

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petitions

of

WILLIAM E. MATTHES AND GERALDINE E. MATTHES

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.

Petitioners, William E. Matthes and Geraldine E. Matthes, 266 Earle Avenue, Lynbrook, New York 11563, 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 Administrative Code of the City of New York for the years 1978 and 1979 (File Nos. 37757 and 45356).

On October 23, 1985, petitioners waived their rights to a hearing and requested that the State Tax Commission 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 for the sole purpose of extending the period **of** limitation **on** assessment.

II Whether petitioner William E. Matthes 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, William E. and Geraldine E. Matthes, filed a New York State and City income tax resident return for 1978 wherein they elected a filing status of "Marriedfiling joint Return". On their return, petitioners reported business income of \$21,442.00. The following table details the manner in which petitioner: computed their reported business income:

<u>Income</u>		
Contractual	\$18,408.00	
Emergency Service	5,487.00	
Snow Removal	<u>725.00</u>	
Total Income		\$24,620.00
<u>Expenses</u>		
Dues	\$ 183.00	
Accounting	100.00	
Telephone (\$20 x 12 mos.)	240.00	
Magazines, Newspapers	194.00	
Truck Repairs and Maintenance	2,265.00	
Gloves, Arctic Wear	<u>196.00</u>	
Total Expenses		<u>\$ 3,178.00</u>
<u>Net Income</u>		\$21,442.00

2. Attached to petitioners' 1978 return was a wage and tax statement issued to Mr. Matthes by The Flying Tiger Line, Inc., reporting wages, tips, other compensation of \$23,894.54. The statement was stamped with an arrow pointing to the \$23,894.54 figure with the legend "Included in Schedule C".

3. On March 24, 1982, the Audit Division issued a Statement of Audit Changes to petitioners for the year 1978 which contained the following explanation and computation:

"The expenses claimed in Schedule C are not ordinary and necessary in the

Your 1978 tax liability is recomputed as follows:

Wages	\$23,894.54
Earnings from Snow Removal	725.00
Interest	25.00
Total New York Income	<u>\$24,644.54</u>
Less: Itemized Deductions	<u>7,374.00</u>
Balance	<u>\$17,270.00</u>
Less: Exemptions	<u>3,250.00</u>
New York Taxable Income	<u>\$14,020.54</u>
 Tax on Above	 \$ 771.85
Less: Household Credit	<u>35.00</u>
Tax Due	<u>\$ 736.85</u>

New York City Nonresident Earnings Tax

Gross Wages	\$23,894.54
Exclusion	<u>1,000.00</u>
Balance	<u>\$22,894.54</u>
Tax on Above @ .0045	\$ 103.03

	<u>NYS</u>	<u>NYC</u>	
Tax Due	\$736.85	\$103.03	
Tax Per Return	<u>474.01</u>	<u>99.00</u>	
Additional Tax Due	\$262.84	\$ 4.03	\$ 266.87"

4. Based on the aforementioned Statement of Audit Changes, the Audit Division, on April 14, 1982, issued a Notice of Deficiency to petitioners for 1978 asserting additional New York State and City tax due of \$262.84 plus interest of \$75.82 for a total amount due of \$338.66.

5. Petitioners timely filed a New York State and City income tax resident return for 1979 wherein they elected a filing status of "Married filing separately on one return." On his portion of said return, Mr. Matthes reported business income of \$25,997.00, while on her portion of the return Mrs. Matthes reported business income totalling \$2,003.00. The following table details the manner in which petitioners computed their respective business income:

William E. Matthes

<u>Income</u>		
Contractual	\$19,405.00	
Emergency Service	12,381.00	
Snow Removal	<u>650.00</u>	
Total Income		\$32,436.00
<u>Expenses</u>		
Dues and Memberships	\$ 228.00	
Accounting	100.00	
Telephone (\$25 x 12 mos.)	300.00	
Magazines, Newspapers	231.00	
Truck Repairs and Maintenance	2,265.00	
Gloves, Arctic Wear	213.00	
Payments to Central Operator: Geraldine Matthes	3,000.00	
Mailings and Postage	<u>102.00</u>	
Total Expenses		<u>\$ 6,439.00</u>
<u>Net Income</u>		\$25,997.00

Geraldine E. Matthes

<u>Income</u>		
Message Center Income	<u>\$ 3,000.00</u>	
Total Income		\$ 3,000.00
<u>Expenses</u>		
Supplies	\$ 294.00	
Calculator	83.00	
Newspapers, Magazines	321.00	
Hospitality	<u>299.00</u>	
Total Expenses		<u>\$ 997.00</u>
<u>Net Income</u>		\$ 2,003.00

6. Attached to petitioners' 1979 return was a wage and tax statement issued to Mr. Matthes by The Flying Tiger Line, Inc., reporting wages of \$31,787.00. Said statement was also stamped with an arrow pointing to the \$31,787.00 figure with the legend "Included in Schedule C".

7. On February 4, 1983, the Audit Division issued a Statement of Audit Changes to petitioner William E. Matthes for 1979 which contained the following explanation and computation:

"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."

Wages	\$31,787.00
Interest Income	<u>46.00</u>
Total Income	31,833.00
Less: Itemized Deductions	<u>6,808.00</u>
Adjusted Taxable Income	25,025.00
Less: Exemptions	<u>2,800.00</u>
Taxable Income	\$22,225.00

8. Based on the aforementioned Statement of Audit Changes, the Audit Division, on April 8, 1983, issued a Notice of Deficiency to petitioners for 1979 asserting additional New York State and City tax due of \$646.78., plus interest of \$214.99, for a total due of \$861.77.

9. 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 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 William E. Matthes' claimed Schedule C deductions were disallowed on that basis.

10. 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 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 taxpreparer; 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.

II William E. Matthes submitted documentary evidence in the form of sales invoices, cancelled checks and worksheets in substantiation of a portion of the business expenses he claimed on Federal Schedule C for the years at issue. However, the evidence submitted did not relate to a characterization of the expenses as business rather than personal. In addition, except for union dues of \$183.00 for 1978, the documents did not substantiate whether any portion of the claimed expenses were unreimbursed employee business expenses or miscellaneous itemized deductions.

CONCLUSIONS OF LAW

A. That the notices of deficiency were properly issued and were not arbitrary and capricious. The returns were patently erroneous and the Audit Division was justified in disallowing the business expenses claimed by petitioner William E. Matthes on Federal Schedules C filed for 1978 and 1979. The notices of deficiency were preceded by statements of audit changes and petitioners had an opportunity to file amended returns claiming employee business expenses as adjustments to income 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 and circumstances.


C. That petitioner William E. Matthes has failed to sustain his burden of proof (Tax Law § 689[e]; Administrative Code § T46-189.0[e]) to show (i) that he was engaged in a trade or business other than as an employee (Internal Revenue Code § 62[1]); (ii) that the expenses in question were trade or business deductions of an employee deductible pursuant to Internal Revenue Code § 62(2); and (iii) that the expenses in question were ordinary and necessary business expenses deductible under Internal Revenue Code § 162(a). Petitioners, however, are entitled to the miscellaneous deduction of union dues for 1978 of \$183.00

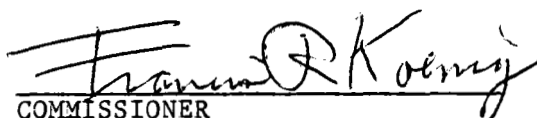
D. That the petition of William E. matthes and Geraldine Matthes is granted to the extent indicated in Conclusion of Law "C", supra; that the Audit Division is directed to recompute the Notice of Deficiency dated April 14, 1982 consistent with the conclusions reached herein; and that, except as so granted, the notices of deficiency dated April 14, 1982 and April 8, 1983 are in all other respects sustained, together with such additional interest as may be lawfully due and owing.

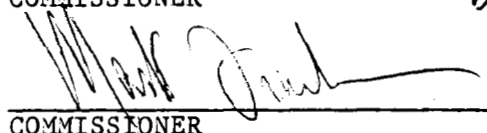
DATED: Albany, New York

STATE TAX COMMISSION

APR 23 1987


PRESIDENT


COMMISSIONER


COMMISSIONER