STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition of	:	
BENJAMIN AND LILIA SON	:	ORDER DTA NO. 819365
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Years 1998 and 1999.	:	

Petitioners, Benjamin and Lilia Son, 25 Hill Crescent Road, Port Jefferson, New York 11777-1258, filed a petition for redetermination of a deficiency or for refund of New York State personal income tax under Article 22 of the Tax Law for the years 1998 and 1999.

A small claims hearing was held before James Hoefer, Presiding Officer, at the offices of the Division of Tax Appeals, State Office Building, Veterans Memorial Highway, Hauppauge, New York on August 26, 2004 at 1:15 P.M. Petitioners appeared by Binder & Binder, P.C. (Harry J. Binder, Esq., of counsel). The Division of Taxation appeared by Christopher C. O'Brien, Esq. (Nazmul Quayyum and Jon Obert).

Presiding Officer Hoefer issued a determination on March 17, 2005 which partially granted the petition by canceling the deficiency for the year 1998. For the year 1999, the determination sustained the deficiency, as adjusted by the Division of Taxation at the hearing, and the imposition of the negligence penalty.

On April 18, 2005, petitioners filed an application for costs pursuant to Tax Law § 3030 with the Division of Tax Appeals. The Division of Taxation's request for a 30-day extension of time to file a motion in opposition to petitioner's application for costs was granted. The Division

of Taxation filed a timely affirmation in opposition on June 17, 2005, which date began the 90-day period for the issuance of this order.

Based upon petitioner's application for costs and attached documentation and the Division of Taxation's affirmation in opposition and attached documentation, the determination issued March 17, 2005 and all pleadings and documents submitted in connection with this matter, Thomas C. Sacca, Administrative Law Judge, renders the following order.

ISSUE

Whether petitioner's are entitled to an award of costs pursuant to Tax Law § 3030.

FINDINGS OF FACT [1]

1. Petitioners[2], Drs. Benjamin T. Son and Lilia V. Son, filed timely New York State resident income tax returns for the years 1998 and 1999. On the 1998 return petitioner claimed a business loss of $80,000.00, while the 1999 return claimed a business loss totaling $15,800.00.

2. The business losses claimed on petitioner's 1998 and 1999 New York returns were also claimed on her 1998 and 1999 Federal income tax returns and reported on Federal Schedule C, Profit or Loss from Business. Federal Schedule C for both years reported that Dr. Lilia V. Son's principal business or profession was a diagnostic medical testing facility known as Doppler Ultrasound Diagnostic Services located at 4242 Folden Street, Flushing, NY 11357. The following table contains a summary of the amounts reported on Schedule C for 1998 and 1999:

---

[1] Findings of Fact 1 through 15 are taken from the small claims determination issued on March 17, 2005.

[2] Petitioner Dr. Benjamin T. Son is involved in this proceeding solely as the result of having filed joint income tax returns with his spouse. Accordingly, unless otherwise noted, all references to petitioner shall pertain to Dr. Lilia V. Son.

ITEM	1998	1999
Gross income	$ -0-	$ -0-
Legal fees	10,000.00	7,500.00
Equipment lease expense	70,000.00	-0-
Supplies	-0-	8,300.00
Net loss	$80,000.00	$15,800.00

3. Following an audit, the Division of Taxation ("Division") issued a Notice of Deficiency to petitioner and her spouse dated March 25, 2002 asserting that $6,581.36 of additional New York State personal income tax was due for the years 1998 and 1999. The Notice of Deficiency also asserted that interest and a negligence penalty was due for each year at issue. The Division's determination that additional tax was due for 1998 was premised on its complete disallowance of the $80,000.00 business loss claimed on Federal Schedule C and also the disallowance of $2,400.00 of miscellaneous itemized deductions for unreimbursed employee business expenses. For the 1999 tax year, the Division disallowed $8,300.00 of the claimed $15,800.00 Federal Schedule C business loss, $2,400.00 of unreimbursed employee business expenses and $6,545.00 of other miscellaneous itemized deductions. These amounts were disallowed as a result of petitioner's failing to provide to the auditor documentation to substantiate that petitioner was involved in a trade or business with a bona fide profit motive, and documentation which established the basis for the amounts claimed as business expenses.

4. At the small claims hearing, the Division withdrew the adjustments it made for the disallowance of $2,400.00 in unreimbursed employee business expenses for both 1998 and 1999 and also the disallowance of $6,545.00 of other miscellaneous itemized deductions for 1999. Accordingly, the only issues left in dispute were the total disallowance of the $80,000.00

business loss for 1998; the partial disallowance of $8,300.00 of the claimed $15,800.00 business loss for 1999 and the assertion of a negligence penalty.

5. From at least 1994 through the date of the small claims hearing, petitioner had been employed on a full-time basis by the State of New York at its Pilgrim State Hospital located in West Brentwood, Suffolk County, New York. Some time prior to June 1, 1994, Dr. Son became acquainted with one Belen A. Sering. Although Ms. Sering was licensed to practice medicine in the Philippines, she did not possess a license to practice medicine in the State of New York.

6. In 1994, petitioner and Ms. Sering entered into two separate agreements for the lease of medical equipment. It appears that petitioner and Ms. Sering initially intended to conduct business in corporate form as Doppler Ultrasound Diagnostic Services, Inc., and some preliminary actions were taken to establish such a corporation. However, when it became known that Ms. Sering was not licensed to practice medicine in New York, thus preventing her from becoming a shareholder in a professional service corporation, no further action was taken to incorporate Doppler Ultrasound Diagnostic Services, Inc. It appears that petitioner and Ms. Sering thereafter operated as either a de facto partnership or joint venture, although they continued to use the name Doppler Ultrasound Diagnostic Services, Inc.

7. The record contains a general letter of introduction on Doppler Ultrasound Diagnostic Services, Inc. letterhead addressed to "Dear Doctor," wherein area doctors were advised of the opening of Doppler Ultrasound Diagnostic Services, Inc.'s vascular laboratory. This letter seeks patient referrals from area doctors for diagnostic services and was signed by Belen A. Sering, M.D., President, and Lilia V. Son, M.D., Vice President.

8. On June 1, 1994, petitioner and Ms. Sering entered into the first of two lease agreements with Copelco Leasing Corporation (hereinafter "Copelco"). The June 1, 1994

agreement was for the lease of a colored imaging Doppler scan and related equipment for use in a vascular laboratory providing Doppler diagnostic services. The full legal name of the lessee as shown on the lease was "Lilia V. Son, M.D. and Belen Sering, M.D., jointly and severally." The lease was for a term of 63 months, payable in 60 installments of $1,644.00 per month starting September 1, 1994. Ms. Sering made the required monthly payments on this first lease from September 1994 through February 1995 and neither petitioner nor Ms. Sering made any payments thereafter.

9. On September 6, 1994, petitioner and Ms. Sering entered into the second lease agreement with Copelco for the lease of medical equipment described as "Mortara Eli/100 Interpretive EKG and Puritan Bennett Spirometer." This lease was also in the name of Lilia V. Son, M.D., and Belen Sering, M.D., jointly and severally, and required monthly payments of $205.35 for a period of 36 months. Ms. Sering made the first three monthly payments and neither petitioner nor Ms. Sering made any payments thereafter.

10. Copelco commenced an action against petitioner and Belen A. Sering to recover the payments it was due pursuant to the two equipment leases dated June 1, 1994 and September 6, 1994. On April 23, 1998, a judgement was entered in favor of Copelco "against defendants Lilia V. Son and Belen A. Sering in the sum of $133,754.31. . . ."

11. On June 18, 1998, petitioner and Copelco entered into a Stipulation of Settlement wherein petitioner agreed to pay Copelco the sum of $70,000.00 and withdraw all notices of appeal. Coplelco agreed to provide petitioner with a release and also file with the court a satisfaction of the judgement with respect to Lilia V. Son only.

12. It is undisputed that in 1998 petitioner borrowed $51,000.00 from the New York State and Local Retirement System and together with $19,000.00 of personal funds she paid the

$70,000.00 due Copelco pursuant to the Stipulation of Settlement dated June 18, 1998. Petitioner, in 1998, also paid her attorney $10,000.00 in legal fees to represent her in the Copleco action. These two amounts form the basis for the expenses claimed by petitioner on her Federal Schedule C for the 1998 tax year.

13. On some unknown date prior to October 12, 1995, it appears that Doppler Ultrasound Diagnostic Services, Inc., Belen A. Sering and petitioner entered into a lease with Chrysler Credit Corporation (hereinafter "Chrysler") for the lease of a motor vehicle. The lease agreement was not submitted in evidence at this proceeding so the actual lessee is not known nor is the duration and cost of the lease disclosed. The record herein contains a letter dated October 30, 1995 addressed to petitioner from a collection agent stating that Chrysler had a claim against petitioner for the sum of $7,949.15 plus interest from October 12, 1995. This same collection agent issued a letter to petitioner dated May 8, 1997 captioned "Chrysler Credit Corporation vs. Doppler Ultrasound Diagnostic Services, Inc., Belen A. Sering and Lilia V. Son" which states that "[T]his letter will confirm that your debt to the creditor has been paid in full upon clearance of your payment money orders. We will take no further action."

14. Although petitioner's Federal Schedule C for 1999 reported a deduction of $8,300.00 for supplies, she readily admits that the $8,300.00 figure was entered on the wrong line of Federal Schedule C. The $8,300.00 deduction at issue for 1999 actually represents petitioner's claimed basis in the motor vehicle leased from Chrysler which petitioner considered to be a business asset rendered useless during the 1999 tax year.

15. The record herein does not disclose if, or to what extent, Doppler Ultrasound Diagnostic Services, Inc. or Belen A. Sering and Lilia V. Son conducted the intended diagnostic services business before it ceased operations. There seems to be no dispute that Ms. Sering was

not able to obtain a license to practice medicine in New York and that she eventually returned to the Phillippines without making any further payments on the two equipment leases or the motor vehicle lease with Chrysler.

16. Following the issuance of the notice of deficiency, petitioner filed a request for conciliation conference with the Division's Bureau of Conciliation and Mediation Services, and on December 13, 2002, a Conciliation Order (CMS No. 191827) was issued which sustained the statutory notice. On February 18, 2003, petitioner filed a petition with the Division of Tax Appeals seeking administrative review of the conciliation order. Subsequent to the filing of the petition, petitioner elected to proceed at the small claims level.

17. A small claims hearing was held before James Hoefer, Presiding Officer, on August 26, 2004, and on March 17, 2005, a determination was issued by the presiding officer. The determination held as follows with regard to the issues of the disallowance of the business losses and the assertion of a negligence penalty:

a. Internal Revenue Code § 62 requires that a taxpayer include in adjusted gross income all income derived from a business less all trade and business deductions attributable to the carrying on of such business. Internal Revenue Code § 162 provides that a deduction is allowed for "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. . . ." Pursuant to Internal Revenue Code § 162(a)(3) lease payments made by a taxpayer "as a condition to the continued use or possession, for purposes of the trade or business, of property . . ." are specifically classified as allowable deductions.

b. While it is undisputed that lease payments made for property used in a trade or business are allowable business deductions, the controversy in the instant matter concerns whether petitioner met her burden of proof (Tax Law § 689[e]) to show that her signature on the

leases, association with Belen A. Sering and other activities with respect to the operation or planned operation of a diagnostic vascular laboratory could be properly considered as a trade or business entered into with a profit motive.

c. Petitioner established, through documentation and credible testimony presented at hearing, that her activities with respect to the diagnostic vascular laboratory qualified as the conduct of a trade or business which she entered into with a bona fide profit motive. Accordingly, the $70,000.00 lease payment made on the medical equipment in 1998 was deemed to be an allowable business deduction. Furthermore, since the $10,000.00 legal fee paid by petitioner in 1998 was the result of a business transaction, it, too, qualified as an allowable business deduction.

d. Petitioner was not entitled to the claimed $8,300.00 deduction in 1999 for her basis in the leased automobile which was alleged to be worthless in said year. The leased automobile, unlike the leased medical equipment, could have been used for personal versus business reasons. Petitioner's testimony that Ms. Sering used the leased vehicle solely for business purposes was insufficient to support that the vehicle was used exclusively for business purposes when one considers that the diagnostic vascular laboratory business apparently failed soon after its inception, perhaps in late 1994 or early 1995, thus bringing into question how the vehicle could have been used exclusively in this business after the date it ceased business operations. It was doubtful that the leased vehicle was used exclusively for business when the business ceased operations in 1994 or 1995, yet petitioner did not, for unstated reasons, gain control of the vehicle until some four years later in 1999.

In addition, the record did not contain any evidence to support that petitioner's basis in the vehicle was $8,300.00 in 1999, and there was no credible evidence to show that the vehicle

was in fact worthless in 1999. Finally, the letter dated May 8, 1997 from the collection agent handling this matter for Chrysler indicated that petitioner's debt to Chrysler had been paid in full. As a cash basis taxpayer it would seem that petitioner would have been entitled to a business deduction in 1997, and not 1999, for the portion of the lease payment that applied to the business use, if any, of the vehicle. For all of these reasons, the $8,300.00 deduction claimed on Federal Schedule C for 1999 was properly disallowed by the Division.

e. Petitioner failed to sustain her burden of proof to show that the deficiency was not due to negligence or intentional disregard of the Tax Law or rules and regulations. Accordingly, the negligence penalty was sustained.

18. On April 18, 2005, the Division of Tax Appeals received an application for costs pursuant to Tax Law § 3030 from petitioner, which sought costs in the amount of $4,584.11. These costs consisted of professional services from Binder & Binder for "reasonable litigation costs" in the amount of $4,545.00 plus disbursements of $39.11, for a total of $4,584.11. Petitioner provided a detailed accounting of the expenses incurred during the period August 10, 2001 through April 13, 2005. The fees related to services performed during the audit, the hearing, the writing and submission of the post-hearing brief and the preparation and filing of the application for costs. An hourly rate of $75.00 was used to compute the $4,545.00 fee.

CONCLUSIONS OF LAW

A. Tax Law § 3030(a) provides, generally, as follows:

> In any administrative or court proceeding which is brought by or against the commissioner in connection with the determination, collection, or refund of any tax, the prevailing party may be awarded a judgment or settlement for:
>
> (1) reasonable administrative costs incurred in connection with such administrative proceeding within the department, and

(2) reasonable litigation costs incurred in connection with such court proceeding.

As relevant herein, *reasonable administrative costs* include reasonable fees paid in connection with the administrative proceeding (***see***, Tax Law § 3030[c][2][B]). Such costs include reasonable fees for the services of attorneys in connection with the administrative proceeding, "except that such fees shall not be in excess of seventy-five dollars per hour unless the [Division of Tax Appeals] determines that an increase in the cost of living or a special factor, such as the limited availability of qualified attorneys for such proceeding, justifies a higher rate" (Tax Law § 3030[c][1][B][iii]; ***see also***, Tax Law § 3030[c][2][B]). Reasonable administrative costs "only include costs incurred on or after the date of the notice of deficiency, notice of determination or other document giving rise to the taxpayer's right to a hearing" (Tax Law § 3030[c][2][B]). For purposes of this section, "fees for the services of an individual (whether or not an attorney) who is authorized to practice before the division of tax appeals shall be treated as fees for the services of an attorney" (Tax Law § 3030[c][3]).

Prevailing party is defined for purposes of section 3030(c)(5), in relevant part, as follows:

> (A) In general. The term "prevailing party" means any party in any proceeding to which [Tax Law § 3030(a)] applies (other than the commissioner or any creditor of the taxpayer involved):
>
> (i) who (I) has substantially prevailed with respect to the amount in controversy, or (II) has substantially prevailed with respect to the most significant issue or set of issues presented, and
>
> (ii) who (I) within thirty days of final judgment in the action, submits to the court an application for fees and other expenses which shows that the party is a prevailing party and is eligible to receive an award under this section, and the amount sought, including an itemized statement from an attorney or expert witness representing or appearing in behalf of the party stating the actual time expended and the rate at which fees and other expenses were computed . . . and
>
> (II) is an individual whose net worth did not exceed two million dollars at the time the civil action was filed, or is an owner of an unincorporated business, or any partnership, corporation, association, unit of local government or

> organization, the net worth of which did not exceed seven million dollars at the time the civil action was filed, and which had not more than five hundred employees at the time the civil action was filed . . . .
>
> (B) Exception if the commissioner establishes that the commissioner's position was substantially justified.
>
> (i) General rule. A party shall not be treated as the prevailing party in a proceeding to which subdivision (a) of this section applies if the commissioner establishes that the position of the commissioner in the proceeding was substantially justified.
>
> (ii) Burden of proof. The commissioner shall have the burden of proof of establishing that the commissioner's position in a proceeding referred to in subdivision (a) of this section was substantially justified, in which event, a party shall not be treated as a prevailing party.
>
> (iii) Presumption. For purposes of clause (i) of this subparagraph, the position of the commissioner shall be presumed not to be substantially justified if the department, inter alia, did not follow its applicable published guidance in the administrative proceeding. Such presumption may be rebutted.
>
> (iv) Applicable published guidance. For purposes of clause (ii) of this subparagraph, the term "applicable published guidance" means (I) regulations, declaratory rulings, information releases, notices, announcements, and technical services bureau memoranda, and (II) any of the following which are issued to the taxpayer: advisory opinions and opinions of counsel.
>
> (C) Determination as to prevailing party. Any determination under this paragraph as to whether a party is a prevailing party shall be made by agreement of the parties or (i) in the case where the final determination with respect to tax is made at the administrative level, by the division of tax appeals, or (ii) in the case where such final determination is made by a court, the court. (Tax Law § 3030[c][5].)

B. It is initially noted that an award under Tax Law § 3030(a) shall be made only for reasonable litigation and administrative costs incurred in connection with administrative proceedings. Administrative costs include only those costs incurred after the issuance of the notice giving rise to the taxpayer's right to a hearing (Tax Law § 3030[c][2][B]). The term "administrative proceedings" is defined in Tax Law § 3030(c)(5)(C)(6) as "any procedure or other action before the division of taxation (such as the bureau of conciliation and mediation

services) or division of tax appeals." Thus, petitioner is not entitled to reimbursement for expenses incurred prior to the issuance of the notice of deficiency on March 25, 2002.

C. In order to be granted an award of costs, it must be determined that the taxpayer is the "prevailing party" pursuant to Tax Law § 3030(c)(5)(A). Furthermore, any such grant is subject to the limitation of Tax Law § 3030(c)(5)(B), which provides that a taxpayer may not be treated as a prevailing party, and thus may not be awarded costs, if the Division establishes that its position was "substantially justified." Petitioner is the prevailing party in this matter insofar as she substantially prevailed on the most significant issue presented, the claimed business deductions for the years at issue (***Heasley v. Commissioner***, 967 F2d 116, 120, 92 US Tax Cas ¶ 50,412). Thus, the critical remaining question is whether the Division's position was "substantially justified" (Tax Law § 3030[c][5][B]), for if it was, then petitioner may not be treated as a prevailing party and is ineligible for an award of costs and fees.

D. Tax Law § 3030 is clearly modeled after Internal Revenue Code § 7430. It is proper, therefore, to use Federal cases for guidance in analyzing this State law (***see***, ***Matter of Levin v. Gallman***, 42 NY2d 32, 396 NYS2d 623; ***Matter of Ilter Sener***, Tax Appeals Tribunal, May 5, 1988). A position is substantially justified if it has a reasonable basis in both fact and law (***see***, ***Information Resources, Inc. v. United States***, 996 F2d 780, 785, 93-2 US Tax Cas ¶ 50,519), with such determination properly based "on all the facts and circumstances surrounding the case, not solely upon the final outcome" (***Phillips v. Commissioner***, 851 F2d 1492, 1499; ***Heasley v. Commissioner***, ***supra***). This determination of "substantially justified" is properly made in view of what the Division knew at the time the position was taken, i.e., when the notices were issued (Tax Law § 3030[c][8][B]; ***see DeVenney v. Commissioner***, 85 TC 927, 930). The fact that the notice was modified by the presiding officer is a factor to be considered. However, this action

does not preclude a finding that the Division's position was substantially justified at the time the notice was issued (***see***, ***Heasley v. Commr., supra***).

E. The determination of whether an individual is entitled to claimed business deductions is a factual one. In order to be entitled to the business deductions, a taxpayer must establish that the activities with regard to the expenses qualified as the conduct of a trade or business which was entered into with a bona fide profit motive, and that the expenses were actually incurred. At the time the statutory notice was issued, the auditor determined that insufficient information had been produced by petitioner to meet the requirements of entitlement to the claimed business deductions. It was not until the hearing that petitioner established through documentation and testimony that she was entitled to properly claim a portion of the business expenses. It is also noted that the determination found that petitioner was not entitled to some of the business expenses claimed, and that the negligence penalty was properly imposed. Under the foregoing standard, and in view of all of the facts and circumstances of this case, the Division has established that its position was "substantially justified" (Tax Law § 3030[c][5][B]). Accordingly, petitioner may not be treated as a prevailing party under Tax Law § 3030, and therefore may not recover costs and fees under Tax Law § 3030(c)(5)(B)(I).

F. In addition, even had the Division of Taxation's position not been substantially justified, Tax Law § 3030(c)(5)(a)(ii)(II) requires that in order to be considered a "prevailing party," petitioner was required to allege and prove that her individual net worth did not exceed two million dollars. In her application for costs, no allegations were made as to such net worth and no proof thereof was offered. (***See***, ***Avancena v. Commissioner***, 63 TCM 3133.)

G. The application of Benjamin and Lilia Son for costs is denied.

DATED: Troy, New York
July 14, 2005

/s/ Thomas C. Sacca
ADMINISTRATIVE LAW JUDGE