

STATE OF NEW YORK

STATE TAX COMMISSION

---

In the Matter of the Petition

of

JOHN T. MELELLA

:

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.

---

Petitioner, John T. Melella, 235 Palisade Avenue, Yonkers, New York 10703, 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. 37551 and 42986).

On October 23, 1985, petitioner waived a hearing before the State Tax Commission and submitted the matter for decision based upon 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.

11. Whether petitioner has substantiated that he was engaged in a trade or business during the years at issue.

111. Whether petitioner has substantiated the character and amount of business expenses claimed as deductions from gross income for the years at issue.

FINDINGS OF FACT

1. John T. Melella (hereinafter "petitioner") timely filed New York State income tax resident returns (with City of New York nonresident earnings tax) for each of the years 1978 and 1979, whereon his occupation was stated to be "Lic Social Worker/C".

2. For 1978, petitioner reported \$13,223.00 in business income. A Schedule C, Federal Form 1040, attached to the return reported the following income and expenses:

"Schedule C - Income From Business or Profession:  
Social Worker/Counseling

Income: Institutional	\$20,614	
Private Practice	<u>400</u>	\$21,014
Expenses:		
Magazines, Newspapers Etc.	293	
Telephone	420	
Office Maintenance	1,200	
Travel (7,000 mi @ 17¢)	1,190	
Parking Tolls	288	
Reference Books	76	
Hospitality	479	
Professional Meeting Expenses	894	
Postage	55	
Office Decor	402	
Office Supplies	96	
Depreciation - (see below)	131	
Cassettes, Recording Supplies	139	
Professional Development	2,025	
Dues & Subscriptions	<u>103</u>	
		<u>7,791.00</u>
		\$13,223"

3. Attached to petitioner's 1978 return was a Wage and Tax Statement issued to petitioner by Bronx Lebanon Hospital Center, showing \$20,614.48 in

"Wages, tips, other compensation". The legend "Included in Schedule C", with an arrow pointing to said figure, was stamped on the statement.

4. For 1979, petitioner reported \$10,556.00 in business income. A Schedule C attached to the return reported the following income and expenses:

"Schedule C - Income From Business or Profession:  
Social Worker/Counselling

Income:	Institutional	\$23,864	
	Private Practice	2,385	
	Consulting NYS	360	
		<hr/>	\$26,609
Expenses:			
	Magazines, Newspapers, Etc.	392	
	Telephone - Inside	480	
	Office Maintenance - Manhattan	1,120	
	Travel (13,540 mi @ 18½¢)	2,504	
	Parking - Manhattan	532	
	Tolls	63	
	Reference Books	387	
	Hospitality - Manhattan Office	1,011	
	Professional Meeting Expense	1,622	
	Postage	182	
	Office Decor & Plants	596	
	Office Supplies	483	
	Depreciation (see below)	195	
	Cassettes, Recording Supplies	162	
	Professional Development & Recruitment	1,724	
	Dues & Subscriptions		
	NASW 90		
	other 240	330	
	Accounting	125	
	Telephone - outside	633	
	Office Maint - Yonkers (\$50 x 12 mos)	600	
	Parking Space - Yonkers	230	
	Cleaning - "	840	
	Hospitality - "	396	
	Insurance	120	
	Interest on Business Loans	701	
	Car Rental	<hr/> 625	<hr/> \$ 16,053

NET INCOME

\$10,556"

5. Attached to petitioner's 1979 return was a Wage and Tax Statement

"Wages, tips other compensation". The legend "Included in Schedule C", with an arrow pointing to said figure, was stamped on the statement.

6. Petitioner filed an unincorporated business tax return for each year at issue. For 1978 he reported a net profit of \$13,223.00 and a subtraction of \$20,614.00. A handwritten explanation of the subtraction appears on the return, characterizing it as "wages subject to FICA tax included in schedule C". Accordingly, a net loss of \$7,391.00 was shown, with no tax due. For 1979 petitioner reported a net profit of \$10,556.00 and a subtraction of \$23,864.00. A stamped arrow with the legend "FICA Wages Included in Schedule C" pointed to the latter figure. Accordingly, a net **loss** of \$13,308.00 was shown, with no tax due.

7. Petitioner filed a New York City nonresident earnings tax return for each year at issue. For 1978 he reported net earnings from self-employment of \$13,223.00. For 1979 he reported net earnings from self-employment of \$10,556.00.

8. On petitioner's 1978 and 1979 personal income tax returns he claimed the standard deduction. No adjustments to income were reported on either return.

9. Petitioner's 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's claimed Schedule C deductions were disallowed on that basis.

10. On March 26, 1982, the Audit Division issued a Statement of Audit Changes to petitioner for the year 1978, wherein his claimed Schedule C expenses were disallowed based on the following explanation:

"Expenses claimed on your 1978 personal income tax return are not ordinary and necessary in the production of income as an employee."

Accordingly, a Notice of Deficiency was issued against petitioner on April 14, 1982, asserting additional New York State personal income tax of \$721.34, additional New York City nonresident earnings tax of \$15.26, plus interest of \$212.50, for a total due of \$949.10.

11. On February 7, 1983, the Audit Division issued a Statement of Audit changes to petitioner for the year 1979, wherein his claimed Schedule C expenses were disallowed based on the following explanation:

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

Accordingly, a Notice of Deficiency was issued against petitioner on April 8, 1983, asserting additional New York State personal income tax of \$1,162.66, additional New York City nonresident earnings tax of \$46.88, plus interest of \$402.04, for a total due of \$1,611.58.

12. Petitioner submitted documentary evidence which was insufficient to show that he was engaged in business as a social worker/counselor during the years at issue. Furthermore, petitioner's claimed business expenses purportedly attributable thereto were not substantiated.

13. Petitioner contends:

(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 petitioner of the opportunity to present substantiation for the claimed deductions;

(b) that petitioner is 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 petitioner does not have cancelled checks or other receipts for certain expenses, the Department of Taxation and Finance should allow petitioner 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. The notices of deficiency for 1978 and 1979 were each preceded by a Statement of Audit Changes; thus petitioner 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 petitioner's returns were selected for examination because of certain practices of his accountant **is** irrelevant. Petitioner's liability depends solely on the facts adduced herein.

C. That petitioner has not sustained his burden of proof under section 689(e) of the Tax Law and section U46-39.0(e) of the Administrative Code of the City of New York, to show that he was engaged in a trade or business other than as an employee. Thus, expenses claimed on Schedule C may not be deducted under

section 62(1) of the Internal Revenue Code. Furthermore, the expenses purportedly attributable to any such business were not properly substantiated.

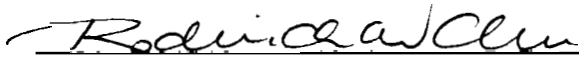
D. That even if petitioner may have been entitled to deduct certain employee business expenses under sections 62(2) or 63(f) of the Internal Revenue Code **if** he had filed Form 2106, or had claimed such expenses as miscellaneous deductions, he nevertheless failed to sustain his burden of proof to substantiate the character or, in many cases, the amount of the claimed business expenses.

E. That the petition of John T. Melella is denied and the notices of deficiency issued April 14, 1982 and April 8, 1983 are sustained, together with such additional interest as may be lawfully owing.

DATED: Albany, New York

STATE TAX COMMISSION

**JUN 18 1987**

  
PRESIDENT

  
COMMISSIONER

  
COMMISSIONER