

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
THOMAS REEVES	:	DETERMINATION
	:	DTA NO. 819086
for Redetermination of a Deficiency or for Refund	:	
of New York State and New York City Personal	:	
Income Tax under Article 22 of the Tax Law and	:	
the New York City Administrative Code for	:	
the Year 1994.	:	

Petitioner, Thomas Reeves, 225 East 73rd Street, Apt. 11G, New York, New York 10021, filed a petition for redetermination of a deficiency or for refund of New York State and New York City personal income tax under Article 22 of the Tax Law and the New York City Administrative Code for the year 1994.

A hearing was held before Dennis M. Galliher, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York on April 24, 2003 at 10:40 A.M., with all briefs to be submitted by October 20, 2003, which date commenced the six-month period for the issuance of this determination. Petitioner appeared by Gallet, Dreyer & Berkey, LLP (David N. Milner, Esq., of counsel). The Division of Taxation appeared by Mark F. Volk, Esq. (Barbara J. Russo, Esq., of counsel).

ISSUES

I. Whether petitioner has established that the amount shown as compensation paid to him by American Futures Group Holding Company, Inc. in 1994 was either an erroneous listing on

such company's tax return or, alternatively, was not taxable compensation but rather represented the repayment of loans petitioner made to such company.

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

FINDINGS OF FACT

1. American Futures Group, Inc. ("AFG") was a commodities futures brokerage company founded in or about 1984 by George Perk and petitioner, Thomas Reeves.¹ Prior to, as well as during the year in issue, 100 percent of the shares of AFG were owned by American Futures Group Holding Company, Inc. ("AFG Holding"), a corporation which had been formed on or about November 11, 1992. In turn, George Perk and petitioner were the only shareholders and officers of AFG Holding during the year in issue, with George Perk owning 52 percent of the stock of AFG Holding and Thomas Reeves owning the remaining 48 percent of the stock of AFG Holding. Petitioner held the office of treasurer and secretary of AFG Holding, and was president of AFG.

2. On his 1994 U.S. Individual Income Tax Return (Form 1040), petitioner reported total income in the amount of \$77,673.00, consisting of \$33,000.00 of wage income, \$4,368.00 of dividend income, and \$40,305.00 of business income. Attached to petitioner's Form 1040 was Form W-2 (Wage and Tax Statement), indicating that the wage income of \$33,000.00 was paid by AFG. Also attached to petitioner's return was Schedule C (Profit or Loss From Business), which reflects gross sales or receipts of \$84,000.00 and a net profit (business income) of \$40,305.00 as having been earned by petitioner under the principal business or profession of "commodities broker." The business address listed on petitioner's Schedule C is 214 E. 82nd

¹ AFG was founded as American Energy Corp. and at some point thereafter changed its name to AFG.

Street, New York, New York. After reducing his reported total income by \$2,251.00 (one-half of self-employment tax), petitioner reported Federal adjusted gross income in the amount of \$75,422.00. The transcript of petitioner's 1994 New York State and City of New York Resident Income Tax Return (Form IT-201) also reflects this same amount, \$75,422.00, as petitioner's total New York income.

3. The Division of Taxation ("Division") conducted a withholding tax audit of AFG, and thereafter also conducted an audit of petitioner's 1994 personal income tax return. In the course of its audits, the Division reviewed the U.S. corporation income tax returns (Form 1120) for AFG and for AFG Holding for the year 1994. The Form 1120 for AFG Holding reports, at Schedule E (Compensation of Officers), total compensation of \$544,950.00 paid to George Perk and Thomas Reeves, in the respective amounts of \$283,374.00 and \$261,576.00. Such total amount (\$544,950.00) is also shown on page one of AFG Holding's Form 1120 as a deduction reducing AFG Holding's total income (and hence its tax liability). The balance sheet (Schedule L) attached to AFG Holding's Form 1120 for 1994 does not reflect any loans or advances to or from shareholders. The Division concluded, based on such Form 1120 in comparison to petitioner's personal income tax return, that petitioner failed to report the compensation income he received from AFG Holding in the amount of \$261,576.00. Accordingly, the Division increased petitioner's New York taxable income by such amount and recalculated his tax liability for 1994.

4. Petitioner was not directly involved in preparing his personal income tax returns, but rather engaged the services of an accountant. He typically placed all of his tax information in an envelope and sent the same to his accountant, who would prepare and thereafter send back the completed tax returns for petitioner's signature. In the same manner, petitioner was not directly

involved in the preparation of Form 1120 for AFG or for AFG Holding. The Form 1120 for AFG Holding, as well as that for AFG, are each dated May 15, 1995. Each return reflects the preparer to be Michael Coglianesse, CPA, and each includes his address, social security number, and signature. The returns do not bear the signature of anyone else on behalf of either corporation (AFG Holding or AFG). The Division's auditor accepted the information and amounts set forth on Form 1120 and accompanying schedules for AFG Holding, without modification or resort to additional audit verification or corroboration. The auditor did not independently verify with the Internal Revenue Service ("IRS") that the Form 1120 for AFG Holding on which she relied had, in fact, been filed with the IRS.

5. On April 9, 2001, the Division issued to petitioner, Thomas Reeves, a Notice of Deficiency asserting additional New York State and New York City personal income tax due for the year 1994 in the respective amounts of \$21,638.81 and \$12,039.88 (totaling \$33,678.69), plus penalties for negligence (Tax Law § 685[b]) and for substantial understatement of liability (Tax Law § 685[p]), plus interest. Petitioner, for his part, disputes the receipt of compensation from AFG Holding in the amount of \$261,576.00, as well as the additional tax asserted as due thereon.

6. At hearing, petitioner provided the testimony of George Perk. Mr. Perk explained that both he and petitioner made periodic short-term loans (advances) to AFG Holding. In turn, AFG Holding would allegedly infuse cash into AFG, as needed, in order to enable AFG to meet the ongoing net capital requirements imposed by the Commodities Futures Trading Commission, the Federal regulatory agency governing AFG's business. According to Mr. Perk, the cash infusions were repaid by AFG to AFG Holding and, in turn, AFG Holding repaid the advances which had been made by Mr. Perk and by petitioner. In support of this claim, Mr. Perk produced a one-

page handwritten sheet of paper, titled “GJP–1994,” reflecting four columns listing, respectively, dates (from January through December), letters (possibly initials), dollar amounts, and letter (e.g., “WT” for wire transfer) or number listings (possibly referencing check numbers).

7. Mr. Perk described the one-page sheet, allegedly prepared by AFG’s treasurer, Richard MacIntosh, as a listing of the disbursements from AFG Holding to Mr. Perk over the course of the year 1994. The foot of the column listing dollar amounts totals \$299,512.00. Mr. Perk focused specifically on two items, dated January 3 (in the amount of \$59,900.00) and January 7 (in the amount of \$52,112.00), totaling together \$112,012.00. Mr. Perk claimed that these amounts were wire transfer repayments of cash advances he had previously made to AFG Holding. He went on to state that he subtracted such \$112,012.00 amount from the total disbursements amount of \$299,512.00, to arrive at \$187,500.00, which he allegedly reported as compensation income on his Federal and (New Jersey) State income tax returns for 1994. He did not offer any explanation concerning the \$95,874.00 difference between such \$187,500.00 compensation amount allegedly reported as income from AFG Holding and the \$283,374.00 amount shown as compensation paid to him on Schedule E of Form 1120 for AFG Holding.

8. Mr. Perk also noted that a similar one-page disbursements sheet was prepared by Mr. MacIntosh for petitioner Thomas Reeves. Although such a sheet for petitioner was not offered in evidence, Mr. Perk claimed that he had seen the same and that the net income, after alleged repayment of advances by AFG Holding to Mr. Reeves, was “around \$120,000.00.” He also noted, in explaining his recall of this dollar amount, that he was “quite embarrassed” over the difference between his compensation and that of Mr. Reeves, noting that “[t]hey should have been much closer We didn’t have a formal agreement, but our compensation tended to be similar, but I remember that number well.”

9. Petitioner also testified at hearing. Although, as noted, he did not furnish a “disbursement sheet” similar to that furnished with respect to Mr. Perk, he described the same scenario with regard to making short-term cash advances to AFG Holding which were subsequently repaid. Petitioner also provided certain statements from his Merrill Lynch Cash Management Account to substantiate his claim that he made such advances and was, in turn, repaid by AFG Holding. In this regard, petitioner pointed to two transactions in particular, totaling \$73,318.00, as follows:

- An entry showing a check (#1669) in the amount of \$63,318.00 to AFG Holding dated 12/31/93, which cleared on 01/12/94, together with an entry showing funds received by wire transfer (payor not specified) in the same \$63,318.00 amount on 01/11/94.
- An entry showing a check (#1676) in the amount of \$10,000.00 to AFG Holding dated 01/31/94, which cleared on 02/04/94, together with an entry showing funds received by wire transfer (payor not specified) in the same \$10,000.00 amount on 02/22/94.

Petitioner stated that there “may have been” other such transactions in 1994, but that he did not have any additional statements or other records to show the same.²

10. There were no notes or other loan agreements between petitioner and AFG Holding executed for any of the advances made. Although both witnesses alluded to corporate board resolutions and other documents (corporate minutes, ledgers, journals or audited financial statements) which would reflect the periodic advances, no such documents were offered in evidence.

² Petitioner pointed to a third entry showing a check (#1580) in the amount of \$20,000.00 to AFG Holding dated 11/30/93, which cleared on 12/01/93, followed by an entry showing funds received by wire transfer (payor not specified) in the same \$20,000.00 amount on 12/02/93. Although this transaction precedes the year in issue, petitioner points to the same to establish an ongoing pattern of advances and repayments.

11. Petitioner submitted his annual Social Security Statement (prepared and issued to him by the U.S. Social Security Administration) dated March 18, 2003. This statement reflects, among other things, petitioner's estimated social security benefits payable under various possible scenarios, as well as a listing of petitioner's earnings record (in this case covering the years 1959 through 2001). For the year in issue, 1994, petitioner's Taxed Medicare Earnings as reflected on his Social Security Statement totaled \$70,222.00.

12. The Division's submitted with its brief proposed findings of fact, numbered "1" through "20". Each of such proposed facts is directly supported by the evidence in the record and each, with the exception of proposed facts "14" and "15", which set forth procedural matters not necessary for inclusion in resolving this matter, has been incorporated into the Findings of Fact set forth herein.

13. Petitioner also submitted with his brief proposed findings of fact, numbered "1" through "14", with respect to which the following rulings are made:

– Proposed findings "1" through "4" and "7" are directly supported by the evidence in the record and each has been incorporated into the Findings of Fact set forth herein.

– Proposed finding "5" asserts that petitioner "had no knowledge concerning the preparation of [Form 1120]." Such finding has been modified to state that petitioner "was not directly involved in the preparation of [such] Form 1120," and as so modified is accepted.

– Proposed finding "6" is accepted with the following clarification . Such proposed finding asserted that the amount of "Taxed Medicare Earnings" on petitioner's Social Security Statement (\$70,222.00) corresponds exactly to the total amount of wages (\$33,000.00) and self-employment income (\$37,222.00) reported on petitioner's 1994 U.S. Income Tax Return (Form 1040). Review of the documents reveals, in fact, that petitioner's return reported \$73,305.00, consisting of \$33,000.00 in wage income and \$40,305.00 of self-employment income per Schedule C.

– Proposed findings "8" and "9" are rejected as not fully supported by the evidence in the record, inasmuch as the documents (Merrill Lynch

statements) showing the alleged repayments do not indicate who made the subject wire transfers into petitioner's cash management account.

–Proposed finding “10” asserts that petitioner did not receive a Form W-2 or other informational return from AFG or AFG Holding reporting W-2 compensation of \$261,576.00. Such proposed finding is modified to state that the auditor's check of the Division's wage reporting system did not reveal any wage compensation having been paid to petitioner by AFG Holding, and as so modified is accepted.

–Proposed finding “12” is rejected as not fully supported by the evidence in the record. While line 1, Schedule C, Form 1040 does list Gross Receipts or Sales in the amount of \$84,000,00, it does not specify or identify the same as having been paid to petitioner by either AFG or AFG Holding.

–Proposed findings “11”, “13 ” and “14” are rejected in that such proposed findings represent conclusions of law (ultimate findings of fact).

SUMMARY OF PETITIONER'S POSITION

14. Petitioner asserts that he did not receive compensation from AFG Holding in the amount of \$261,576.00 for the year 1994. Instead, petitioner maintains that he properly reported all of his earnings on his Form 1040 and on his New York State personal income tax return, specifically consisting of wage income of \$33,000.00 paid to him by AFG, plus Schedule C self-employment income paid to him by either AFG or AFG Holding for his work as a commodities broker, against which he was entitled to claim the various expenses listed on Schedule C. Petitioner maintains that he was involved with the “sales and salesmen side” (front office) of AFG's business, as opposed to the financial side (back office) which was handled by Mr. Perk. Petitioner also asserts that he made, as described, certain short-term advances to AFG Holding, and apparently posits that the repayments thereof may have been erroneously treated by AFG Holding as compensation to him and reflected as such on its tax return (Form 1120). Finally, petitioner complains that the Division's assertion of tax is improper insofar as it is based on the Form 1120 for AFG Holding, noting in this regard that the copy of such Form 1120 in evidence

does not bear the signature of either himself or of George Perk, that the Division did not verify that such return was in fact filed with the Internal Revenue Service, and that the same may have been a nonfiled return form prepared by AFG Holding's accountant for some (unspecified) purpose other than for filing as AFG Holding's actual return for the year in issue.

CONCLUSIONS OF LAW

A. It is well established, and petitioner concedes, that a Notice of Deficiency issued by the Division is presumed to be correct until the contrary is established, and the burden of showing that such a notice is incorrect rests upon the petitioner (Tax Law § 689[e]; ***Matter of Leogrande v. Tax Appeals Tribunal***, 187 AD2d 768, 589 NYS2d 383, ***lv denied*** 81 NY2d 704, 595 NYS2d 398; ***Matter of Tivolacci v. State Tax Commn.***, 77 AD2d 759, 431 NYS2d 174). In this case, petitioner has failed to provide such evidence as would support either cancellation or any adjustments or reductions to the Notice of Deficiency.

B. Petitioner has argued first that the Notice of Deficiency in this case should be canceled because the basis upon which it is premised is flawed. Petitioner apparently accepts that the Division's reliance upon the Form 1120 for AFG Holding constituted an initial rational basis for issuance of the notice. However, petitioner points out that the copy of such Form 1120 in evidence is not signed by either of the corporation's officers and that there is no evidence that such return was in fact filed with the IRS. Petitioner argues, in this regard, that the Form 1120 might simply have been prepared as "an exercise by the corporation's accountant for some unknown internal purpose." In turn, petitioner argues that these flaws overcome the rational basis for the notice and require its cancellation.

C. Petitioner's argument that the lack of an officer's signature, and the lack of any proof that the Form 1120 was in fact filed with the IRS, must result in cancellation of the notice is

rejected. First, such return was obtained and reviewed as part of the Division's audit of AFG (*see*, Finding of Fact "3"; *Matter of American Futures Group, Inc., George G. Perk, Officer and Thomas Reeves, Officer*, Tax Appeals Tribunal, February 6, 2003). Thus, the Division was clearly entitled to rely upon the same. Moreover petitioner, as one of the two officers of AFG Holding, would presumably have been in a position to obtain and present a verified copy or transcript of the return AFG Holding filed with the IRS for 1994, so as to show if, and how, such return differed from that relied upon by the Division. No such information was presented.

Without more, petitioner's contention that such return may not have been filed, and that AFG Holding filed some other Form 1120 which did not show the compensation amount at issue, is merely speculation and is rejected. In the same vein, petitioner offered no testimony from the accountant who prepared and signed the return obtained upon audit, offered in evidence herein, and relied upon by the Division. Against this background, petitioner's assertion that the Form 1120 in evidence might have been prepared "as an exercise by the corporation's accountant for some unknown internal purpose" is likewise rejected as mere speculation.

D. Petitioner has also argued that he did not receive the amount of compensation income (\$261,576.00) listed as paid to him by AFG Holding at Schedule E of Form 1120. Specifically, it appears petitioner argues that such listing was either entirely erroneous, because the Form 1120 relied upon by the Division was not filed and petitioner did not in fact receive the listed amount of compensation, or because the amount listed as compensation may have been nontaxable disbursements to petitioner from AFG Holding in repayment of advances made by petitioner to AFG Holding. Neither of these positions is supported by the evidence.

E. Petitioner's first assertion, that the return was not filed or was erroneous in amount, has been rejected as unsupported speculation. As to the claim concerning repayment of advances,

the evidence in support consists of the testimony of George Perk and petitioner, together with the one-page sheet relating to Mr. Perk and the Merrill Lynch statements relating to petitioner. In this regard, petitioner's Merrill Lynch statements do show checks to AFG Holding and subsequent wire transfers in the same dollar amounts going back into petitioner's account during the year in question. However, the payor of such wire transfers is not identified. Even accepting, *arguendo*, that petitioner made periodic loans to AFG Holding and that the wire transfers shown on the Merrill Lynch statements were repayments made by AFG Holding to petitioner, there is no evidence to establish that such repayments were erroneously reflected by AFG Holding, on its accounting records or tax returns, as taxable compensation to petitioner. In this respect, such transfers total only \$73,318.00 (*see* Finding of Fact "9"). In fact, such \$73,318.00 amount is far less than the \$261,576.00 amount of compensation shown as having been paid to petitioner and deducted by AFG Holding on its tax return, in response to which petitioner noted only that there "may have been other" such advances and repayments. Furthermore, there were no corporate minutes, resolutions, notes or other loan documents, ledgers or journals, evidence of loan collateralization or payments of interest, or other documents offered in evidence to support petitioner's claim that loans were made. Ultimately, there is nothing beyond speculation that the alleged repayments were incorrectly reflected by AFG Holding on its Form 1120 as compensation, or that such amounts were in any manner linked to the amount of compensation shown on AFG Holding's Form 1120.

F. Petitioner's witness, George Perk, testified, based on his one-page disbursements sheet, that he netted repayments of advances totaling \$112,012.00 against AFG Holding disbursements to him totaling \$299,512.00 to arrive at taxable compensation paid to him by AFG Holding in the amount of \$187,500.00. He went on to state that he had seen a similar disbursements sheet

for petitioner which, when netted in the same manner, resulted in taxable compensation of approximately \$120,000.00 paid to petitioner by AFG Holding (*see*, Finding of Fact “8”). This \$120,000.00 lesser amount of “net” compensation from AFG Holding (i.e., less than the \$261,576.00 shown on the Form 1120) is itself entirely unaccounted for by petitioner on his personal income tax return. That is, petitioner’s return reflects wage income of \$33,000.00 paid by AFG, plus Schedule C business income (as opposed to compensation income) in the net amount of \$40,305.00, from his work as a “commodities broker.” In fact, neither Schedule C nor any other part of petitioner’s return reflects any income (including the “netted” \$120,000.00 noted by Mr. Perk) or any other amounts paid by AFG Holding to petitioner.³ On balance, petitioner has offered nothing to overcome the Division’s position and thus the Notice of Deficiency must be sustained.⁴

G. Petitioner has offered no argument or evidence which would support reduction or abatement of the penalties which were properly imposed in this matter, and the same are, therefore, sustained.

³ Petitioner asserted that the Schedule C gross receipts of \$84,000.00 for his work as a commodities broker were paid by either AFG or AFG Holding. Since AFG was the operating company, it appears that of the two, AFG (rather than AFG Holding) would have been the more likely payor. Petitioner also alluded to the possibility that such income was included by his accountant on Schedule C, as business income, rather than as compensation income on Form 1040 because of “something to do with my pension plan.” Petitioner was unable to provide any further explanation or specifics in this regard.

⁴ Notice is taken of the fact that in *American Futures Group, Inc., George G. Perk, Officer and Thomas Reeves, Officer (supra)*, the Tax Appeals Tribunal found that petitioner Thomas Reeves’ compensation from AFG Holding was in the amount of \$261,576.00 (*see Berger v. Dynamic Imports, Inc.*, 57 Misc 2d 988, 274 NYS2d 537; *Matter of Kolovinas*, Tax Appeals Tribunal, December 28, 1990; 57 NY Jur2d Evidence and Witnesses, § 47; New York State Administrative Procedures Act § 306[4]).

H. The petition of Thomas Reeves is hereby denied and the Notice of Deficiency dated April 9, 2001 is sustained.

DATED: Troy, New York
February 12, 2004

/s/ Dennis M. Galliher
ADMINISTRATIVE LAW JUDGE