

STATE OF NEW YORK

STATE TAX Commission

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In the Matter of the Petition

of

**FRANK LENNON** AND ANN LENNON

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 T **of** the Administrative Code **of** the City :  
**of** New York for the Years 1978 and 1979.

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Petitioners, Frank Lennon and Ann Lennon, 35 Ontario Avenue, Massapequa,  
New York 11758, 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. 37729 and 44749).

On October 23, 1985, petitioners waived their right to a hearing and  
requested the State Tax Commission to render a decision based on the entire  
record contained in their file, with all briefs to be submitted by October 8,  
1986. After due consideration, the State Tax Commission hereby renders the  
following decision.

#### ISSUES

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

11. Whether petitioners have substantiated that **Mr.** Lennon **was** engaged in  
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. For the years 1978 and 1979, petitioners, FrankLennon and Ann Lennon, filed New York State income tax returns under filing status "married filing separately on one return". Mr. Lennon filed New York City nonresident earnings tax returns and State unincorporated business tax returns for 1978 and 1979.

2. Petitioners' tax returns were selected for examination along with those of approximately 100 other individuals because their returns had been prepared by a particular accountant. An investigation had disclosed that this accountant had consistently prepared returns on which an individual with wage or salary income **shown** on wage and tax statements had reported this 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.

3. The 1978 State income tax return listed Mr. Lennon's occupation as "Matrls Hol Spec'l and Mrs. Lennon's occupation as "Bank Teller". Mr. Lennon reported total income of \$19,650.00, consisting **of** business income **of** \$19,616.00 and interest income of **\$34.00**. Mrs. Lennon reported total income **of** \$1,371.00, consisting **of** income from wages of \$494.00 and interest income of \$877.00.

(a) On a Federal Schedule C, Mr. Lennon allocated his total income as follows:

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Contractual	\$17,800.00
Emergency Service	3,864.00
Other	<u>250.00</u>
Total	\$21,914 .00

(b) The Schedule C shows the following expenses:

Telephone (\$30 x 12 mos.)	\$ 360.00
Magazines, Newspapers, Etc.	192.00
Tools, Parts	487.00
Trucking Expense	<u>746.00</u>
Gloves, Arctic Wear	92.00
Soldering & Compressor	120.00
Utilities	100.00
Tax Preparation Fee	<u>201.00</u>
Dues	
Total	\$2,298.00

The \$2,298.00 in total expenses deducted from total income of \$21,914.00 resulted in the business income of \$19,616.00 reported.

(c) A wage and tax statement attached to the return showed "wages, tips, other compensation" to Mr. Lennon of \$21,914.00 from The Flying Tiger Line, Inc. of Los Angeles, California. The wages **so** reported are circled and a handwritten arrow points to the compensation figure and a legend states, "Included in Schedule C". A second wage and tax statement showed wages to Mrs. Lennon in the amount of \$493.82 from Waldbaum, Inc.

(d) Mr. Lennon claimed total New York itemized deductions of \$5,971.00, and Mrs. Lennon claimed no New York deductions.

(e) The unincorporated business tax return shows total business income of \$19,616.00 less subtractions of \$21,614.00, resulting in a net **loss** of \$1,998.00. Accordingly, no unincorporated business tax was shown as due.

(f) Mr. Lennon's New York City Nonresident Earnings Tax Return for 1978 shows net earnings from self-employment of \$15,693.00.

4. On April 2, 1982, the Audit Division issued a Statement of Audit Changes to Mr. Lennon for 1978, containing the following explanation: "Amount

expense .inproduction of income earned as an employee." Additional State and City tax of \$183.24 was asserted on a New York taxable income of \$12,727.00, calculated as follows:

Wages & other compensation	\$21,914.00
Interest income	34.00
Total New York income	<u>21,948.00</u>
New York itemized deductions	5,971.00
Balance	<u>\$15,977.00</u>
Exemptions: 5 @ 650.00	3,250.00
Corrected New York taxable income	<u>\$12,727.00</u>

5. On April 14, 1982, the Audit Division issued to petitioners a Notice of Deficiency for the year 1978, asserting State and City tax due of \$183.24 plus interest. No penalties were imposed.

6. The 1979 income tax return lists Mr. Lennon's occupation as "MATRLS HOL SPEC", and Mrs. Lennon's occupation as "CHILD CARE CTR". Mr. Lennon reported income of \$19,813.00, consisting of business income of \$19,284.00 and interest income of \$529.00. An adjustment to income was taken of \$438.00, resulting in total income of \$19,375.00. Mrs. Lennon reported income of \$3,325.00, consisting of business income of \$2,796.00 and interest income of \$529.00. An adjustment to income was made of \$439.00, resulting in total income of \$2,886.00. The adjustments to income were not explained, and their source is unknown.

(a) A wage and tax statement attached to the return shows income to Mr. Lennon from "Wages, tips, other compensation" in the amount of \$27,057.38 from The Flying Tiger Line, Inc. The statement is stamped with an arrow pointing to the compensation figure and bearing the legend, "Included in Schedule C".

(b) On an attached Schedule C, Mr. Lennon reported total income from business or profession of \$27,157.00, allocated to: "contractual" \$20,696.00; emergency service" \$6,361.00; and "Exhibits" \$100.00.

(c) The Schedule C for Mr. Lennon shows the following expenses:

Telephone (30 x 12 mos.)	\$ 360.00
Magazines, newspapers, etc.	398.00
Tools, parts	437.00
Trucking expense	561.00
Gloves, arctic wear	493.00
Soldering & compressor utilities	193.00
Tax preparation fee	100.00
Dues	250.00
Hospitality	798.00
Maintenance & supplies	383.00
Payment to Ann Lennon Secretary	<u>3,900.00*</u>
TOTAL	<u>\$7,873.00</u>

\* Included in wife's Schedule C.

The \$7,873.00 in total expenses were subtracted from total income of \$27,157.00, and the result was **shown** as the \$19,284.00 net business income reported.

(d) The Schedule C for Mrs. Lennon shows income from business or profession of \$4,725.00, allocated to: "child care center" \$825.00; "Frank Lennon Service" \$3,900.00. The following expenses are shown:

Magazines, books	\$ 192.00
<b>Milk</b> cookies, luncheon	312.00
Travel (2,720 mi @ 18½	503.00
Toys	218.00
Diapers	197.00
Cleaning	382.00
Bathroom maintenance	<u>125.00</u>
TOTAL	<u>\$1,929.00</u>

The \$1,929.00 in total expenses were subtracted from total income of \$4,725.00, and the result was shown as the \$2,796.00 net business income reported.

(e) Mr. Lennon claimed New York itemized deductions of \$6,218.00, including medical and dental expenses of \$1,245.00.

(f) Mr. Lennon's New York City Nonresident Earnings Tax Return shows net earnings from self-employment **of** \$19,284.00.

(g) Mr. Lennon's Unincorporated Business Tax Return shows total business income of \$19,284.00, less subtractions **of** \$27,057.00 (also noted as "wages subject to FICA tax included in Schedule C"), resulting in a net **loss** of \$7,773.00. Accordingly, **no** unincorporated business tax was shown as due.

(h) Mrs. Lennon's Unincorporated Business Tax Return shows total business income **of** \$2,796.00. **An** exemption of \$5,000.00 was subtracted from income. Accordingly, no taxable business income was shown, and no tax was **shown** as due.

7. **On** February 7, 1983, the Audit Division issued a Statement **of** Audit Changes to petitioners for 1979, asserting total New York State and New York City tax due **of** \$720.16 on total taxable income **of** \$17,922.45. The statement contained this 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."

Petitioners' tax liability 'was recomputed under filing status "married filing jointly". New **York** itemized deductions were reduced to \$6,040.93 as the result **of** an adjustment to petitioners' medical and dental expenses made **by** the Audit Division. The household credit was disallowed.

8. On April 8, 1983, the Audit Division issued to petitioners a Notice **of** Deficiency for 1979 asserting additional State and City tax due of \$720.16 plus interest. No penalty was imposed.

9. **To** substantiate the claimed expenses for 1978 and 1979, petitioners submitted affidavits and the following documentation:

(a) Mr. Lennon submitted a substantial number of invoices representing parts purchases made in connection with a welding business which he purportedly operated in his spare time. These invoices totalled \$1,278.09. Mr. Lennon stated that he was reimbursed for all parts, and the parts purchases shown on the invoices were not claimed as business expenses on the Schedule C. No other proof was offered of a business activity separate from his employment.

(b) Other documentation submitted for 1978 included cancelled checks, invoices, property tax bills and statements of interest paid. There was no evidence offered to show that these expenses were other than personal in nature, and many of them appear to have been included in petitioners' itemized deductions.

(c) Mrs. Lennon submitted a letter which stated that the writer had paid Mrs. Lennon approximately \$800.00 In 1979 for childcare services rendered by Mrs. Lennon. No receipts or proof of expenditures incurred in relation to such services were submitted.

(d) Mr. Lennon produced invoices for the purchase of automobile parts in 1979. Again, these purchases were not claimed as deductions on his Schedule C.

(e) Petitioners submitted proof of medical expenses of \$1,851.04 in 1979. Petitioner claimed medical expenses in 1979 of \$1,245.00. This was reduced by the Audit Division to \$1,067.00.

(f) Petitioners paid their accountant \$150.00 in 1978 and 1979 for preparation of their State and Federal income tax forms.

10. Petitioners base their protest of tax assessments under consideration on the following grounds:

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

(b) that petitioners are one 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. Mr. Lennon submitted wage and tax statements showing income as an employee, yet he reported no income from wages, salaries, tips and other compensation. In addition, he submitted Federal Schedules C reporting , his employee income as business income. These returns were patently erroneous, and the Audit Division was justified in making a determination of tax due based on adjustments to correct inconsistencies apparent on the face of the returns. Each Notice of Deficiency was preceded by a Statement of Audit Changes fully informing petitioners of the basis for the assessment and affording petitioners the opportunity to file amended returns.

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 Mr. Lennon may have carried on a welding business during the years at issue. However, other than receipts for the purchase of automobile



parts, purchases which were not claimed as expenses on his Schedule C, he provided no proof **of** such business activity. Furthermore, he submitted no proof of actual expenditures for those business expenses which were claimed **on** his Schedule C. Accordingly, Mr. Lennon has not sustained his burden of proof (Tax Law § 689[e] ; Administrative Code § U46-39.0[e]) to show that he was engaged in a trade or business other than as an employee and that he was entitled to the expenses claimed on his 1978 and 1979 Schedules C.

D. That Mrs. Lennon has established that she rendered childcare services in her home in 1979. Generally speaking, an ordinary and necessary business expense incurred in carrying on a trade or business **is** deductible under I.R.C. § 162(a). However, Mrs. Lennon has provided no proof **of** actual expenditures incurred in carrying **on** a childcare service; accordingly she **is** not entitled to the deductions claimed on her 1979 Schedule C. Finally, there is no evidence in the record that Mrs. Lennon actually provided secretarial services to Mr. Lennon and that she was compensated for doing **so**.

E. That during the tax years at issue, section 213(a)(1) of the Internal Revenue Code provided **as** follows:

"There shall be allowed as a deduction the following amounts, not compensated for by insurance or otherwise

(1) the amount by which the amount of the expenses paid during the taxable year ... for medical care of the taxpayer, his spouse, and dependents ... exceeds 3 percent of the adjusted gross income".

Petitioners have shown proof **of** medical expenses of \$1,851.04 in 1979, an amount exceeding 3 percent **of** their adjusted gross income for that year by \$1,006.14. Thus, the Audit Division properly adjusted petitioners' itemized deductions by reducing the medical and dental expenses allowed.

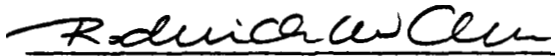
F. That petitioners have established that they were entitled to deductions of \$150.00 in 1978 and \$150.00 in 1979 for fees paid to their accountant for preparation of tax forms. Their itemized deductions will be increased accordingly

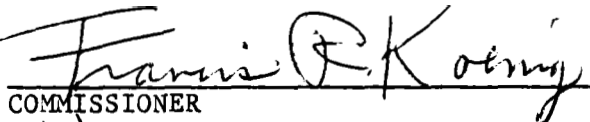
G. That the petitions of Frank Lennon and Ann Lennon are granted to the extent indicated in Conclusion of Law "F"; that the notices of deficiency issued on April 14, 1982 and April 8, 1983 shall be modified accordingly; and that in all other respects, the petitions are denied.


DATED: Albany, New York

STATE TAX COMMISSION

MAY 29 1987

  
PRESIDENT

  
COMMISSIONER

  
COMMISSIONER