

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petition

of

A. M. TOURS, INC.

DECISION

for Redetermination of a Deficiency or for  
Refund of Franchise Tax on Business Corporations :  
under Articles **9-A** and 27 of the Tax Law for  
the Fiscal Year Ended September **30**, 1978.

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Petitioner, A. M. Tours, Inc., 1650 Broadway, Room 704, New York, New York 10019, filed a petition for redetermination of a deficiency or for refund of franchise tax on business corporations under Articles 9-A and 27 of the Tax Law for the fiscal year ended September **30**, 1978 (File No. 40402).

A hearing was held before Doris E. Steinhardt, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, **on** September 10, 1985 at 2:45 P.M., with additional documentary evidence to be submitted by September 27, 1985. Petitioner appeared by Albert A. Medenilla, President. The Audit Division appeared by John P. Dugan, Esq. (Anne W. Murphy, Esq., of counsel).

#### ISSUE

Whether the Audit Division properly characterized certain funds paid by petitioner to its president as distributed or undistributed earnings, rather than as compensation.

#### FINDINGS OF FACT

1. For the fiscal year ended September 30, 1978, for federal corporation income tax purposes, petitioner, A. M. Tours, Inc., filed a U.S. Small Business Corporation Income Tax Return, reflecting taxable income of \$20,000.

amount of \$12,658.00; the corporation did not avail itself of any deduction for compensation to officers. Petitioner subsequently submitted an amended federal return, deducting officers' compensation of \$12,658.00 and reporting a taxable income of zero.

2. For the fiscal year ended September 30, 1978, petitioner filed a New York State franchise tax report, remitting therewith the minimum tax of \$250.00

3. Petitioner is engaged in business as a travel agency. Its sole officers and shareholders are Albert Medenilla and his wife, Amparo. Mr. Medenilla manages and devotes most of his time to petitioner's business.

4. On March 30, 1982, the Audit Division issued to petitioner a Notice and Demand for Payment of Franchise Tax, assessing franchise tax under Tax Law Article 9-A for the fiscal year 1978 in the amount of \$1,041.00, with accrued interest. The assessment was predicated on the disallowance of petitioner's deduction of compensation to officers. On his 1978 individual federal return, Mr. Medenilla had reported such compensation on Schedule E, Supplemental Income Schedule, as income from a small business corporation. The Audit Division therefore concluded that petitioner improperly reduced its federal taxable income by \$12,658.00, earnings distributed (or undistributed) to a shareholder. At the hearing held, counsel to the Audit Division conceded that petitioner's allegedly improper deduction of officers' compensation did not constitute a mathematical error (transcript p. 7).

5. At irregular intervals, Mr. Medenilla draws advances from the corporation and records the amounts thereof in journal account 104, denominated advances to officers and employees. According to such account, he received \$6,801.16 during the fiscal year ended September 30, 1978. At the close of fiscal year 1978, petitioner showed a profit of \$12,658.00.

entry to account 104: he debited the account in the amount of \$5,856.84, the excess of \$12,658.00 (petitioner's profit) over \$6,801.16 (the total of his advances).

6. On his Schedule **SE**, Computation of Social Security Self-Employment Tax, submitted to the Internal Revenue Service for 1978, Mr. Medenilla reported net earnings of \$14,508.00: \$1,850.00 derived from A. M. Tax & Accounting Services, plus \$12,658.00 derived from A. M. Tours, Inc.

#### CONCLUSIONS OF LAW

A. That in accordance with the provisions of Tax Law section 1081(d), where a mathematical error appears on a return, the Audit Division "shall notify the taxpayer that an amount of tax in excess of that shown upon the return is due, and that such excess has been assessed" via the issuance to the taxpayer of a Notice and Demand for Payment of Franchise Tax. As the Audit Division so conceded, petitioner's mischaracterization of a portion of the payments to its president (\$5,856.84) as compensation to officers, rather than as its own distributed or undistributed earnings, and the resultant overstatement of deductions did not constitute a mathematical error within the meaning of section 1081(d). (Compare Matter of Martin Hurwitz, State Tax Comm., June 29, 1983, wherein the taxpayer's use of an erroneous minimum tax figure was found to be a mathematical error; and Internal Revenue Code section 6213[g][2], which defines the term "mathematical or clerical error" for purposes of restrictions on deficiencies.) The disallowance by the Division of petitioner's deduction for compensation to officers should therefore have been accomplished through the issuance of a Notice of Deficiency (section 1081[a]), not through an assessment.

B. That the period of limitations for the issuance of a notice of deficiency against petitioner with respect to the **fiscal** year ended September 30, 1978 has expired (section 1083[a]).

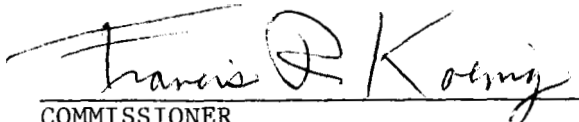
C. That the petition of A. M. Tours, Inc. **is** granted, and **the** Notice and Demand for Payment **of** Franchise Tax issued on March 30, 1982 is cancelled.

DATED: Albany, New York

STATE TAX COMMISSION

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PRESIDENT

  
COMMISSIONER

  
COMMISSIONER