

STATE OF NEW YORK

STATE **TAX** COMMISSION

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In the Matter of the Petition

of

VINCENT A. D'ORAZIO and  
ROSALIE S. D'ORAZIO

DECISION

for Redetermination of a Deficiency or for  
Refund of New York State Personal Income and  
Unincorporated Business Taxes under Articles :  
22 and 23 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, Vincent A. D'Orazio and Rosalie S. D'Orazio, 3318 Polo Place, Bronx, New York 10465, filed a petition for redetermination of a deficiency or for refund of New York State personal income and unincorporated business taxes under Articles 22 and 23 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 No. 43386).

A formal hearing was held before Frank W. Barrie, Hearing Office, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on October 18, 1984 at 9:15 A.M., with all briefs to be submitted by January 21, 1985. Petitioners appeared by William T. Barbera, Esq. The Audit Division appeared by John P. Dugan, Esq. (Lawrence Newman, Esq., of counsel).

#### ISSUES

I. Whether the Audit Division's reconstruction of petitioners' income for the years 1978 and 1979, through utilization of bank deposit analyses, properly determined that petitioners had additional unreported business income.

II. Whether petitioners willfully and fraudulently concealed their New York

therefore subject to a 50 percent penalty for fraud imposed pursuant to section T46-185.0(e) of Chapter 46, Title T of the Administrative Code of the City of New York.

FINDINGS OF FACT

1. Petitioners herein, Vincent A. D'Orazio and Rosalie D'Orazio, filed New York State income tax resident returns for 1978 and 1979 and also New York State unincorporated business tax returns for both of said years. During 1978 and 1979, petitioner Vincent A. D'Orazio operated a retail gasoline station and net income from the operation of said gas station totalled \$14,208.00 in 1978 and \$39,597.82 in 1979.

2. The portion of petitioners' 1978 and 1979 New York State income tax returns which pertained to the New York City tax on resident individuals were left blank and, therefore, petitioners paid **no** New York City income tax for said years.

3. **On** January 18, 1982, petitioners executed a consent extending the period of limitation for assessment of personal income and unincorporated business taxes for 1978 to any time on **or** before April 15, 1983.

4. **As** the result of a field audit of petitioners' personal and business books and records, the Audit Division, on September 22, 1982, issued to petitioners a Statement **of** Personal Income Tax Audit Changes and a Statement of Unincorporated Business Tax Audit Changes. The following adjustments were proposed on the aforementioned statements:

<u>Personal Income Tax</u>	<u>1978</u>	<u>1979</u>
Additional Income	\$37,326.00	\$29,400.00
Insurance Expense - Personal	1,559.00	1,465.00
Real Estate Taxes	---	685.00
Medical Expense	85.00	115.00
Net Adjustments	<u>\$38,970.00</u>	<u>\$31,665.00</u>

<u>Unincorporated Business Tax</u>	<u>1978</u>	<u>1979</u>
Additional Income	\$37,326.00	\$29,400.00
Insurance Expense - Personal	1,559.00	1,465.00
Interest Income	290.75	496.63
Allowance for Taxpayer Services	(2,158.40)	---
Net Adjustments	<u>\$37,017.35</u>	<u>\$31,361.63</u>

5. In addition to proposing the above net adjustments, the Audit Division also determined that petitioners were residents of New York City for 1978 and 1979. The New York City resident income tax due was computed based on reported income plus the net adjustments per audit, The Audit Division also determined that the deficiency in New York City tax was due to fraud and it therefore asserted a 50 percent penalty for fraud.

6. Based on the Statement of Personal Income Tax Audit Changes and the Statement of Unincorporated Business Tax Audit Changes, the Audit Division, on January 21, 1983, issued four (4) notices of deficiency to petitioners for the following amounts:

	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
(a)	\$10,877.96	\$ 1,244.99	\$ 3,895.72	\$16,018.67
(b)	2,360.96	1,180.48	726.63	4,268.07
(c)	1,908.78	95.44	749.71	2,753.93
(d)	1,411.24	70.56	434.33	1,916.13
Totals	<u>\$16,558.94</u>	<u>\$ 2,591.47</u>	<u>\$ 5,806.39</u>	<u>\$24,956.80</u>

7.(a) The deficiency in tax of \$10,877.96 included New York State personal income tax of \$4,886.90 and \$4,433.10 for 1978 and 1979, respectively, and New York City personal income tax of \$1,557.96 for 1978. The penalty amount of \$1,244.99 included a 5 percent negligence penalty computed on the New York State tax allegedly due and a 50 percent fraud penalty computed on the New York City tax allegedly due.

(b) The deficiency in tax of \$2,360.96 represents the New York City personal income tax allegedly due for 1979. The penalty amount of \$1,180.48 represents the assertion of a 50 percent fraud penalty.

(c) The deficiency in tax of \$1,908.78 represents the New York State unincorporated business tax allegedly due for 1978. The penalty amount of \$95.44 represents the assertion of a 5 percent negligence penalty.

(d) The deficiency in tax of \$1,411.24 represents the New York State unincorporated business tax allegedly due for 1979. The penalty amount of \$70.56 represents the assertion of a 5 percent negligence penalty.

8. Petitioners' books and records were maintained on a single entry cash basis. Since petitioners' accountant made an adjustment at the end of each year for estimated cash drawings, the Audit Division determined that the books were inadequate and it therefore reconstructed gross receipts for 1978 and 1979 through the utilization of bank deposit analyses. For 1978, the bank deposit analysis disclosed additional business income of \$37,326.00 and, for 1979, the bank deposit analysis produced \$29,400.00 of additional business income.

9. The Audit Division revised its bank deposit analysis for 1978 as the result of additional information provided by petitioners at a pre-hearing conference. Said revision was a reduction of \$11,580.32 in the additional income disclosed by the bank deposit analysis. The \$11,580.32 reduction was based on petitioners' disclosure of a savings account (Yorkville Savings account #8496) which revealed that a withdrawal of \$14,780.32 was made from said account and subsequently redeposited into a difference account. To arrive at the reduction of \$11,580.32, the Audit Division subtracted from the non-taxable transfer of \$14,780.32 two deposits made to the account in the amounts of \$1,200.00 and \$2,000.00. These deposits had not previously been included in

the bank deposit analysis for 1978. In addition to the reduction in the additional income per the bank deposit analysis, the Audit Division also reduced its adjustment for medical expenses by \$25.00, from \$85.00 to \$60.00. Accordingly, the net adjustment for the year 1978 was reduced to \$27,365.00 (\$38,970.00 less \$11,580.00 less \$25.00). No reductions were made to the proposed net adjustments for 1979.

10. The Audit Division, in its computation of additional business income pursuant to the bank deposit analyses, determined that petitioners' personal living expenses for 1978 and 1979 totalled \$23,008.00 and \$23,518.00, respectively. A portion of the total personal living expenses for each year were estimated based on the auditor's personal experience, the auditor's review of those personal living expenses paid by check and alleged guidelines established by the Audit Division. The amounts estimated by the auditor were determined without consultation or discussion with petitioners as to the actual amounts expended. Of personal living expenses for 1978, \$23,008.00 in total, \$9,877.00 was paid by check and the balance, \$13,131.00, was presumably paid by cash. For 1979, the Audit Division determined personal living expenses of \$23,518.00, with \$11,834.00 paid by check and \$11,747.00 presumably paid by cash.

11. Petitioners objected to various cash personal living expenses which were estimated by the Audit Division. The following represent those areas in which petitioners presented credible evidence in rebuttal to the estimates of the Audit Division:

(a) Cash for Groceries and Outside Meals - During the years 1978 and 1979 petitioners were members of a food plan and in 1978 they paid by check \$1,940.00 to said food plan and in 1979 they paid by check a total of \$2,222.00. The Audit Division estimated that petitioners expended \$5,200.00 per year for food and outside meals. By subtracting the food plan purchases from said total of \$5,200.00

purchases made by cash. Most of petitioners' food was obtained from the food plan with little being purchases elsewhere. Petitioners did not provide an amount for food purchases made outside the food plan.

(b) Clothing Expense - For 1978 and 1979 the Audit Division estimated an annual clothing expense of \$2,400.00. Petitioner Vincent D'Orazio **was** working six or seven days per week at the gas station and was provided with uniforms by the gas station. During the years at issue petitioners also purchased clothes from an individual who made regular sales visits to their home. These purchases were made by check and were included in the bank deposit analyses. Again petitioners did not provide an amount for total clothes purchases.

(c) Recreation, Entertainment & Vacation Expense - For this category the Audit Division estimated an annual expense of \$1,300.00. During the years at issue petitioners did not take vacations. Petitioners did not provide an amount expended for recreation and entertainment.

12. During the years at issue petitioner Vincent A. D'Orazio purchased cigarettes by cash for resale in **his** gas station. Said petitioner withdrew cash from a business savings account to purchase the aforementioned cigarettes. The following chart represents cash withdrawn by petitioner Vincent A. D'Orazio from the business savings account and used to purchase cigarettes:

<u>Date</u>	<u>1978</u>	<u>1979</u>
3/9/78	\$2,800.00	
4/5/78	2,000.00	
4/11/78	3,000.00	
5/12/78	1,970.79	
10/31/79		\$1,800.00
Total	<u>\$9,770.79</u>	<u>\$1,800.00</u>

The Audit Division did not allow petitioners credit for the above cash withdrawals in its bank deposit analyses. Petitioners have not submitted any evidence to show that a withdrawal of \$1,139.00 made on May 4, 1978 was used for the purchase of cigarettes. Petitioners were given credit for a withdrawal of \$625.68 made on November 29, 1978.

13. Petitioners maintain that the bank deposit analyses prepared by the Audit Division did not properly consider depreciation, a deduction for which no cash funds were expended. In its bank deposit analysis for 1978, the Audit Division reduced "business expenses paid by cash" by the amount of petitioners' claimed depreciation deduction of \$660.00. The effect of this \$660.00 adjustment was to reduce gross receipts per the bank deposit analysis and effectively give petitioners credit for this non-cash deduction. The depreciation deduction for 1979 of \$1,660.96 was handled by the Audit Division in a similar fashion.

14. Petitioners also maintain that the bank deposit analysis for 1978 incorrectly duplicated a \$1,644.00 expense for insurance and medicine and that they are entitled to a credit for said duplication. No evidence or further explanation was provided in the record or elsewhere to support this bare assertion.

15. Petitioners argued that the bank deposit analysis for 1979 contained the following errors:

(a) a duplication of an expense for an individual retirement account;

(b) a failure *to* give credit for fiduciary funds (e.g., sales tax, withholding taxes, etc.) of \$8,630.00;

(c) a failure to properly consider accounts payable of \$6,138.00; and

(d) a failure to increase the allowable depreciation deduction from \$1,660.00 to \$3,979.00.

With respect to the allegation raised in Findings of Fact "15(a)" and "15(d)", supra, petitioners failed to present any evidence to support said assertions. Concerning the Audit Division's failure *to* allow credit for fiduciary funds, it must be noted that sales taxes were included by petitioners in gross receipts and that a deduction **was** claimed when **said taxes were paid**

Finally, the Audit Division did not take into consideration accounts payable (or accounts receivable), since petitioners were reporting income and expenses on a cash basis.

16. During 1979, petitioners closed out two (2) savings accounts, one on July 2, 1979, withdrawing \$733.16, and the second on October 30, 1979, withdrawing \$661.99. The Audit Division did not allow petitioners credit for these withdrawals as either a non-taxable transfer to another bank account or as cash used for personal living expenses. No grounds were offered by the Audit Division explaining why credit was not allowed for the aforementioned withdrawals.

17. During the years at issue, petitioners resided at 3318 Polo Place, Bronx, New York and were residents of New York City as defined in section T46-105.0(a)(1) of Chapter 46, Title T of the Administrative Code of the City of New York. Petitioner Vincent A. D'Orazio has been a life long resident of New York City. The record does not disclose the length of Mrs. D'Orazio's residence in New York City.

18. Both the 1978 and 1979 New York State income tax resident returns require that a taxpayer list his and/or her "home address". Petitioners' returns for 1978 and 1979 listed their home address as "757 Central Park Avenue, Yonkers, New York". This is the address of Mr. D'Orazio's gas station. The City of Yonkers, New York lies outside the jurisdictional limits of the City of New York and therefore a taxpayer permanently residing in Yonkers would not be subject to New York City personal income tax as a resident individual.

19. The returns filed by petitioners for both years at issue contained entries on essentially **all** required lines, except for the following, which were left blank:



- (a) The City of New York tax;
- (b) The name of petitioners' school district and corresponding school district code; and
- (c) Petitioners' New York State county of residence<sup>1</sup>

20. Petitioners were aware of the fact that they were residents of New York City and were also aware **of** the fact that as residents **of** New York City they were required to pay New York City personal income taxes. Petitioners assert that they relied completely on their certified public accountant to prepare all necessary returns and that they were not knowledgeable with respect to tax matters.

21. The Federal and New York State income tax returns for 1978 and 1979 were prepared by petitioners' certified public accountant. Said accountant did not sign either of the New York State returns as the preparer. It is not known whether the accountant signed the Federal returns as the preparer. Petitioners' Federal returns for the two years at issue also listed their address as "757 Central Park Avenue, Yonkers, New York".

22. No evidence was adduced at the hearing with respect to the five (5) percent negligence penalty asserted on the proposed New York State personal income and unincorporated business tax liabilities.

#### CONCLUSIONS OF LAW

A. That pursuant to Finding of Fact "9", supra, the additional income disclosed by the bank deposit analysis for 1978 is to be reduced by \$11,580.32

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<sup>1</sup> The Audit Division, upon processing of the returns in question, inserted "West" in the box provided for county of residence. "West" is presumably an abbreviation for Westchester County. The City of Yonkers, New York is

and the adjustment for medical expenses for 1978 is to be reduced by \$25.00, from \$85.00 to \$60.00.

B. That the \$5,200.00 per year which the Audit Division estimated petitioners expended for groceries and outside meals, said amount having been determined without discussion or consultation with petitioners as to even the approximate amounts expended, is deemed excessive, given Mr. D'Orazio's testimony and also petitioners' participation in a food plan. Since petitioners did not provide the amount which was spent outside the food plan, a cash expenditure of \$35.00 per week (in addition to the food plan purchases) is considered appropriate given the facts involved herein. Accordingly, total groceries and outside meals expense is reduced to \$3,760.00 ( $\$35.00 \times 52 + \$1,940.00$ ) for 1978 and \$4,042.00 ( $\$35.00 \times 52 + \$2,222.00$ ) for 1979.

C. That the Audit Division's estimate of petitioners' annual clothing expense of \$2,400.00 and annual recreation, entertainment and vacation expense of \$1,300.00, again determined without discussion or consultation with petitioners as to even the approximate amounts expended, are deemed excessive considering the facts found herein. Since petitioners did not provide any figures as to actual amounts expended, it is reasonable to reduce the Audit Division's estimates by one-half. Accordingly, petitioners annual expense for clothing is reduced to \$1,200.00 and their annual expense for recreation, entertainment and vacations is reduced to \$650.00.

D. That pursuant to Finding of Fact "12", supra, petitioners are entitled to credit for cash withdrawn from a business savings account and subsequently used for the purchase of cigarettes. For 1978 the credit is \$9,770.79 and for 1979 the credit equals \$1,800.00.

**E.** That the bank deposit analyses prepared by the Audit Division properly gave petitioners credit for depreciation by reducing business expenses paid by cash. (See Finding of Fact "13", supra.)

**F.** That petitioners have failed to sustain their burden of proof (Tax Law sections 722 and 689(e) and section T46-189.0(e) of the New York City Administrative Code) to show that: (i) for 1978 the bank deposit analysis incorrectly duplicated a \$1,644.00 deduction for insurance and medicine; (ii) for 1979 the bank deposit analysis incorrectly duplicated the expense for an individual retirement account; and (iii) for 1979 the allowable depreciation deduction should be increased to \$3,979.00.

**G.** That the inclusion of fiduciary funds by petitioners in gross receipts is offset by the fact that the payment of said funds was claimed as a deduction. Accordingly, to allow a credit for fiduciary funds included in the bank deposit analyses, without a corresponding adjustment to the claimed deduction, would be improper.

**H.** That petitioners are not entitled to a credit for accounts payable due to the fact that they are cash basis taxpayers. Any adjustment for accounts payable, and also accounts receivable, would be reserved for accrual basis taxpayers.

**I.** That petitioners are entitled to credit for the two saving accounts closed out in 1979 (Finding of Fact "16", supra). The funds withdrawn from said accounts (\$733.16 and \$661.99) were used by petitioners for cash personal living expenses or were redeposited into a different account.

**J.** That pursuant to section T46-189.0(e)(1) of the Administrative Code of the City of New York, the burden of proof is upon the Audit Division to show that "...the petitioner has been guilty of fraud with intent to evade tax"

The standard of proof necessary to support a finding of fraud by the Tax Commission requires clear, definite and unmistakable evidence of every element of fraud, including willful, knowledgeable and intentional wrongful acts or omissions constituting false representation, resulting in a deliberate nonpayment or underpayment of taxes due and owing. Matter of J. David Goldin and Susan Goldin, State Tax Commission, April 25, 1980. The Audit Division has failed to sustain its burden of proof as to fraud.

K. That petitioners have failed to sustain their burden of proof to show that the Audit Division improperly assessed a five (5) percent negligence penalty on the proposed New York State personal income and unincorporated business tax liabilities.

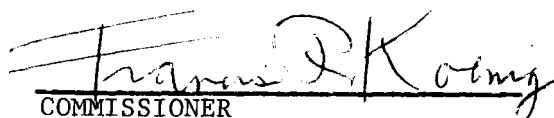
L. That the petition of Vincent A. D'Orazio and Rosalie S. D'Orazio is granted to the extent indicated in Conclusions of Law "A", "B", "C", "D", "I" and "J"; that the Audit Division is directed to recompute the four notices of deficiency dated January 21, 1983, consistent with the conclusions rendered herein; and that, except as so granted, the petition is in all other respects denied.

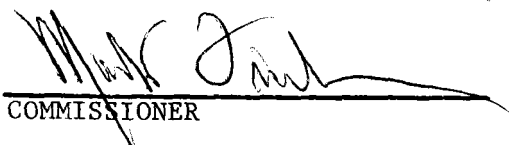
Dated: Albany, New York

STATE TAX COMMISSION

FEB 18 1983

PRESIDENT

  
COMMISSIONER

  
COMMISSIONER

*dissent. The fraud*