

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition

of :

MICHAEL I. JACOBS AND LOIS P. JACOBS

DECISION

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 Nonresident Earnings Tax under Chapter 46,
Title U of the Administrative Code of the City :
of New York for the Years 1978 and 1979.

Petitioners, Michael I. Jacobs and Lois P. Jacobs, 33 Birchwood Park Drive, Syosset, New York 11791, 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 nonresident earnings tax under Chapter 46, Title U of the Administrative Code of the City of New York for the years 1978 and 1979 (File Nos. 37547, 37938 and 43127).

On October 23, 1985, petitioners waived a hearing before the State Tax Commission and agreed to submit the matter for decision based on the Audit Division file, as well as a brief and additional documents to be submitted by October 8, 1986. After due consideration of the record, the State Tax Commission hereby renders the following decision.

ISSUES

I. Whether the notices of deficiency were issued without any basis and for the sole purpose of extending the period of limitation on assessment.

II. Whether petitioner Michael I. Jacobs has substantiated that he was engaged in a trade or business during the years at issue.

III. Whether petitioners have substantiated the character and amount of business expenses claimed as deductions from gross income for the years at issue.

FINDINGS OF FACT

1. Petitioners, Michael I. Jacobs and Lois P. Jacobs, filed New York State income tax resident returns with New York City nonresident earnings tax for 1978 and 1979. For each year, petitioners filed separately on one return. Also for each year, petitioner Michael I. Jacobs listed his occupation as "Computer Consultant", while petitioner Lois P. Jacobs listed her occupation as "Recreation Teacher".

2. Tax Year 1978

(a) Petitioner Michael I. Jacobs reported \$18,073.00 in business income, while petitioner Lois P. Jacobs reported \$23,060.00 in wage or salary income.

(b) Petitioner Michael I. Jacobs filed a Schedule C, Federal Form 1040, showing his main business activity as computer consultant and using his residence address. The following income and expenses were reported:

"Schedule C - Income From Business or Profession - Computer Consult.

Income - Compute [sic] Services to Institutions	24,512	
- Others	50	
- Referrals: Teacher Placement	--	
- " : Tutoring	--	
- " : Remediation Placements	--	
- Screenings for Summer Camps	50	
	<u>50</u>	24,612
Expenses:		
Telephone - inside	360	
- outside	480	840
Meeting & Technical Conference Exp.		2,693
Travel: (4,800 mi @ 17c)	816	
Parking	239	
Tolls	<u>28</u>	1,083

Accounting	100	
Hospitality	683	
Magazines, Newspapers	291	
Messengers, Delivery	467	
Cab Fares & Other Transit	<u>382</u>	
		<u>6,539</u>
		<u>18,073"</u>

(c) Attached to the return was a Wage and Tax Statement issued to petitioner Michael I. Jacobs by The Equitable Life Assurance Society of the **United States in the amount of \$24,512.36 in "Wages, tips, other compensation"**. A stamped arrow with the legend "Included in Schedule C" pointed to said figure. Federal, State and New York City income taxes and FICA tax were withheld. The statement reported that Mr. Jacobs was covered by a pension plan.

(d) Petitioners itemized their deductions and claimed **\$806.00 in** miscellaneous deductions. **All** itemized deductions were taken by petitioner Lois P. Jacobs.

(e) Petitioner Michael I. Jacobs filed a New York State Unincorporated Business Tax Return reporting **\$18,073.00 in** net profit and total income. After deducting subtractions of **\$24,512.00**, said petitioner reported a net **loss of \$6,439.00**, with **no** tax shown as due.

3. Tax Year 1979

(a) Petitioner Michael I. Jacobs reported **\$20,431.00** in business income and petitioner Lois P. Jacobs reported **\$22,029.00 in** wage and salary income.

(b) Petitioner Michael I. Jacobs filed a Schedule **C** Federal **Form 1040**, again as a computer consultant and using his residence address, reporting the following income and expenses:

"Schedule C - Income From Business or Profession: E.D.P. Consultant

Income: Compute [sic] Services to Institutions	\$27,431
Consultations	<u>550</u>
	<u>27,981</u>

Expenses :

Telephone Inside	\$ 360	
Meeting & Technical Conference Exp.	1,340	
Travel: (7,860 mi @ 18c)	1,454 ¹	
Parking	263	
Tolls	82	
Accounting	125	
Hospitality	972	
Magazines, Newspapers	397	
Messengers, Delivery	643	
Cab Fares & Other Transit	876	
Telephone Outside	487	
Supplies	<u>551</u>	
		<u>7,550</u>
		<u>20,431"</u>

(c) Attached to the return was a Wage and Tax Statement issued to petitioner Michael I. Jacobs by The Equitable Life Assurance Society of the United States for \$27,431.00 in "Wages, tips, other compensation". A stamped arrow with the legend "Included in Schedule C" pointed to said figure. Federal, State and New York City income taxes and FICA tax were withheld. Pension plan coverage was shown.

(d) Petitioners itemized their deductions and claimed \$1,125.00 in miscellaneous deductions. Of the \$9,647.00 in New York itemized deductions, petitioner Michael I. Jacobs deducted \$4,375.00 and petitioner Lois P. Jacobs deducted \$5,272.00.

(e) Petitioner Michael I. Jacobs filed a New York State Unincorporated Business Tax Return reporting net profit and total income of \$20,431.00 less

1 The travel expense was miscalculated. It should have been \$1,414.80 (7,860 x .18 = 1,414.80).

\$27,431.00 in subtractions, for a net loss of \$7,000.00. A stamped arrow with the legend "FICA wages included in Schedule C" pointed to the amount of subtractions.

4. Petitioners' tax returns were selected for examination along with those of approximately 100 other individuals on the basis that said returns had been prepared by a particular accountant. An investigation had disclosed that said accountant had consistently prepared returns on which an individual with wage or salary income shown on wage and tax statements had reported said income as business receipts on Federal Schedule C. Department of Taxation and Finance auditors were directed to review the returns and to disallow claimed business expense deductions if the taxpayer appeared to be an employee receiving wage or salary income reported on wage and tax statements. Petitioner Michael I. Jacobs' claimed Schedule C deductions were disallowed on that basis.

5. (a) On March 24, 1982, the Audit Division issued a Statement of Audit Changes to petitioners for 1978, asserting additional New York State and New York City taxes due of \$977.81. The statement explained as follows:

"Business expenses claimed on Federal Schedule 'C' are not considered ordinary and necessary in the production of income received as an employee.

New York itemized deductions are re-distributed to reflect a lower tax liability."

(b) On April 14, 1982, the Audit Division issued a Notice of Deficiency to petitioner Michael I. Jacobs for 1978, in the amount of \$529.67, **plus** interest.

(c) On April 14, 1982, the Audit Division issued a Notice of Deficiency to petitioner Lois P. Jacobs for 1978, in the amount of \$448.14 plus interest.

6. (a) On February 1, 1983, the Audit Division issued a Statement of Audit Changes to petitioners in the amount of \$1,115.91 in additional New York State and New York City taxes due. The statement explained as follows:

"Under authorization of Federal Law (Section 6103(d) of the Internal Revenue Code), we have received notification of Federal audit changes. The items changed were: 1) medical and dental and 2) taxes.

As a salaried employee, you are not a business entity and therefore are not entitled to claim Schedule C deductions. Such expenses are not ordinary and necessary for the production of income as an employee."

(b) On April 8, 1983, the Audit Division issued a Notice of Deficiency to petitioner Michael I. Jacobs for 1979, for \$558.02 in additional tax due, plus interest.

(c) On April 8, 1983, the Audit Division issued a Notice of Deficiency to petitioner Lois P. Jacobs for 1979, in the amount of \$557.89, plus interest.

(d) The Federal changes noted above are apparently not at issue herein.

7. A letter dated June 4, 1981 to the Internal Revenue Service signed by Joan Albach, Personnel Manager of The Equitable Life Assurance Society of the United States, Operations Engineering Department, provided as follows:

"Michael Jacobs has been employed by The Equitable Life Assurance Society of the United States from June 1973. During 1979 he was a Project Manager on the development of a New Employee Payroll System. This responsibility included the supervision of approximately 10 to 15 employees. As a Manager in the Equitable, Michael is not paid for any overtime and is not re-imbursed for out of pocket expenses like purchase of coffee/refreshments or soda for employees he is supervising."

8. A letter dated July 6, 1981, addressed "To Whom It May Concern" from Howard L. Huempfer, Vice President of Colorcraft Refinishing, Inc., provided as follows:

"Michael Jacobs is employed by Colorcraft Refinishing, Inc. as an independent computer consultant.

He started work in January 1979. He was contracted to install a payroll system by year-end 1980. However, problems developed and the computer system was not installed until May 1981. He was paid in June 1981. He is still under contract to perform maintenance on the system."

Mr. Jacobs was paid \$5,000.00 by Colorcraft Refinishing, Inc. by check dated June 18, 1981. The record, however, contains no other details as to work performed by Mr. Jacobs for this corporation.

9. Petitioners submitted diaries, expense records, cancelled checks, paid bills and other documents, which are insufficient to show that petitioner Michael I. Jacobs was anything but an employee of The Equitable Life Assurance Society of the United States for the years at issue. While Mr. Jacobs may have performed consulting work for Colorcraft Refinishing, Inc. during 1979, the extent of such work or expenses related thereto have not been shown.

10. Petitioners have established that they paid \$100.00 in tax preparation fees in each year at issue.

11. Petitioners contend:

(a) that the notices of deficiency were issued on an arbitrary and capricious basis just prior to the expiration of the period of limitation on assessment, thus depriving petitioners of the opportunity to present substantiation for the claimed deductions;

(b) that petitioners are part of a large group of taxpayers who were selected for special scrutiny because their returns had been prepared by the same tax preparer; and

(c) that where petitioners do not have cancelled checks or other receipts for certain expenses, the Department of Taxation and Finance should allow petitioners a reasonable estimate of such expenses.

CONCLUSIONS OF LAW

A. That the notices of deficiency were properly issued and were not arbitrary or capricious. The returns were patently erroneous and the Audit Division was justified in disallowing the Schedule C business income and expenses. Each Notice of Deficiency was preceded by a Statement of Audit Changes and petitioners had an opportunity to file amended returns claiming employee business expenses as adjustments on Federal Form 2106, or as itemized miscellaneous deductions, but did not do so.

B. That the fact that petitioners' returns were selected for examination because of certain practices of their accountant is irrelevant. Petitioners' liability depends solely on the facts adduced herein.

C. That petitioners have not sustained their burden of proof under Tax Law § 689(e) and Administrative Code § U46-39.0(e) to show that petitioner Michael I. Jacobs was engaged in a trade or business other than as an employee. Thus, the expenses claimed on Schedule C may not be deducted under section 62(1) of the Internal Revenue Code.

D. That petitioners are entitled to an additional miscellaneous deduction of \$100.00 for each year for tax preparation fees.


E. That while it would appear that petitioner Michael I. Jacobs may have been entitled to deduct certain other expenses as employee business expenses under sections 62(2) or 63(f) of the Internal Revenue Code if he had filed Form 2106, or had claimed such expenses as miscellaneous deductions, petitioners nevertheless failed to sustain their burden of proof under Tax Law § 689(e) and Administrative Code § U46-39.0(e) to show the character or, in many cases, the amount of the claimed business expenses.

F. That except as provided in Conclusion of Law "D" the petition of Michael I. Jacobs and Lois P. Jacobs is denied and the notices of deficiency issued April 14, 1982 and April 8, 1983 are otherwise sustained.

DATED: Albany, New York

STATE TAX COMMISSION

AUG 12 1987


PRESIDENT


COMMISSIONER


COMMISSIONER