

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
Jose & Ann J. Sanchez :
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 Years :
1973 & 1975. :

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 8th day of September, 1982, he served the within notice of Decision by certified mail upon Jose & Ann J. Sanchez, the petitioners in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Jose & Ann J. Sanchez
70 Granny Rd.
Farmingville, NY 11738

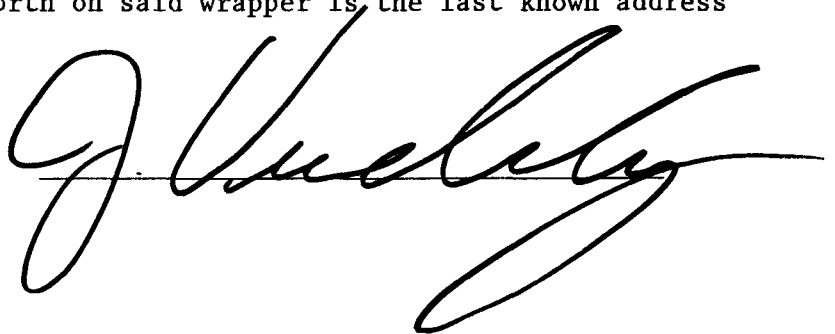
and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

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
8th day of September, 1982.



AUTHORIZED TO ADMINISTER
OATHS PURSUANT TO TAX LAW
SECTION 174



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

September 8, 1982

Jose & Ann J. Sanchez
70 Granny Rd.
Farmingville, NY 11738

Dear Mr. & Mrs. Sanchez:

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
Law Bureau - Litigation Unit
Albany, New York 12227
Phone # (518) 457-2070

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative

Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition
of
JOSE SANCHEZ AND ANN SANCHEZ
for Redetermination of a Deficiency or for
Refund of Personal Income Tax Under Article
22 of the Tax Law for the Years 1973 and
1975.

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DECISION

Petitioners, Jose Sanchez and Ann Sanchez, 70 Granny Road, Farmingville, New York 11738, filed a petition for redetermination of a deficiency or for refund of personal* income tax under Article 22 of the Tax Law for the years 1973 and 1975 (File No. 19542).

A small claims hearing was held before James Hoefer, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on October 9, 1980 at 10:45 A.M. and continued to a conclusion at the same location on January 27, 1981 at 1:30 P.M. Petitioner Jose Sanchez appeared pro se and for his wife. The Audit Division appeared by Ralph J. Vecchio, Esq. (Frank Levitt, Esq., of counsel, at the October 9, 1980 hearing and Samuel Freund, Esq., of counsel, at the January 27, 1981 hearing).

ISSUES

I. Whether the Department of Taxation and Finance has failed to acknowledge receipt of the Sanchezs' petition, and, if so, is the State Tax Commission thereby barred from further proceedings.

II. Whether the Department's failure to reconvene a pre-hearing conference for the purposes of discovery and/or stipulation precludes the Commission from further proceedings.

III. Whether compensation of \$19,793.33 received by petitioner Jose Sanchez from his employer in 1975 as the result of an arbitration award constitutes taxable income or a nontaxable award for damages.

IV. Whether the Audit Division has properly disallowed petitioners' claimed business losses in 1973 and 1975 of \$5,278.00 and \$5,648.00, respectively.

FINDINGS OF FACT

1. Petitioners, Jose Sanchez and Ann Sanchez, timely filed a joint New York State Income Tax Resident Return for 1973 and separate resident returns for 1975. On the 1973 return petitioners claimed a business loss of \$5,278.00, while on his separate 1975 return, petitioner Jose Sanchez claimed a business loss of \$5,648.00. Wage income reported by petitioner Jose Sanchez on his 1975 return totaled \$20,066.00. In arriving at reported 1975 wage income of \$20,066.00, petitioner Jose Sanchez deducted the sum of \$14,763.56. Said amount, although received in 1975, was considered by petitioner as "back pay" and taxable in 1974.

2. On April 11, 1977 the Audit Division issued a Notice of Deficiency to petitioners for the years 1973 and 1975 assessing additional personal income tax of \$2,688.50, plus interest of \$269.81, for a total due of \$2,958.31. In a typewritten statement inserted at the bottom of the Notice of Deficiency the Audit Division indicated that "The 1974¹ overpayment of \$17.29 plus interest of \$2.92 totaling \$20.21 due you will be applied against this deficiency leaving a balance still due of \$2,938.10".

¹ The 1974 tax year is not involved in this proceeding since petitioners have not filed a petition for a redetermination or for refund for said year.

3. The above mentioned Notice of Deficiency was based on an explanatory Statement of Audit Changes, originally dated August 26, 1976, wherein the business losses claimed in 1973 and 1975 were disallowed since:

"...the activity is presumed not to have been engaged in for profit where the losses recur repeatedly. Where profits do not result in two out of five consecutive years, such business activity is not considered as engaged in for a profit."

The Statement of Audit Changes also proposed to increase petitioner Jose Sanchez's 1975 wage income by \$14,763.56, the amount which he considered as back pay and taxable in 1974. The Audit Division's explanation for this adjustment was that "Wages are considered income in the year received, and not in the year earned".

4. In early 1974 petitioner Jose Sanchez was discharged by his employer from his duties as a field representative due to alleged acts of insubordination. Mr. Sanchez filed a grievance against his employer and an arbitrator's award, dated April 29, 1975, ruled that he had been "...discharged without reason or just cause". The award further specified that the employer was to:

"...return the grievant, Jose Sanchez, to the position he held prior to his wrongful discharge, within five days after the receipt by it of this Award, with all rights reserved to him under the collective bargaining agreement between the parties; and further that (the employer) pay to him damages in the sum of \$19,793.33, less any earnings that he may have received from the date of his discharge until the date of his return to work."

5. The arbitrator's award dated April 29, 1975 was appealed by the employer, however, said appeal was unsuccessful and Mr. Sanchez was reinstated to the position he held prior to the wrongful discharge in September, 1975. Pursuant to the arbitrator's award, Mr. Sanchez received a check from his employer, dated September 18, 1975, in the sum \$16,132.66; said amount computed by the employer in a memorandum dated October 17, 1975 as follows:

1974 wages due	\$14,763.56
1975 wage due through 8/8/75	<u>11,282.72</u>
Total	26,046.28
Less other earnings	<u>5,316.08</u>
Total	20,730.20
Less withholding taxes, social security taxes & union dues	<u>4,597.54</u>
Net	<u>\$16,132.66</u>

6. Petitioners now argue that the entire amount of the arbitrator's award of \$19,793.33 represented damages received on account of personal injuries or sickness and, as such, is not includable in gross income pursuant to section 104(a)(2) of the Internal Revenue Code. A claim for refund was filed with the Internal Revenue Service for the year 1975 wherein petitioners asserted that the \$19,793.33 was not includable in gross income. The Internal Revenue Service, after examination, approved petitioners' claim for refund.

7. The tax returns filed by petitioners for the years 1972, 1973, 1974 and 1975 each reported a loss from Mr. Sanchez's sales activities in both the real estate and insurance fields. The Audit Division disallowed the business losses as a matter of law [Internal Revenue Code section 183(d)] and did not conduct an audit or investigation as to the relevant facts and circumstances under which Mr. Sanchez operated his business [Treasury Regulation §1.183-2(b)].

8. Petitioners argue that their petition for redetermination was not acknowledged in accordance with the provisions of 20 NYCRR 601.4(a). Admitted in evidence as part of petitioners' exhibit "5" is a photostatic copy of a Tax Appeals Bureau Form TA-15 which was addressed to petitioners and indicated that "This is to acknowledge receipt of the petition of: Jose and Ann J. Sanchez".

9. Petitioner Jose Sanchez attended a pre-hearing conference conducted pursuant to authority contained in 20 NYCRR 601.4(c). A resolution of the controversy was not reached at said pre-hearing conference and the matter was therefore forwarded for a small claims hearing. Petitioners submit that the

pre-hearing conference was not used as a basis for a written stipulation of the facts agreed to and those still in disagreement. Petitioners did not submit to the Law Bureau a proposed stipulation of facts pursuant to 20 NYCRR 601.7(a).

CONCLUSIONS OF LAW

A. That petitioners' argument to dismiss on the ground that their petition was not acknowledged pursuant to 20 NYCRR 601.4(a) is without merit. Petitioners' own evidence indicates that they received proper acknowledgment (Finding of Fact "8").

B. That petitioners' argument to dismiss on the ground that the pre-hearing conference was not utilized for the purpose of discovery or stipulation is also denied. The Rules of Practice and Procedure should not be regarded as mandatory but directory only (Matter of Santoro v. State Tax Commission, Albany County Special Term, Conway, J., January 4, 1979). Additionally, petitioners did not submit a proposed stipulation of facts to the Law Bureau in accordance with 20 NYCRR 601.7(a).

C. That section 697(b) of the Tax Law provides:

"The tax commission for the purpose of ascertaining the correctness of any return, or for the purpose of making an estimate of taxable income of any person, shall have power to examine or to cause to have examined, by any agent or representative designated by it for that purpose, any books, papers, records or memoranda bearing upon the matters required to be included in the return, and may require the attendance of the person rendering the return or any officer or employee of such person, or the attendance of any other person having knowledge in the premises, and may take testimony and require proof material for its information, with power to administer oaths to such person or persons."

D. That pursuant to 20 NYCRR 153.4 the Tax Commission is not required to accept as correct any Federal change in taxable income but may conduct an independent audit or investigation.

E. That section 104(a)(2) of the Internal Revenue Code provides that gross income does not include "the amount of any damages received (whether by suit or agreement) on account of personal injuries or sickness". Treasury Regulation §1.104-1(c) provides in pertinent part that:

"The term 'damages received (whether by suit or agreement)' means an amount received (other than workmen's compensation) through prosecution of a legal suit or action based upon tort or tort type rights, or through a settlement agreement entered into in lieu of such prosecution."

F. That the award received by petitioner Jose Sanchez in 1975 as the result of the arbitrator's decision is not excludable from gross income pursuant to section 104(a)(2) of the Internal Revenue Code and Treasury Regulation §1.104-1(c). Said award was not received by Mr. Sanchez on account of personal injuries; nor was the award granted in payment for damages to petitioner's personal vis-a-vis professional reputation. Petitioner has not shown that he expressly requested his employer to pay him a cash award based on damages to his personal reputation or his physical or mental health. The basis of the controversy between Mr. Sanchez and his employer was contractual in nature and the arbitrator's award was essentially back pay. Petitioner Jose Sanchez's claim against his employer did not arise from tort-like injuries to petitioner's person as contemplated by section 104(a)(2) of the Internal Revenue Code. (See: Seay v. Commissioner, 58 TC 32; Whitehead v. Commissioner, 41 TCM 365; Knuckles v. Commissioner, 349 F 2d 610; and Glynn v. Commissioner, 76 TC ____).

G. That petitioner Jose Sanchez, as a cash basis taxpayer, must include in 1975 gross income that portion of the award received from his employer in said year. Since the entire award was received by Mr. Sanchez in 1975, no portion of said award can be attributed to the year 1974 as back pay.

H. That the Audit Division's disallowance of the business losses claimed on petitioner's 1973 and 1975 returns based solely on the fact that profits were not realized in two out of five years [I.R.C. 183(d)] is erroneous as a matter of law. Treasury Regulation §1.183-1(a) provides in pertinent part that:

"Whether an activity is engaged in for profit is determined under section 162 and section 212(1) and (2) except insofar as section 183(d) creates a presumption that the activity is engaged in for profit."

Section 183(d) of the Internal Revenue Code and Regulation §1.183-1(a) creates a favorable presumption that an activity is engaged in for profit where a profit is shown in two out of five consecutive years. The fact that petitioners did not show a profit in two out of five years does not, in and of itself, constitute proper grounds for disallowance of the claimed business losses as an activity not engaged in for profit.

I. That the petition of Jose Sanchez and Ann Sanchez is granted to the extent indicated in Conclusions of Law "H", supra, and that, except as so granted, the petition is in all other respects denied.

DATED: Albany, New York

SEP 08 1982

STATE TAX COMMISSION

ACTING

PRESIDENT

COMMISSIONER

COMMISSIONER