

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition

of

BRUCE and ANNETTE I. SHINDHELM

DECISION

for Redetermination of a Deficiency or for
Refund of Personal Income and Unincorporated :
Business Taxes under Articles **22** and **23** of the :
Tax Law for the Years 1979 through 1981.

Petitioners, Bruce and Annette I. Shindhelm, RD #6, Hayts Road, Ithaca, New York 14850, filed a petition for redetermination of a deficiency or for refund of personal income and unincorporated business taxes under Articles 22 and **23** of the Tax Law for the years 1979 through 1981 (File No. 44975).

A hearing was held before Timothy J. Alston, Hearing Officer, at the offices of the State Tax Commission, 333 East Washington Street, Syracuse, **New** York, **on** July 9, 1986 at 9:15 A.M. Petitioners appeared by Bruce Shindhelm. The Audit Division appeared by John P. Dugan, Esq. (James Della **Porta**, Esq* — of counsel).

ISSUE

Whether an audit performed by the source and application of funds method of income reconstruction properly determined petitioners' income.

FINDINGS OF FACT

1. Petitioners, Bruce and Annette I. Shindhelm, filed joint New York State income tax returns for the years 1979 through 1981.

a) For 1979, petitioners reported \$4,044.34 in business income, plus \$3.12 in interest, for a total of \$4,047.46. On Federal Schedule C, Form 1040,

petitioner Bruce Shindhelm reported \$24,615.00 in gross receipts, and deductions of \$20,570.66, for a net profit of \$4,044.34.

b) For 1980, petitioners reported \$2,705.74 from Annette Shindhelm's earnings as a waitress, plus \$3.36 in interest and **a** business loss of \$8,619.63, apparently attributable to Bruce Shindhelm's business operations (**no** Schedule C was attached to the return) resulting in a net loss of \$5,910.53.

c) For 1981, petitioners reported \$2,549.87 from Annette Shindhelm's earnings and **a** business loss **of** \$5,032.49 (again, **no** Schedule C was attached to the return), resulting in a net **loss of** \$2,482.62.

2. **On** April 11, 1983, the following notices of deficiency were issued to petitioners:

a) **To** Bruce and Annette **I.** Shindhelm for 1979, \$523.40 in income tax and \$34.03 as a negligence penalty, plus interest.

b) **To** Bruce and Annette **I.** Shindhelm for 1979, \$320.45 in unincorporated business tax and \$147.40 in penalties, including a negligence penalty and section 685(a)(1) and (a)(2) penalties for failure to file an unincorporated business tax return and to pay unincorporated business tax, plus interest (no unincorporated business tax was determined due for 1980, **as** the net audited income was **less** than the \$5,000.00 exemption; **no** unincorporated business tax was determined for 1981, as the rate for that year was reduced to zero prior to repeal of the tax).

c) **To** Bruce and Annette **I.** Shindhelm for 1980 and 1981, \$429.57 in Income tax and \$27.92 as a negligence penalty, plus interest.

d) **To** Annette **I.** Shindhelm for 1980 and 1981, \$47.40 in income ~~tax~~ and \$3.07 as a negligence penalty, plus interest.

(Two notices of deficiency were issued for income **tax** for 1980 and 1981, as the Audit Division recalculated petitioners' tax on the basis of "married, filing separately on one return", rather than "married, filing joint return", **as** such recalculation resulted in a lower overall tax.)

3. The deficiencies at issue arose from a sales tax audit of petitioner Bruce Shindhelm's business, Finger Lakes Wrecker Service, which he operated from his home. Annette **I.** Shindhelm was not involved in operating the business. The sales tax auditor determined that Mr. Shindhelm's records were inadequate, since bank statements, cancelled checks or check register stubs were not kept for the audit period. Accordingly, an audit by the source and application of funds method of income reconstruction was used. After a sales tax assessment was calculated using reconstructed income **as** taxable sales, the matter was referred for income tax audit action. The source and application of funds audit was again utilized as the basis for the income tax and unincorporated business tax deficiencies at issue herein.

4. The auditor calculated petitioners' personal living expenses for the years at issue by:

- a) deducting capital and business expenses paid by check from total checking account disbursements, to arrive at unidentified personal living expenses paid by check; and
- b) adding the unidentified personal living expenses paid by check to estimated personal living expenses paid by cash.

The calculations are as follows:

Year	Unidentified Personal Living Expenses Paid	Estimated Cash	Total
	<u>By Check</u>	<u>Personal Living Expenses</u>	<u>Personal Living Expenses</u>

5. The source and application of funds audit found the following additional income for the years at issue:

1979	\$12,382.49
1980	\$14,037.07
1981	\$18,676.97

All additional income was attributed to Mr. Shindhelm's business operations.

6. At the hearing, petitioner Bruce Shindhelm objected to the audit in two respects:

a) he claimed that it failed to recognize that his father had loaned him about \$14,000.00 and also had given him cash gifts during the period at issue; and

b) that an inheritance from the estate of his late uncle, Charles Levinsky, had been \$7,500.00 and not \$5,000.00, as allowed by the auditor.

CONCLUSIONS OF LAW

A. That petitioners' books and records were inadequate; accordingly, it was proper for the Audit Division to reconstruct petitioners' income by means of a source and application of funds audit.

B. That the audit method was improper to the extent that total unidentified personal living expenses paid by check was added to total estimated personal living expenses paid by cash. Use of this technique affords no protection against the double counting of expenses which would occur whenever checks are drawn direct for, or converted to cash for, payment of expenses included in the category of estimated personal living expenses paid by cash.

C. That the additional income found by the audit should be reduced for the years at issue by the estimated personal living expenses paid by cash, to wit:

1979	\$ 6,917.28
1980	8,069.83


D. That petitioners have not sustained their burden of proof imposed under section 689(e) of the Tax Law to show that any further reduction *is* warranted.

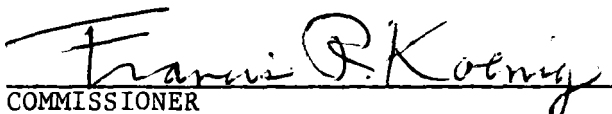
E. That except as provided in Conclusion of Law "C", the petition of Bruce and Annette I. Shindhelm is denied and the notices of deficiency are otherwise sustained. The Notice of Deficiency for unincorporated business tax, however, is *to* be cancelled insofar as it applies to petitioner Annette I. Shindhelm, since she was not involved in operating the business.


DATED: Albany, New York

STATE TAX COMMISSION

FEB 03 1987


PRESIDENT


COMMISSIONER


COMMISSIONER