

STATE OF NEW YORK  
STATE TAX COMMISSION

In the Matter of the Petition :  
of  
Louis & Josephine Merola :

AFFIDAVIT OF MAILING

for Redetermination of a Deficiency or a Revision :  
of a Determination or a Refund of  
Personal Income Tax :  
under Article 22 of the Tax Law  
for the Year 1972. :

State of New York  
County of Albany

Jay Vredenburg, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 9th day of January, 1981, he served the within notice of Decision by certified mail upon Louis & Josephine Merola, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Louis & Josephine Merola  
42 Ridge Dr.  
Plainview, NY 11803

and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the petitioner herein and that the address set forth on said wrapper is the last known address of the petitioner.

Sworn to before me this  
9th day of January, 1981.

*Cornie A. Hagelund*

*J. Vredenburg*

STATE OF NEW YORK  
STATE TAX COMMISSION

In the Matter of the Petition :  
of  
Louis & Josephine Merola :  
for Redetermination of a Deficiency or a Revision :  
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Personal Income Tax :  
under Article 22 of the Tax Law  
for the Year 1972. :

AFFIDAVIT OF MAILING

State of New York  
County of Albany

Jay Vredenburg, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 9th day of January, 1981, he served the within notice of Decision by certified mail upon Lawrence Krug the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Mr. Lawrence Krug  
One Winston Court  
Dix Hills, NY 11746

and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the representative of the petitioner herein and that the address set forth on said wrapper is the last known address of the representative of the petitioner.

Sworn to before me this  
9th day of January, 1981.

*Connie A. Hagelund*

*J. Vredenburg*

STATE OF NEW YORK  
STATE TAX COMMISSION  
ALBANY, NEW YORK 12227

January 9, 1981

Louis & Josephine Merola  
42 Ridge Dr.  
Plainview, NY 11803

Dear Mr. & Mrs. Merola:

Please take notice of the Decision of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 690 of the Tax Law, any proceeding in court to review an adverse decision by the State Tax Commission can only be instituted under Article 78 of the Civil Practice Laws and Rules, and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 months from the date of this notice.

Inquiries concerning the computation of tax due or refund allowed in accordance with this decision may be addressed to:

NYS Dept. Taxation and Finance  
Deputy Commissioner and Counsel  
Albany, New York 12227  
Phone # (518) 457-6240

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative  
Lawrence Krug  
One Winston Court  
Dix Hills, NY 11746  
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

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|---|---|----------|
| In the Matter of the Petition           | : |          |
|   | : |          |
| of                                      | : |          |
|   | : |          |
| LOUIS AND JOSEPHINE MEROLA              | : | DECISION |
|   | : |          |
| for Redetermination of a Deficiency or  | : |          |
| for Refund of Personal Income Tax under | : |          |
| Article 22 of the Tax Law for the Year  | : |          |
| 1972.                                   | : |          |

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Petitioners, Louis and Josephine Merola, 42 Ridge Drive, Plainview, New York 11803, filed a petition for redetermination of a deficiency or for refund of personal income taxes under Article 22 of the Tax Law for the year 1972. (File No. 14303).

A formal hearing was held before Neil Fabricant, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on May 15, 1978 at 10:45 A.M. Petitioners appeared by Lawrence Krug, CPA. The Audit Division appeared by Peter Crotty, Esq. (Irwin Levy, Esq., of counsel).

ISSUE

Whether a loss from certain monies advanced by petitioners to a corporation constituted an ordinary loss or a short-term capital loss.

FINDINGS OF FACT

1. Petitioners filed a joint New York State income tax resident return for 1972 on which they claimed a miscellaneous deduction of \$20,031.41 as a business loss.

2. On January 26, 1976, the Audit Division issued a Statement of Audit Changes and Notice of Deficiency against the petitioners for the year 1972 recomputing their income tax liability and imposing additional tax in the amount of \$1,121.35, with interest of \$234.09, for a total of \$1,355.44. The

petitioners timely filed a petition with respect to the aforesaid deficiency.

3. The Statement of Audit Changes stated, in part, that:

"A loss incurred as a result of a loan made to a corporation which went bankrupt constitutes a non-business bad debt deduction which is treated like a short-term capital loss. The loss is therefore limited to \$1,000.00 per year.

Business loss of \$20,031.41 is disallowed as an itemized deduction as Section 1244 loss is not properly a miscellaneous deduction. It should be reported as a Schedule A deduction.

Your 1972 New York State income tax liability has been recomputed as follows:

|   |             |             |
|---|-------------|-------------|
| Total income as reported                                |             | \$28,195.65 |
| Section 1244 loss allowed                               |             | 1,000.00    |
| Capital loss (\$19,031.41) limited to                   |             | 1,000.00    |
| Total income as adjusted                                |             | \$26,195.65 |
| Total itemized deductions as reported                   | \$27,689.97 |             |
| Business loss disallowed                                | 20,031.41   |             |
| Total itemized deductions as adjusted                   | \$ 7,658.56 |             |
| Life insurance premiums                                 | 100.00      |             |
| Balance   | \$ 7,758.56 |             |
| Less New York State income tax modification             | 1,471.95    |             |
| New York itemized deductions as adjusted                |             | 6,286.61    |
| Balance   |             | \$19,909.04 |
| Exemptions  |             | 2,600.00    |
| New York taxable income                                 |             | \$17,309.04 |
| Tax from tax rate schedule                              |             | \$ 1,094.00 |
| Tax surcharge @ .025%                                   |             | 27.35       |
| New York State personal income tax due                  |             | \$ 1,121.35 |
| New York State personal income tax<br>previously stated |             | .00         |
| NEW YORK STATE PERSONAL INCOME TAX DUE                  |             | \$1,121.35  |
|   | Int.        | 234.09      |
|   | Total Due   | \$1,355.44" |

4. Jole Restaurant Corp. was incorporated under the laws of the State of New York on February 16, 1970. Louis Merola was president and his wife Josephine, Secretary-Treasurer. The corporation operated a fish and chips franchise restaurant at 3068 Hempstead Turnpike, Levittown, New York. Louis Merola, at that time and up to and including 1972, was employed full time as a switchman for the New York Telephone Co. Josephine Merola was a teacher. Both worked "behind the counter" of the restaurant.

5. Petitioners' representative contended that petitioners made an initial investment of \$10,450.00 in the business in 1968 and advanced additional monies over the following years. The total investment, he claimed, was \$20,031.41. At the time the corporation was organized, \$1,000.00 of the investment was attributed to capital stock and the balance of the investment to loans.

6. On the U.S. Corporation Income Tax Return of Jole Restaurant Corp. for fiscal year ending January 31, 1971, there is an item, "Loans from stockholders, \$15,684.59". The balance sheet of the return reported stockholders' equity of \$1,000.00 in common stock, both at the beginning and end of the taxable year.

7. On March 15, 1973, Jole Restaurant Corp. was dissolved. The corporation filed a final U.S. Corporation Income Tax Return for fiscal year ending January 31, 1973. Stockholders' equity was reported at \$1,000.00 in common stock at the beginning of the taxable year and \$16,684.59 in common stock at the end of the taxable year.

8. The Audit Division conceded that petitioners had established an ordinary loss of \$1,000.00 on "1244 stock" (Section 1244 Internal Revenue Code) but claimed that the balance of the loss neither qualified as section 1244 stock or as a business bad debt.

#### CONCLUSIONS OF LAW

A. That only \$1,000.00 of petitioners' loss qualified as a loss on small business stock under section 1244 of the Internal Revenue Code and is to be treated as an ordinary loss. The balance of the loan is to be treated as a bad debt.

B. That under section 166 of the Internal Revenue Code, business bad debts may be deducted as ordinary losses, while non-business bad debts are deductible as short-term capital losses.

C. That loans by an officer or employee to a corporation are usually not related to his business, since the business of the corporation is not the business of its employees or officers. The loans, if uncollectible, are non-business bad debts.

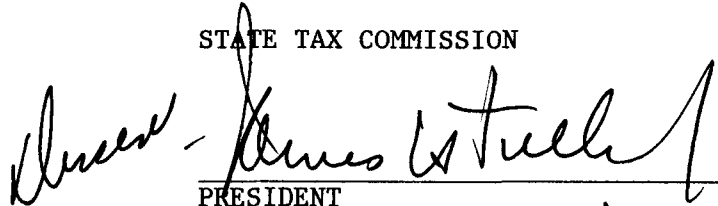
D. That a stockholder who lends money to his corporation is not in business when his only return is that of an investor, even though his return on the loan is substantially due to his services. A loss would be a non-business bad debt. (Whipple v. Commissioner, 373 U.S. 193).

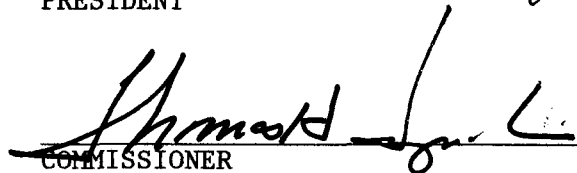
E. That the petition of Louis and Josephine Merola is hereby denied.


DATED: Albany, New York

JAN 09 1981

STATE TAX COMMISSION

  
PRESIDENT

  
COMMISSIONER

  
COMMISSIONER