV, Inc., Tax Appeals Tribunal, July 30, 1992).

D. As noted in Finding of Fact "13", in addition to the gambling winnings reported by petitioner, the Division of Taxation credited petitioner with \$160,100.00 because such cash was placed in the Poughkeepsie Savings Bank safe deposit box prior to the year at issue. Consequently, the amount petitioner forfeited to the State of \$212,650.05 is very close to the amount of unexplained cash of \$220,173.00

E. The Assets Forfeiture Law (CPLR Article 13-A) is described in Weinstein-Korn-Miller, NY Civ Prac ¶ 1310.01, as follows:

"Complex and lengthy, Article 13-A offers prosecutors a powerful tool to use against criminal activity, by permitting the commencement of a civil lawsuit against certain classes of people for the forfeiture of property, or its value equivalent, which was obtained as a result of, or used in the commission of a crime [footnote omitted]."

It appears that in lieu of an action by the District Attorney against petitioner under this law, petitioner and the District Attorney's Office in reaching terms on a plea bargain agreed to the forfeiture of \$212,650.05 without the institution of a separate action by the District Attorney. As noted in Finding of Fact "9", petitioner failed to submit documentation which would detail his plea bargain and this forfeiture. In any event, petitioner has not established his entitlement to a business expense or loss deduction for the amount forfeited.

F. New York income tax law evinces a strong intent to conform to Federal authority wherever possible (Hunt v. State Tax Commission, 65 NY2d 13, 489 NYS2d 451). Consequently, the reasoning of Judge Hamblen in Mack v. Commissioner (58 TCM 89), a matter involving similar facts, is persuasive:

"In March 1980, Roanoke City Police confiscated \$14,000 cash from Mack in a gambling raid. A sharply defined public policy against illegal gambling existed in the State of Virginia.... Accordingly, a loss deduction for the seized \$14,000 cash is denied.

* * *

...Mack had no right, constitutional or otherwise, to engage in illegal gambling.... He did so at his own risk, and the resulting losses should be borne solely by him. Otherwise, the government would be forced to underwrite a portion of the costs incurred by Mack in his illegal enterprises" (id. at 91).

The court in Mack also noted that it was well settled under Federal case law that cash confiscations "if allowed at all, would be as loss deductions under section 165 [of the Internal Revenue Code] rather than as ordinary and necessary business expenses under section 162 [citations omitted]."

In short, New York, like the State of Virginia, has a sharply-defined public policy against illegal gambling (Penal Law §§ 225.00 - 225.40). Accordingly, a loss deduction for the seized and forfeited \$212,650.05 is denied.

G. It is observed that IRC § 162(f) provides that:

"No deduction shall be allowed under subsection (a) [trade or business expenses] for any fine or similar penalty paid to a government for the violation of any law."

The fact that the forfeiture by petitioner to the State was pursuant to a plea bargain does not provide a loophole to evade this explicit limitation (*cf.*, Colt Industries, Inc. v. United States, 880 F2d 1311; Henson Robinson Co. v. Commissioner, 48 TCM 508).

H. Petitioner's argument that his income from illegal gambling should be subject to the maximum tax benefit is without merit. Tax Law former § 603-A,¹⁰ which prescribed a maximum tax rate on New York personal

service income, provided, in part, as follows:

"(b)(1) For purposes of this section the term 'New York personal service income' means

(A) wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered, but does not include that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered. In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income-producing factors, under regulations prescribed by the tax commission, a reasonable allowance as compensation for the personal services rendered by the taxpayer shall be considered as earned income...."

I. The tax regulations at 20 NYCRR former 100.4(c) defined personal service income, in pertinent part, as follows:

¹⁰When section 603-A was added to the Tax Law by chapter 70 and amended by chapter 729 of the Laws of 1978, "New York personal service income" was defined as items of income includible as personal service income for purposes of section 1348 of the IRC, an analogous Federal maximum tax provision. Section 1348(b)(1)(A) of the IRC, prior to its repeal effective for taxable years beginning after December 31, 1981, defined "personal service income" as any income which is earned income within the meaning of section 401(c)(2)(C) of the IRC or section 911(b) of the IRC or which is an amount received as a pension or annuity which arises from an employer- employee relationship or from tax deductible contributions to a retirement plan.

After section 1348 of the IRC was repealed in 1981, section 603-A of the Tax Law was amended to incorporate substantially the same definition of earned income that was contained in section 401(c)(2)(C) of the IRC (section 603-A[b][1][B] of the Tax Law), section 911(b) of the IRC (section 603-A[b][1][A] of the Tax Law) and the pension and annuity provision of section 1348(b)(1) of the IRC (section 603-A[b][i][C] of the Tax Law). The maximum tax rate on New York personal service income was repealed by Laws of 1987 (ch 28, § 5, eff April 20, 1987).

"(1) New York personal service income. For purposes of this section, the term New York personal service income means items of income includible as personal service income for purposes of section 1348 of the Internal Revenue Code....

* * *

(2) Personal service income. (i) For purposes of section 1348 of the Internal Revenue Code, personal service income generally includes wages, salaries, professional fees, bonuses, commissions on sales or on insurance premiums, trips and other amounts received as compensation for personal services actually rendered. It also includes prizes and awards that are not gambling winnings...."

J. The regulation quoted above which excludes gambling winnings from "personal service income" subject to the maximum tax benefit is consistent with the statutory definition of "New York personal service income" (cf.,

Blue Spruce Farms, Inc. v. State Tax Commn., 99 AD2d 867, 472 NYS2d 744, affd 64 NY2d 682, 485 NYS2d 526 [unless a regulation is shown to be irrational or inconsistent with the statute, it should be upheld]).

K. Finally, the Division of Taxation's request that a penalty for a frivolous petition under Tax Law § 2018 should be imposed is denied. It is observed that petitioner's maintenance of this proceeding has resulted in a substantial reduction of the assessment, as noted in Finding of Fact "13".

L. The petition of Salvatore J. Rizzo is granted to the extent that tax due is to be recalculated based upon the reduced amount of unexplained cash of \$220,173.00, as noted in footnote "9", but in all other respects is denied, and the Notice of Deficiency dated September 5, 1989, as modified, is sustained.

DATED: Troy, New York
September 17, 1992

/s/ Frank W. Barrie
ADMINISTRATIVE LAW JUDGE