STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
JAMES W. SPRING	:	SMALL CLAIMS DETERMINATION DTA NO. 820315
for Redetermination of Deficiencies or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law and New York City Personal Income Tax under Chapter 17, Title 11 of the Administrative Code of the City of New York for the Years 1998, 1999 and 2000.	:	

Petitioner, James W. Spring, 601 East 20th Street, Apt. 2E, New York, New York 10010, filed a petition for redetermination of deficiencies or for refund of New York State personal income tax under Article 22 of the Tax Law and New York City personal income tax under Chapter 17, Title 11 of the Administrative Code of the City of New York for the years 1998, 1999 and 2000.

A small claims hearing was held before James Hoefer, Presiding Officer, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York on January 18, 2006 at 1:00 P.M., with all briefs and documents due by February 3, 2006. Petitioner appeared by Gallagher, Flynn & Company, LLP (Thomas H. Astore, CPA). The Division of Taxation appeared by Christopher C. O'Brien, Esq. (Susan Parker).

ISSUE

Whether petitioner has sustained his burden of proof to show that his activities as a producer constituted a trade or business engaged in for profit, thus permitting the expenses

associated with such activity to be considered as ordinary and necessary business deductions pursuant to Internal Revenue Code § 162.

FINDINGS OF FACT

1. On May 17, 2002, the Division of Taxation ("Division") corresponded with petitioner, James W. Spring, indicating that its records revealed that petitioner had not filed New York State and City personal income tax returns for the 1998, 1999 and 2000 tax years. The Division's letter indicated that if returns for 1998, 1999 and 2000 had been filed, he should send copies of each return along with information regarding any refund received or copies of the canceled check in payment of any tax due. If petitioner had not yet filed returns for 1998, 1999 and 2000, he was instructed to submit the returns. Petitioner did not respond to the Division's letter.

2. The Division next mailed to petitioner three statements of proposed audit changes, each dated October 4, 2002, wherein it computed his New York State and City personal income tax liability based on information it had received from the Internal Revenue Service. Each Statement of Proposed Audit Changes allowed petitioner the standard deduction and "credit for taxes withheld based on information present in our withholding tax records." Penalties were also imposed for late filing, negligence and underpayment of estimated taxes. The following table details the Division's computation of the New York State and City taxes due for each year in question as set forth in its statements of proposed audit changes:

ITEM	**1998**	**1999**	**2000**
Adjusted gross income	$39,561.00	$39,315.00	$46,540.00
Less standard deduction	-7,500.00	-7,500.00	-7,500.00
Taxable income	$32,061.00	$31,815.00	$39,040.00

NYS & NYC tax due	$3,071.00	$2,889.00	$3,637.00
Less NYC school tax credit	-12.00	-39.00	-45.00
Total tax due	$3,059.00	$2,850.00	$3,592.00
Less tax withheld	-1,371.00	-2,312.00	-3,099.00
Balance of tax due	$1,688.00	$538.00	$493.00

3. On October 30, 2002, less than one month after the Division issued the statements of proposed audit changes, petitioner filed with the Division his New York State and City personal income tax returns for the years 1998, 1999 and 2000. Adjusted gross income reported on petitioner's New York State and City returns included the following items of income and loss:

ITEM	**1998**	**1999**	**2000**
Wage income	$39,562.00	$45,015.00	$46,540.00
Interest income	34.00	31.00	20.00
Business loss	(9,798.00)	(10,567.00)	(10,206.00)
NY adjusted gross income	$29,798.00	$34,479.00	$36,354.00

Petitioner's returns claimed the same standard deduction and City of New York school tax credit as allowed by the Division in each Statement of Proposed Audit Changes. The returns also claimed prepayments of tax through withholding and estimated tax payments in amounts greater that those allowed in each Statement of Proposed Audit Changes. For 1998, petitioner's return claimed a total of $2,371.00 for prepayments of tax and the City of New York school tax credit and, after subtracting State and City taxes due of $1,969.00, a refund of $402.00 was shown. The 1999 tax return claimed $2,474.00 for New York State and City withholding tax payments and the City of New York school tax credit and, after subtracting State and City taxes due of $2,374.00, a refund of $100.00 was claimed. The return for 2000 reflected credit of $3,143.00 for withholding tax payments and the City of New York school tax credit, and since

only $2,564.00 of tax was shown as due, an overpayment of $579.00 was claimed. The Division concedes that petitioner is entitled to claim the higher prepayments of tax as shown on his returns for 1998, 1999 and 2000.

4. Sometime prior to December 13, 2002, petitioner corresponded with the Division regarding each Statement of Proposed Audit Changes. By letter dated December 13, 2002, the Division advised petitioner that his returns for 1998, 1999 and 2000, filed on October 30, 2002, were being processed as original returns and that these returns had been selected for review. The Division requested that petitioner:

> send information recording your business Schedule C income for the tax years 1998, 1999, and 2000. Please include items of verification for both income claimed on Schedule C as well as expenses claimed on Schedule C.
>
> You generally must have documentary evidence, such as receipts, cancelled checks, or bills to support your expenses.

5. Petitioner, in response to the Division's request for substantiation, submitted substantial documentary evidence in support of the expenses claimed on Federal Schedule C for each year in question. After reviewing the documents submitted, the Division determined that petitioner's activities as a producer lacked a profit motive and that the Federal Schedule C losses should therefore be disallowed as hobby losses. The Division concluded that the three statements of audit changes it issued on October 4, 2005 accurately computed the taxes due for 1998, 1999 and 2000. Accordingly, on March 31, 2003, the Division issued to petitioner three notices of deficiency which asserted tax due in the same amounts as set forth in the statements of audit changes, together with updated penalties and interest.

6. In 1987, petitioner graduated from Hampshire College in Amherst, Massachusetts with a degree in film production. After he graduated, petitioner moved to New York City to pursue a

career in film production. Petitioner eventually became involved in producing, directing and editing[1] some 20 music videos which played on such venues as MTV. Although petitioner's work in the music video field was critically acclaimed, he came to the realization sometime in 1997 or 1998 that it would be much more profitable if he could direct and produce an independent feature-length film. Accordingly, petitioner changed the focus of his film production activities from music videos to feature-length film.

7. Pursuant to an "Option Agreement" between petitioner and Ron Kolm, petitioner obtained "an option to acquire the motion picture, television and ancillary rights in and to that certain series of original short stories and written by Owner [Kolm] . . . which Producer [petitioner] intends to develop into a feature-length motion picture." According to petitioner it is a long and arduous task to direct and produce an independent feature-length film since there are numerous revisions in the developmental stage of the story and script, readings with actors and the production of a short story, which incorporates some of the main characters of the story. A short story is produced first to showcase the talent and expertise of the producer and director and is ultimately used as a tool to attract prospective investors to fund the costs associated with the subsequent production of the feature-length film. Petitioner's short story, "Bad Karma," written by Ron Kolm, produced by Elana Fisher and directed by petitioner, debuted at the New York Underground Film Festival on March 9, 2000 and was also entered in other prominent festivals around the country throughout the year 2000.

8. In 1999, petitioner engaged the Sloss Law Office, P.C., to represent him regarding his planned production of the feature-length film and other entertainment-related matters. Sloss

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[1] On his resume, petitioner is listed as producer, director and editor on 13 music videos, director and editor on 5 music videos and producer on 2 music videos.

Law Office, P.C., is a well known firm specializing in the entertainment industry, and petitioner believed that the use of such a high profile firm would lend credibility to his project and hopefully open more doors for him.

9. To further enhance the prospect of a successful feature-length film, petitioner enlisted the services of an experienced producer, Elana Fisher, to produce the film. Petitioner also put together a business plan for the film, which was then entitled "Dumb Luck." The business plan contained a synopsis of the film, short introduction of the "team" (key individuals involved in the production), industry overview, production strategy, distribution strategy and case study. The business plan, like the short story, is used as an integral tool in the search for funds needed to capitalize the production of the film. Petitioner also at some point created a separate bank account with respect to his activities as a producer.

10. Petitioner's activities with respect to both the production of music videos and the development of a feature-length film were carried on on a part-time basis from an office maintained in his apartment. During the years at issue petitioner was employed on a full-time basis by Mark Uriu, Inc.; however, he devoted most of his spare time to the development of the feature-length film.

11. Petitioner's income tax returns for the years 1993 through 2001 reported, on Federal Schedule C, the income or loss generated from his activities as a self-employed producer. The 1993 and 1995 income tax returns reported net profits of $630.00 and $26.00, respectively. The returns for the other seven years all reported net business losses. The following chart reflects the income and expenses reported on petitioner's Federal Schedule C for each year in dispute:

ITEM	**1998**	**1999**	**2000**
Gross receipts	$2,500.00	$2,000.00	$2,000.00

Depreciation and § 179 exp.	7,663.00	4,253.00	4,559.00
Legal & professional exp.	923.00	-0-	-0-
Office exp.	164.00	590.00	555.00
Rent/lease business prop.	936.00	3,487.00	2,041.00
Repairs	390.00	431.00	469.00
Supplies	773.00	565.00	1,039.00
Travel	123.00	186.00	410.00
Meals & entertainment	-0-	-0-	336.00
Utilities	120.00	120.00	150.00
Other exp.	2,129.00	2,012.00	2,647.00
Total Exp.	12,298.00	12,567.00	12,206.00
Net loss	$-9,798.00	$-10,567.00	$-10,206.00

CONCLUSIONS OF LAW

A. Tax Law § 689(e) places on petitioner the burden to refute the Division's disallowance of the business loss deductions and to establish that he is entitled to the expenses claimed (***see***, ***Matter of Schneier***, Tax Appeals Tribunal, November 9, 1989). The starting point for determining New York State and City personal income tax liability is a taxpayer's Federal adjusted gross income (Tax Law § 612[a]; 20 NYCRR 112.1). Since the New York State and City Tax Law is patterned after the Internal Revenue Code, Federal law is determinative of the substantive question presented in this matter (***see, Hunt v. State Tax Commn.,*** 65 NY2d 13, 16-17, 489 NYS2d 451, 453; ***Matter of Rizzo***, Tax Appeals Tribunal, June 3, 1993, ***confirmed Rizzo v. Tax Appeals Tribunal***, 210 AD2d 748, 621 NYS2d 115).

B. The issue to be addressed is whether petitioner's activities as a producer were engaged in for profit within the meaning of Internal Revenue Code § 183, which provides, generally, that where an activity is "not engaged in for profit," deductions attributable to such activity are

allowable only to the extent of income from such activity. Resolution of this issue turns on whether petitioner had an actual and honest objective of making a profit (***see, Dreicer v. Commissioner***, 78 TC 642, 645, ***affd*** 702 F2d 1205). Such an objective is properly determined based on a review of the surrounding facts and circumstances and in consideration of the nine factors set forth in Treas Reg § 1.183-2(b) (***see, Hoag v. Commissioner***, 66 TCM 326, 328).

C. The "nine factors" listed in the regulations to help determine whether a taxpayer has engaged in an activity for profit are as follows: (1) the manner in which the taxpayer carries on the activity, (2) the expertise of the taxpayer or his advisors, (3) the time and effort expended by the taxpayer in carrying on the activity, (4) expectation that assets used in the activity may appreciate in value, (5) the success of the taxpayer in carrying on other similar or dissimilar activities, (6) the taxpayer's history of income or losses with respect to the activity, (7) the amount of occasional profits, if any, which are earned, (8) the financial status of the taxpayer, and (9) elements of personal pleasure or recreation (Treas Reg § 1.183-2[b]). The factors listed above are intended as guidelines and are nonexclusive. Accordingly, no single factor or combination of factors is conclusive in indicating a profit objective (***see, Yancy v. Commissioner*** 48 TCM 872, 874).

D. After carefully considering the entire record, focusing on the nine factors noted above, I conclude that petitioner has met his burden of proof to establish that his activities as a producer during the years in question were carried on with an actual and honest objective of making a profit. Some of the factors are not relevant to the facts of this case and others, while pertinent, do not weigh significantly either for or against a characterization of petitioner's activities as constituting a bona fide trade or business engaged in with the required profit motive.

Supporting the conclusion reached herein is the fact that petitioner was knowledgeable with respect to film production, having a college degree in filmmaking and valuable hands-on experience through his production of music videos. Petitioner utilized the services of a respected law firm, brought a qualified producer in to help develop and complete the project, produced and distributed a short story, developed a comprehensive business plan, maintained a separate bank account for his business activities and kept adequate records of his income and expenses. Petitioner devoted substantial time to his filmmaking activities, and he is not a "high income" taxpayer trying to shield other income from taxation through the pursuit of a hobby disguised as a business. Indeed, petitioner's filmmaking activities created a financial hardship, further supporting that his continued pursuit of these activities was for profit.

Although petitioner has shown a history of business losses throughout the years 1993 through 2001, it must be noted that petitioner, once he determined music video production would not produce significant profits, changed the focus of his business to the production of a feature-length film. Considering the nascent stage of petitioner's feature-length film activities and the extended time period needed to develop and produce an independent feature-length film, it is not unexpected to see losses for several years. The very nature of petitioner's film production activities would not produce a profit until the movie was completed and, hopefully, sold to distributors. During the years at issue, petitioner's filmmaking activities were, in essence, a "work in progress," with the financial reward, if any, coming only upon the completion of the project. Notwithstanding a history of business losses, petitioner has shown that he took the necessary steps to establish that his filmmaking activities were engaged in with a profit motive. Accordingly, petitioner is entitled to deduct the business losses as claimed on his New York State and City income tax returns for the years 1998, 1999 and 2000.

E. It is noted that petitioner's New York State and City income tax returns for the years 1998, 1999 and 2000, claiming refunds of $402.00, $100.00 and $579.00, respectively, were late-filed on October 30, 2002. As applicable to this proceeding, Tax Law § 687, entitled "Limitations on credit or refund" provides that "(a) General. --- Claim for credit or refund of an overpayment of income tax shall be filed by the taxpayer within three years from the time the return was filed or two years from the time the tax was paid, whichever of such periods expires the later. . . ." All of petitioner's payments of tax for 1998 were from tax withheld from wages and estimated tax payments and these payments are deemed to have been made on April 15, 1999 (Tax Law § 687[i]). Accordingly, the $402.00 refund claimed on petitioner's 1998 New York State and City income tax return, which was first filed on October 30, 2002, cannot be granted since the statute of limitations for refund, as set forth in Tax Law § 687(a), has expired. Petitioner's 1999 and 2000 tax returns were filed within the statute of limitations for refund and therefore the Division is directed to issue said refunds to petitioner together with such interest as may be due and owing.

F. With respect to the penalties imposed by the Division in its notices of deficiency, it must be noted that in each of the three years at issue petitioner's prepayment of tax actually exceeded his liability. Accordingly, the late filing penalty and estimated tax penalty cannot be imposed pursuant to Tax Law § 685(a)(1)(C) and (c)(5), respectively. Although it is permissible for the Division to assert the negligence penalty because petitioner's returns were not filed on time (Tax Law § 687[m]), petitioner has shown that there was no negligence or intentional disregard of the Tax Law or regulations. Accordingly, the negligence penalty imposed pursuant to Tax Law § 685 (b) is also canceled.

G. The petition of James W. Spring is granted to the extent indicated in Conclusions of Law "D", "E" and "F"; the Division's three notices of deficiency dated March 31, 2003 are hereby canceled in full and the Division is directed to refund to petitioner the sum of $100.00 for 1999 and $579.00 for 2000, plus such interest as allowed by law.

DATED: Troy, New York
April 27, 2006

/s/ James Hoefer
PRESIDING OFFICER