

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petitions

of

ROBERT C. ESTRADA AND MAXINE J. ESTRADA

DECISION

for Redetermination of Deficiencies or for
Refunds of New York State Personal Income Tax :
under Article 22 of the Tax Law for the Years
1978 and 1979.

Petitioners, Robert C. Estrada and Maxine J. Estrada, 37 Grant Street, Farmingdale, New York 11735, filed petitions for redetermination of deficiencies or for refunds of New York State personal income tax under Article 22 of the Tax Law for the years 1978 and 1979 (File Nos. 38012 and 42461).

On October 23, 1985, petitioners waived their right to a formal 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 Maxine J. Estrada has substantiated that she 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. On April 1, 1979, petitioners timely filed a New York State Income Tax Resident Return for 1978 wherein they elected a filing status of "Married filing separately on one Return". On her portion of said return, petitioner Maxine J. Estrada reported business income of \$6,112.00. The following table details the manner in which Mrs. Estrada computed her reported business income:

Income		\$20,984.00
Expenses:		
Automobile	\$3,370.00	
Office Maintenance	600.00	
Telephone	772.00	
Licenses	14.00	
Office Supplies	684.00	
Tax Preparation	125.00	
Depreciation of Equipment	293.00	
Magazines, Newspapers, Etc.	298.00	
Recording Tapes	173.00	
Office Hospitality	973.00	
Postage	186.00	
Reference Books	131.00	
Prospecting, Promotion	1,938.00	
Outside Services	437.00	
Dues, Subscriptions	371.00	
Travel (Other Than Car)	620.00	
Professional Development	446.00	
Watch Dogs	386.00	
Air Conditioning	300.00	
Floor Maintenance	120.00	
Bathroom Maintenance	150.00	
Messenger Expense	725.00	
Attache Case, Writing Supplies, Calculator	284.00	
Secretarial	846.00	
Cleaning	630.00	
Total Expenses		<u>14,872.00</u>
Net Income		<u>\$ 6,112.00</u>

2. Attached to petitioners' 1978 return was a wage and tax statement issued to Mrs. Estrada by the State of New York, reporting wages, tips, other compensation of \$18,437.06. The statement was stamped with an arrow pointing to the \$18,437.06 figure with the legend "Included in Schedule C".

3. On March 26, 1982, the Audit Division issued a Statement of Audit Changes to petitioners for the year 1978 which contained the following explanation and computation:

"Deductions of \$14,872.00 (Wife's Schedule C) are disallowed as not being ordinary and necessary employee expenses.

<u>Recomputation of New York Income Tax</u>	
	<u>Wife</u>
Total New York income reported	\$ 6,211.00
Add: Disallowance	14,872.00
Total New York income corrected	<u>\$21,083.00</u>
Less: Itemized deductions	-0-
Balance	<u>\$21,083.00</u>
Less: Exemptions	650.00
Taxable balance	<u>\$20,433.00</u>
State tax (on above amount)	\$ 1,451.96
Less: Credit	80.00
Balance	<u>\$ 1,371.96</u>
State tax previously computed	<u>108.05</u>
ADDITIONAL TAX DUE	<u><u>\$ 1,263.91"</u></u>

4. Based on the aforementioned Statement of Audit Changes, the Audit Division, on April 14, 1982, issued a Notice of Deficiency to petitioner Maxine J. Estrada for 1978 asserting additional New York State tax due of \$1,263.91, plus interest of \$364.61, for a total allegedly due of \$1,628.52.

5. Petitioners timely filed a joint New York State Income Tax Resident Return for 1979 wherein they reported business income of \$8,484.00. The following table details the manner in which petitioners computed reported business income:

Income		
Family Court	\$21,622.00	
Other Fees	<u>3,063.00</u>	
Total Income		\$24,685.00

Expenses :

Automobile Expense	\$ 3,952.00	
Office Maintenance	720.00	
Telephone - Inside	600.00	
Licenses	40.00	
Interest on Checking Plus	305.00	
Depreciation of Equipment	293.00	
Tax Preparation	125.00	
Magazines, Newspapers, Etc.	306.00	
Recording Tapes	316.00	
Office Hospitality	877.00	
Postage	188.00	
Reference Books	124.00	
Prospecting, Promotion	2,165.00	
Outside Services	435.00	
Dues, Subscriptions	310.00	
Travel (Other Than Car)	694.00	
Professional Development	606.00	
Watch Dogs	358.00	
Air Conditioning	300.00	
Floor Maintenance	120.00	
Bathroom Maintenance	255.00	
Messenger Expense	780.00	
Attache Case, Writing Supplies, Calculator	308.00	
Secretarial	845.00	
Cleaning	635.00	
Telephone - Outside	543.00	
Total Expenses		<u>16,201.00</u>
Net Income		<u>\$ 8,484.00</u>

6. Attached to petitioners' 1979 return was a wage and tax statement issued to Mrs. Estrada by the State of New York, reporting wages of \$21,621.89. Said statement was also stamped with an arrow pointing to the \$21,621.89 figure with the legend "Included in Schedule C".

7. On March 22, 1983, the Audit Division issued a Statement of Audit Changes to petitioners for 1979 which contained the following explanation and computation:

"Since you have failed to reply to our letters of December 22, 1982 and January 4, 1983, we have made the following adjustments on your 1979 New York State income tax return.

The wages and other fees in the total amount of \$24,685.00 for the wife has been added to the total New York income reported of \$43,121.00. The expenses claimed on Schedule C of \$16,021.00 is [sic] disallowed in full.

New York Taxable Income Reported	\$28,898.00
Add: Wife's wages and other fees	<u>24,685.00</u> ¹
New York Taxable Income Corrected	\$53,583.00

Tax per rate schedule	\$ 6,061.62
Less: Maximum Tax Benefit	<u>496.31</u>
Adjusted New York Tax	\$ 5,565.31
New York State previously stated	<u>2,502.54</u>

PERSONAL INCOME TAX DUE	<u>\$3,062.77"</u>
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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 tax due of \$3,062.77, plus interest of \$1,018.03, for a total allegedly due of \$4,080.80.

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 Maxine J. Estrada's claimed Schedule C deductions were disallowed on that basis and also,

1 In its computation, the Audit Division failed to take into consideration the fact that petitioners reported net business income of \$8,484.00. Accordingly, the adjustment to reported taxable income as shown on the Statement of Audit Changes is overstated by \$8,484.00.

for the 1979 tax year, on the basis that petitioners failed to respond to two Audit Division letters requesting additional information and documentary evidence.

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 limitation on assessment, thus depriving them of the opportunity to present substantiation for the claimed deductions;

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

11. Petitioners submitted documentary evidence in the form of sales invoices, cancelled checks and worksheets in substantiation of a portion of the business expenses claimed on Mrs. Estrada's Federal Schedules C. With respect to the 1978 tax year, the evidence submitted did not relate to a characterization of the expenses as business rather than personal. With respect to the 1979 tax year, the evidence submitted also did not relate to a characterization of the expenses as business rather than personal, with the following exceptions:

(a) an interest expense of \$305.00 paid to the European American Bank is properly deductible as an itemized interest deduction;

(b) a tax return preparation fee of \$125.00 is properly deductible as an itemized miscellaneous deduction; and

(c) union dues and professional association dues totalling \$263.00 are properly deductible as an itemized miscellaneous deduction; however, since petitioners' return already claims a deduction of \$60.00 for union dues, the additional allowable deduction *is* reduced to \$203.00.

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 Maxine J. Estrada on her Federal Schedules C. 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 adduced herein.

C. That petitioner Maxine J. Estrada has failed to sustain her burden of proof (Tax Law 5 689[e]) **to** show (i) that she 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).

D. That for the year 1979, the Audit Division overstated the adjustment to income by \$8,484.00 (see footnote 1, supra). Furthermore, for the 1979 tax


year petitioners have substantiated that they are entitled to additional itemized deductions totalling \$633.00 (\$305.00 + \$125.00 + \$203.00).

E. That the petitions **of** Robert C. Estrada and Maxine J. Estrada are granted to the extent indicated in Conclusion of Law "D", supra; that the Audit Division is directed to recompute the Notice of Deficiency dated April 8, 1983 consistent with the conclusions reached herein; and that, except as so granted, the petitions are in **all** other respects denied.


DATED: Albany, New York

STATE TAX COMMISSION

JUN 25 1987


PRESIDENT


COMMISSIONER


COMMISSIONER