STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
SCOTT AND LINA TRABOLD	:	DETERMINATION DTA NO. 821098
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 under the Administrative Code of the City of New York for the Years 2001, 2002 and 2004.	:	

Petitioners, Scott and Lina Trabold, 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 under the Administrative Code of the City of New York for the years 2001, 2002 and 2004.

A hearing was held before Catherine M. Bennett, Administrative Law Judge, at the offices of the Division of Tax Appeals, Riverfront Professional Tower, 500 Federal Street, Troy, New York, on August 21, 2007 at 10:00 A.M, with all briefs due by February 15, 2008, the date upon which the six-month period for the issuance of this determination commenced. Petitioners appeared by Allen Lokensky & Associates (Allen Lokensky, Public Accountant). The Division of Taxation appeared by Daniel Smirlock, Esq. (Robert A. Maslyn, Esq., of counsel).

ISSUES

I. Whether it has been established that Mr. Lokensky, petitioners' representative, has been the target of improper retaliatory action by the Division of Taxation, which resulted in petitioners' returns being audited.

II. Whether petitioners have established that they are the target of improper repetitive audits by the Division of Taxation, such that the notices at issue should be dismissed for all years.

III. Whether the Division of Taxation properly determined that petitioners have failed to present sufficient evidence to establish that their itemized deductions of $26,749.00 and $46,129.00 claimed for tax years 2001 and 2002, respectively, were bona fide deductible expenses.

IV. Whether the Division of Tax Appeals has jurisdiction to review the denial of petitioners' tax refund for tax year 2004.

FINDINGS OF FACT

1. Petitioners' representative, Allen Lokensky, previously represented another tax client (XY for the purpose of privacy) before the Division of Taxation (Division). Mr. Lokensky found the actions of the auditor in that case inappropriate, and he complained. The case eventually was handled by the Bureau of Conciliation and Mediation Services (BCMS). Thereafter, the Division sent out audit letters to 21 of Mr. Lokensky's clients requesting verification of all deductions claimed on those taxpayers' resident income tax returns for tax years 2001 and 2002. All the letters were sent on March 5, 2004 and set a 30-day response date. This date fell during the height of the tax filing period, a time when Mr. Lokensky is very busy. Mr. Lokensky filed a protest with the Division, complaining that the audits were in retaliation for the complaint filed in the XY case against the auditor who handled that matter. The Division's Commissioner for Operations responded to the complaint, but did not remove the auditor from the matter, nor counter the decision to pursue the substantiation requested of the various taxpayers. On or about September 8, 2005 at BCMS, an agreement was reached between Mr. Lokensky and the Division

by which 6 of the 21 taxpayers would be audited for the years in issue and, if approved, the balance of the audits would be canceled. Petitioners herein were one of the six chosen by the Division to be audited, the primary focus of which was itemized deductions for tax years 2001 and 2002.

Tax Years 2001 and 2002

2. Petitioners, Scott and Lina Trabold, filed their 2001 and 2002 New York State and City resident personal income tax returns, claiming New York itemized deductions of $26,749.00 and $46,129.00, respectively, as follows:

Itemized Deduction	2001	2002
Medical and Dental	$175.00	$1,740.00
Taxes	7,526.00	15,840.00
Interest	0	6,067.00
Gifts to Charity	6,745.00	6,405.00
Job Expenses and other Miscellaneous Expenses	17,722.00	20,747.00
Total Itemized Deductions	**$32,168.00**	**$50,799.00**
State, local and foreign income taxes and other subtraction adjustments	5,419.00	4,670.00
New York State Itemized Deduction	**$26,749.00**	**$46,129.00**

3. By correspondence dated March 3, 2004 and August 16, 2004, the Division requested documentation to support the deductions claimed on petitioners' 2001 and 2002 New York State resident income tax returns. Although petitioners' representative, Allen Lokensky, corresponded with the Division questioning the audit of petitioners' returns, no documentation was received by the Division at that time.

4. The Division thereafter issued two separate statements of proposed audit changes, both dated January 18, 2005, notifying petitioners that their itemized deductions for tax years 2001

and 2002 were disallowed as unsubstantiated, and that instead the standard deduction would apply for each year. The Division determined tax due in the amount of $914.41 and $2,035.00, plus interest, for tax years 2001 and 2002, respectively.

5. The Division thereafter issued two notices of deficiency to petitioners, dated March 14, 2005, assessing tax in the amount of $914.41 and $2,035.00, plus interest, respectively, for 2001 and 2002.

6. Mr. Trabold is a salesman for Automatic Data Processing, Inc. (ADP), a national company which processes payroll information. Petitioners neither appeared at the hearing to provide testimony nor submitted affidavits on their behalf in lieu of testimony.

7. Documentation submitted by petitioners for 2001, prepared by Mr. Trabold, included a cover sheet with the totals of the itemized deduction categories listed: a medical expense worksheet produced in the preparation of petitioners' return for 2001 that delineates the components of the medical expenses; a copy of federal schedule A for 2001; a copy of the Miscellaneous Itemized Deduction Statement, also produced as part of the preparation of petitioners' 2001 tax returns; copies of two forms 2106, Employee Business Expenses, for both petitioners for 2001; copies of credit card statements in the name of Lina Trabold covering purchases from December 2000 to November 1, 2001, on which there are notations asserting that a charge relates to a particular category of itemized deduction; numerous copies of checks to Verizon, AT&T, AT&T Wireless Services and Voicestream Wireless; and copies of checks in the total amount of approximately $2,200.00 made out to various doctors and other medical service providers.

8. Documentation prepared by Mr. Trabold and submitted by petitioners for 2002 included a spreadsheet divided into the following categories and total expenses: medical ($4,567.24),

business travel ($3,536.22), client meetings ($545.45), meals and entertainment ($771.28), business meeting ($620.33), internet ($215.10), telephone ($435.34), cell phone ($859.00), business expense ($59.72), business gifts ($888.53) and business supplies ($56.75); a medical expense worksheet, produced in the preparation of petitioners' return for 2002 that delineates a breakdown of what comprises the medical expenses; a handwritten explanation of the medical insurance premiums deducted from Mr. Trabold's paychecks on a bi-weekly basis in the amount of $73.15 for medical insurance and $12.96 for dental insurance; several copies of Mr. Trabold's pay stubs showing deductions for "medical" and "dental" bearing an asterisk next to the amounts, indicating below that such amounts are "excluded from federal taxable wages"; copies of credit card statements in the name of Lina Trabold covering purchases from November 2001 to December 3, 2002, on which there are notations asserting that a charge relates to a particular category of itemized deduction, with a handwritten numeric reference relating back to the spreadsheet described above; a copy of federal schedule A for 2002; a copy of Mr. Trabold's Form 2106, Employee Business Expenses, for 2002; copies of checks in the total amount of approximately $160.00 made out to various doctors and other medical service providers; additional checks to Verizon, Ford Motor Credit Co., the Port of Authority, NMAC, AT&T and Voicestream Wireless; a receipt from Staples in the amount of $31.76 for business supplies; and only partially legible copies of toll, parking and tax receipts totaling approximately $229.00.

Tax Year 2004

9. Petitioners filed their 2004 Form IT-201, New York State Resident Income Tax Return, on or after March 15, 2005, seeking a refund in the amount of $3,476.00. After its review of the return the Division corresponded with petitioners by a letter dated April 18, 2005, requesting additional information concerning their New York itemized deductions for that year. The

Division requested a copy of petitioners' federal schedule A and all of the information which would verify each and every deduction, including canceled checks and receipts. The letter was specific about the type of documentation that was required.

10. When petitioners did not respond to the April 18, 2005 letter, the Division issued a Statement of Tax Refund, dated August 22, 2005, adjusting petitioners' refund to $1,018.00, stating the following:

> Your 2004 refund has been adjusted. Since there was no response to the inquiry letter sent on 4/18/05, requesting documentation for the itemized deductions claimed, they have been disallowed and the corresponding standard deduction has been applied.

11. At the hearing, no evidence of substantiation of petitioners' itemized deductions for tax year 2004 was introduced.

12. Petitioners were permitted additional time post-hearing for a final submission of documentation that their representative stated was available for review. Inasmuch as the submission of documentation was more than three weeks late, and the record had officially closed, the post-hearing submission was returned to the representative and was not considered in this determination.

SUMMARY OF THE PARTIES' POSITIONS

13. Mr. Lokensky maintains that in targeting petitioners, the Division has not established that it followed a usual procedure when the Division singled him out as the tax preparer and requested substantiation of itemized deductions from 21 of his clients on the same day during the busy tax season, and that as such, this was an abuse of process, and retaliatory against him for complaining about the actions of an auditor in the XY audit matter. On that basis, Mr. Lokensky

believes that all the audits should be dismissed, even the audits of the six taxpayers that were agreed to be reviewed as a sample, which includes Mr. and Mrs. Trabold.

As to the petitioners herein, Mr. Lokensky argues that the notices in issue should be canceled, since these taxpayers have been inappropriately subjected to repetitive audits which, based upon Internal Revenue Service (IRS) audit guidelines, is not permissible. Further, since the Division does not have a similar repetitive audit guideline, it is bound to follow the IRS guideline.

Petitioners claim that at previous levels of the audit protest process, substantiation was provided and the Division ignored it. Petitioners maintain that what they provided to substantiate itemized deductions for 2001 and 2002 was either sufficient, or the Division never informed them what would be needed.

As to the 2004 refund denial, petitioners assert it should be granted as part of the improper repetitive audits of these petitioners. Having filed Form IT-113-X, claim for refund, after February 21, 2007, Mr. Trabold maintains that the Division of Tax Appeals will have jurisdiction to hear a protest of the reduced refund if, after more than six months, the Division does not respond to the claim. However, Mr. Lokensky states that at the time of the hearing, jurisdiction had not been perfected with the Division of Tax Appeals.

14. The Division argues that petitioners' claim of improper retaliatory audits is without basis in fact or law.

The Division maintains that the IRS guideline for repetitive audits is just that, merely a guideline that does not govern the Division. Secondly, the guideline only applies where there are successive no-change audits, which is not the case here.

As to the merits of substantiating the itemized deductions for 2001 and 2002, the Division argues that petitioners have not provided adequate source documentation, proof or explanation to entitle them to the asserted deductions.

Referencing tax year 2004, the Division claims that petitioners' failure to protest the Statement of Tax Refund dated August 22, 2005 within 90 days of its issuance left the Division of Tax Appeals without jurisdiction to hear any arguments on the merits of matters concerning that year.

CONCLUSIONS OF LAW

A. Petitioners' representative first argues that the Division acted in a retaliatory manner against him as a tax preparer, after he complained that the audit of another taxpayer was poorly handled (Finding of Fact 1).

The Division has the authority to examine a taxpayer's return to ascertain its correctness and to request substantiation of any items claimed on the return (Tax Law § 697[b]). There is no evidence whatsoever that the Division selected petitioners' returns for audit in order to harass them or Mr. Lokensky, or that it was an abuse of process. The concession of reducing the number of returns to be reviewed from 21 to 6 was not insignificant. Given Mr. Lokensky's participation in this negotiation and the Division's significant reduction of the cases it would review in detail, premised on whether the deductions were found to be properly substantiated, the Division's actions are in no way retaliatory or abusive. Thus, the argument that the audit of petitioners 2001 and 2002 returns should be rejected and the notices canceled has no merit.

B. Petitioners next argue that the notices issued for 2001, 2002 and 2004 should be canceled on the basis that, as taxpayers, they have been inappropriately subjected to repetitive

audits. The argument is based upon IRS audit guidelines, an excerpt of which is presented from the EO Pre-Examination Guidelines and Procedures relating to consecutive examinations:

> 1. Policy Statement P-4-5 prohibits examiners from surveying or examining a tax return if they have examined a return for the same taxpayer for any of the three preceding tax periods unless there has been an intervening survey or examination by a different examiner.
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> * * *
>
> 4.75.10.12 (05-01-2004)
> Repetitive Examinations and Prior Examination Record
>
> 1. The repetitive examination concept applies when an examination of the same issue(s) in either of the two preceding years resulted in a no change.

Petitioners' argument has no merit. Petitioners rely upon IRS guidelines, which are federal government policy statements and not statutes, case law or regulations related to New York. Although it may be appropriate to rely upon federal statutes, regulations or case law in the absence of a relevant state provision, there is no mandate to apply federal policy guidelines to a state dispute. Even if it were allowable, petitioners' case does not fall within the criteria set forth by the guidelines. Under the IRS guide, an audit is considered repetitive, and prohibited, when it involves the examination of the same issues in either of the two preceding tax years, where the result was no change. When petitioners' 2001, 2002 and 2004 itemized deductions were questioned, insufficient documentation resulted in three audits with changes. Accordingly, the facts in this case do not qualify for application of the IRS provision.

C. Tax Law § 615 provides that the New York itemized deductions of a resident individual are the same as the itemized deductions allowed for federal income tax purposes, with certain modifications not relevant herein. Accordingly, it is appropriate to look to the provisions of the Internal Revenue Code (IRC), federal regulations and federal case law to determine the deductibility of an item. Each category of itemized deduction is addressed separately below.

D. IRC § 213 allows a deduction for expenses paid during a taxable year that are not compensated by insurance for medical care of the taxpayer, spouse or dependent to the extent such expenses exceed 7.5% of adjusted gross income (AGI). This includes medical insurance premiums only to the extent such amounts are for insurance covering expenses of medical care (and not other loss benefits). "Medical care" means amounts paid for the diagnosis, cure, mitigation, treatment or prevention of disease, or for the purpose of affecting any structure or function of the body. Generally, fees paid to a health club or institute are personal expenses, unless it can be shown that the treatments by such institutes are prescribed by a physician and are substantiated by a statement by the physician that the treatments are necessary for the alleviation of a physical or mental defect or illness of the person receiving the treatments.

In order to substantiate claims under IRC §213, the taxpayer must document the name and address of the person to whom the payment is being made and the amount and date of the payment. If requested the taxpayer must be able to provide a statement or itemized invoice from the individual or entity to whom payment was made showing the nature of the service rendered and for whom such services were provided (Treas Reg § 1.213-1[h]). In this case, petitioners only provided a listing of what comprised the medical expenses deducted on the tax returns and copies of checks totaling approximately $2,200.00 for 2001 and $160.00 for 2002 that appeared to be medical expenditures. However, there was no explanation as to whom the medical services were being provided, what services were being provided or when. Markings across from credit card charges on the account of Lina Trabold were not further identified or explained, and many did not appear to be connected to medical services. The list of medical expenses for both years included exercise programs and clothing for the same; however, appropriate substantiation in the nature of a physician's statement or prescription was not provided. The medical and dental

insurance deductions on Mr. Trabold's pay stubs indicated that such amounts were excluded from federal wages. No explanation was provided which would allow a determination that petitioners had the right to deduct those premiums as an itemized deduction. In short, there was insufficient substantiation of the medical expenses, and even if the checks were allowed without more, the total would not exceed 7.5% of AGI to result in a deduction.

E. IRC § 170 allows a deduction for charitable contributions that meet specific criteria, and Treas Reg § 1.170A-13 sets forth the record keeping requirements for such deductions, which generally require a taxpayer to maintain a cancelled check, receipt from the donee charitable organization acknowledging the same or other reliable written record showing the name of the donee, the date and the amount of the contribution. Petitioners submitted no records, explanation or documentation of the charitable deductions listed on their returns in question. Accordingly, the Division properly disallowed them.

F. IRC § 164 allows an itemized deduction for state, local and foreign real property taxes paid in the tax year in which the deduction is sought by the person upon whom they are imposed, generally the owner of the property. However, it is incumbent upon petitioners to substantiate that payment was made. Even in a case where the property tax bills were available, the Tax Court denied the deductions since the taxpayer failed to produce cancelled checks or receipts to prove payment (***Obot v. Commn***, 2005 TCM (RIA) 2005-195). In this case, although it was claimed that the real estate taxes were paid through the company holding the mortgage, petitioners did not produce a Form 1098 or other similar proof of payment for any of the tax years. Accordingly, the Division properly disallowed the deduction.

G. The Division also properly disallowed an interest expense deducted on petitioners' 2002 return. There was no explanation of the type of interest being deducted, proof of payment or any other substantiation for this deduction.

H. IRC § 162 allows a deduction for all the ordinary and necessary reasonable expenses paid or incurred during the taxable year in carrying on a trade or business. To be deductible, an expense must be incurred in connection with an active trade or business carried on by the taxpayer, which is generally one carried on with regularity for economic profit or as a livelihood. An employee's performance of services constitutes a trade or business, and an employee may claim unreimbursed business expenses on Schedule A of Form 1040 as an itemized deduction. In order for business travel, entertainment and other ordinary and necessary business unreimbursed expenses to be deductible, the following elements must be substantiated by adequate records or evidence that corroborate the taxpayer's own statement (IRC § 274[d]; Temporary Reg § 1.274-5T[c][1]): the amount, the date of the expenditure, the place, the business purpose and the business relationship. In this case there was neither documentation nor testimony by petitioners establishing the nature of their employment as the basis for the unreimbursed business expenses deducted on their returns for 2001 and 2002. There are no travel logs, calendars, date books or receipts which might lend some assistance. There were merely a few copies of taxi receipts and toll charges. None was identified as required. There were copies of cancelled check payments to several telephone companies, but none was identified to distinguish the portion of business and personal use, and no explanation was provided as to how such items were used in petitioners' business settings. The tax returns listed business miles driven; however, there were no records to substantiate the same. Petitioners simply failed to provide any substantiation as to the employment connection, deductible amounts

business purpose or the business relationship that surrounded the expenditure. Absent this, the Division properly disallowed the deductions for job and other miscellaneous expenses.

I. When the Division issues notices of deficiency to a taxpayer, a presumption of correctness attaches to the notices, and the burden of proof is on the taxpayer to demonstrate by clear and convincing evidence that the deficiency is erroneous (***Matter of Atlantic & Hudson Ltd. Partnership,*** Tax Appeals Tribunal, January 30, 1992). Petitioners thus had the burden to show entitlement to the deductions claimed on their federal schedule A and to substantiate the amount of the deductions (***see*** Tax Law § 658[a]; § 689(e); 20 NYCRR 158.1; ***Matter of Macaluso***, Tax Appeals Tribunal, September 22, 1997, ***confirmed*** 259 AD2d 795, 686 NYS2d 193 [1999]). Furthermore, petitioners were required under the Tax Law to maintain adequate records of their items of deductions for the years in issue (Tax Law § 658[a]; 20 NYCRR 158.1[a]). Petitioners failed to do this for all deductions, except where noted above in limited circumstances. Thus, petitioners have not carried their burden of proof that they were entitled to such itemized deductions. With the disallowance of nearly all the itemized deductions for each tax year, the itemized deductions for 2001 and 2002 fall below what is allowable as a standard deduction. Thus, the Division properly allowed petitioners the standard deduction for the tax years in issue and recomputed the tax due accordingly.

J. The final issue to be addressed is whether the Division of Tax Appeals has jurisdiction to review the denial of petitioners' tax refund for tax year 2004. Petitioners filed their 2004 return on or about March 15, 2004, at which time they claimed a refund due in the amount of $3,476.00. By a statement of tax refund, the Division notified petitioners that their claim for refund was adjusted to $1,018.00, due to petitioners' failure to provide documentation for the claimed itemized deductions. Petitioners maintained at the hearing that jurisdiction had not yet

been perfected, since a Form IT-113, claim for refund, was filed on behalf of petitioners less than six months before the hearing date, and it would be actionable by petition only after that time if the Division does not act on it. The Division argues that since petitioners failed to protest the statement of tax refund dated August 22, 2005 within 90 days of its issuance, the petition filed in April 2006 was untimely, and the Division of Tax Appeals is without jurisdiction to address the 2004 denial. Both arguments are rejected.

The filing of petitioners' 2004 return requesting a refund was the legal equivalent of filing a claim for refund with Form IT-113. When the Division notified petitioners that it was adjusting its refund on August 22, 2005, that date commenced the period in which petitioners had to file a petition protesting the disallowance or adjustment of the refund, and petitioners had two years in which to do so (Tax Law § 689[c]). Since the petition in this matter was filed April 19, 2006, petitioners made a timely protest to the refund adjustment, and the Division of Tax Appeals had jurisdiction to hear the merits of the refund disallowance. At the hearing, the parties were directed to present any information on the merits of the refund adjustment, including substantiation of the itemized deductions that were disallowed, resulting in the adjustment. Although the Division was steadfast in its position that the Division of Tax Appeals did not have jurisdiction over tax year 2004, it presented testimony and any documentation it had to support its position that the refund was properly reduced. Petitioners' representative, though repeatedly asked, failed to present any documentation or testimony to support the position that the itemized deductions should not be disallowed. Tax Law § 689(e) places the burden of proof on petitioners to show by clear and convincing evidence that the Division's adjustment of petitioners' 2004 requested tax refund is erroneous (***Matter of Suburban Restoration Co., Inc. v. Tax Appeals***

Tribunal, 299 AD2d 751, 750 NYS2d 359 [2002]). Petitioners have not proven by any evidence, least of all convincing evidence, that the Division's adjustment was erroneous.

K. The petition of Scott and Lina Trabold is hereby denied. The Division of Taxation's notices of deficiency dated March 14, 2005, for tax years 2001 and 2002 are sustained, and the refund denial for tax year 2004, dated August 22, 2005, is upheld.

DATED: Troy, New York
August 14, 2008

/s/ Catherine M. Bennett
ADMINISTRATIVE LAW JUDGE