

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
Michael Nardone :
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 :
1976 - 1978. :

AFFIDAVIT OF MAILING

State of New York
County of Albany

Connie Hagelund, being duly sworn, deposes and says that she is an employee of the State Tax Commission, over 18 years of age, and that on the 10th day of November, 1983, she served the within notice of Decision by certified mail upon Michael Nardone, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Michael Nardone
Milton Ave.
Highland, NY 12528

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
10th day of November, 1983.

Martha L. Drunelle

Connie R. Hagelund

STATE OF NEW YORK

STATE TAX COMMISSION

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for Redetermination of a Deficiency or a Revision :
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State of New York
County of Albany

Connie Hagelund, being duly sworn, deposes and says that she is an employee of the State Tax Commission, over 18 years of age, and that on the 10th day of November, 1983, she served the within notice of Decision by certified mail upon Raymond M. Pezzo the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Raymond M. Pezzo
19 Davis Ave.
Poughkeepsie, NY 12603

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
10th day of November, 1983.

Mauba L. Smalle

Connie Hagelund

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

November 10, 1983

Michael Nardone
Milton Ave.
Highland, NY 12528

Dear Mr. Nardone:

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 Law 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
Building #9 State Campus
Albany, New York 12227
Phone # (518) 457-2070

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative
Raymond M. Pezzo
19 Davis Ave.
Poughkeepsie, NY 12603
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition	:	
of	:	
MICHAEL NARDONE (DECEASED)	:	DECISION
for Redetermination of a Deficiency or for	:	
Refund of Personal Income Tax under Article 22	:	
of the Tax Law for the Years 1976 through 1978.	:	

Petitioner, Michael Nardone (deceased), Milton Avenue, Highland, New York 12528, 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 1976 through 1978 (File No. 31617).

A formal hearing was held before Dennis M. Galliher, Hearing Officer, at the offices of the State Tax Commission, Building 9, State Office Campus, Albany, New York, on October 18, 1982 at 9:15 A.M., with all briefs to be submitted by May 1, 1983. Petitioner appeared by Raymond M. Pezzo, Esq. The Audit Division appeared by Paul B. Coburn, Esq. (Harry Kadish, Esq., of counsel).

ISSUES

I. Whether the assertion against petitioner of a deficiency in personal income tax due for the year 1976 is precluded by operation of the statute of limitations.

II. Whether the Audit Division properly disallowed net losses arising from petitioner's apple farming operation during the years at issue, upon the basis that such farming operation was not carried on with the bona fide objective of realizing a profit thereon.

III. Whether the imposition of a penalty against petitioner pursuant to section 685(c) of the Tax Law for the year 1977 was proper and, if so, whether the amount of such penalty was properly calculated by the Audit Division.

FINDINGS OF FACT

1. Petitioner, Michael Nardone, together with his wife Rosemary Nardone who is not a party to this proceeding, timely filed New York State Income Tax Resident Returns (Forms IT-201/208) for each of the years 1976, 1977 and 1978. On April 4, 1980, a validated consent was executed by petitioner and Mrs. Nardone, allowing the assessment of personal income and/or unincorporated business taxes for the year ended December 31, 1976 to be made at any time on or before April 15, 1981.

2. On October 1, 1980, the Audit Division issued to petitioner, Michael Nardone, a Notice of Deficiency asserting additional tax due for the years 1976 through 1978 in the amount of \$12,673.49, plus penalty and interest for 1976 and 1977, and interest (only) for 1978. A Statement of Personal Income Tax Audit Changes dated July 18, 1980 and issued to petitioner provided, in explanation of the above-asserted deficiency, as follows:

"[t]he farm losses on the above returns are being disallowed, as the recurring losses and a review of the information obtained to date does not establish the farming activity was carried on with the expectation of making a profit."

3. The above-noted Statement of Audit Changes further specified the losses disallowed and the additional tax asserted as due for each individual year, as follows:

<u>Year</u>	<u>Farm Loss Disallowed</u>	<u>Corrected Tax Due</u>	<u>Tax Previously Computed</u>	<u>Additional Tax Due</u>
1976	\$28,775.00	\$46,170.05	\$41,853.80	\$ 4,316.25
1977	1,766.00	36,288.65	36,023.75	264.90
1978	66,694.00	25,796.05	17,703.71	8,092.34
				<u>\$12,673.49</u>

Penalties pursuant to Tax Law section 685(c) [underpayment of estimated taxes] were asserted in the amounts of \$1,149.24 for 1976 and \$1,293.15 for 1977, respectively.

4. Subsequent to the filing of a petition, but prior to the hearing date, Mr. Nardone died. Rosemary Nardone, as executrix of Mr. Nardone's estate, executed a power of attorney authorizing the continued representation of petitioner in this matter by Raymond M. Pezzo, Esq.

5. Mr. Nardone was, until his death, engaged in the practice of law for a period of over thirty years in the Kingston, New York area. He was also involved in the operation of an insurance business and the operation of a large apple farm.¹

6. Mr. Nardone began his apple farming operation approximately forty-five years ago, and by the years at issue it had become one of the largest apple growing operations in the Hudson Valley. In 1960, approximately 350 acres of land were under cultivation as apple orchards. Mr. Nardone purchased many neighboring farms during subsequent years such that by 1978 his apple orchards under cultivation included approximately 950 acres. His farm land was located in the Towns of Lloyd, New York and Marlboro, New York.

7. The farm was operated as a sole proprietorship. A single entry, cash basis system of accounting was maintained, with the books and records of the farm kept separate and distinct from those maintained for Mr. Nardone's law practice and other activities. The farm's books and records, together with underlying documents in substantiation of expenses claimed, were found acceptable upon audit by the Audit Division. Accordingly, the only issue raised by the Audit Division concerns whether or not the farming operation was carried on with the bona fide intention of realizing a profit, thus determining the deductibility of net losses incurred in such activity.

¹ Mr. Nardone's farm acreage was not all contiguous, but was handled as one integrated farming operation and is referred to herein as one farm.

8. The continual expansion of the farm's acreage required large outlays of capital both for purchase of the land and for the machinery and equipment needed to handle the increased acreage. Much of the acreage acquired had not previously been used for growing fruit trees and was broken up by stone wall boundaries. Removal (burial) of the stone wall boundaries as well as preparation of the new acreage for tree planting was required.

9. The new acreage was opened up, fertilized, mowed and prepared, and new trees were planted. After planting, these new trees required trimming, training and other general care, and all orchard acreage had to be mowed and maintained.

10. In addition to increasing acreage, Mr. Nardone also undertook a program of orchard densification beginning in 1976. This program involved the planting of dwarf and semi-dwarf apple trees, both in the new acreage and in the older orchard areas. These dwarf and semi-dwarf trees, which only became commercially available for planting in or about 1976, were planted between existing productive trees and also as entire orchards. Older, non-productive trees were removed in some areas and replaced with the new dwarf and semi-dwarf trees. The purpose of the program was to increase the number of trees and hence the amount of fruit grown per acre, and worked on the basis that dwarf and semi-dwarf trees may be planted as close as fifteen feet apart, while the traditional full-size trees require a spacing of thirty to fifty feet. Also, the dwarf and semi-dwarf trees can produce a marketable crop four to five years after planting, while full-size trees require seven to ten years after planting before a marketable crop is produced.

11. In each of the years from 1973 through 1980 the farm operation resulted in a net loss, except for the years 1973 and 1980, in which profits of \$60,985.00 and \$35,557.00, respectively, were realized.

12. Mr. Nardone hired managers to operate his farm, including one John Curry who was manager from 1953 through 1978, and one Iain Ormiston who went to work for Mr. Nardone in 1960 as a machinery maintenance worker and field hand and who, by the years at issue, had become a co-manager with Mr. Curry. Both Mr. Curry and Mr. Ormiston had been born and raised on farms. Except for various courses dealing primarily with pesticide and insecticide spraying as taken by Mr. Ormiston and resulting in a State license to apply such sprays, neither Mr. Curry nor Mr. Ormiston received formal academic training in farming. Mr. Curry has been involved with farming for his entire life, working on his parents' farm until their deaths, at which time he went to work for Mr. Nardone. Mr. Ormiston, like Mr. Curry, for the most part gained his knowledge of farming through "hands-on" experience.

13. Mr. Nardone and his managers consulted frequently with various experts, including the State Agricultural Department's Cooperative Extension Service, scientists (including a leading pomologist) at Cornell University's Experimental Station, and commercial pesticide spray representatives, concerning methods of improving the farm's productivity and efficiency. Mr. Nardone and his managers also consulted with neighboring growers concerning operating methods.

14. Mr. Nardone's actual personal working time at the farm consisted of visits "a couple of times" during each week and spending half days at the farm on weekends, especially during the harvest season. It was asserted that Mr. Nardone had been very active in managing the farm in his earlier years, but during the years at issue he was approaching seventy years of age and thus his active work involvement was necessarily limited. In addition to his visits to the farm, Mr. Nardone was in almost daily telephone contact with his farm managers.

15. During the years at issue, the farm did not have a packaging facility and there were very few businesses capable of packaging the volume of fruit produced by the Nardone farm. The farm's crop output was thus marketed in bulk, specifically by being sold in twenty bushel containers to large wholesalers as middlemen, rather than being packaged and sold directly to retail outlets such as grocery stores. It was asserted that the generally depressed apple market, the necessity of dealing through wholesalers rather than directly with retailers, and the limited number of outfits capable of handling the farm's output resulted in additional cost, low selling prices and contributed to the farm's lack of profitability. Following the years at issue, the farm built a packaging plant, thus allowing an escape from wholesalers' charges by enabling direct dealing with retailers.

16. It was also asserted that inclement weather, including severe hail, the labor and capital costs of continual farm expansion and the period of time between planting of new trees and realization of a marketable crop all contributed to the lack of profitability in the years at issue.

17. No portions of the farm were set aside for recreational use by Mr. Nardone or his family or friends. A farm pond was used only for irrigation and not for swimming.

18. The farm contributed in the years at issue to an apple grower's fund for advertising of the product within the marketing area. Such advertising was handled by the New England Apple Institute.

19. Petitioner asserts the manner of the farm's operation, including the increase of acreage, the planting of then newly-available dwarf and semi-dwarf trees, the hiring of competent managers, the consultation with various experts and the manner of complete and accurate recordkeeping for the farm, indicates a

consistent trend toward increasing the farm's output, improving its operation, and the bona fide intention of realizing a profit. In addition, petitioner maintains that any deficiency for the year 1976 is barred by operation of the statute of limitations and further, that the applicability of the penalty under section 685(c) of the Tax Law, as asserted for the year 1977, as well as the Audit Division's computation of such penalty, is in error.

20. The penalty computed under Section 685(c) for 1976 and 1977 was apparently based on the following:

	Tax Computed On Return	Prepayments	Balance Due With Return
1976	\$42,680.15	\$13,593.90	\$29,086.25
1977	\$35,887.75	\$13,079.86	\$22,807.89

Although the underpayment or balance due on the 1977 return was less than that on the 1976 return, the penalty asserted for 1977 (\$1,293.15) was greater than the amount of such penalty asserted for 1976 (\$1,149.24). No explanation was given for the larger penalty asserted for 1977.

CONCLUSIONS OF LAW

A. That a valid consent was executed by petitioner (and his wife) allowing the assertion of a deficiency for 1976 to occur at any time on or before April 15, 1981. The instant deficiency was issued on October 1, 1980, and thus was not barred for 1976 (or for any of the years at issue) by operation of the statute of limitations.

B. That the determination of whether or not a taxpayer engages in a particular activity with the intention of realizing a profit thereon rests upon an examination of all the facts and circumstances presented [see Treas. Reg. sec. 1.183-2(b)]. In the instant case such examination reveals that, although not profitable during the years at issue, petitioner's apple farming operation was carried on with the objective of realizing a profit. The Nardone farm was

a large scale commercial enterprise operated in a business-like manner by qualified personnel. The manner of its operation, including the continual expansion of farm acreage, the extensive orchard densification program based on introduction of the then newly-developed dwarf and semi-dwarf trees, the consultations with various experts concerning farming methods and operation and the maintenance of (separate) complete and accurate books and records for the farm, all evidenced petitioner's intent to improve the farm's output and operation in a good faith effort to generate a profit. Accordingly, the limitation on the deductibility of losses arising from activities not engaged in for profit, as contained in section 183 of the Internal Revenue Code, is inapplicable and the net losses from the farming operation as deducted by Mr. Nardone are allowable in full.

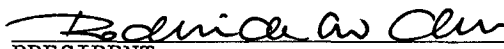
C. That petitioner has failed to submit any information showing that he qualifies for relief under section 685(d) of the Tax Law from the imposition of the penalty imposed pursuant to section 685(c) of the Tax Law. However, in view of Finding of Fact "20", supra, the Audit Division is directed to recompute the penalty asserted under section 685(c) for the year 1977.

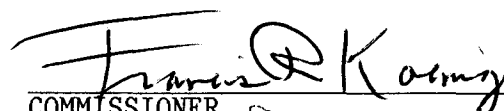
D. That the petition of Michael Nardone (deceased) is granted to the extent indicated herein and the Notice of Deficiency dated October 1, 1980 as modified is sustained.

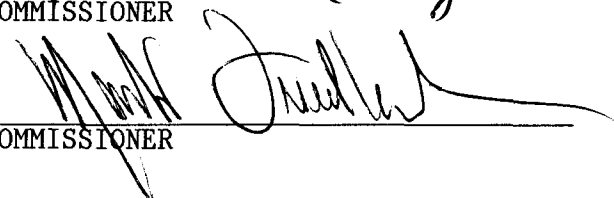
DATED: Albany, New York

NOV 10 1983

STATE TAX COMMISSION


PRESIDENT


COMMISSIONER


COMMISSIONER