

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
Anthony Ravish :
for Redetermination of a Deficiency or a Revision :
of a Determination or a Refund of Personal Income :
Tax & UBT under Article 22 & 23 of the Tax Law for :
the Years 1976 & 1977. :

AFFIDAVIT OF MAILING

State of New York
County of Albany

David Parchuck, 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 4th day of February, 1983, he served the within notice of Decision by certified mail upon Anthony Ravish, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Anthony Ravish
Joslen Blvd.
Hudson, NY 12534

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
4th day of February, 1983.

David Parchuck

Annice P. Chapman

AUTHORIZED TO ADMINISTER
OATHS PURSUANT TO TAX LAW
SECTION 174

STATE OF NEW YORK

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State of New York
County of Albany

David Parchuck, 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 4th day of February, 1983, he served the within notice of Decision by certified mail upon Richard V. D'Alessandro the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Richard V. D'Alessandro
111 Washington Ave.
Albany, NY 12210

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
4th day of February, 1983.

David Parchuck

Annie O'Hageland

AUTHORIZED TO ADMINISTER
OATHS PURSUANT TO TAX LAW
SECTION 174

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

February 4, 1983

Anthony Ravish
Joslen Blvd.
Hudson, NY 12534

Dear Mr. Ravish:

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 & 722 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
Richard V. D'Alessandro
111 Washington Ave.
Albany, NY 12210
Taxing Bureau's Representative

STATE TAX COMMISSION

A small claims hearing was held before James Hoefer, Hearing Officer, at the offices of the State Tax Commission, Building 9, Room 107, State Campus, Albany, New York, on January 12, 1982 at 1:15 P.M. and continued to a conclusion at the same location on January 29, 1982 at 9:15 A.M. Petitioner appeared by Richard V. D'Alessandro, Esq. The Audit Division appeared by Paul B. Coburn, Esq. (Harry Kadish, Esq., of counsel).

ISSUES

I. Whether it was proper for the Audit Division to use the source and application of funds method to reconstruct petitioner's income and, if proper, were all non-taxable receipts eliminated from the audit.

II. Whether the Audit Division properly asserted a five percent (5%) negligence penalty against petitioner.

FINDINGS OF FACT

1. Petitioner herein, Anthony Ravish, timely filed New York State income tax resident returns for the years 1976 and 1977. Petitioner also filed unincor-

porated business tax returns for both years in question, reporting the business income generated from his operation of a retail liquor store.

2. On August 2, 1979, the Audit Division issued a Notice of Deficiency to petitioner for the years 1976 and 1977, assessing additional personal income and unincorporated business tax due of \$5,715.81, plus penalty and interest of \$1,381.73, for a total due of \$7,097.54. The aforementioned Notice of Deficiency was based on an explanatory Statement of Audit Changes, dated January 3, 1979, wherein total New York income and unincorporated business income was increased by \$27,368.00 for 1976 and \$2,641.00 for 1977.

3. The Audit Division's assertion that petitioner underreported his income for 1976 by \$27,368.00 was based on a field audit of petitioner's personal and business books and records. Using the source and application of funds method, the Audit Division determined petitioner's known sources of funds to be \$41,054.00, while his total application of funds was \$68,422.00. The difference between applications and sources, to wit \$27,368.00, represents alleged additional unreported business income. The additional income for 1977 of \$2,641.00 was the result of the Audit Division's assertion that petitioner underreported his ending inventory for 1977 by said amount, thereby overstating his cost of goods sold.

4. At the hearing held herein the parties stipulated that the additional income for 1976 should be reduced by \$1,708.68 as said amount represented a nontaxable transfer of funds from one bank account to another.

5. In computing petitioner's additional unreported income for 1976, the Audit Division included in total application of funds an increase in petitioner's personal checking account. Included in the increase in the personal checking account was a deposit of \$965.56 made on January 5, 1976. The \$965.56 was the deposit of a dividend check which was dated December 30, 1975.

6. On January 2, 1976, petitioner deposited \$1,000.00 into a personal savings account which he asserts represents the deposit of non-taxable cash on hand. At the hearing, petitioner testified that he was in the habit of making deposits during the first part of the year so as to have the interest added to his passbooks. During the tax year 1976 petitioner maintained a total of eight (8) savings accounts. Of the eight accounts, one showed no deposits or withdrawals during 1976, another was not opened until February 3, 1976, while a third one had a zero balance at the beginning of the year. The other five (5) accounts all showed deposits on or before January 7, 1976. Petitioner testified that the \$1,000.00 deposited on January 2, 1976 came from cash on hand kept in a safe at home or in a bank safe deposit box.

7. During the tax year 1976 petitioner asserts that he received, in cash, repayment of the following loans:

- a) \$2,500.00 loan repayment from James Moratta,
- b) \$5,000.00 loan repayment from Mary Kowalsky,
- c) \$4,500.00 loan repayment from Anthony Corapi, and
- d) \$3,000.00 loan repayment from Harold Knott.

8. All four (4) loans, which were made in prior years, were non-interest bearing loans. None of the loans were evidenced by written agreements. Petitioner asserts that he made the loans in cash and that the recipients of the loans repaid him in cash. No evidence was adduced at the hearing to indicate the source (e.g. withdrawal from savings account, withdrawal from checking account, sale of stocks, etc.) from which petitioner derived the cash to make the loans. Further, no evidence was submitted to show the source from which the recipients obtained the cash allegedly given to petitioner in repayment of the loans. Only the alleged repayment of the \$5,000.00 by Mary Kowalsky was evidenced by a receipt. Said receipt, dated July, 1976, was

signed by petitioner and indicated "received from Mary Kowaski (sic) five thousand dollars for payment in full on loan".

9. Mr. Moratta, a personal friend of petitioner, and Mrs. Kowalsky, petitioner's sister, both testified to the effect that they repaid to Mr. Ravish in 1976 the sums of \$2,500.00 and \$5,000.00, respectively. Mr. Corapi, a resident of California, submitted an affidavit acknowledging his debt to petitioner, as well as its repayment in 1976. Mr. Knott, petitioner's father-in-law, did not testify or submit an affidavit.

10. Petitioner's testimony with respect to the repayment of the loans was consistent with Mr. Moratta's and Mrs. Kowalsky's testimony and the statements made by Mr. Corapi in his affidavit. Mr. Ravish further testified that the cash received from the repayment of the loans was deposited into bank accounts, retained as cash on hand or used for personal living expenses. No evidence was submitted as to a breakdown of what portion of the alleged loan repayments were deposited into bank accounts, retained as cash on hand or used for personal living expenses.

11. The Audit Division, in its computation of unreported income for 1976, included as an application of funds \$5,200.00 in personal living expenses paid by cash. This amount was an estimated figure arrived at by the auditor without consultation or discussion with petitioner as to the actual personal living expenses which petitioner paid by cash. Petitioner testified that his life style was such that his personal living expenses paid by cash in 1976 would have been "approximately" \$3,000.00. Other than petitioner's "rough estimate" of \$3,000.00, no documentary or other evidence was submitted with respect to the personal living expenses paid by cash. An examination of checks written against petitioner's business and personal checking accounts revealed that only

four (4) checks were drawn to cash and that a nominal amount of checks were drawn for such personal living expenses as food, clothing, utilities, entertainment, vacations, auto expenses and maintenance of a personal residence.

12. Petitioner further testified at the hearing that regardless of the dollar amount of personal living expenses paid by cash, that all of said expenses were paid from cash on hand accumulated over a number of years. No documentary or other evidence was adduced to support the payment of cash living expenses from cash on hand.

13. The Audit Division included in total applications of funds four (4) checks written to cash. The first of the these checks was dated February 23, 1976, in the amount of \$1,000.00, while the remaining three checks, each in the amount of \$100.00, were dated November 24, 1976, November 26, 1976 and December 6, 1976. Petitioner argues that to charge him with \$1,300.00 for checks written to cash, while at the same time charging him with \$5,200.00 for cash living expenses, duplicates taxable income by the amount of the cash checks.

14. Petitioner, in 1976, used a cash method of accounting, reporting sales when received and expenses when paid. The profit generated from the operation of the liquor store was computed using the cash method of accounting. On December 31, 1975, petitioner had unpaid invoices (accounts payable) for merchandise delivered on or before December 31, 1975 of \$8,770.58. Accounts payable for merchandise delivered on or before December 31, 1976 totaled \$10,871.56. Petitioner asserts that the increase in accounts payable from the beginning of the year, when compared to the end of the year, to wit \$2,100.98, represents a source of funds, thereby reducing the alleged unreported income by \$2,100.98.

15. During the tax year 1976 petitioner maintained a margin account with Merrill Lynch, Pierce, Fenner & Smith, Inc. (hereinafter "Merrill Lynch"). At the beginning of 1976 petitioner had a balance due Merrill Lynch of \$172,533.00. At the end of 1976 the balance due Merrill Lynch in the margin account totaled \$257,995.00. Petitioner asserts that the increase in the margin account balance, \$85,462.00, represents an additional source of funds which the Audit Division failed to consider in its audit. In its audit, the Audit Division considered only the actual amounts received from Merrill Lynch as a source of funds and only the actual payments made to Merrill Lynch as an application of funds. The value of stocks purchased during 1976 were not considered as an application of funds nor was the increase in the balance of the margin account considered as a source of funds.

16. Petitioner's book of original entry consisted of a single entry journal wherein receipts and expenditures were recorded on a cash basis. Throughout the hearing held herein, petitioner steadfastly maintained that he had cash on hand as of January 1, 1976 of approximately \$30,000.00. Petitioner testified that approximately \$10,000.00 of cash on hand was maintained in a safe at home, while the remaining \$20,000.00 was kept in a bank safe deposit box. No records were kept by petitioner as to the exact beginning or ending balances of the alleged cash on hand, nor were any records kept concerning funds deposited or withdrawn from cash on hand. No evidence was presented to indicate that petitioner advised the Audit Division of the existence of cash on hand until after the results of the audit were revealed. The net decrease or increase in the alleged cash on hand for 1976 was not considered as a source or application of funds by the Audit Division.

17. No evidence or argument was presented by petitioner with respect to the Audit Division's assertion that income for 1977 was underreported by \$2,641.00 due to the understatement of the ending inventory for said year. The Audit Division performed a source and application of funds audit for the year 1977, however, said audit resulted in a nominal understatement of income which the Audit Division elected not to assess.

18. Included in petitioner's brief were proposed findings of fact, as to which this Commission makes the following rulings:

- a) Proposed findings 1, 2, 3, 5, 7, 8, 9, 14, 15, 17 and 19 are adopted and have been incorporated into this decision.
- b) Proposed findings 4, 11, 12, 21, 22, 24 and 25 are rejected as not established by the evidence.
- c) Proposed findings 6, 10, 13, 16, 18, 20, 23, 26 and 27 are rejected as being conclusory in nature.

CONCLUSIONS OF LAW

A. That the Audit Division's use of an indirect method to reconstruct petitioner's income for the year 1976 is proper. That a taxpayer's books appear superficially adequate does not preclude the use of an indirect audit method nor are such indirect methods limited only to cases where a taxpayer has no books or the books are patently inadequate. The Audit Division need not prove specific inaccuracies in a taxpayer's books in order to resort to an indirect audit method. (See Holland v. United States, 348 U.S. 121).

B. That pursuant to the stipulation entered between petitioner and the Law Bureau, as set forth in Finding of Fact "4", supra, additional unreported income for 1976 is to be reduced by \$1,708.68.

C. That the \$965.56 deposited on January 5, 1976 represented the deposit of a 1975 dividend check. Since this amount is taxable income for the year

1975, it can not be included in income for 1976. That unreported income for 1976 is to be reduced by \$965.56.

D. That petitioner has failed to sustain the burden of proof under section 689(e) of the Tax Law to show that the \$1,000.00 deposited on January 2, 1976 into a personal savings account represented the deposit of cash on hand accumulated in prior years.

E. That petitioner has failed to sustain the burden of proof to establish the existence of the four (4) loans enumerated in Finding of Fact "7", supra, and their repayment during the year 1976 (Iauco v. Comm., 43 TCM 541). Further, it must be noted that if the factual existence of the four (4) loans and their repayment during the year 1976 were recognized, which this Commission does not, petitioner's failure to establish what portion of the cash repayments were deposited into bank accounts, funneled into cash on hand or used for cash living expenses is fatal. Since the net decrease or increase in cash on hand for 1976 was not considered as a source or application of funds in the audit, any funds funneled into cash on hand would have no effect on the proposed understatement of income.

F. That the Audit Division's estimate of petitioner's personal living expenses paid by cash (\$5,200.00), without discussion or consultation with petitioner as to even the approximate amounts expended, constitutes an estimate which lacks a proper basis. That in light of the Audit Division's failure to establish any basis for their estimate of personal living expenses paid by cash, petitioner's estimate of \$3,000.00, although not exact, is accepted as more accurate. Petitioner has failed to sustain the burden of proof to show that cash living expenses were paid from cash on hand. That unreported income for 1976 is to be reduced by \$2,200.00 (\$5,200.00 - \$3,000.00).

G. That the \$1,300.00 of cash obtained from the four (4) checks written to cash is considered to have been expended for cash living expenses. (See United States v. Caserta, 199 F2d 905). That the \$1,300.00 is to be deleted from unreported income as to avoid duplication of cash living expenses.

H. That an adjustment of \$2,100.98 for the increase in accounts payable for inventory is not warranted in the instant matter. Petitioner is a cash basis taxpayer reporting expenses as they are paid. Under the source and application of funds method of reconstructing income, an adjustment for any increase or decrease in accounts payable for inventory would apply only to an accrual basis taxpayer.

I. That no adjustment is warranted for the increase in the margin account balance. The Audit Division included as an application of funds only those amounts actually paid to Merrill Lynch and considered as a source of funds only those amounts actually received from Merrill Lynch (in this case dividends were the only amounts received from Merrill Lynch). Had total purchases of securities through the margin account been considered by the Audit Division as an application of funds, then the increase in the margin account balance would properly be recognized as a source of funds. A complete analysis of all transactions affecting the margin account would produce the identical result as that found by the Audit Division using only the actual payments to and amounts received from the margin account.

J. That petitioner bears the burden of proof to establish that no portion of the deficiency was due to negligence or intentional disregard of the Tax Law or the rules or regulations. Petitioner has failed to sustain his burden. Accordingly, the five percent (5%) negligence penalty is sustained.

K. That petitioner has failed to sustain his burden of proof to show that the ending inventory for 1977 was not understated by \$2,641.00. Accordingly, the tax due assessed for the year 1977 is deemed correct.

L. That the petition of Anthony Ravish is granted to the extent indicated in Conclusions of Law "B", "C", "F" and "G" and that, except as so granted, the petition is in all other respects denied.

DATED: Albany, New York

FEB 02 1983

STATE TAX COMMISSION

ACTING

PRESIDENT

COMMISSIONER

COMMISSIONER