

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
SAMIR AND FARIDEH MASRI	:	SMALL CLAIMS DETERMINATION DTA NO. 820524
for Redetermination of a Deficiency or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law and New York City Personal Income Tax pursuant to the Administrative Code of the City of New York for the Years 1999 and 2000.	:	

Petitioners, Samir and Farideh Masri, 14 Beach Road, #3D, Great Neck, New York 11023-1165, 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 and New York City personal income tax pursuant to the Administrative Code of the City of New York for the years 1999 and 2000.

A small claims hearing was held before James Hoefer, Presiding Officer, at the offices of the Division of Tax Appeals, 400 Oak Avenue, Garden City, New York, on September 21, 2005 at 10:00 A.M. and continued to conclusion before the same Presiding Officer at the same location on May 23, 2006 at 12:30 P.M. Petitioners appeared at both hearings *pro se*. The Division of Taxation appeared at both hearings by Christopher C. O'Brien, Esq. (Debbie Shum).

Since neither party herein elected to reserve time to file a post-hearing brief, the three-month period for the issuance of this determination commenced as of the date the hearing was completed.

ISSUES

I. Whether the Division of Taxation properly determined that petitioners had understated gross receipts for both 1999 and 2000 based on a bank deposit analysis audit.

II. Whether the Division of Taxation properly disallowed certain Schedule C expenses for both 1999 and 2000 on the basis that they were not ordinary and necessary business deductions or ordinary and necessary expenses incurred in the production or collection of income.

III. Whether the deficiency in question was due to negligence or intentional disregard of the Tax Law, rules or regulations, thereby subjecting petitioners to the negligence penalty imposed pursuant to Tax Law § 685(b).

IV. Whether petitioners are entitled to have interest on any tax due computed at the rate set for amnesty applications.

FINDINGS OF FACT

1. Petitioners, Samir and Farideh Masri, timely filed New York State resident personal income tax returns for the years 1999 and 2000. Mr. Masri also filed a City of New York Nonresident Earnings Tax Return for 1999. Petitioners' New York adjusted gross income for each year at issue included the following items of income:

ITEM	1999	2000
Wages	\$22,900.00	\$23,100.00
Interest income	91.12	23.19
Dividend income	9.92	6.71
Business income	521.65	3,438.00
Capital gains	-0-	681.93
Adjustments: ½ of s/e tax and IRA	(2,036.85)	(2,242.89)
New York adjusted gross income	\$21,485.84	\$25,006.95

2. During both years in question, Mrs. Masri was employed by Cachet Industries, Inc. earning wages of \$22,900.00 and \$23,100.00. Mr. Masri was a self-employed certified public accountant and his Federal Schedule C, Profit or Loss From Business, for 1999 and 2000 reported the following items of income and expense:

ITEM	1999	2000
Gross income	\$21,603.77	\$43,159.12
Less: Commissions and fees	3,850.00	10,312.00
Insurance	350.00	1,350.00
Legal and professional	875.00	3,885.00
Office expense	295.00	1,348.17
Supplies	623.00	395.00
Taxes and licenses	457.00	660.00
Travel and meals	-0-	3,151.96
Continuing education	613.25	1,476.50
Books and library	5,031.11	4,953.79
Publications	377.05	365.40
Seminar materials	853.20	2,350.00
Train trip	112.98	-0-
Storage	-0-	570.76
Telecom	62.53	54.62
Dues	138.00	495.28
PO box	44.00	44.00
Meals	-0-	620.64
Home office deduction	7,400.22	7,687.99
Total deductions	21,082.34	39,721.11
Net profit	\$521.43	\$3,438.01

3. The Division of Taxation (“Division”), apparently as a result of the receipt of a “squeal” letter, initiated a field audit of petitioners’ 1999 and 2000 New York State and City income tax returns. Using a bank deposit analysis, the Division determined that petitioners had understated gross receipts by \$22,577.00 for 1999 and \$3,407.00 for 2000. The bank deposit analyses are summarized in the following table:

ITEM	1999	2000
Deposit wife’s Fleet account	\$36,507.00	\$44,965.00
Deposit wife’s Fleet credit line account	6,294.00	7,144.00
Deposit Chase business account	30,181.00	20,071.00
Deposit investment account	2,500.00	-0-
Total deposits	75,482.00	72,180.00
Less: Gross receipts per Schedule C	21,603.00	43,159.00
Net payments per W-2	18,747.00	21,788.00
Checks from Mr. Masri to Mrs. Masri	8,400.00	4,000.00
Tax refunds	2,173.00	673.00
Redemption of CD	1,982.00	-0-
Loan from Mrs. Masri’s employer	-0-	3,000.00
Balance	\$22,577.00	(440.00)
Plus: Amex credit card paid by brother	-0-	3,000.00
Amex payment made by a corporation	-0-	847.26
Understated gross receipts	\$22,577.00	\$3,407.00

4. The Division also disallowed certain business expenses claimed on Federal Schedule C as both unsubstantiated and nondeductible personal expenses. For the 1999 tax year, the Division disallowed \$10,609.31 of claimed expenses, which amount included books and library \$5,031.11; seminar materials \$853.20; commissions and fees \$3,850.00 and legal and

professional \$875.00. Petitioners do not acquiesce to any of the disallowed deductions for 1999. The table below sets forth those Federal Schedule C expenses which the Division disallowed for the 2000 tax year, along with the amounts to which petitioners acquiesce:

ITEM	DISALLOWED	ACQUIESCE	IN DISPUTE
Books and library	\$4,953.79	-0-	\$4,953.79
Seminar materials	2,350.00	-0-	2,350.00
Meals	620.64	-0-	620.64
Commissions and fees	10,312.00	\$7,787.00	2,525.00
Insurance	1,350.00	1,000.00	350.00
Legal and professional	3,885.00	885.00	3,000.00
Travel	3,151.96	-0-	3,151.96
Total	\$26,623.39	\$9,672.00	\$16,951.39

5. Based on the results of its audit, the Division increased petitioners' reported New York State taxable income for 1999 by \$30,841.00 (\$22,577.00 for understated gross receipts plus \$10,609.00 for disallowed deductions less \$2,345.00 for additional self-employment tax allowed as an adjustment to income). The \$30,841.00 adjustment produced additional New York State tax due of \$1,637.23. For the 2000 tax year, the Division increased petitioners' reported New York State taxable income by \$27,909.00 (\$3,407.00 for understated gross receipts plus \$16,952.00 for disputed disallowed deductions plus \$9,672.00 for acquiesced disallowed deductions less \$2,122.00 for additional self-employment tax allowed as an adjustment to income). The \$27,909.00 adjustment produced additional New York State tax due of \$1,480.04. The Division also determined that for the 1999 tax year, \$55.60 of additional New York City nonresident earnings tax was due. The origin of the \$55.60 of additional New York City

nonresident earnings tax due is not disclosed in the record; however, petitioners do not contest this amount and therefore it will not be addressed hereinafter.

6. On March 5, 2004, the Division issued a Notice of Deficiency to petitioners asserting that \$55.60 of additional New York City nonresident earnings tax and \$1,637.23 of additional New York State personal income tax was due for 1999 and that \$1,480.04 of additional New York State personal income tax was due for 2000. The Notice of Deficiency also asserted that interest and negligence penalty, imposed pursuant to Tax Law § 685(b), were due.

7. Petitioners protested the Notice of Deficiency by filing a Request for Conciliation Conference with the Division's Bureau of Conciliation and Mediation Services ("BCMS"). As the result of a conciliation conference, BCMS issued a Conciliation Order which reduced the understated gross receipts for 1999 by \$5,200.00, but otherwise sustained all other adjustments proposed by the Division in its Notice of Deficiency. At the small claims hearing held herein, the Division conceded that in computing the revised tax due for 1999, which revision incorporated the adjustments made by BCMS, it incorrectly used the sum of \$25,144.00 for understated gross receipts instead of the correct figure of \$22,577.00. Accordingly, for purposes of this proceeding the understated gross receipts figure for the 1999 tax year is \$17,377.00 (\$22,577.00 - \$5,200.00).

UNDERSTATED GROSS RECEIPTS

8. For both years in question, Mr. Masri reported his business income on Federal Schedule C using an accrual basis of accounting. During the 1999 tax year, the sums of \$666.66 and \$1,500.00 were deposited into Mr. Masri's Chase business account. The \$666.66 represents the last monthly payment Mr. Masri received from a lawsuit which was settled in 1997. The \$1,500.00 deposit represents a client fee received in 1999 for work performed in 1998. Since

Mr. Masri reported his business income on an accrual basis, the \$666.66 payment and \$1,500.00 payment were accrued to and taxed in prior years.

9. At various times in 1999, Mr. Masri received loan proceeds totaling \$7,000.00 from his brother located in the United Kingdom. The \$7,000.00 in loan proceeds were deposited by Mr. Masri in his Chase business account. On October 13, 2000, Mr. Masri's brother made, as a loan, a direct payment of \$3,000.00 to Mr. Masri's American Express account. There are no loan documents executed between Mr. Masri and his brother and, to date, no payments have been made on the loans. Mr. Masri testified that in all likelihood his brother will forgive the debt, thus making the \$10,000.00 a gift.

10. During the years at issue, it was customary for Mrs. Masri to buy numerous items throughout the year for her elderly mother, who would then reimburse her in cash for these expenses. For the 1999 tax year, approximately \$3,000.00 in cash was received by Mrs. Masri from her mother and these cash payments were deposited into her Fleet account. Mrs. Masri also received \$2,000.00 in cash from her son, which she also deposited into her Fleet account.

11. For the 2000 tax year, the Division concedes that its \$3,407.00 understated gross receipts figure should be reduced by \$550.00 (\$500.00 received by petitioners from their son and \$50.00 for a LIPA refund check).

DISALLOWED SCHEDULE C EXPENSES

12. The disallowed Schedule C expenses noted in Finding of Fact "4" were initially disallowed as both unsubstantiated and nondeductible personal expenses. During the course of this proceeding, petitioners adduced evidence to substantiate that the disallowed expenses had been paid and the Division therefore conceded that the expenses in question have been

substantiated as to the dollar amount. The Division still maintains that the expenses were properly disallowed as nondeductible personal expenses.

13. Petitioner Samir Masri was licensed as a certified public accountant in the early 1980s; however, he was not actively engaged in a public accounting practice until 1996 or 1997. Prior to his practice of public accounting, Mr. Masri was engaged in business as a licensed life insurance agent.

14. A review of the books and library expenses, totaling \$5,031.11 for 1999 and \$4,953.79 for 2000, reveals Mr. Masri's purchase of a diverse collection of books. The following is a small sample of the books purchased: "Coins of Tabaristan and Some Sassanian Coins of Susa"; "Ancient Near Eastern Cylinder Seals"; "The Cambridge History of Iran: the Seleucid, Parthian and Sasanian Periods, Part I"; "Bihzad: Master of Persian Painting"; "Plants in Indian Temple Art"; "The Jahangirnama: Memoirs of Jahangir, Emperor of India"; "Religions of the Silk Road: Overland Trade and Cultural Exchange from Antiquity to the Fifteenth Century"; and "The Diffusion of Classical Art in Antiquity."

15. In the development of his professional practice as a CPA, Mr. Masri has targeted a niche client market among collectors of art, antiquities and carpets, and teachers and students of Oriental history, particularly of the Silk and Monsoon Roads. Mr. Masri has published articles in the trade magazine Rug News and is an active member of the Hajji Baba Club, the oldest rug collecting group in the United States. Mr. Masri asserts that the books and library expenses claimed for 1999 and 2000 were incurred to maintain and improve his skills to retain and expand his niche clientele and thus constituted ordinary and necessary expenses under Internal Revenue Code § 162(a) or, alternatively, were deductible expenses under Internal Revenue Code § 212 as having been incurred in the production or collection of income. Mr. Masri stated that the books

he purchased represent “a major interest of mine, I am deeply involved in it and I have the good fortune of being able to do it for business as well as for pleasure.” Mr. Masri was “developing clients who had similar interests to myself.”

16. Although Mr. Masri was no longer actively engaged in the sale of life insurance products during the years at issue, he continued to receive income, in the form of commissions, from policies written in prior years, and this commission income was included in gross receipts reported on Schedule C. For the 1999 tax year, 17.65% of gross receipts reported on Schedule C were from life insurance renewal commissions. For the 2000 tax year, 22.73% of gross receipts came from life insurance renewal commissions.

17. The seminar materials expense, totaling \$853.20 for 1999 and \$2,350.00 for 2000, is similar in nature to the books and library expenses discussed above. The seminars put on by Mr. Masri were not open to the general public and were attended by no less than 10 nor more than 20 people. All people attending were either clients of Mr. Masri or individuals he was interested in pursuing as potential clients. The subject matter of the seminars, which were held in a meeting room in the Great Neck Library, varied, but all were in the nature of art history, ancient history, Middle Eastern history, etc. One seminar involved music from China where petitioner hired Chinese musicians to perform at the seminar.

18. The commissions and fees expense in dispute totals \$3,850.00 for 1999 and \$2,525.00 for 2000. The \$3,850.00 claimed expense for 1999 represents fees charged for speakers, presenters and performers at the seminars. For 2000, the \$2,525.00 expense represents a \$275.00 payment to Bill Warden, a seminar speaker or presenter, and \$2,250.00 paid to an “N. Neman” an individual who performed accounting work for Mr. Masri on a subcontract basis.

19. The legal and professional expense for 1999 of \$875.00 represents a \$25.00 gratuity, a \$250.00 payment to an attorney and a \$600.00 payment to a person identified as "Moore" as an expense related to a January 1999 seminar. The \$3,000.00 of legal and professional expenses claimed for 2000 consist of payments made to N. Neman for accounting work performed as a subcontractor.

20. The meal expense of \$620.64 claimed for 2000 represents \$120.00 spent on two meals while Mr. Masri was visiting the Textile Museum in Washington, D.C., with members of the Hajji Baba Club on April 15, 2000. Also included are three meals of \$25.15 on August 15, 2000, \$31.77 on October 24, 2000 and \$73.57 on December 20, 2000; however, other than the disclosure of the date and amount of the expense, the record is devoid of any further details. Finally, there is a \$372.15 claimed meal expense for a Christmas party held in December 2000 for family and clients.

21. The insurance expense of \$350.00 for 2000 represents the amount paid by Mr. Masri to be bonded in New York as a public and general insurance adjuster.

22. The \$3,151.96 claimed travel expense for 2000 consists of \$473.35 spent on a trip to the United Kingdom where petitioner Samir Masri testified that he met with a potential telecommunications client and also visited with his brother. An additional \$795.61 was spent on a trip to Paris, France for Mr. Masri to attend a coin auction with a client. Mr. Masri went with the client in an advisory role only and he received no fee, payment or reimbursement from the client for attending the auction. Also included in 2000 travel expenses was \$1,815.00 spent on the Long Island Railroad for train tickets for Mr. Masri to visit clients located in New York City. Finally, there is a \$68.00 charge for a Greyhound bus fare; however, there is no clear explanation in the record of the business nature of this expense.

AMNESTY INTEREST RATE

23. The Division first contacted petitioners concerning the field audit of their 1999 and 2000 income tax returns on September 23, 2002. Mr. Masri delayed meeting with the Division's auditor until June 2, 2003, and the audit was not closed out until March 5, 2004, when the Division issued its Notice of Deficiency. Applications for New York's third amnesty period were required to be filed between November 18, 2002 and January 31, 2003. This third amnesty program offered taxpayers a chance to satisfy, *inter alia*, unpaid personal income tax liabilities and offered a reduction in applicable rates of interest by two percentage points. Since the audit was not completed by the January 31, 2003 amnesty application deadline, petitioners did not make an amnesty application with respect to any unpaid personal income tax liabilities for the years 1999 and 2000.

CONCLUSIONS OF LAW

A. There is no dispute that it is permissible for the Division to reconstruct petitioners' income using an indirect audit method and that a bank deposit analysis audit constitutes an accepted method of reconstructing income. Essentially what is at issue here is whether certain adjustments should be made to the bank deposit analysis.

B. In the instant matter, petitioner Samir Masri reported his business income on an accrual basis of accounting and since a bank deposit analysis audit is done on a cash basis, it is necessary to make adjustments to effect an accrual basis result in those instances where an accrual basis of accounting is utilized. Here, petitioners have shown that the sums of \$666.66 and \$1,500.00, although deposited into an account in 1999 and included in the Division's bank deposit analysis for 1999, had been accrued to and taxed in previous tax years. Furthermore, petitioners have established that during the 1999 tax year they received \$7,000.00 in nontaxable funds from Mr.

Masri's brother; that Mrs. Masri received \$3,000.00 of nontaxable cash from her mother and that \$2,000.00 of nontaxable cash was received from their son. Accordingly, the understated gross receipts figure for 1999 is reduced by \$14,166.66, from \$17,377.00 to \$3,210.34. The \$1,270.00 adjustment petitioners sought for cash purportedly given by Mr. Masri to Mrs. Masri has not been satisfactorily proven and therefore no adjustment is allowed for this item.

For the 2000 tax year, adjustment is made for the \$3,000.00 of nontaxable cash received from Mr Masri's brother and, coupled with the two concessions made by the Division totaling \$550.00, there remains no understatement of gross receipts for this year.

C. Internal Revenue Code § 162(a) provides for a deduction for "ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. . . ." Additionally, Internal Revenue Code § 212 provides for a deduction for "all the ordinary and necessary expenses paid or incurred during the taxable year - (1) for the production or collection of income. . . ."

D. Addressing the claimed books and library expenses first, I am not convinced that there is a sufficient proximate relationship between the subject matter of the books and the nature of Mr. Masri's business activities. Although Mr. Masri attempts to establish a direct link between the books and his development of a niche clientele, I cannot find that petitioners have sustained their burden of proof (Tax Law § 689[e]) to show that these were ordinary and necessary business expenses or that they were expenses related to the production or collection of income. From the evidence and testimony before me it appears that Mr. Masri's purchase of the books was primarily for personal reasons and had, at best, a tangential business connection.

E. With respect to the claimed seminar expenses, I reach the same result as noted in Conclusion of Law "D". Once again, it appears to me that the seminars dealt with subject

matters of great personal interest to Mr. Masri, and petitioners have failed to adduce sufficient evidence to establish that these were deductible expenses under Internal Revenue Code §§ 162(a) or 212.

F. The commission and fee expenses of \$3,850.00 for 1999 and \$275.00 for 2000, which amounts relate to fees paid to speakers, presenters and performers at the seminars were likewise properly disallowed for the reasons noted in the two preceding Conclusions of Law. The \$2,250.00 fee paid to N. Neman during the 2000 tax year to perform accounting work as a subcontractor is an allowable ordinary and necessary business expense.

G. The \$875.00 legal and professional expense claimed in 1999 has also been properly disallowed. There is simply insufficient evidence to establish that these were ordinary and necessary expenses incurred in a trade or business or were for the production or collection of income. The \$3,000.00 legal and professional expense claimed in 2000 for payments made to N. Neman are allowed as these payments were made for accounting work performed as a subcontractor.

H. The \$620.64 meal expense claimed in 2000 was also properly denied. Petitioners have failed to meet their burden of proof to show that these were ordinary and necessary business deductions.

I. The \$350.00 insurance expense claimed in 2000 represents an ordinary and necessary business deduction and is therefore allowed.

K. The \$3,151.96 travel expense claimed in 2000 is allowed in the amount of \$1,815.00 for the Long Island Railroad ticket expenses. The remaining claimed expenses in the sum of \$1,336.96 for the trips to the United Kingdom and Paris, France and the \$68.00 bus ticket are disallowed as petitioners have failed to establish that these were deductible expenses.

L. Turning next to the issue concerning the imposition of the negligence penalty pursuant to Tax Law § 685(b), I conclude that the deficiency at issue was not due to negligence or intentional disregard of the Tax Law, rules or regulations. It is noted that petitioners were able to fully document the claimed expenses as to the dollar amount and there remains only a small understatement of gross receipts for one of the two years in question. Accordingly, the negligence penalty is canceled.

M. Finally, petitioners' request to have interest computed at the rate set for amnesty applications is denied. Petitioners, knowing that the 1999 and 2000 tax returns were under audit, could have filed a timely amnesty application for any additional taxes which they felt were due; however, they chose not to avail themselves of this option. The period for amnesty applications has expired and there is no provision in the law which would allow the benefits afforded by the amnesty program, specifically the interest rate reduction, to be applied in a retroactive manner.

N. The petition of Samir and Farideh Masri is granted to the extent set forth in Conclusions of Law "B", "F", "G", "I", "K" and "L"; the Division of Taxation is directed to modify the Notice of Deficiency dated March 5, 2004 to be consistent with this determination; and, except as so granted, the petition is in all other respects denied.

DATED: Troy, New York
August 17, 2006

/s/ James Hoefler
PRESIDING OFFICER