STATE OF NEW YORK

DIVISION OF TAX APPEALS

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| In the Matter of the Petition | : | |
| of | : | |
| **GARY AND BONITA STONE** | : | DETERMINATION<br>DTA NO. 819685 |
| for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Years 1995 and 1996. | : | |

Petitioners, Gary and Bonita Stone, 10 Harris Road, Saratoga Springs, New York 12866, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the years 1995 and 1996.

A hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals, Riverfront Professional Tower, 500 Federal Street, Troy, New York, on July 8, 2004, at 10:00 A.M., with all briefs to be submitted by October 1, 2004, which date began the six-month period for the issuance of this determination. Petitioners appeared *pro se*. The Division of Taxation appeared by Christopher C. O'Brien, Esq. (Justine Clarke Caplan, Esq., of counsel).

## *ISSUE*

I. Whether petitioners reported Federal audit changes for the years 1995 and 1996 to New York State within 90 days as required by Tax Law § 659.

II. If petitioners failed to report the Federal audit changes for 1995 and 1996, whether they have established reasonable cause for their failure to do so.

## *FINDINGS OF FACT*

1. The Division of Taxation ("Division") issued a Notice of Additional Tax Due to Gary and Bonita Stone, dated August 20, 2001, which asserted additional tax due for the year 1995 in the sum of $7,901.58, interest of $3,862.16 and penalty of $2,464.05 for a total due of $14,227.79. The notice was issued after the Division received notification of certain Federal audit changes by the Internal Revenue Service as authorized by Internal Revenue Code § 6103(d). The notice provided the following explanation for the deficiency:

> Our records indicate that the Internal Revenue Service has made changes to your federal return. Section 659 of the New York State Law requires that federal audit changes be reported to the New York State Tax Department within 90 days of the final federal determination.
>
> A search of our files indicates that you did not report these changes to New York State. If you have reported the federal audit changes, please send a copy of the report and a copy of both sides of the canceled check showing our deposit serial number stamped on the face of the check.
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> When you do not report federal audit changes as required, the New York Tax Law provides for assessment of the tax due at any time. There is no time limit provided by section 683(c) of the New York Tax Law.

2. The Division issued a second Notice of Additional Tax Due to Gary and Bonita Stone, dated August 20, 2001, which asserted additional tax due for the year 1996 in the sum of $14,519.68, interest of $5,476.77 and penalty of $3,464.36 for a total due of $23,460.81. This second notice was also issued as a result of notification of Federal audit changes received from the Internal Revenue Service and contained the same explanation set forth above.

3. Both notices explained that negligence penalty equal to five percent of the deficiency was assessed pursuant to Tax Law § 685(b)(1). In addition, the notices stated that a penalty equal to 50% of the interest due on the deficiency or portion thereof due to negligence or intentional disregard of the law was assessed pursuant to Tax Law § 685(b)(2).

4. On March 30, 2000, petitioners, by their representative, executed a consent to income tax audit changes with the Internal Revenue Service ("IRS"), which acknowledged and agreed that they understated taxable income by $100,282.00 due to modifications in their Schedule C income and disallowed deductions and, as a result, owed additional tax of $32,117.00 plus penalty and interest for the year 1995. On March 15, 2000, petitioners signed a consent to income tax audit changes with the IRS which admitted that they understated taxable income by $208,688.00 due to additional Schedule C income and disallowed deductions, resulting in additional tax of $59,015.00 plus penalty and interest for the year 1996.

Petitioners were represented by Phillip K. Whittemore, CPA, with respect to the IRS matter. However, petitioners retained Richard Dickenson, CPA, with regard to the New York State action. Mr. Dickenson appeared at the conference in the Bureau of Conciliation and Mediation Services, but not in the Division of Tax Appeals.

5. The IRS asserted penalty under Internal Revenue Code ("IRC") § 6662 (b)(1) and (2), which imposed penalty for negligence or disregard of the rules and regulations or substantial underpayment of tax.

6. Both revenue agent reports for the years in issue stated that the IRS had agreements with state tax authorities whereby information about changes in income was exchanged with states and that the taxpayer should file a state form if the changes affected the amount of state income tax.

7. Petitioners conceded that they never reported the Federal changes for 1995 and 1996 to the State of New York and never filed amended returns for those years. While petitioners filed a timely personal income tax return for 1996, they did not file their income tax return for 1995 until April of 1999.

## *SUMMARY OF PETITIONERS' POSITION*

8. Petitioners argue that there was an unexpected and confusing issue of net operating losses which might have had an impact on their liability for the years 1995 and 1996. Petitioners contend that the disallowance and redistribution of the net operating losses by the IRS resulted in the substantial Federal and State tax liabilities and penalties. They reason that since the liabilities were both unexpected and beyond their control, the penalties should be abated. Petitioners alluded to resurrecting the net operating loss issue, but have not taken any action to do so.

9. Also, petitioners contend that any failure on their part to comply with the requirements of the Tax Law to report Federal changes to their income was due to their reliance on their tax professional, which they believe was reasonable. In this regard, petitioners submitted a letter written by Mr. Dickenson to the Division of Audit, in which he asked for time to research the net operating loss issue. There was no evidence that Mr. Dickenson took any further action on the issue.

## *CONCLUSIONS OF LAW*

A. Tax Law § 659 provides that if the amount of a taxpayer's Federal taxable income reported on his Federal income tax return for any taxable year is changed or corrected, the taxpayer shall report the change or correction within 90 days after the final determination of such change or correction. If a taxpayer fails to comply with this provision of Tax Law § 659, the Division is authorized to assess the additional tax due at any time. (Tax Law § 683[c][1][C].) As detailed in the facts, the Division properly issued notices of deficiency for additional income tax due based upon the information it received from the IRS, after petitioners failed to notify the Division of the changes within 90 days.

B. In challenging the notices, petitioners bore the burden of proving by clear and convincing evidence that the deficiency assessment was erroneous (***Matter of Leogrande v. Tax Appeals Tribunal***, 187 AD2d 768, 769, 589 NYS2d 383, ***lv denied*** 81 NY2d 704, 595 NYS2d 398; Tax Law § 689[e]). Petitioners' failure to produce any evidence demonstrating that the assessment was erroneous leaves intact "the presumption of correctness which attached to the notice of deficiency" (***Matter of Leogrande v. Tax Appeals Tribunal, supra*** at 769, quoting ***Matter of Kourakos v. Tully***, 92 AD2d 1051, 461 NYS2d 540, ***appeal dismissed*** 59 NY2d 967, 466 NYS2d 1030, ***lv denied*** 60 NY2d 556, 468 NYS2d 1026, ***cert denied*** 464 US 1070). Although petitioners raised the possibility of challenging the redistribution of their net operating losses by the IRS, they offered no evidence or arguments to demonstrate that this was a serious contention.

C. In the alternative, petitioners conceded that they never filed the required report of Federal income tax audit changes and indeed owe the tax and interest thereon, but maintain that the penalties assessed should be abated because the failure to file the report and pay the tax was due to reasonable cause and not willful neglect. Petitioners believe there are two bases for abatement: first, they contend that the changes made by the IRS were unexpected and beyond their control; and second, they believe that they reasonably relied on the bad advice of their accountant, to their detriment.

D. The regulation at 20 NYCRR 2392.1 provides, in pertinent part, as follows:

> (a)(1) Where any person fails to timely file a return, fails to timely pay any taxes due or fails to meet or fulfill any other act or requirement of the Tax Law, thereby subjecting such person to the additions to tax, penalties, or interest penalty imposed pursuant to sections . . . 685(a) . . . of the Tax Law . . . , the applicable additions to tax, penalties, interest penalty and/or the interest amount, as listed above, must be imposed unless it is shown that such failure was due to reasonable cause and not due to willful neglect. In the event that these amounts have been

> imposed and it is later determined any such failure was due to reasonable cause and not due to willful neglect, all or part of these amounts will be canceled. The absence of willful neglect is not sufficient grounds for not imposing or for canceling these amounts.

The regulation discusses reasonable cause as follows:

> In determining whether reasonable cause and good faith exist, the most important factor to be considered is the extent of the taxpayer's efforts to ascertain the proper tax liability. In addition to any relevant grounds for reasonable cause . . ., circumstances that indicate reasonable cause and good faith with respect to the substantial understatement or omission of tax, where clearly established by or on behalf of the taxpayer, may include the following:
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> * * *
>
> (iv) the reliance by the taxpayer on any written information, professional advice or other facts, provided such reliance was reasonable and the taxpayer had no knowledge of circumstances which should have put the taxpayer upon inquiry as to whether such facts were erroneous. (20 NYCRR 2392.1[g][2].)

With respect to petitioners' argument that the audit changes made by the IRS were unexpected and beyond their control, petitioners have not demonstrated that the position taken by the IRS was unreasonable or incorrect, or fully explained why their application of the net operating losses was deemed incorrect and disallowed. To the contrary, they indicated their acquiescence in the IRS position on the losses with their execution of the consent to the income tax audit changes. To insist at this late date that the Federal audit changes were unexpected or beyond their control is unjustified.

Petitioners cannot shield themselves from liability by claiming reliance on the advice of their accountants. They submitted no evidence with respect to their application of the net operating losses or the advice they received on the issue. Further, they did not submit any evidence from Mr. Whittemore, who represented them on this matter before the IRS, and the letter of July 15, 2002 from Mr. Dickenson is without probative value since it merely requested time to research the net operating loss issue. In fact, the record reveals no follow-up on that

letter. In failing to provide full disclosure of all the facts surrounding the net operating loss issue, petitioners have failed to establish reasonable cause. (***See*** 20 NYCRR 2392.1[g][2][iv].)

Reliance on the advice of counsel does not in itself establish reasonable cause ***(Matter of 1230 Park Assocs. v. Commissioner of Taxation and Fin.,*** 170 AD2d 842, 566 NYS2d 957, ***lv denied*** 78 NY2d 859, 575 NYS2d 455; ***Matter of LT & B Realty Corp. v. New York State Tax Commn.,*** 141 AD2d 185, 535 NYS2d 121). Petitioners have not shown that their reliance was in good faith or that it was reasonable for them to have relied upon the particular advice given to them. Without full disclosure of the circumstances and the advice that was rendered, petitioners have not established that their failure to report and pay the tax was due to reasonable cause (***See Matter of Auerbach v. State Tax Commn.,*** 142 AD2d 390, 536 NYS2d 557.)

D. The petition of Gary and Bonita Stone is denied and the two notices of additional tax due, dated August 20, 2001, are sustained.

DATED: Troy, New York
December 9, 2004

/s/ Joseph W. Pinto, Jr.
ADMINISTRATIVE LAW JUDGE