

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petitions

of

ARTHUR SCHWARTZ AND CYNTHIA SCHWARTZ

DECISION

for Redetermination of Deficiencies or for  
Refunds of New York State Personal Income Tax  
under Article 22 of the Tax Law and New York :  
City Personal Income 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, Arthur and Cynthia Schwartz, 16 Melissa Lane, Old Bethpage,  
New York 11804, filed petitions for redetermination of deficiencies or for  
refunds of New York State personal income tax under Article 22 of the Tax Law  
and New York City personal income tax under Chapter 46, Title T of the Adminis-  
trative Code of the City of New York for the years 1978 and 1979 (File Nos.  
37737 and 44365).

On October 23, 1985 petitioners advised the State Tax Commission that they  
desired to waive a hearing and submit their case to the State **Tax** Commission  
for decision based upon the entire record contained in the file, with the  
submission of additional evidence by October 8, 1986. After due consideration  
of said record the Commission 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 Arthur Schwartz has substantiated that he was  
engaged in a trade or business during the years at issue.

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

FINDINGS OF FACT

I. Petitioners, Arthur and Cynthia Schwartz, timely filed New York State income tax resident returns for each of the years 1978 and 1979. For 1978 petitioners chose to file under the status "Married filing joint return". For 1979 petitioners chose to file under the status "Married filing separately on one Return".

(a) Petitioners 1978 income tax return listed petitioner Arthur Schwartz's occupation as "program development", and reported \$14,444.00 in total income (for both petitioners), consisting of \$2,113.00 in wages, salaries, tips (representing Mrs. Schwartz's W-2 income); \$264.00 of interest income; \$100.00 of dividends; \$20,104.00 reported as business income and an \$8,137.00 loss listed from partnerships, estates and trusts and small business corporations

(i) A copy of Federal C attached to the return reported alleged business income of \$24,317.00 for Arthur Schwartz, as follows:

American Studies Program	\$22,350.00
After School Center	1,127.00
Youth Employment Training Program	840.00
Total-	<u>\$24,317.00</u>

In addition, the Federal Schedule C reported the following alleged business expenses:

Hospitality Hadassah Assoc.	\$ 849.00
Supplies	238.00
Photography Expenses	294.00
Travel: Fund Raising/Yes Program (7,000 miles @ 17¢)	1,190.00
Planning Sessions - Concerts/Tours	293.00
Books, Reference Books	376.00
Magazines, Newspapers	293 00

Accounting	125.00
Dues	<u>195.00</u>
TOTAL	\$4,213.00

The \$24,317.00 in reported business income less the above-noted expenses totalling \$4,213.00 resulted in \$20,104.00 net business income reported.

(ii) Petitioner Arthur Schwartz's Wage and Tax Statement (Form W-2) attached to the 1978 return showed \$24,316.52 in wages, tips and other compensation from the City of New York Board of Education. The statement was stamped with an arrow bearing the legend "Included in Schedule C", indicating that the \$24,316.52 was included in Schedule C as alleged business income.

(iii) The unincorporated business tax return filed by Arthur Schwartz showed the following: net profit and total income from business before New York modifications was \$20,104.00; from this amount was subtracted \$24,317.00 resulting in a total and net loss from business of \$4,213.00. This "loss" amount is the same as the amount of business expenses claimed per Schedule C.

(b) The 1979 return also listed petitioner Arthur Schwartz's Occupation as "program development" and reported total income for petitioner Arthur Schwartz in the amount of \$19,632.00, consisting of \$142.00 in interest income, \$24,197.00 in business income, \$36.00 as the taxable portion of a capital gain distribution and a \$4,484.00 loss listed from partnerships, estates and trusts and small business corporations. The total of the foregoing items was reduced by an adjustment totalling \$259.00 to arrive at the total income figure of \$19,632.00.

(i) A COPY of Federal Schedule C attached to the return reported alleged business income of \$30,322.00 for Arthur Schwartz as follows:

American Studies Program	\$24,000.00
After School Center	1,800.00
Youth Employment Training Program	3,022.00
Tutoring	<u>1,500.00</u>
TOTAL	<u>\$30,322.00</u>

The Federal Schedule C also listed the following alleged business expenses:

Hospitality-Hadassah Assoc.	\$ 983.00
Supplies-Teaching	472.00
Photography Exp.	637.00
Travel Fund Raising (Yes Program)	
(8,420 miles @ <del>18</del> <sup>17</sup> ¢)	1,558.00
Planning Sessions - Concert Tours	486.00
<b>Books</b> Reference Books	291.00
MagazinesNewspapers	318.00
Telephone	360.00
Accounting	125.00
Dues	239.00
After School Center Expense	284.00
Program Development Expense - Choir/Yes	<u>372.00</u>
TOTAL	<u>\$6,125.00</u>

The \$30,322.00 in reported business income less the above-noted expenses totalling \$6,125.00 resulted in \$24,197.00 net business income reported.

(ii) Petitioner Arthur Schwartz's Wage and Tax Statement (Form W-2) attached to the 1979 return showed \$30,321.61 in wages, tips and other compensation from the City of New York Board of Education. Like the 1978 statement, a stamped arrow bearing the legend "Included in Schedule C" pointed to said compensation as being reported as alleged business income.

(iii) The unincorporated business tax return filed by Arthur Schwartz for 1979 showed the following: net profit and total income from business before New York modifications was \$24,197.00; from this amount was subtracted \$30,322.00 resulting in a total and net loss from business of \$6,125.00. The amount of this reported net loss equals the amount of asserted business expenses claimed per Schedule C.

(c) For the year 1978 petitioners claimed a New York itemized deduction in the amount of \$7,881.00, which included miscellaneous itemized deductions totalling \$221.00. For the year 1979 petitioners claimed a New York itemized deduction of \$9,131.00, taken entirely on Arthur Schwartz's return. Included in such amount were miscellaneous itemized deductions totalling \$416.00. <sup>1</sup>

2. Petitioners filed joint Federal individual income tax returns for each of the years 1978 and 1979. On the return for 1978 petitioners claimed (excess) itemized deductions of \$4,757.00. For the year 1979 petitioners claimed (excess) itemized deductions of \$6,275.00. In addition, for 1979 petitioner Arthur Schwartz claimed an adjustment for unreimbursed employee business expenses (Form 2106) in the amount of \$259.00. <sup>2</sup>

3. Petitioners' tax returns were selected for examination along with those of approximately 100 other individuals on the basis that the returns had been prepared by a particular accountant. An investigation had disclosed said accountant had consistently prepared returns on which an individual with wage

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1 Petitioners' miscellaneous itemized deduction for 1978 was comprised of investment expenses (\$13.00), safe deposit box (\$15.00) and business publications (\$193.00), which amounts were not questioned. For 1979, the miscellaneous deduction was comprised of investment expenses (\$9.00), safe deposit box (\$15.00) and business publications (\$392.00), which amounts were not questioned.

2 **This** adjustment represents car expenses and was calculated as follows:

4,311	miles travelled
x 18¢	rate per mile
\$798.00	
+151.00	parking fees & tolls
\$949.00	
-690.00	employer's reimbursement
<u>\$259.00</u>	

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 Arthur Schwartz's claimed Schedule C deductions were disallowed for both years on that basis.

4. (a) **On April 14, 1982** the Audit Division issued two notices of deficiency to the petitioners which asserted a deficiency in personal income tax for the year 1978 in the aggregate amount of \$239.60 plus interest. A Statement of Audit Changes previously issued to petitioners on January 24, 1982 explained that "expenses in the amount of \$4,213.00 have been disallowed since they are not considered ordinary and necessary expenses in production **of** income as an employee."

(b) **On April 8, 1983** the Audit Division issued a Notice of Deficiency to petitioner Arthur Schwartz asserting a deficiency of personal income tax for the year 1979 in the amount of \$3,741.97, plus interest, and a Notice of Deficiency to petitioner Cynthia Schwartz asserting a deficiency of personal income tax for 1979 in the amount of \$17.50, plus interest. A Statement of Audit Changes dated March 7, 1983 provided as explanation: "Wages from the City of New York were not included in the itemized list of income on the return for state or city. This adjustment is now being made. Household credit is disallowed as your gross income exceeds \$25,000.00." Subsequent to issuance **of** the Notice of Deficiency, the Audit Division, by memorandum, corrected the amount **of** additional tax asserted as due from Mr. Schwartz by admitting that the Statement of Audit Changes overstated Mr. Schwartz's income by \$24,196.61.

This correction reduces the additional amount of tax due as asserted by the

Audit Division to \$455.50 which, when combined with the asserted deficiency against petitioner Cynthia Schwartz in the amount of \$17.50, results in a revised asserted deficiency for 1979 totalling \$473.00, plus interest.

(c) For both years the itemized deductions claimed by petitioners were not changed or questioned in conjunction with the issuance of the notices of deficiency, nor was there any change or question regarding petitioner Arthur Schwartz's 1979 claimed adjustment for unreimbursed employee business expense (Form 2106). In addition, penalties were not imposed for either year.

5. Upon submission, petitioner presented documentary evidence which showed the following:

(a) Petitioner Arthur Schwartz was a teacher during the years in question. He was also the teacher in charge of the After School Center and teacher liason for the Youth Employment Training Program.

(b) Petitioners submitted documentary evidence in the form of summary sheets, sales invoices and worksheets pertaining to the amounts claimed as business expenses under the headings of hospitality, supplies, mileage, planning sessions, tolls, parking, recruiting, etc., for each year. However, from the evidence submitted, it is not clear whether and to what extent the expenses were properly characterized as trade or business expenses rather than personal expenses in nature. In addition, except for union dues of \$195.00 for 1978 and \$239.00 for 1979, it is not clear from the evidence submitted whether any portion of the claimed expenses constitute unreimbursed employee business expenses or additional miscellaneous itemized deductions.

6. 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 limitations on

assessment, thus depriving petitioners of the opportunity to present substantiated to the Audit Division 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 such items as would substantiate the amounts claimed, 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 claimed Schedule C business expenses. The notices of deficiency were preceded by statements of audit changes, and petitioners had an opportunity to file amended returns claiming unreimbursed employee business expenses as adjustments to income on Form 2106, or additional miscellaneous itemized deductions, but did not do so. In this regard, petitioner Arthur Schwartz included Form 2106 with his 1979 return when filed, claiming thereon those unreimbursed employee business expenses to which he felt entitled. Said amount was not questioned upon audit, nor amended by petitioners.

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 failed to sustain their burden of proof pursuant to Tax Law section 689(e) and Administrative Code section T64-189.0(e) to show that Arthur Schwartz was engaged in a trade or business or that any portion of the business expenses claimed on Schedule C by Arthur Schwartz were deductible.



income as unreimbursed employee business expenses (as opposed to nondeductible personal expenses). Accordingly, with the exception of union dues, which are clearly allowable as additional miscellaneous itemized deductions totalling \$195.00 for 1978 and \$239.00 for 1979, the Audit Division's disallowance of deductibility for the claimed Schedule C expenses *is* sustained.

D. That the Notice of Deficiency for 1979, as conceded by the Audit Division, is to be reduced to \$473.00. In addition, miscellaneous itemized deductions are to be increased by \$195.00 for 1978 and \$239.00 for 1979, and the notices of deficiency are **to be** recomputed and further reduced accordingly.


E. That the petitions of Arthur and Cynthia Schwartz are granted to the extent indicated in Conclusion of Law "D", but are otherwise denied and the notices of deficiency issued April 14, 1982 and April 8, 1983, as recomputed in accordance herewith, are sustained.


Dated: Albany New York

STATE TAX COMMISSION

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PRESIDENT

  
COMMISSIONER

  
COMMISSIONER