

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition

of

JULIAN LIEBMAN

DECISION

for Redetermination of a Deficiency or for
Refund of Personal Income Tax under Article 22
of the Tax Law for the Years 1978 and 1979.

Petitioner Julian Liebman, 7 East Drive, Woodbury, New York 11797, 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 1978 and 1979 (File Nos. 36266 and 36319).

A hearing was held before Allen Caplowaith, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on October 21, 1985 at 3:15 P.M. Petitioner appeared by Elliot H. Goldberg, C.P.A. The Audit Division appeared by John P. Dugan, Esq. (Herbert Kamrass, Esq., of counsel),

ISSUE

Whether the Audit Division properly disallowed petitioner's claimed 1978 depreciation deduction of \$23,894.00.

FINDINGS OF FACT

1. Julian Liebman (hereinafter "petitioner") timely filed a New York State Income Tax Resident Return for the year 1978 whereon he reported a business **loss** of \$23,756.00, comprised, according to two Federal schedules C annexed thereto, of a gain of \$412.00 derived from premium financing activities and a

loss of \$24,168.00 sustained from "publishing and distribution of book".
According to the applicable Schedule C, said loss was computed as follows:

Total Income		\$ 1,987.00
Less deductions for:		
a - Amortization	\$ 274.00	
b - Depreciation	23,894.00	
c - Printing, binding & distribution	<u>1,987.00</u>	
Total Deductions		<u>\$26,155.00</u>
NET LOSS		<u>(\$24,168.00)</u>

2. Subsequently, on June 13, 1979 petitioner filed an amended 1978 return whereon an investment credit of \$1,477.76 was claimed. Said amount was equal to petitioner's tax liability as reported on his original return. Accordingly, the amended return shows no tax liability for petitioner during said year.

3. For 1979 petitioner and his wife, Leone Liebman, filed a joint New York State Income Tax Resident Return. Annexed thereto was a Federal Schedule C whereon petitioner reported the income and deductions attributable to "publishing distribution of books", as follows:

Total Income	\$ 3,947.00
Less: deduction for printing, binding & distribution	\$ 3,947.00

Since the reported income and deduction were equal, no profit or loss was reported on said schedule.

4. For 1979 petitioner claimed an investment credit carryover of \$2,821.00. Said credit reduced petitioner's 1979 tax liability to zero.

5. Petitioner's primary source of income during each of the years at issue was from his activities as an insurance agent.

6. On August 4, 1981, the Audit Division issued a Statement of Audit Changes to petitioner wherein the following adjustments were made:

	<u>1978</u>	<u>1979</u>
"Amounts Reported Per Federal Schedule C:		
Gross receipts hereby disallowed as not being income to taxpayer	(\$1,987.00)	(\$3,947.00)
The following expenses are hereby disallowed:		
Depreciation	\$23,894.00	
Amortization	274.00	
Printing, binding & distribution	<u>1,987.00</u>	<u>3,947.00</u>
Net Adjustment	<u>\$24,168.00</u>	<u>\$ -0-</u>

7. Additionally, said statement disallowed the 1978 and 1979 investment credits claimed. Accordingly, although no change was made to petitioner's reported taxable income for 1979, additional tax due resulted from the disallowance of the credit for that year.

8. On November 6, 1981, the Audit Division issued two (2) notices of deficiency against petitioner. One notice asserted additional personal income tax for 1978 of \$2,967.65, plus interest of \$677.60, for a total due of \$3,645.25. The other notice asserted personal income tax for 1979 of \$2,820.58, plus interest of \$404.28, for a total due of \$3,224.86.

9. According to the Audit Division's Schedule C Analysis, the aforesaid adjustments were made based on the following explanations:

"Depreciation Exp. -- deduction taken in 1978 for supposed investment of \$183,050. Investment was financed through the issuance of a non-recourse note in the amount of \$163,000 and a supposed cash payment of \$20,050. Based on information secured and in accordance with the intent of Federal Revenue Ruling 77-110, the non recourse note given as part of the purchase price is not to be included in the basis for depreciation purposes.

Amortization Exp. -- disallowed as unsubstantiated.

Printing, Binding & Distribution Exp. -- in accordance with agreement, these expenses were paid and reimbursed by the seller and therefore should not have been reported by the taxpayer.

Gross Receipts -- this amount represents reimbursement from seller (of book rights) for printing, binding & distribution expenses noted above. This is not income **to** the taxpayer and should have properly been reflected by the seller.

Since the investment was financed through the issuance of a non recourse note which cannot be included in the basis of the property for depreciation purposes, the investment credit taken thereon **is** being disallowed in full.

Unused portion **of** 1978 credit taken as an investment credit carryover is disallowed."

10. On October 11, 1978, Manor Books, Inc. ("Manor") entered into an "Acquisition Agreement" with Carl Publishing Co., Inc. ("Carl") wherein Manor sold to Carl **all of** its right, title, privileges, interest, ownership and claims of any kind and character whatsoever, in all the physical properties necessary and appropriate **to** print paperback books and covers embodying certain literary works together with the right to print, publish, distribute and sell such literary work in the form of paperback or other soft cover books. Both the physical properties above described and the literary work will hereinafter be referred to as ("the properties").

11. Under the terms **of** said Acquisition Agreement, Carl agreed **to** pay for the aforestated properties partly in cash and partly by its non-negotiable promissory note. The properties and titles as well **as** the cash portion paid for same were purportedly detailed in certain schedules attached to the Acquisition Agreement. However, such schedules were not submitted into evidence. According to a "Security Agreement" entered into on the same date, the note was in the principal amount of \$163,000.00.

12. The Acquisition Agreement further provided that:

- a - The note was to be payable on December **31**, 1987 and payable only out of 85 percent of the gross receipts derived and actually received by Carl from the exploitation of the properties.
- b - The note was in no event to result in any personal deficiency or judgement against Carl.
- c - **In** the event **of** a default in the payment of interest and principal on the note upon maturity thereon, Manor was **to** have no recourse whatsoever against Carl.

13. On November 26, 1978, Carl entered into a "Purchase and Assumption Agreement" with petitioner wherein Carl **sold** to petitioner the physical properties necessary and appropriate to manufacture paperback books embodying a literary work entitled "NEDRA" written by Lee Floren (Grace Lang) together with all of its rights and interests in and under the Acquisition Agreement to said literary work.

14. In consideration of the properties sold to petitioner under said agreement, petitioner agreed to pay Carl the following:

- a - Twelve thousand (\$12,000.00) dollars by certified or bank check.
- b - Eight thousand five hundred (\$8,500.00) dollars by negotiable promissory note.
- c - The sum of one hundred sixty three thousand (\$163,000.00) dollars by assuming all of Carl's obligations under the note.

15. Petitioner did not personally appear for the hearing. His representative initially claimed that the aforestated transaction **was** entered into for the production **of** income and, as such, petitioner should properly be allowed a depreciation deduction on his entire purchase price.

16. Petitioner submitted an appraisal dated October 18, 1978 from one Charles R. Byrne, Literary Agent, wherein Mr. Byrne concluded that the purchase

price (\$183,500.00) was reasonable and that the book should produce income over a period of five to nine years, assuming effective promotion.

17. No evidence was submitted to show that any type of promotion for the book existed during the years at issue.

18. During the hearing petitioner altered his position. He submitted two Internal Revenue Service form letters dealing with the treatment of tax shelters. Neither letter was mailed specifically to petitioner. Said letters relate to a specific time limited policy of the Internal Revenue Service wherein it would allow out-of-pocket expenses (cash investment) as an ordinary deduction in the initial year of investment "in an effort to administratively dispose of certain Tax Shelter Program cases at the lowest possible level". Petitioner now requests similar treatment with respect to his cash investment.

19. Petitioner submitted a copy of his check to Carl dated November 26, 1978 in the amount of \$22,000.00 to evidence his cash investment. Said amount does not coincide with the payments as provided in the Purchase and Assumption Agreement.

20. Petitioner conceded the investment credit issue for 1978 and 1979. Since the investment credit was the sole issue for 1979, on October 31, 1985 he submitted a Withdrawal of Petition and Discontinuance of Case form with respect to the deficiency asserted for 1979.

21. No substantiation was provided to establish the value of the property or that the amount of the nonrecourse note approximated the value of the property. Furthermore, no evidence was submitted to show that the book was ever printed or sold.

22. No evidence was submitted to establish that the property was used in a trade or business or held for the production of income.

23. The other adjustments incorporated into the 1978 Notice of Deficiency were not contested.

CONCLUSIONS OF LAW

A. That the liability on a nonrecourse interest bearing note given as a part of the purchase price of property the value of which could not be shown to approximate the amount of the note, may not be included in the basis of the property for depreciation purposes pursuant to Revenue Ruling 77-110 of the Internal Revenue Service.

B. That section 167 of the Internal Revenue Code allows depreciation only for property used in a trade *or* business or for property held for the production of income.

C. That petitioner has failed to sustain his burden of proof, imposed pursuant to section 689(e) of the Tax Law, to show that the property at issue was used for the specified purposes covered under section 167 of the Internal Revenue Code. Accordingly, a depreciation deduction is not properly allowable on petitioner's 1978 return.

D. That the State Tax Commission is not required to follow Internal Revenue Service examination policies which were established "in an effort to administratively dispose of certain Tax Shelter Program cases at the lowest possible level".

E. That since the other adjustments incorporated into the 1978 Notice of Deficiency were not contested, such adjustments are hereby sustained.

F. That the issue with respect to taxable year 1979 is moot, since petitioner has withdrawn his petition with respect thereto (see Finding of Fact "20" supra).

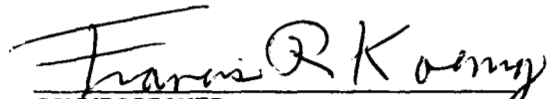
G. That the petition of Julian Liebman is denied and the Notice of Deficiency issued November 6, 1981, with respect to taxable year 1978, is sustained together with such additional interest as may be lawfully owing.


DATED: Albany, New York

STATE TAX COMMISSION

MAR 24 1982


PRESIDENT


COMMISSIONER


COMMISSIONER