

STATE OF NEW YORK

DIVISION OF TAX APPEALS

---

In the Matter of the Petition

of

FRANK L. CURCIO AND MARY CURCIO

DETERMINATION

for Redetermination of a Deficiency or for  
Refund of Personal Income Tax under Article 22  
of the Tax Law for the Years 1981 and 1982.

---

Petitioners, Frank L. Curcio and Mary Curcio, 635 Culver Parkway,  
Rochester, New York 14609, filed a petition for redetermination of a deficiency  
or for refund of personal income taxes under Article 22 of the Tax Law for the  
years 1981 and 1982 (File No. 60744).

A hearing was held before Timothy J. Alston, Hearing Officer, at the  
offices of the State Tax Commission, 259 Monroe Avenue, Rochester, New York, on  
September 17, 1986 at 2:45 P.M., with all briefs to be submitted by March 16,  
1987. Petitioners appeared by Patrick J. Lane, Esq. 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 for the years  
at issue.

#### FINDINGS OF FACT

1. On February 26, 1985, following an audit, the Audit Division issued to  
petitioners, Frank L. Curcio and Mary Curcio, a Notice of Deficiency asserting  
personal income tax due for the years 1981 and 1982 in the aggregate amount of  
\$2,428.00, plus penalty and interest. Petitioners filed joint returns during

the years at issue. Petitioners' main source of income during these years was a gas station owned and operated by Frank L. Curcio.

2. On audit, the Audit Division utilized a source and application of funds method to determine additional income earned by petitioners during the years at issue. The audit results are set forth below in summary form.

<u>Sources of Funds</u>	<u>1981</u>		<u>1982</u>	
Business income	\$15,732.00		\$9,205.00	
Depreciation	<u>1,175.00</u>		<u>5,525.00</u>	
		\$16,907.00		\$14,730.00
Real estate commissions	-0-		2,027.50	
Rental income	<u>3,330.00</u>		<u>3,600.00</u>	
		\$ 3,330.00		\$ 5,627.50
Bank Balances				
Business checking acct.	3,237.78		987.96	
Tax account	1,325.25		384.56	
Personal checking acct.	119.98		226.54	
Personal checking acct.	<u>111.39</u>		<u>264.31</u>	
		\$ 4,794.40		\$ 1,863.37
Mortgage Proceeds		30,000.00		-0-
Loan From Relatives		<u>-0-</u>		<u>5,200.00</u>
<u>Total Sources of Funds</u>		\$55,031.40		\$27,420.87
<u>Application of Funds</u>				
Bank Balances				
Business checking acct.	\$ 987.96		\$ 634.32	
Tax acct.	384.56		196.25	
Personal checking acct.	226.54		381.58	
Personal checking acct.	<u>264.31</u>		<u>821.05</u>	
		\$ 1,863.37		\$ 2,033.20
Capital Expenditure:				
Building		42,961.86		-0-
Loan Repayment -				
1st National Bank		80.00		1,071.00
Sales Tax Audit		-0-		6,193.32
Personal Cost of Living		<u>28,382.95</u>		<u>26,881.61</u>

<u>Total Application of Funds</u>	\$73,288.18	\$36,179.13
<u>Overapplication of Funds</u>	18,256.78	8,758.26
Adjustment	-0-	1,973.61
<u>Net Overapplication of Funds</u>	18,256.78	6,784.65
<u>Additional Tax Due</u>	2,090.83	363.84

3. The "Personal Cost of Living" component of petitioner's application of funds, as determined by the Audit Division, is set forth below.

	<u>1981</u>	<u>1982</u>
Payments by Check:		
Marine Midland Account	\$4,885.95	\$5,685.91
Community Savings Account	<u>6,076.01</u>	<u>4,795.25</u>
	\$10,961.96	\$10,481.16
Business Checking Acct.		
IRS	4,694.40	2,646.00
NYS	1,261.56	453.66
Insurance	<u>1,670.33</u>	<u>2,291.79</u>
	\$ 7,625.99	\$ 7,391.45
Payments by Cash:		
Personal mtge. \$262/month	\$ 3,144.00	\$ 2,358.00
Utilities		
Heat & elec.	1,093.00	1,093.00
Water	88.00	88.00
Telephone	150.00	150.00
Cable	<u>120.00</u>	<u>120.00</u>
	\$ 1,451.00	\$ 1,451.00
Food Expense \$60/week	3,120.00	3,120.00
Miscellaneous \$40/week	<u>2,080.00</u>	<u>2,080.00</u>
Total Personal Cost of Living	\$28,382.95	\$26,881.61

4. With respect to petitioners' sources of income, the Audit Division used the net profit and depreciation amounts listed on petitioner Frank Curcio's Federal Schedule C for each of the years at issue. The gross profit listed on petitioner Mary Curcio's 1982 Schedule C was used for "Real estate commissions". The Audit Division also used petitioners' gross rental income as set forth on their Federal Schedule E's for the years at issue.

5. With respect to petitioners' bank balances, the Audit Division used the balance in each of the accounts as of January 1 of the year at issue for its source figures.

6. As to the "mortgage proceeds" and "loan from relatives", the Audit Division based these amounts on statements made by petitioner.

7. With respect to its determination of petitioners' application of funds, the Audit Division used the end-of-year balances for each of the respective accounts for these figures. The capital expenditure figure was based on the amount of the mortgage proceeds and statements of petitioner with respect to down payments and closing costs. The "Sales Tax Audit" figure was based on petitioners' payment of \$6,193.32 during 1982 for previously unpaid sales taxes found on an audit of the service station. The "Loan repayment - 1st National Bank" figure was derived from an analysis of petitioners' business checking account and represented repayment of business loans.

8. As to the "Personal Cost of Living" figures, the Audit Division first calculated payments for personal expenses made by checks drawn on each of petitioners' four checking accounts. Additionally, the Audit Division calculated payment of a personal mortgage by cash in the amount of \$262.00 per month.<sup>1</sup> The utilities payments were also estimated.

9. The Audit Division incorrectly calculated petitioners' payments by check for 1981 with respect to their Marine Midland account. The audit workpapers revealed that said payments correctly totalled \$5,202.75 and not \$4,885.75 as calculated by the Audit Division.

---

1 The difference between the personal mortgage figures for the years at issue resulted from the Audit Division's finding of three payments of said mortgage by check in 1981.

10. On January 1, 1981, petitioner Frank Curcio had \$2,000.00 in cash on hand from the business and \$2,231.00 in credit card receipts which he subsequently turned in for cash. Neither of these amounts were considered in determining petitioners' beginning bank balances for 1981. Cash on hand and credit card receipts were also not considered in determining petitioners' bank balances at the end of each year at issue. Petitioners presented no evidence as to whether the cash and credit card receipts on hand on January 1, 1981 differed significantly from cash and credit card receipts on hand at the end of the years at issue. Petitioners contended that the cash and credit card receipts on hand at the beginning of 1981 should properly have been included in determining petitioners' beginning bank balances for 1981.

11. The Audit Division did not credit Mr. Curcio with an estimated amount of inventory at the beginning of 1981; nor did the Audit Division consider the value of the inventory at the end of each year in determining petitioners' sources and applications of funds. Rather, the Audit Division assumed that the value of the inventory remained constant throughout the audit period. Petitioners contended that they should have been credited with an estimated amount of inventory on hand at the beginning of 1981. Petitioners presented no evidence that the value of the inventory changed from the beginning of the years at issue to the end of the years at issue.

12. Petitioners further contended that their sources of income should properly have included depreciation taken on their return other than that taken in connection with the gas station. Specifically, petitioners contended depreciation taken on their rental property as set forth on their Schedule E should have been included as a source of income.

13. Petitioners earned interest in the respective amounts of \$245.00 and \$288.00 for the years 1981 and 1982. Neither of these amounts was included as a source of funds on audit. No evidence was received as to whether the amounts earned as interest was withdrawn from petitioners' account.

14. The Sun Oil Company supplied petitioner Frank Curcio's purchases of gasoline throughout the audit period. Sun Oil Company required that an escrow account be established as security for such purchases. This account was established and maintained by adding a certain charge per gallon of gasoline for each order and adding that charge to the escrow account. Mr. Curcio withdrew \$4,000.00 from this account in 1981 as part of the financing of his purchase of the service station. This \$4,000.00 was classified as an application of funds for 1981, but not as a source of funds for that year. Amounts which were added to the escrow account were included as part of Mr. Curcio's cost of goods sold on his Schedule C. The \$4,000.00 in question had been deposited prior to 1981.

15. Petitioner Frank Curcio included sales tax paid within gross receipts and gross profits on his Schedule C. From these amounts, he deducted sales tax paid along with his other business deductions to arrive at net profit.

16. With respect to the sales tax paid in 1982 of \$6,193.00 which was included as an application of funds, no evidence was presented as to whether the \$6,193.00 was included in Mr. Curcio's gross receipts for 1982 or whether said \$6,193.00 was included within his deduction for taxes paid on his Schedule C.

17. Petitioner Frank Curcio contended that he had received a loan of \$6,000.00 in 1981 from his mother to help finance his purchase of the gas station. Mr. Curcio made two bank deposits on November 1, 1981. His check

register had a notation indicating "loan" next to a \$3,000.00 deposit. The remaining \$3,000.00 of the loan was purportedly included as part of petitioner's other deposit on November 1, 1981, a \$4,374.24 deposit which also purportedly included the day's receipts. Petitioner's mother died shortly after the disputed transaction. Petitioner contended that this loan should have been included as a source of funds.

18. Petitioners also took issue with the Audit Division's calculation of petitioners' personal living expenses contending that the Audit Division's estimate of such amounts was inaccurate. Petitioners, however, presented no evidence regarding their actual expenses during the period at issue.

#### CONCLUSIONS OF LAW

A. That the audit method was improper to the extent that the Audit Division failed to allow as a source of funds for 1981 the \$4,000.00 withdrawal from petitioner Frank Curcio's escrow account. Petitioners established that these funds were applied to the purchase of the service station, and further, that these funds were deposited in the escrow account prior to 1981. The Audit Division's contention that monies deposited in the escrow account were included in petitioner's gross receipts is therefore without merit, for even if true, the \$4,000.00 in question would have been included as a part of gross receipts in years prior to the audit period. It was therefore improper not to allow these monies, deposited in prior years, as a source of income during 1981. Accordingly, the Audit Division **is** directed to recompute petitioners' 1981 tax liability by including the \$4,000.00 in question as a source of income for that year.

B. That the Audit Division is also directed to recalculate petitioners' 1981 personal living expenses in accordance with Finding of Fact "9",

C. That the audit method was in all other respects proper. The Audit Division's omission of the value of cash on hand, credit card receipts, and inventory to determine the sources of income available to petitioners was, in effect, offset by the omission of the value of the aforementioned items at the close of each year in determining petitioners' applications of funds. It is further noted that petitioners presented no evidence to show that the value of these items at the end of the years at issue varied from the value of said items at the beginning of each year. As to petitioners' contention that the depreciation taken on their rental property should have been included as a source of funds, inasmuch as their gross rental income was considered a source and given that such depreciation was deducted from gross rental income it follows that the claimed depreciation was actually included as a source as part of petitioners' gross rental income. Inclusion of this depreciation as a separate source of funds would thus amount to a duplication of sources. With respect to the interest income earned by petitioners, inasmuch as petitioners presented no evidence as to whether such funds were withdrawn from their bank account, the Audit Division properly omitted these amounts from its source calculations. Finally, with respect to the sales tax of \$6,193.32 paid in 1982, petitioners' failure to establish whether or not said amounts were included in Mr. Curio's gross receipts for 1982 or included within his deduction for taxes paid on his Schedule C, results in the Audit Division's properly omitting said amount from the sources of funds calculation. As to the Audit Division's calculation of personal living expenses, petitioners failed to present specific evidence showing wherein said calculations were improper.



D. That petitioners have not sustained their burden of proof imposed under section 689(e) of the Tax Law to establish the existence of the purported loan received from Mr. Curcio's mother in 1981. Specifically, the lack of documentation regarding said loan, or even a deposit or deposits in the amount of the loan, results in petitioners' failure to meet their burden of proof with respect to this contention.

E. That petitioners have failed to present any evidence tending to show reasonable cause for their failure to report the additional income found on audit. Accordingly, the Audit Division's assertion of penalty herein is sustained.

F. That the petition of Frank L. Curcio and Mary Curcio is granted to the extent indicated in Conclusions of Law "A" and "B"; the Audit Division is directed to adjust the Notice of Deficiency, dated February 26, 1985, in accordance therewith; and except as so granted, the petition is in all other respects denied.

DATED: Albany, New York

SEP 03 1987

  
\_\_\_\_\_  
ADMINISTRATIVE LAW JUDGE