

STATE OF NEW YORK
DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
JOSEPH AND JOSEPHINE MACALUSO	:	
for Redetermination of a Deficiency or for	:	
Refund of New York State and New York City	:	
Personal Income Taxes under Article 22 of the	:	
Tax Law and the New York City Administrative	:	
Code for the Years 1983 through 1985.	:	DETERMINATION
	:	DTA NOS. 810181
	:	AND 810182

In the Matter of the Petition	:	
of	:	
SIPAM CORP.	:	
for Redetermination of a Deficiency or for	:	
Refund of Corporation Franchise Tax under	:	
Article 9-A of the Tax Law for the Fiscal Years	:	
Ended September 30, 1983 through September 30,	:	
1985.	:	

Petitioners Joseph and Josephine Macaluso, 1091 Cuyama Road, Ojai, California 93023, filed a petition for redetermination of a deficiency or for refund of New York State and New York City personal income taxes under Article 22 of the Tax Law and the New York City Administrative Code for the years 1983 through 1985.

Petitioner Sipam Corp., P.O. Box 874, Ojai, California 93023, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the fiscal years ended September 30, 1983 through September 30, 1985.

A consolidated hearing was commenced before Timothy J. Alston, Administrative Law Judge, at the offices of the Division of Tax Appeals, Riverfront Professional Tower, 500 Federal Street, Troy, New York, on December 16, 1993 at 1:15 P.M. and continued to conclusion on December 17, 1993 at 9:00 A.M. Petitioners filed a brief and additional evidence on March 15, 1994. The Division of Taxation filed a brief on April 13, 1994. Petitioners filed

a reply brief on May 2, 1994. Petitioners appeared by John R. Serpico, Esq. The Division of Taxation appeared by William F. Collins, Esq. (John Michaelson, Esq., and John Matthews, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation's determination of petitioner Sipam Corp.'s items of income and expenses for the period at issue was proper.

II. Whether the Division of Taxation's determination of additional taxable income to petitioner Sipam Corp. resulting from Sipam's sale of the Conca D'Oro Motel business and real property was proper.

III. Whether the Division of Taxation properly determined that petitioner Joseph Macaluso received a constructive dividend from Sipam Corp. in the full amount of the additional income to Sipam Corp. resulting from the Division of Taxation's determination of Sipam Corp.'s income and expenses and its sale of the Conca D'Oro Motel.

IV. Whether the Division of Taxation properly determined that petitioner Joseph Macaluso received a constructive dividend from Sipam Corp. in the full amount of certain payments purportedly made by Sipam Corp. in 1984 and 1985 which were characterized as "loans" on Sipam Corp.'s disbursement records.

V. Whether the deficiencies against the individual petitioners for the years 1983 and 1984 were time-barred or whether the six-year limitations period under Tax Law § 683(d)(1) was applicable.

VI. Whether, under the instant circumstances, the Division of Taxation properly issued a Notice of Deficiency to Josephine Macaluso for the year 1985 where she did not file a return for that year.

VII. Whether petitioner Josephine Macaluso was an "innocent spouse" under Tax Law former § 651(b)(5)(i) during the years at issue and was therefore not liable for the deficiency asserted herein.

FINDINGS OF FACT

Petitioner Sipam Corp. ("Sipam"), a New York corporation incorporated in October 1976, owned and operated a motel known as the Conca D'Oro Motel¹ located at 2232 Forest Avenue, Staten Island, New York. During the period at issue, the Conca D'Oro Motel rented exclusively to welfare recipients. Sipam's certificate of incorporation indicates that its tax year was to end on December 31.

Sipam filed its Federal income tax return (Form 1120) for the year ended May 31, 1983. Sipam did not file Federal income tax returns for any subsequent periods. Unsigned copies of Sipam's unfiled Federal income tax returns for the years ended May 31, 1984 and May 31, 1985 were entered into the record herein.

Sipam did not file any New York corporation franchise tax reports for any part of the relevant period.

Petitioners Joseph and Josephine Macaluso, husband and wife, timely filed joint Federal and New York State personal income tax returns for the years 1983 and 1984. Petitioners did not file either Federal or

State returns for 1985. On their 1983 and 1984 New York returns, petitioners reported adjusted gross income of \$129,736.00 and \$62,000.00, respectively.

Mr. Macaluso became president of Sipam in 1977, soon after the corporation's formation, and remained president at all times relevant herein. Mr. Macaluso was also a director of Sipam. According to a "Resolution" of the board of directors of Sipam, dated March 27, 1979, signed by Mr. Macaluso and a Mr. Roberto Mameli, Mr. Macaluso was given "the authority to make loans at his own discretion." Minutes of meetings of Sipam's board of directors dated March 22, 1981 and February 28, 1983 indicate that Mr. Macaluso was given complete discretion regarding an expansion of the Conca D'Oro Motel. Additionally, the minutes of a board meeting of April 7, 1984 indicate a board decision to allow Mr. Macaluso

¹The motel is also referred to as the Conca D'Oro Hotel at various points in the record.

"complete and total control in all financial decisions that concern Sipam Corporation."

Regarding the stock ownership of Sipam, the record contains some conflicting evidence. Sipam's unfiled Federal income tax return for the year ended May 31, 1985 states that Mr. Macaluso owned 100% of Sipam's stock. In contrast, the minutes of a meeting of Sipam's board on July 20, 1977 indicate the issuance of 100 shares of Sipam stock to Mr. Macaluso and 100 shares to Princex Trading International ("Princex"), a Panama corporation. Other corporate records also indicate that Mr. Macaluso was issued 100 shares of stock on July 20, 1977 and indicate that Princex transferred 50 of its shares to Zurital Trading Corporation ("Zurital"). Additionally, the minutes of a Sipam board meeting held on January 8, 1985 with Mr. Macaluso present indicate the board's decision "that other stockholders be consulted about the decision whether or not to sell the motel." These minutes further state the board's decision "to contact Mr. Roberto Mameli and inform him of the proposal [to sell the motel] so that he can get the decision of the foreign stockholders . . . so that we may pursue this offer if it is acceptable." The minutes of the board meeting held on April 7, 1985 state that "[t]he letter from Mr. Mameli was read to the Board, giving Mr. Macaluso authority to further pursue the sale of the Conca D'Oro Motel." The record also contains a resolution of Princex Trading International, Inc., dated March 20, 1979, which indicates that Princex owned 50% of the capital stock of Sipam and that Princex had transferred 50% of its shares to Zurital. The resolution also indicates that Princex remitted \$1,077,500.00 to Sipam during 1977 and 1978 "for the purchase of the land and the construction of the buildings."

The record also contains a document, the purpose of which is unexplained but pursuant to which Roberto Mameli, as president of Zurital, states that Zurital owns 25% of the shares of Sipam. This document is dated May 9, 1988.

Although the record contains little evidence of Sipam's day-to-day activities, the minutes of the board clearly indicate that Mr. Macaluso was in charge of Sipam's operations. Mr. Macaluso had no involvement in Sipam's clerical or bookkeeping activities. Such responsibilities were delegated to a Mr. Stephen Sano, an accountant, and Mr. Sano's mother,

employed by Sipam in a clerical capacity. The record also indicates that Mr. Macaluso hired an individual to manage the property.

The expansion of the motel referred to in the minutes resulted in an increase in the number of rooms from 59 to 120 rooms. This expansion occurred in the early 1980's.

Sipam sold the Conca D'Oro Motel to an unrelated party on May 24, 1985. Under the terms of the sale, Sipam received \$600,000.00 for the sale of the business and \$4,100,000.00 for the sale of the real property. The purchase price for the real property was paid, in part, by a purchase money mortgage and note given to Sipam in the amount of \$3,975,000.00.

Pursuant to the terms of an Assignment of Mortgage dated December 3, 1985, Sipam assigned the \$3,975,000.00 purchase money mortgage to Mr. Macaluso for \$1,000.00.

The record also indicates that, by assignment dated December 20, 1985, Mr. Macaluso assigned the purchase money mortgage to Gateway State Bank in consideration of \$120,000.00. This assignment indicates that the mortgage had a principal value of \$3,906,164.00 as of December 1, 1985.

Also present in the record is an assignment dated March 12, 1986 whereby, in consideration of \$1,000.00, Mr. Macaluso assigned the same purchase money mortgage to Bellevue Estates, Inc., a California corporation with an address of 1091 Cayama Road, Ojai, California. Stephen M. Sano executed the assignment on behalf of the assignee.

The record also contains an assignment dated August 26, 1986 whereby Bellevue Estates, Inc. assigned the same purchase money mortgage back to Mr. Macaluso for \$1,000.00.

The record contains no explanation or other information regarding the assignments referred to in Findings of Fact "12", "13" and "14", nor does the record contain any information regarding any other assignments of the purchase money mortgage. Given the chronology of assignments as noted, it would seem that some additional information would be necessary to explain what happened between the December 20, 1985 assignment and the March 12, 1986 assignment.

The record herein contains copies of four loan agreements, each dated August 14, 1978,

the terms of which indicate that Sipam borrowed as follows:

Lender	MJJ Investors Co. ²	Zurital	Princex	Crailhurst Ltd.
Amount of Loan	\$500,000.00	\$450,000.00	\$450,000.00	\$400,000.00

By a letter dated January 26, 1986, Zurital, acting through Mr. Mameli, appears to have ratified the December 3, 1985 assignment of mortgage to Mr. Macaluso with the following conditions:

- "1. You personally [sic] assume and agree to pay, the existing obligations to the stockholders. By this, we mean, the outstanding loans made to Sipam Corporation in 1977, and any and all outstanding interest that is due and payable on said loans.
- "2. After the above mentioned obligations are met, any and all appropriate share of the profit from the sale of the Conce [sic] D'Oro Motel be paid to the stockholders of record."

The January 26, 1986 letter further states:

"If there is not going to be any further business, then Sipam Corporation will become a Dormant Corporation. If in your opinion, there will not be any further business for Sipam Corporation, then we feel that you should investigate the feasibility [sic] and practicality of dissolving [sic] Sipam."

Mr. Macaluso made the following payments to Princex and Zurital:

<u>Date of Check</u>	<u>Payee</u>	<u>Amount</u>
12/17/86	Zurital	\$225,000.00
3/19/86	Zurital	100,000.00
3/19/86	Zurital	400,000.00
4/14/87	Princex	100,000.00
5/4/87	Princex	100,000.00
5/30/87	Princex	150,000.00
6/15/87	Zurital	100,000.00
7/7/87	Zurital	100,000.00
9/8/87	Zurital	150,000.00
12/15/87	Princex	100,000.00
3/25/88	Zurital	100,000.00
4/15/88	Zurital	86,500.00
date illegible	Princex	86,500.00

Mr. Macaluso testified that the payments listed above were made in consideration of the

²It should be noted that Mr. Macaluso signed the loan agreement on behalf of MJJ Investors Co.

December 3, 1985 assignment of mortgage to him. Mr. Macaluso further testified that he paid Princex and Zurital through Mr. Mameli a total of \$1,900,000.00 in respect of the assignment and that no written agreement was ever drawn up in respect of this arrangement with Mr. Mameli.

Mr. Macaluso also paid Mr. Mameli \$30,000.00 by check dated November 24, 1987. Mr. Macaluso testified that this payment was intended for Mr. Mameli to pay Federal withholding taxes.

The minutes of Sipam's board meeting of April 7, 1985 state, in part:

"Discussion pursued concerning the future of Sipam Corp after the sale of the motel. Several alternative ideas were presented for the Boards option [sic], such as purchasing another motel in another part of the city, land development, building of residential units or condominiums. These ideas were taken into consideration and will be pursued for further discussion at subsequent meetins [sic]."

Petitioners Joseph and Josephine Macaluso were audited by the Internal Revenue Service ("IRS") for the years 1986, 1987 and 1988. The results of this audit were eventually resolved by agreement of the parties under the aegis of the United States Tax Court. Petitioners entered into the record herein copies of the Tax Court "decisions" relative to the IRS audit. Said decisions merely recite the amount of the tax deficiencies, penalties and interest for the years at issue in the IRS audit.

Petitioners Joseph and Josephine Macaluso also entered into evidence herein their joint 1986 Federal income tax return. Said return listed \$450,000.00 in interest income from Conca D'Oro Motel, Inc. and also listed as a deduction \$450,000.00 in interest paid to Roberto Mameli and \$55,000.00 in interest paid to Gateway State Bank.

On audit, the Division of Taxation ("Division") determined Sipam's audited gross receipts for the period at issue by reference to a document entitled "Welfare Hotels Fact Sheet" which was prepared internally by the Division using information obtained from the New York City Department of Social Services. The "fact sheet" listed "estimated welfare receipts" of the Conca D'Oro Motel for the calendar years 1983, 1984 and 1985. The Division determined the estimated welfare receipt amounts to be Sipam's audited gross receipts for its fiscal years ended

September 30, 1983 and September 30, 1984.³ For the year ended September 30, 1985, the Division determined Sipam's gross receipts to be the difference between the 1985 estimated receipts per the fact sheet and the reported gross receipts of the corporation that purchased the motel in May 1985. As determined in the foregoing manner, the Division determined the following audited gross receipts for Sipam:

Fiscal Year Ended	9/30/83	9/30/84	9/30/85
Audited Gross Receipts	\$1,275,562.00	\$2,247,872.00	\$960,447.00

It is noted that petitioner did not take issue with the estimated welfare receipt figures as listed on the Welfare Hotels Fact Sheet. It is further noted that documentation submitted by petitioner in an effort to refute the Division's audit result indicated a total gross receipts figure for the period at issue which exceeded the Division's total figure by \$250,117.00.

In determining Sipam's allowable expenses for the fiscal year ended September 30, 1984, the Division used as its starting point the total cash expenses claimed on Sipam's unfiled Form 1120 for the year ended May 31, 1984. Such total cash expenses amounted to \$1,804,395.00. The Division then disallowed certain claimed expenses. Specifically, the Division disallowed 80% of the following expenses:

<u>Expense</u>	<u>Amount Claimed Per Return</u>
Repairs	\$141,809.00
Taxes	120,377.00
Interest	275,956.00
Consultants/Legal/Accounting	230,484.00
Casual Labor	132,295.00
Miscellaneous Expenses	<u>67,321.00</u>
	\$968,242.00 x .80 = \$774,594.00 =

Amount Disallowed

The Division also disallowed in full the following claimed expenses:

<u>Expense</u>	<u>Amount Disallowed</u>
Automobile	\$ 14,806.00

³The Division's records indicated that Sipam's tax year ended September 30.

Travel & Entertainment	56,779.00
Outside Contractors	57,622.00
Electrician ⁴	30,700.00
Closing Costs	11,521.00
Equipment	<u>27,308.00</u>
	\$198,736.00

The Division thus disallowed a total of \$973,330.00 of the cash expenses claimed on Sipam's unfiled Federal income tax return for the year ended May 31, 1984. The Division allowed as expenses the difference between the amount claimed and the amount disallowed, which amounted to \$831,065.00. The Division then added to that amount Sipam's claimed depreciation of \$96,199.00 to reach total allowed expenses of \$927,264.00.

Audited gross receipts less allowable expenses as determined on audit above resulted in audited taxable income for the fiscal year ended September 30, 1984 of \$1,320,608.00.

On its unfiled Federal return for the year ended May 31, 1984, Sipam claimed a total of \$1,099,052.00 in "Other Deductions". Attached to the return was a schedule listing the specific components of such other deductions. Included in the list of "Other Deductions" is an entry for "Real Estate Taxes" in the amount of \$165,229.00, which was not disallowed on audit by the Division.

In determining Sipam's allowable expenses for the fiscal year ended September 30, 1985, the Division used as its starting point the total cash expenses claimed on Sipam's unfiled Form 1120 for the year ended May 31, 1985. Such expenses amounted to \$417,847.00.

The Division next disallowed certain expenses claimed on the return. Specifically, the Division disallowed 80% of the following

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Sipam's return claimed \$35,015.00 in electrician expenses. The Division allowed \$4,315.00 of such claimed expenses.

claimed expenses:

<u>Expense</u>	Amount Claimed Per <u>Return</u>
Repairs	\$ 33,411.00
Taxes	70,935.00
Interest	43,605.00
Miscellaneous other than Auto	<u>77,162.00</u>
	\$225,113.00 x .80 = \$180,090.00 =

Amount Disallowed

The Division also disallowed, in full, petitioner's claimed automobile expenses of \$5,269.00 for the year ended May 31, 1985.

The Division further disallowed \$25,376.00 in cash expenses based upon a comparison of Sipam's cash disbursements as indicated by records reviewed by the Division on audit and the cash expenses taken on Sipam's tax return. Specifically, records reviewed by the Division on audit revealed \$563,269.00 in total disbursements for the year ended May 31, 1985. Capital expenditures accounted for \$171,158.00 of these total disbursements, leaving \$392,471.00 available for cash expenses for the year. As noted, Sipam claimed \$417,847.00 in cash expenses on its return. The Division thus disallowed the amount of cash expenses claimed on the return which exceeded the amount available for such expenses as indicated by the disbursement records reviewed by the Division on audit.

In total, the Division disallowed \$210,735.00 of the cash expenses claimed on Sipam's unfiled Federal income tax return for the year ended May 31, 1985. The Division allowed as expenses the difference between the amount claimed and the amount disallowed, which amounted to \$207,112.00. The Division then added to that amount Sipam's claimed depreciation of \$96,199.00 to reach total allowed expenses of \$303,311.00.

Audited gross receipts less allowable expenses as determined on audit resulted in audited taxable income for Sipam for the fiscal year ended September 30, 1985 of \$657,136.00.

Sipam did not provide disbursement records to the Division on audit for the fiscal year ended September 30, 1983. Accordingly, the Division disallowed a percentage of the cash expenses claimed on Sipam's filed Federal income tax return for the year ended May 31, 1983.

Specifically, the Division disallowed 52.18% of such cash expenses. This particular percentage was used because it represented the average of the percentages of disallowance of cash expenses for the two subsequent years at issue.⁵

Applying the percentage of disallowance to the cash expenses claimed on the return resulted in total cash expenses disallowed of \$316,871.00 and total cash expenses allowed of \$290,394.00. Following an addback of the \$87,621.00 in depreciation claimed, the Division determined total expenses allowed of \$378,015.00.

Audited gross receipts less allowed expenses resulted in audited taxable income to Sipam for the fiscal year ended September 30, 1983 of \$897,547.00.

The Division also determined that Sipam had additional unreported income for the fiscal year ended September 30, 1985 resulting from the sale of the Conca D'Oro Motel in May 1985.⁶ This additional income had two components. First, the Division determined \$600,000.00 in additional ordinary income to Sipam based upon the sale of the Conca D'Oro Motel business. Second, the Division determined \$2,167,464.00 in capital gain income resulting from Sipam's sale of the real property. The capital gain was calculated as follows:

Gross consideration	\$4,100,000.00
Basis	(1,847,536.00)
Brokerage Fees	(30,000.00)
Other Expenses	(55,000.00)
Gain	\$2,167,464.00

The Division introduced into the record a copy of an automobile retail installment contract dated September 20, 1982 which indicated the purchase of an automobile by Sipam. The contract contained a heading "Use For Which Purchased" and listed thereunder an "X" in a

⁵Percentage of disallowance as used herein equals the ratio of total cash expenses disallowed to total cash expenses per returns. For the fiscal years ended September 30, 1984 and September 30, 1985, this ratio equaled 53.94% and 50.43%, respectively.

⁶Although petitioner took issue with the Division's determination of tax due arising from the sale of the motel, the Division's calculation of gain in respect of the sale is not in dispute.

box labeled "Personal". The record contains no other evidence regarding Sipam's use of this or any other car.

In order to establish the amount of water, sewer and real estate taxes paid by Sipam during the period at issue, Sipam introduced into the record photocopies of documents maintained by the City of New York listing various water, sewer and real estate tax charges to Sipam's premises. The headings of the various columns of these documents (referred to by Sipam as "History of Payments") are, for the most part, either abbreviations or are

illegible (or both). To explain these documents, Sipam introduced an affidavit by Anthony P. Barone, an attorney and vice-president and counsel of Regency Abstract, Inc. Mr. Barone's affidavit offered an explanation of the various column headings contained on these documents. Mr. Barone's affidavit did not offer an explanation for the final two column headings on the right side of the documents, both of which were sub-headings under the heading "Liquidation". The History of Payments documents and the affidavits together appear to indicate that Sipam paid \$207,260.00 in real estate taxes and \$13,782.00 in water and sewer charges on the subject property during the period at issue.

Mr. Macaluso testified that Sipam was in arrears on its real estate taxes at the time of the sale of the motel in 1985 and that Sipam paid about \$120,000.00 in back real estate taxes at that time. Upon review of the "History of Payments" documents submitted by petitioners, there appears to be no indication of any activity on or about May 25, 1985.

During the course of its audit of Sipam, the Division determined that petitioner Joseph Macaluso was a principal stockholder of Sipam and that he had directly or constructively received substantial income from the corporation. Accordingly, the Division attributed to Mr. Macaluso the additional corporate income resulting from the Sipam audit. Specifically, the Division determined that the full amount of the additional unreported income of Sipam resulting from the Division's audit of the corporation's gross receipts and disallowance of certain claimed expenses constituted a constructive dividend to Mr. Macaluso in amounts as follows:

<u>1983</u>	<u>1984</u>	<u>1985</u>
\$897,547.00	\$1,320,608.00	\$657,136.00

The Division also determined that the full amount of the contract price from Sipam's sale of the Conca D'Oro Motel business (i.e., \$600,000.00) constituted a constructive dividend to Mr. Macaluso for the year 1985.

With respect to Sipam's 1985 sale of real property, the Division attributed income to Mr. Macaluso as follows:

Total Capital Gain on Sale	\$2,167,464.00
Less: Depreciation	<u>(653,642.00)</u>
Remaining Capital Gain	\$1,513,822.00

The Division then determined 40% of the remaining capital gain, or \$605,529.00, to be a capital gain to Mr. Macaluso and 60%, or \$908,293.00, to be an item of tax preference for Mr. Macaluso, subject to minimum income tax.

Also with respect to the sale of the real property, the Division determined \$653,642.00 to be additional ordinary income to Mr. Macaluso for 1985 as depreciation recapture.

The Division also determined that Mr. Macaluso received constructive dividends from Sipam in the amount of certain payments purportedly made by Sipam during 1984 and 1985 which were characterized as loans on Sipam's disbursement records. The Division's review of Sipam's records revealed that such loans totalled \$503,502.00 in 1984 and \$48,603.00 in 1985.

The Division took issue with the existence and validity of the purported loans because the Division believed that the parties which purportedly received the loan proceeds could be related to Sipam. Additionally, there were no loan documents or records of repayment and Sipam offered no explanation for the loans. Further, the parties purportedly receiving the loans did not file tax returns. The Division thus characterized the purported loans as retained earnings.

Sipam's disbursement records indicate approximately 120 separate "loan disbursements" during 1984 and 1985. The amounts of such disbursements ranged from \$50.00 to \$28,000.00. Some disbursements were made in round number amounts, others were not. One entity, Staten

Island Realty Holding Corp., appears as the recipient of the majority of these disbursements. Other entities listed as receiving these loans are: US Mining International Ltd.; Ceramicus Manufacturing, Ltd.; Ramfis Realty, Inc.; and an entity listed in the auditor's workpapers as MVJ.

Mr. Macaluso described the purported loan to US Mining International as an investment. Mr. Macaluso further testified that Mr. Mameli had suggested making the purported loan to US Mining International.

Following the field audit, the Division issued to Sipam six notices of deficiency under Article 9-A of the Tax Law, each dated January 31, 1990. Said notices asserted tax due as follows:

<u>Period Ended</u>	<u>Tax</u>	<u>Amount</u>
9/30/83	Corporation Franchise	\$ 89,754.70
9/30/83	MTB ⁷ Tax	16,155.85
9/30/84	Corporation Franchise	132,060.80
9/30/84	MTB Tax	22,450.33
9/30/85	Corporation Franchise	342,460.00
9/30/85	MTB Tax	<u>58,218.20</u>
Total Tax Due		\$661,099.88

The Sipam notices also asserted penalties and interest. Statements of franchise tax audit changes contained in the Division's audit report indicated that penalties were asserted pursuant to Tax Law § 1085(a)(1) and (b)(1).

Also following the field audit, on December 15, 1989, the Division issued to petitioners Joseph and Josephine Macaluso a Notice of Deficiency which asserted additional New York State and New York City personal income taxes due as follows:

<u>Year</u>	<u>Tax</u>	<u>Amount</u>
1983	NYS	\$ 125,139.59
1983	NYC	42,439.00
1984	NYS	253,768.01
1984	NYC	<u>82,334.38</u>

⁷"MTB" refers to Metropolitan Transportation Business Tax Surcharge imposed under Tax Law § 209-B.

1985	NYS	383,837.48
1985	NYC	<u>127,460.16</u>
	Total Tax Due	\$1,014,978.62

The income tax notice also asserted penalties and interest. The Division's audit report indicated that penalties were asserted pursuant to Tax Law § 685(b)(1) for each of the years at issue. With respect to 1985, the audit report indicated additional penalties asserted pursuant to Tax Law § 685(a)(1), (b)(2) and (p).

On August 21, 1985, Sipam executed a contract of sale pursuant to which it agreed to sell to Anthony and Josephine Cupo certain real property adjacent to the Conca D'Oro Motel. The purchase price for the property was \$385,000.00, subject to an existing mortgage of \$221,167.55. Simultaneous with the contract of sale, the parties also executed a lease of the same property with Sipam as landlord and Anthony and Josephine Cupo as tenant. The lease had a term of 20 years with the tenant agreeing to pay \$10.00 in rent, the balance due on a mortgage, and all taxes. The lease further provided that it would terminate when the landlord "is ready to convey good and marketable title" to the tenant at any time during the lease term pursuant to the August 21, 1985 contract of sale.

The contract of sale between Sipam and the Cupos was not consummated and title to the property did not pass from Sipam to the Cupos. The lease did take effect and the Cupos took possession of the property as tenants under the terms of the lease.

On August 22, 1989, Sipam, by Joseph Macaluso, president, executed a deed pursuant to which title to the Cupo property passed to Joseph Macaluso.

On December 6, 1989, Sipam filed New York State franchise tax reports under Article 9-A (Forms CT-4 and CT-3M/4M) for the fiscal years ended September 30, 1981 through September 30, 1983 and September 30, 1985 through September 30, 1988. Said reports were signed by Joseph Sano, vice president. None of these reports contained any notation indicating that these were "final" reports or returns.

At hearing, in response to a question regarding whether Mrs. Macaluso was authorized to take money from Sipam, Mr. Macaluso stated: "Mrs. Macaluso never knew . . . my wife

never knows what I do" (tr., p. 147).

At hearing, the Division asserted an additional deficiency against petitioners Joseph and Josephine Macaluso. Specifically, the Division took the position that the individual petitioners had additional taxable income of \$3,974,000.00 based on the terms of the assignment of mortgage from Sipam to Joseph Macaluso, dated December 3, 1985 (see, Finding of Fact "11"). In making this assertion of an additional deficiency, the Division's representative stated that, under the statutory notices, the Division had "only assessed petitioners one-half of the dividend he received of \$4 million" (tr., p. 13). This statement mischaracterizes the theory upon which the Division assessed tax against the Macalusos in respect of the sale of the Conca D'Oro Motel. Under the Notice of Deficiency, the Division deemed a constructive dividend to Mr. Macaluso based on the full amount of Sipam's gain on the sale of the motel (see, Findings of Fact "46" through "48"). The theory of liability for the additional deficiency advanced at hearing is that Mr. Macaluso received a mortgage worth \$3,975,000.00 in consideration of only \$1,000.00.

CONCLUSIONS OF LAW

A. Tax Law § 1081(a) provides that where a taxpayer fails to file a return required under Article 9-A of the Tax Law, the Division is authorized to estimate the taxpayer's New York tax liability from any information in its possession. Contrary to petitioners' contention, the Division was not required under the instant circumstances to consider the adequacy or inadequacy of Sipam's books and records prior to its determination of Sipam's taxable income (see, Matter of Lee, Tax Appeals Tribunal, October 11, 1990).

B. Petitioners did not take issue with the Division's determination of Sipam's gross receipts. Indeed, petitioners' calculation of gross receipts exceeded the Division's calculation (see, Finding of Fact "26"). However, even if petitioners did dispute the Division's gross receipts figures, it is noted that a reconstruction of a taxpayer's income and expenses via third-party information is an acceptable and reasonable method to estimate such tax liability (see, Matter of Cousin's Service Station, Tax Appeals Tribunal, August 11, 1988). Accordingly, the Division's use of information obtained from the New York City Department of Social Services

was proper.

C. Petitioners did take issue with the Division's disallowance of certain claimed deductible expenses. Specifically, petitioners contended that the Division's method of disallowance of such expenses was irrational.

Petitioners bore the burden of establishing entitlement to the claimed deductible expenses at issue herein (see, Matter of Fazal Ahmad, P.C., Tax Appeals Tribunal, August 8, 1991). Petitioners have clearly failed to meet this burden. Except with respect to real estate taxes (discussed below), the record in this matter is devoid of any source documentation, such as checks or invoices, establishing the amount of the claimed deductible expenses. The record is also devoid of any testimony with respect to such expenses. Indeed, Mr. Macaluso, the only witness at hearing having any firsthand knowledge of the business, testified that he had no involvement in Sipam's accounting or bookkeeping activities. Additionally, Mr. Macaluso's testimony provided little information regarding the corporation's day-to-day activities. Mr. Macaluso thus offered no testimony regarding the specific deductions disallowed by the Division. Accordingly, petitioner has failed to substantiate the expenses as claimed on the unfiled returns for the years ended May 31, 1984 and May 31, 1985 or the expenses disallowed for the fiscal year ended September 30, 1983.

It should also be noted that, with respect to the Division's disallowance of automobile expenses, the record contains no evidence indicating how the automobile was used or that an automobile was used in connection with the operation of Sipam's business. Accordingly, the record does not establish that the automobile expenses were an ordinary and necessary expense of the business (see, Internal Revenue Code § 162).

Petitioners did present documentation purporting to establish Sipam's real estate taxes paid during the period at issue (see, Finding of Fact "42"). It is noted that several of the column headings contained in the "History of Payments" documents are illegible and/or unexplained and that no source documents have been offered to corroborate the "History of Payments" documents. It is also noted that, while Mr. Macaluso testified that Sipam paid about

\$120,000.00 in real estate taxes at the time of the sale of the motel, the "History of Payments" documents do not indicate any such payment (see, Finding of Fact "43"). It is concluded, therefore, that petitioners have failed to establish the amount of real estate taxes paid by Sipam during the period at issue. Moreover, it is noted that, in total, the Division allowed as an expense \$203,491.00 for "real estate taxes" and "taxes" during the period at issue. This figure is about 98% of the real estate tax expense claimed by petitioners.⁸ In sum, petitioners have failed to show that any adjustment to the audit results with respect to taxes paid by Sipam is warranted.

D. Petitioners also contended that the audit method was erroneous to the extent that the Division used income amounts that were based upon a calendar year and expense figures that were based on a year ended May 31. This contention is rejected. The use of these varying periods resulted from Sipam's failure to maintain and/or make available its records and was, under the circumstances, reasonable. Further, petitioners have not shown that the use of these periods resulted in a greater assessment.

E. Regarding the tax asserted against Sipam resulting from the sale of the Conca D'Oro Motel, petitioners did not take issue with the Division's calculation of Sipam's gain in respect of this sale. Petitioners did contend, however, that no taxable gain should be attributed to Sipam in respect of the sale because it was liquidated pursuant to Internal Revenue Code former § 337 within 12 months of May 25, 1985, the date of the motel's sale.

F. As in effect during the relevant period, Internal Revenue Code § 337(a) provided as follows:

"GENERAL RULE. -- If, within the 12-month period beginning on the date on which a corporation adopts a plan of complete liquidation, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet

⁸Petitioners have vigorously attacked as irrational the Division's disallowance of 80% of the amounts claimed as "taxes" on Sipam's 1984 and 1985 tax returns. Petitioners fail to acknowledge, however, the Division's allowance of \$165,229.00 categorized as real estate taxes claimed for the year 1984 (see, Finding of Fact "30").

claims, then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period."

G. Sipam did not adopt a formal plan of liquidation. This failure, however, is not dispositive of the issue.⁹

"It is clear from the cases that the adoption of a plan of liquidation within the meaning of section 337 does not require the adoption of a formal resolution of liquidation by the directors or stockholders. The determination of whether a plan of liquidation existed at the time of the sale of the assets is a question of fact" (Badias & Seijas, Inc. v. Commr., 36 TCM 518, 523).

H. In the instant matter, Sipam sold its sole business operation, the Conca D'Oro Motel, on May 24, 1985. Sipam ceased to be a going concern at that point and its activities during the balance of 1985, i.e., the contract of sale and lease of the property to the Cupos and the assignment of the

mortgage to Mr. Macaluso, appear to have been for the purpose of winding up Sipam's affairs and distributing its assets to the shareholders. Pursuant to Treas Reg § 1.332-2(c), then, Sipam was in a status of liquidation from the time it sold the motel on May 24, 1985. Further, based on these actions, it is concluded that Sipam had adopted a plan of liquidation within the meaning of Internal Revenue Code former § 337(a) as of that date (see, Mountain Water Co. of LaCrescenta v. Commr., 35 TC 418, 426).

Sipam, however, failed to achieve a complete liquidation of assets within 12 months of its sale of the motel. Specifically, Sipam retained title to the parcel of property adjacent to the motel which was leased to the Cupos and further retained its rights as landlord under the terms of such lease. Considering that the selling price for this parcel under the aborted contract of sale was \$385,000.00, it is obvious that this asset had significant value. Sipam retained title to this property until 1989, more than three years following the expiration of the 12-month tax-free liquidation period. Since Sipam failed to liquidate all of its assets within 12 months of its

⁹It should be noted that Sipam's concomitant failure to report to the IRS certain information regarding its liquidation plan, as required by the Internal Revenue Code and Regulations, is also not fatal to its claim herein (see, Treas Reg § 1.337-6; Rev Rul 65-30).

(deemed) adoption of a liquidation plan, it has failed to qualify for nonrecognition of its gain under Internal Revenue Code former § 337(a).

It is noted that Sipam's apparent inability to convey good and marketable title to the adjacent property in August of 1985 (see, Findings of Fact "58" and "59") could have been overcome by transferring title to the property to a trustee. Such a transfer could be considered a distribution in liquidation (see, Rev Rul 72-137). As noted, however, Sipam retained title to the property and thus failed to completely liquidate within the required 12-month period.

I. Petitioners also contended that "[t]he best evidence and ultimate determination of whether or not there was a proper liquidation under IRC Section 337 is how the transaction was treated by the Internal Revenue Service" (Petitioners' brief, p. 18). This contention is rejected. The record herein does not indicate that the IRS audit of Mr. and Mrs. Macaluso even considered whether Sipam had successfully liquidated under section 337. The evidence submitted with respect to the IRS audit of Mr. and Mrs. Macaluso makes no reference whatsoever to section 337. Remarkably, petitioners also asserted that "[t]he IRS found and stipulated before the Court that there was a liquidation pursuant to IRC section 337 and that the sale was correctly reported on the installment basis" (Petitioners' brief, p. 19). There is no evidence in the record to support this assertion.

J. Regarding the Division's determination that 100% of the unreported income and retained earnings of Sipam as found on audit and the gain resulting from the sale of Sipam's assets should be deemed constructive dividends to Mr. Macaluso, it is noted that the Division may properly use the results of an audit conducted under one article of the Tax Law in an audit conducted under another article (see, Matter of Petito, Tax Appeals Tribunal, October 17, 1991; Matter of Bruno, Tax Appeals Tribunal, May 13, 1993). Accordingly, the Division's use of the additional income as determined on the Sipam audit in its audit of the Macalusos was proper. Furthermore, absent an explanation as to the disposition of unreported corporate income and retained earnings, a shareholder may properly be deemed to have received this income and earnings as a constructive dividend in proportion to his interest in the corporation (see, Matter

of Petito, supra). Here, petitioners have failed to prove that the Division's disallowance of Sipam's expenditures was improper (see, Conclusion of Law "C"). In other words, petitioners have not proven that Sipam in fact made the disallowed expenditures, nor have petitioners offered any other explanation of the disposition of the disallowed expenditures. Further, given the lack of loan documents, evidence of repayment or any explanation, petitioners have failed to establish the existence and validity of the purported loans. Accordingly, the Division's determination that Mr. Macaluso received constructive dividends in respect of the disallowed expenditures and purported loans of Sipam and the gain resulting from the sale of Sipam's business and real property was proper (see, Matter of Petito, supra).

K. Petitioners contended that the fact that expenses were disallowed resulting in an increase in net income to Sipam is insufficient to determine a constructive dividend to Mr. Macaluso. Petitioners asserted that:

"it is first necessary to find that there was a distribution to the shareholder or there was a proper disallowance of an expenditure which was expended for the economic benefit of the shareholder" (Petitioner's brief, p. 14).

This contention is rejected. As noted, under Petito (supra), petitioners bore the burden of explaining the disposition of the unreported income and retained earnings of Sipam as determined on audit. Since petitioners have offered no satisfactory explanation, the Division's assessment must be sustained.

L. The Division erred, however, in its determination that Mr. Macaluso was a 100% shareholder of Sipam. Upon review of the record herein, it is concluded that petitioners have proven that Mr. Macaluso was a 50% shareholder of Sipam. Accordingly, all constructive dividends deemed received by Mr. Macaluso should reflect his proportionate, i.e., 50%, interest in Sipam (see, Matter of Petito, supra).

The record does contain some evidence to support the Division's conclusion, e.g., the unfiled 1985 corporate return. Further, the minutes of certain Sipam board meetings lend some support to the Division's position (see, Finding of Fact "5"). Better evidence in the record, however, supports petitioners' position. Specifically, evidence in the record indicates that

Mr. Macaluso received 100 shares of stock out of the 200 shares issued; the corporate minutes of Sipam indicate the need for and the granting of approval by Princex and Zurital for the sale of the motel and the assignment of the mortgage; the payments by Mr. Macaluso to Princex and Zurital; and the numerous documents in the record which indicate the stock interest of Zurital and Princex (see, Findings of Fact "6", "7" and "17"). Additionally, the payments by Mr. Macaluso to Princex and Zurital are indicative of a significant equity interest (see, Finding of Fact "19").

In sum, the record herein establishes that Mr. Macaluso was a 50% shareholder of Sipam. Accordingly, the Division is directed to adjust the amount of constructive dividends it deemed paid to Mr. Macaluso to reflect his proportionate interest as a 50% shareholder of Sipam.

M. As noted, the Division asserted an additional deficiency at hearing arising from the December 3, 1985 assignment of the mortgage from Sipam to Mr. Macaluso. The Division erroneously sought to link the assertion of tax on this assignment to its assertion of tax against Sipam arising from its sale of the motel. Clearly, the gain realized by Sipam as a result of its sale of the motel and the gain, if any, realized by Mr. Macaluso by his acquisition of the mortgage are separate transactions resulting in separate and distinct gains. The Division's assertion of tax due with respect to the assignment thus constitutes an asserted increase in the Notice of Deficiency with respect to which the Division bears the burden of proof (see, Tax Law § 689[e][3]).

The Division has failed to meet this burden. As previously discussed, the record herein establishes that Mr. Macaluso was a 50% shareholder. This fact, along with the letter from Mr. Mameli dated January 26, 1986 and the payments to Zurital and Princex, compels the conclusion that, notwithstanding the terms of the assignment itself, the Division has failed to affirmatively prove that Mr. Macaluso received the mortgage from Sipam in consideration of \$1,000.00. Furthermore, as noted herein, upon the sale of the motel Sipam received a purchase money mortgage. The Division properly used the face value of the mortgage in computing Sipam's gain on the sale. The Division then deemed such gain to be a constructive dividend to

Mr. Macaluso. Having previously taxed Mr. Macaluso on the gain resulting from the sale of the motel, the Division cannot then assess tax on the assignment of the mortgage, for such an action amounts to taxing the same gain twice. Under such circumstances, any assertion of tax due on the assignment was improper.

N. Petitioners Joseph and Josephine Macaluso also argued that the income tax deficiencies for the years 1983 and 1984 were barred by the three-year period of limitations set forth in Tax Law § 683(a). The Division claims that the six-year period of limitations set forth in Tax Law § 683(d) is properly applicable herein because petitioners improperly failed to report on their returns an amount greater than 25% of the amount of New York adjusted gross income stated on the return.

Petitioners' contention is rejected. Petitioners reported \$129,736.00 and \$62,000.00, respectively, as their New York adjusted gross income for the years 1983 and 1984. Even as modified herein, petitioners' additional adjusted gross income as determined on audit exceeds 100% of the amount reported. Accordingly, the six-year period of limitations is applicable herein and the 1983 and 1984 deficiencies were not time-barred.

O. Petitioner Josephine Macaluso contended that the Division's issuance of a Notice of Deficiency against her for the year 1985 was improper since she did not file a New York return for that year and since "[t]here is no evidence that Josephine Macaluso had income in . . . 1985 which warranted her filing returns" (Petitioners' brief, p. 24).

For 1985, Tax Law § 651(a)(1) provided that every resident individual required to file a Federal income tax return for the taxable year was required to file a New York return. Tax Law § 651(b)(2) provided that, in the case of a husband and wife, if neither files a Federal return and if they do not elect to file separate New York returns, "they shall file a joint New York income tax return."

Petitioners' contention is rejected. The record herein establishes that neither Mr. Macaluso nor Mrs. Macaluso filed a Federal return for 1985. Moreover, there is clearly not sufficient evidence in the record to find that Mrs. Macaluso had no income and therefore was

not required to file a Federal income tax return for 1985. Indeed, no evidence was presented on this point. Under such circumstances, Tax Law § 651(b)(2) required that Mr. Macaluso and Mrs. Macaluso file a joint New York return for 1985. Since petitioners did not file such a return, the Division properly asserted the 1985 income tax deficiency, as determined on audit, against both Mr. Macaluso and Mrs. Macaluso.

P. Prior to April 17, 1985, Tax Law § 651(b)(5)(i) provided as follows:

"Under regulations prescribed by the tax commission, if

"(A) a joint return has been made pursuant to paragraph (2)(A) or paragraph (3) of this subsection for a taxable year and on such return there was omitted from New York adjusted gross income an amount properly included therein which is attributable to one spouse and which is in excess of twenty-five per cent of the amount of New York adjusted gross income stated in the return,

"(B) the other spouse establishes that in signing the return he or she did not know of, and had no reason to know of, such omission and

"(C) taking into account whether or not the other spouse significantly benefited directly or indirectly from the items omitted from New York adjusted gross income and taking into account all other facts and circumstances, it is inequitable to hold the other spouse liable for the deficiency in tax for such taxable year attributable to such omission, then the other spouse shall be relieved of liability for tax (including interest, penalties and other amounts) for such taxable year to the extent that such liability is attributable to such omission from New York adjusted gross income."

Petitioner Josephine Macaluso has clearly failed to establish entitlement to the benefit of the "innocent spouse" provisions of Tax Law former § 651(b)(5)(i). The only evidence in the record regarding the state of Mrs. Macaluso's knowledge of the omitted income is Mr. Macaluso's testimony that his wife "never knows" what Mr. Macaluso does (see, Finding of Fact "62"). At best, this testimony represents Mr. Macaluso's opinion regarding his wife's knowledge. This testimony does not establish whether Mrs. Macaluso knew or should have known of the omitted income. Notably absent from the record on this point is testimony (or an affidavit) from Mrs. Macaluso regarding her knowledge (or lack thereof) of the omitted income. Furthermore, petitioners have presented no evidence to show that it would be inequitable to hold Mrs. Macaluso liable for the subject deficiency within the meaning of clause (C) of Tax Law former § 651(b)(5)(i). Most significantly, no evidence was presented to show that

Mrs. Macaluso did not benefit from the omitted income (cf., Matter of Miller, Tax Appeals Tribunal, February 22, 1991; Matter of Rollo, State Tax Commn., May 28, 1987).

Tax Law former § 651(b)(5) was amended effective April 17, 1985 (see, L 1985, ch 65, § 113). Even as amended, however, the law still requires that the individual seeking benefit of this provision establish that he or she neither knew nor should have known of the understatement of income. As discussed above, petitioner Josephine Macaluso has failed to establish this element. Furthermore, regulations promulgated under the amended section 651(b)(5) required a consideration of whether the individual claiming innocent spouse status has benefitted directly or indirectly from the omitted income (see, 20 NYCRR 151.10[e]). As noted above, no evidence was presented on this point. Accordingly, petitioner Josephine Macaluso has failed to establish entitlement to the benefit of Tax Law former § 651(b)(5) for the year 1985.

Q. The petition of Sipam Corp. is in all respects denied and the notices of deficiency, dated January 31, 1990 are sustained.

R. The petition of Joseph and Josephine Macaluso is granted to the extent indicated in Conclusion of Law "L". The petition is in all other respects denied. The Division is directed to modify its Notice of Deficiency, dated December 15, 1989, in accordance with Conclusion of Law "L"; as modified, said notice is sustained.

DATED: Troy, New York
October 31, 1994

/s/ Timothy J. Alston
ADMINISTRATIVE LAW JUDGE