

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
Gerald W. Earl : AFFIDAVIT OF MAILING
for Redetermination of a Deficiency or Revision :
of a Determination or Refund of Personal Income Tax :
under Article 22 of the Tax Law for the Years 1973 :
through 1975 and Unincorporated Business Tax under :
Article 23 of the Tax Law for the Year 1975. :

State of New York }
ss.:
County of Albany }

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 6th day of April, 1984, he served the within notice of Decision by certified mail upon Gerald W. Earl, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Gerald W. Earl
34 Park Ave.
Rochester, NY 14607

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office 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
6th day of April, 1984.

David Parchuck

Annice A. Hegland
Authorized to administer oaths
pursuant to Tax Law section 174

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
Gerald W. Earl : AFFIDAVIT OF MAILING
for Redetermination of a Deficiency or Revision :
of a Determination or Refund of Personal Income Tax :
under Article 22 of the Tax Law for the Years 1973 :
through 1975 and Unincorporated Business Tax under :
Article 23 of the Tax Law for the Year 1975. :

State of New York }
ss.:
County of Albany }

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 6th day of April, 1984, he served the within notice of Decision by certified mail upon Jack M. Battaglia, the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Jack M. Battaglia
Suite 1111, First Federal Plaza
Rochester, NY 14614

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office 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
6th day of April, 1984.

David Parchuck

William A. Haggerty
Authorized to administer oaths
pursuant to Tax Law section 174

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

April 6, 1984

Gerald W. Earl
34 Park Ave.
Rochester, NY 14607

Dear Mr. Earl:

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, a proceeding in court to review an adverse decision by the State Tax Commission may be instituted only 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
Jack M. Battaglia
Suite 1111, First Federal Plaza
Rochester, NY 14614
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

| | | |
|--|---|----------|
| In the Matter of the Petition | : | |
| of | : | |
| GERALD W. EARL | : | DECISION |
| for Redetermination of a Deficiency or for | : | |
| Refund of Personal Income Tax under Article 22 | : | |
| of the Tax Law for the Years 1973 through 1975 | : | |
| and Unincorporated Business Tax under Article 23 | : | |
| of the Tax Law for the Year 1975. | : | |

Petitioner, Gerald W. Earl, 34 Park Avenue, Rochester, New York 14607, 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 through 1975 and unincorporated business tax under Article 23 of the Tax Law for the year 1975 (File No. 22462).

A formal hearing was held before Julius Braun, Hearing Officer, at the offices of the State Tax Commission, One Marine Midland Plaza, Rochester, New York 14604, on October 28, 1981 at 4:30 P.M. and continued to conclusion on December 8, 1982 at 9:15 A.M., with all briefs to be submitted by October 15, 1983. Petitioner Gerald W. Earl appeared by Jack M. Battaglia, Esq. The Audit Division appeared by Paul B. Coburn, Esq., (Thomas Sacca, Esq., of counsel).

ISSUES

I. Whether the Audit Division's use of the "Net Worth" method to reconstruct income was proper.

II. Whether the net worth method properly reflected income received by petitioner from the construction of a Day Care Center.

III. Whether the amount for "Accounts Receivable - Jerry Earl Enterprises, Inc." was overstated on the net worth statement for 1975.

IV. Whether petitioner is entitled to a demolition loss for 1974.

V. Whether petitioner is entitled to carryback to the years in issue net operating losses incurred in 1976, 1977 and 1978.

VI. Whether petitioner is entitled to deduct a loss attributable to his investment in the partnership of Orsini & Earl.

VII. Whether the Audit Division sustained its burden of proof as to the increase in the amount of its Notice of Deficiency based on a revised Statement of Net Worth.

FINDINGS OF FACT

1. On April 14, 1978, the Audit Division issued a Statement of Audit Changes to Gerald W. Earl (hereinafter "petitioner") proposing personal income tax for the years in issue of \$12,987.08, plus penalties, pursuant to section 685(b) of the Tax Law, and interest. Said statement also proposed unincorporated business tax due for 1975 of \$3,078.96, plus penalties, pursuant to section 685(a)(1) and (2) and section 685(b) of the Tax Law, and interest. The total tax, penalty and interest due for all years amounted to \$21,132.33. The personal income tax for 1973 resulted in an overpayment of \$772.11 which was offset against the tax due for 1974 and 1975. The statement had the words "Revision of Form IT-38FA¹ Dated May 25, 1977" written above petitioner's name. Accordingly, a Notice of Deficiency was issued on April 14, 1978.

2. On December 20, 1976, petitioner signed a "Consent Fixing Period of Limitation upon Assessment of Personal Income and Unincorporated Business Taxes" for taxable year 1973 until April 15, 1978.

3. Petitioner maintained no formal business books or records. He maintained one checking account for his two corporations, a partnership of which he was a

¹ This Statement of Audit Changes was not part of petitioner's file.

member, an apartment complex at 1232 Mt. Hope Avenue, other rental properties owned, expenses incurred in his unincorporated business and his personal living expenses. He did not maintain a separate checking account for his personal living expenses. In October of 1977, the Audit Division, using a Net Worth Statement, reconstructed petitioner's adjusted gross income for the years in issue resulting in an overpayment for 1973 and income tax deficiencies for 1974 and 1975 as follows:

| | <u>12/31/72</u> | <u>12/31/73</u> | <u>12/31/74</u> | <u>12/31/75</u> |
|--|--------------------|---------------------|---------------------|---------------------|
| <u>Assets</u> | | | | |
| Cash on hand | \$ 1,000.00 | \$ 1,000.00 | \$ 1,000.00 | \$ 1,000.00 |
| Business checking account | | | | |
| Central Trust Co. | 1,454.00 | 54,787.00 | 71,484.00 | 4,842.00 |
| Loans receivable - Red Carpet Enterprises, Inc. | 6,937.00 | 16,137.00 | 38,616.00 | 26,972.00 |
| Loans receivable - Jerry Earl Enterprises, Inc. | | (5,539.00) | 66,250.00 | 66,304.00 |
| Loans receivable - Joseph Kennedy | | | 8,629.00 | 8,200.00 |
| Investments 1180-1182 & 1132-1138 Mt. Hope Ave. properties | | 10,243.00 | 17,450.00 | 17,450.00 |
| Investments - partnership Orsini & Earl | 2,687.00 | 3,725.00 | 50,753.00 | 50,753.00 |
| Accounts receivable - Day Care Center | | | | 2,000.00 |
| Transportation & other equipment | | 4,000.00 | 4,808.00 | 4,808.00 |
| Salvage value of equipment | | 1,400.00 | 1,400.00 | 1,400.00 |
| Land - 288 Dartmouth St. | 5,000.00 | 5,000.00 | | |
| Rental properties & improvements | 65,383.00 | 65,383.00 | 40,930.00 | 44,848.00 |
| Total Assets | <u>\$82,461.00</u> | <u>\$156,136.00</u> | <u>\$301,320.00</u> | <u>\$228,577.00</u> |
| <u>Liabilities</u> | | | | |
| Due to partnership - Orsini & Earl | | | | |
| (a) Hub House transactions | (14,462.00) | 88,853.00 | 66,048.00 | 66,048.00 |
| (b) Other than Hub House | 13,763.00 | 15,838.00 | 15,838.00 | 15,838.00 |
| Loans payable | 25,474.00 | | 3,100.00 | 3,100.00 |
| Depreciation - transportation and other equipment | | 750.00 | 1,993.00 | 2,824.00 |
| Depreciation - rental properties | 27,154.00 | 30,332.00 | 18,325.00 | 20,448.00 |
| Deferred income - Dartmouth property | | | 10,211.00 | 9,820.00 |
| Mortgage payable | 22,707.00 | 21,250.00 | 867.00 | |
| Deferred income - Day Care Center | | | 122,835.00 | |
| Total Liabilities | <u>\$74,636.00</u> | <u>\$157,023.00</u> | <u>\$239,217.00</u> | <u>\$118,078.00</u> |

| | | | | |
|--|-------------|----------------------|---------------------|---------------------|
| Net worth | \$ 7,825.00 | \$ (887.00) | \$ 62,103.00 | \$110,499.00 |
| Net worth at beginning of year | | 7,825.00 | (887.00) | 62,103.00 |
| Increase (decrease) in net worth | | <u>\$ (8,712.00)</u> | <u>\$ 62,990.00</u> | <u>\$ 48,396.00</u> |
| Add: personal living expenses | | 9,750.00 | 9,180.00 | 14,229.00 |
| Less: capital gain deduction and nontaxable portion of installment mortgage payments | | | (3,456.00) | (195.00) |
| AGI per audit | | <u>\$ 1,038.00</u> | <u>\$ 68,714.00</u> | <u>\$ 62,430.00</u> |
| AGI per amended return | | <u>36,411.00</u> | <u>21,559.00</u> | <u>(5,819.00)</u> |
| Understatement (overstatement) of AGI | | (35,373.00) | 47,155.00 | 68,249.00 |
| Deficiency (Refund) | | \$ (772.11) | \$ 6,294.27 | \$ 7,464.92 |

Unincorporated business tax due for 1975 was computed to be \$3,078.96

4. On July 25, 1979, the statement of net worth was revised and showed an increase in the personal income and unincorporated business tax deficiencies for 1974 and 1975 as follows:

| | <u>12/31/72</u> | <u>12/31/73</u> | <u>12/31/74</u> | <u>12/31/75</u> |
|---|--------------------|---------------------|---------------------|---------------------|
| <u>Assets</u> | | | | |
| Cash on hand | \$ 1,000.00 | \$ 1,000.00 | \$ 1,000.00 | \$ 1,000.00 |
| Business checking account Central Trust Co. | 1,454.00 | 54,787.00 | 63,855.00 | 4,842.00 |
| Loans receivable - Red Carpet Enterprises, Inc. | 6,937.00 | 16,137.00 | 38,616.00 | 26,972.00 |
| Loans receivable - Jerry Earl Enterprises, Inc. | | (5,539.00) | 66,250.00 | 95,594.00 |
| Mortgage receivable - Joseph Kennedy | | | 8,629.00 | 8,200.00 |
| Investments 1180-1182 & 1132-1138 Mt. Hope Ave. properties | | 10,243.00 | 17,450.00 | 17,450.00 |
| Investments - partnership Orsini & Earl | 11,930.00 | (6,520.00) | 54,242.00 | 54,242.00 |
| Accounts receivable - Day Care Center | | | | 2,000.00 |
| Transportation & other equipment | | 4,000.00 | 4,808.00 | 4,808.00 |
| Salvage value of equipment | | 1,400.00 | 1,400.00 | 1,400.00 |
| Rental properties & improvements | 65,383.00 | 65,383.00 | 40,930.00 | 44,848.00 |
| Land - 288 Dartmouth St. | 5,000.00 | 5,000.00 | | |
| Deferred expenses - Day Care Center | | | 17,828.00 | |
| Total Assets | <u>\$91,704.00</u> | <u>\$145,891.00</u> | <u>\$315,008.00</u> | <u>\$261,356.00</u> |
| <u>Liabilities</u> | | | | |
| Due to partnership - Orsini & Earl | | | | |
| (a) Hub House transactions | (14,462.00) | 104,251.00 | 93,515.00 | 93,515.00 |
| (b) Other than Hub House | 13,763.00 | (4,652.00) | (4,652.00) | (4,652.00) |

| | | | | |
|--|--------------------------|----------------------|---------------------|----------------------------------|
| Loans payable | 25,474.00 | | 3,100.00 | 3,100.00 |
| Depreciation - transportation and other equipment | | 750.00 | 1,993.00 | 2,842.00 |
| Depreciation - rental properties | 27,154.00 | 30,332.00 | 18,325.00 | 20,448.00 |
| Deferred income - Dartmouth property | | | 10,211.00 | 9,820.00 |
| Mortgage payable | 22,707.00 | 21,250.00 | 867.00 | |
| Deferred income - Day Care Center | | | 125,535.00 | |
| Total Liabilities | <u>\$74,636.00</u> | <u>\$151,931.00</u> | <u>\$248,894.00</u> | <u>\$125,055.00</u> ² |
| Net worth | \$17,068.00 ³ | \$ (6,040.00) | \$ 66,114.00 | \$136,301.00 |
| Net worth at beginning of year | | 17,068.00 | (6,040.00) | 66,114.00 |
| Increase (decrease) in net worth | | <u>\$(23,108.00)</u> | <u>\$ 72,154.00</u> | <u>\$ 70,187.00</u> |
| Add: personal living expenses | | 9,750.00 | 9,180.00 | 14,229.00 |
| Less: capital gain deduction and nontaxable portion of installment mortgage payments | | | (3,456.00) | (195.00) |
| AGI per audit | | <u>\$(13,358.00)</u> | <u>\$ 77,878.00</u> | <u>\$ 84,221.00</u> |
| AGI per amended return ⁴ | | <u>36,411.00</u> | <u>21,559.00</u> | <u>5,819.00</u> |
| Understatement (overstatement) of AGI | | <u>\$(49,769.00)</u> | <u>\$ 56,319.00</u> | <u>\$ 90,040.00</u> |
| Deficiency (Refund) | | \$ (772.11) | \$ 7,668.87 | \$ 10,815.29 |

Unincorporated business tax due for 1975 was recomputed to be \$4,277.46.

5. The Audit Division's net worth calculation is based, in part, upon a net worth audit of the partnership "Orsini & Earl". A deficiency issued to the partnership was the subject of a hearing before the State Tax Commission. At the hearing, the Audit Division and petitioner herein agreed that "all the testimony in connection with the determination of deficiency in the Orsini & Earl matter will be incorporated by reference into this hearing". The decision in the matter of Orsini & Earl issued by the State Tax Commission on May 6, 1983, concluded (1) that expenses incurred in the construction of the 1232 Mt. Hope Avenue apartment complex were erroneously charged to expenses of the

² The correct amount for total liabilities as of December 31, 1975 is \$125,073.00.

³ The purpose of computing the net worth for 12/31/72 (not in issue) was to determine the beginning net worth for 12/31/73.

⁴ The AGI per amended return does not include the net operating loss deduction.

partnership rather than to construction projects of Gerald Earl, personally, and (2) the partnership failed to report net income of \$121,523.00 from construction of Hub-House projects.

6. Petitioner reported his income on the "Completed Contract Basis".⁵ In 1974 and 1975, he received income and incurred expenses as follows in connection with construction of a Day Care Center which was completed in 1975.

| | <u>1974</u> | <u>1975</u> | <u>TOTAL</u> |
|-------------------|---------------------|-----------------------|---------------------------------|
| Gross Receipts | \$289,850.00 | \$ 98,529.10 | \$388,379.10 |
| Expenses Paid | 182,142.63 | 123,292.08 | 305,434.71 |
| Net Profit (Loss) | <u>\$107,707.37</u> | <u>(\$ 24,762.98)</u> | <u>\$ 82,944.39⁶</u> |

The information as to income received was furnished by the Committee Chairman of the Day Care Center and as to expenses incurred, by petitioner's accountant. Petitioner asserted that (1) the net profit computed by the auditor for the Audit Division of \$83,041.64 be reduced by \$24,665.36 (petitioner arrived at this amount by subtracting the net profit realized of \$83,041.64 from the difference between deferred income and deferred expenses for 1974) and (2) direct overhead expenses of \$14,054.35 were omitted by the auditor in computing the net profit for the Day Care Center. Petitioner testified that these overhead costs were paid by him personally out of his checking account and that the Audit Division had in its possession the checks and ledgers showing how they were charged out. Petitioner did not contest the amounts for income and expenses which were furnished by the chairman of the Day Care Center and his accountant, respectively.

⁵ Under this method a taxpayer reports income and deducts costs properly allocable to a particular contract in the tax year in which the contract is completed.

⁶ The difference between the Day Care Center net income of \$83,041.64, as determined by the auditor, and the net income shown on the original Profit and Loss Statement prepared by the auditor of \$82,944.39 appears to be attributable to mathematical errors.

7. Petitioner asserted that Accounts Receivable - Jerry Earl Enterprises, Inc., as shown on the net worth statement for 1975, contains \$18,500.00 in expenses which should have been charged to his unincorporated business but which were erroneously charged to the corporation. The auditor for the Audit Division testified that checks were requested but not furnished by petitioner and therefore, it was assumed that said amount was used to pay corporate expenses. At the hearing, petitioner submitted a list of his checks for the period July 1, 1975 through December 31, 1975, which he claims were previously given to the Audit Division. He also submitted a reconciliation of his checking account for the period July 1, 1975 to December 31, 1975 showing a larger checking account balance as of December 31, 1975 than that computed by the Audit Division. The auditor later examined these checks and, based on said examination, the Audit Division maintained that these payments were made for expenses incurred on behalf of petitioner's two corporations, personal living expenses and investments. Petitioner contended that none of these checks were written on behalf of Jerry Earl Enterprises, Inc.; however, one of the checks listed represented payment for the New York Franchise Taxes due of said corporation. Petitioner did not submit any reliable documentary evidence to show that these expenses were related to his unincorporated business and not to Jerry Earl Enterprises, Inc.

8. Petitioner stated that he did not receive the revised Net Worth Statement dated July 25, 1979 for the years 1973 through 1975 showing a larger tax due than the tax shown due on the Notice of Deficiency dated April 14, 1978 and therefore, the burden of proof as to whether expenses of \$18,500.00 were paid for the benefit of Jerry Earl Enterprises, Inc. is on the Audit Division.

9. The amounts shown on the net worth statement for Account Receivable - Jerry Earl Enterprises, Inc. for 1973 and 1974 also include amounts allegedly spent for construction of two buildings owned by said corporation which were located at 1232 Mt. Hope Avenue and 20 Cook Street. The Audit Division asserted that petitioner spent \$75,000.00 and \$72,294.00 in 1973 and 1974 respectively, based on an "economic proposal" received from petitioner which projected the total cost of said property. The projected total cost determined by the auditor of \$247,000.00 was reduced by (1) capital investments made of \$50,718.00, (2) \$41,240.00 which the auditor later determined was not spent by petitioner to purchase the Cook Street property, and (3) expenses paid by the corporation of \$7,748.00, resulting in a total cost to Gerald W. Earl for 1973 and 1974 of \$147,294.00. During the hearing held herein, petitioner submitted his own proposal showing a projected cost of \$114,174.28 which he contended more accurately reflected the cost of construction and acquisition of property. Petitioner allocated 52.203 percent of the projected cost to 1973 and the balance to 1974. The amount computed by petitioner included an item for \$27,000.00 which represented "work estimated to complete three additional units - which were never done". Petitioner, who was general contractor for the project, testified that the amount of \$27,000.00 was never expended for the three apartments. The auditor for the Audit Division testified that he had no direct proof that the amount he arrived at of \$147,294.00 was spent on the properties located on Mt. Hope Avenue and Cook Street.

10. Petitioner contended that he was not given credit for a demolition loss which he incurred in 1974 on property purchased at 1180-1182 Mt. Hope Avenue on October 4, 1973. He testified that the property cost \$12,747.00 of which \$10,000.00 was allocated to the building. Demolition costs amounted to

\$3,270.00, resulting in a total claimed loss of \$13,270.00. He asserted that he acquired this property for the purpose of using it as rental property, but as a result of vandalism, which rendered the property unsalvagable, he decided to demolish said property. Petitioner submitted a copy of a check dated September 25, 1974 made payable to Jim Frederico Wrecking Co., in the amount of \$3,270.00, which he contended represented the cost of demolishing the building. Petitioner did not carry insurance on the building and he did not notify the Police Department at the time the building was vandalized.

11. On September 18, 1981, petitioner filed an amended "Perfected Petition" in which he stated for the first time that he incurred net operating losses in tax years 1976, 1977 and 1978 which, when carried back to the years in issue, would reduce if not eliminate any tax deficiency. He also filed amended New York State income tax resident returns for 1973 and 1974 on January 15, 1982, and for 1975, on December 8, 1982 showing the application of the net operating loss deduction in Schedule A of each return. Petitioner did not submit any evidence as to whether net operating loss carrybacks were claimed for Federal income tax purposes, allowed by the Internal Revenue Service for same years, or whether claims for refund were filed and refunds later received. Petitioner asserted that Audit Division had ample time in which to audit the net operating loss carrybacks and make a determination as to their validity and since it failed to do so, such losses must be taken into account in computing the deficiencies for the years in issue.

12. Petitioner asserted that upon termination of the partnership Orsini & Earl in 1973, he (1) did not receive any assets from the partnership and, as a result, he sustained a loss of \$54,000.00 on his investment and (2) did not

receive a distributive share of partnership income of \$54,242.00⁷ for 1974 as indicated by the Audit Division. He testified that since the partnership was terminated⁸ in 1973 and there were outstanding liabilities of \$86,180.00, the net worth should reflect his share of said liabilities in the amount of \$43,090.00 (50% of \$86,180.00) and eliminate the amount of \$54,242.00 shown as an asset on the statement of net worth. The petition filed by Gerald W. Earl in 1978, on behalf of the partnership Orsini & Earl, stated, in part, that "The partnership terminated on December 31, 1973, at which time the partner, Gerald W. Earl, assumed and paid for all of the outstanding liabilities of the partnership, and the distributions to Gerald W. Earl on termination of the partnership were less than the basis for his partnership interest which was at least \$75,058.00 at the time of termination of the partnership."

CONCLUSIONS OF LAW

A. That use of the net worth method of reconstructing taxable income is justified whenever books and records are inadequate and do not disclose the correct amount of taxable income (see Holland v. United States, 348 U.S. 121 (1954)). Where books and records do not clearly reflect taxable income, the Audit Division's reconstruction of income will be presumed to be correct with the burden of proof upon the petitioner to disprove the Division's computation. Tax Law §689(e).

⁷ The amount of \$54,242.00 does not represent petitioner's distributive share of partnership income for 1974. Petitioner's distributive share for 1974 is 50% of the net profit of Orsini & Earl of \$121,523.00, or \$60,762.00, and if adjusted by the profit for 1972 of \$11,930.00 and the loss for 1973 of \$18,450.00, results in his investment in Orsini & Earl of \$54,242.00.

⁸ It should be noted that the decision rendered by the State Tax Commission in the Matter of Orsini & Earl, dated May 6, 1983, which has been incorporated by reference into this hearing (Finding of Fact "5" supra) recognized the existence of said partnership for 1974 and concluded that a partnership continues in existence for the purpose of winding up its business affairs.

B. That petitioner's argument that the difference between the amounts of deferred income and deferred expenses on the revised statement of net worth for 1974 of \$107,707.00 be reduced by expenses of \$24,665.36 to correspond with the net income determined by the Audit Division of \$83,041.64 is without merit because petitioner failed to consider the income received and expenses paid in 1975 when the project was completed (see Finding of Fact "6" supra). Therefore, the additional expenses claimed by petitioner are not allowable.

C. That petitioner has not sustained his burden of proof imposed by section 689(e) of the Tax Law to show that additional overhead expenses of \$14,054.55 were directly attributable to the Day Care Center. Therefore, said expenses are not allowable.

D. That the adjustments made for 1974 to "Deferred expenses - Day Care Center" and "Investments - partnership Orsini & Earl" resulted in an increase in the Notice of Deficiency for said year and places the burden of proof upon the Audit Division [Tax Law §689(e)(3)]; however, as mentioned in Conclusion of Law "B", the Audit Division properly determined the net income of the Day Care Center by reducing the difference between the amounts for deferred income and deferred expenses by income and expenses in 1975, thereby arriving at a net profit of \$83,041.64. The adjustment made to Investments - partnership Orsini & Earl was based on an audit of the partnership for 1974 which resulted in a net profit of \$121,523.00, of which petitioner's share was \$60,762.00 (see Matter of Orsini & Earl, State Tax Commission, May 6, 1983). Said amount was adjusted by the profit and loss for 1972 and 1973 as shown in footnote "7" on page 10 and resulted in an investment in Orsini & Earl of \$54,242.00 as of December 31, 1974 and 1975. Therefore, the Audit Division sustained its burden of proof imposed by section 689(e)(3) of the Tax Law.

The adjustments made for 1975 to Accounts Receivable - Jerry Earl Enterprises, Inc., as shown on the revised Net Worth Statement, also resulted in an increase in the Notice of Deficiency and places the burden of proof upon the Audit Division (Tax Law §689(e)(3)). While the \$18,500.00 mentioned in Finding of Fact "7" supra, may have been used to pay corporate expenses, the Audit Division has failed to sustain its burden of proof to show that the \$18,500.00 was a corporate expense. Therefore, the amount shown on the revised net worth statement for 1975 of \$95,594.00 is to be reduced by \$18,500.00.

The Audit Division has not sustained its burden of proof imposed by section 689(e)(3) of the Tax Law to show that \$27,000.00 was spent for the three apartments mentioned in Finding of Fact "9" supra; however, petitioner has failed to sustain his burden of proof in regard to other adjustments made to the two buildings mentioned and therefore, said other adjustments are sustained. The Audit Division is directed to reduce the total projected costs determined by audit of \$147,294.00 by \$27,000.00 and the resulting balance is to be allocated between 1973 and 1974 in the same ratio as allocated by petitioner. The amounts shown on the revised statement of net worth for 1973 and 1974 for Accounts Receivable - Jerry Earl Enterprises, Inc. should, accordingly, be adjusted.

E. That the loss claimed by petitioner due to demolition of property at 1180-1182 Mt. Hope Avenue is not allowable since petitioner failed to sustain his burden of proof imposed by section 689(e) of the Tax Law to show that the demolition of said property occurred as a result of a plan formed subsequent to the acquisition of the building (I.R.C. section 165(a)). Therefore, petitioner is neither entitled to a demolition loss nor is he entitled to a reduction in his net worth.

F. That section 687(d) of the Tax Law provides:

"A claim for credit or refund of so much of an overpayment as is attributable to the application to the taxpayer of a net operating loss carryback shall be filed within three years from the time the return was due for the taxable year of the loss..."

Petitioner's claims for credit or refund of personal income taxes for 1973, 1974 and 1975, based on net operating loss carrybacks from 1976, 1977 and 1978, were required to be filed by April 15, 1980, April 15, 1981 and April 15, 1982, respectively. Since petitioner did not assert his claims for credit or refund until September 18, 1981 when he filed his perfected petition, his claims for 1973 and 1974 are untimely and, therefore, are denied. For tax year 1975, petitioner's claim for credit or refund was timely filed since he asserted said claim in his amended perfected petition filed on September 18, 1981, which is prior to the expiration of time (April 15, 1982) provided for in section 687(d) supra; however, for New York State income tax purposes, New York adjusted gross income is defined as Federal adjusted gross income with certain modifications not applicable here [Tax Law §612(a)]. New York taxpayers are permitted to carry back or carry forward operating losses only insofar as such items are, for Federal income tax purposes, deducted from gross income to arrive at adjusted gross income (see Berg v. Tully, 92 A.D.2d 436, 461 N.Y.S.2d 562). Since petitioner has not shown that his Federal adjusted gross income for 1975 included a net operating loss deduction, said deduction cannot be allowed in computing his New York adjusted gross income. Therefore, petitioner's claim for refund for 1975 is denied.

G. That petitioner submitted no documentary evidence to substantiate payment of his share of partnership liabilities referred to in Finding of Fact "12" supra, or to show that a loss was incurred on disposition of the partnership

assets. Therefore, petitioner has not sustained his burden of proof imposed by section 689(e) of the Tax Law to show that he incurred a loss on his investment in the partnership Orsini & Earl for the years in issue.

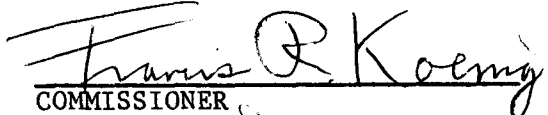
H. That the petition of Gerald W. Earl is granted to the extent shown in Conclusion of Law "D", supra; and that, except as so granted, the petition is in all other respects denied.

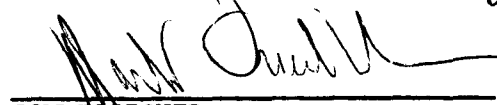
DATED: Albany, New York

STATE TAX COMMISSION

APR 06 1984


PRESIDENT


COMMISSIONER


COMMISSIONER

REQUEST FOR BETTER ADDRESS

| | | |
|--|--|-------------------------------|
| Requested by Tax Appeals Bureau Room 107 - Bldg. #9 State Campus Albany, New York 12227 | Tax Appeals Bureau Room 107 - Bldg. #9 State Campus Albany, New York 12227 | Date of Request 5/3/84 |
|--|--|-------------------------------|

Please find most recent address of taxpayer described below; return to person named above.

| | |
|---|--------------------------------------|
| Social Security Number | Date of Petition F - Dec - 4/6/84 |
| Name Gerald W. Carl | |
| Address 34 Park Ave. Rochester, N. Y. 14607 | |

Results of search by Files

| | |
|---|-----------|
| <input type="checkbox"/> New address: | |
| <input type="checkbox"/> Same as above, no better address | |
| <input checked="" type="checkbox"/> Other: | Unclaimed |

| | | |
|-------------------|---------|--------------------------|
| Searched by DP | Section | Date of Search 5/3/84 |
|-------------------|---------|--------------------------|

PERMANENT RECORDFOR INSERTION IN TAXPAYER'S FOLDER

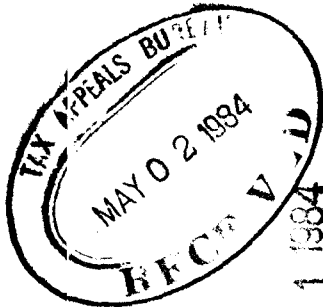
TA 26 (9-79)

STATE OF NEW YORK
State Tax Commission
TAX APPEALS BUREAU
STATE CAMPUS
ALBANY, N. Y. 12227

LR 4/19/84
715 ST



Gerald W. Earl
34 Park Ave.
Rochester, NY 14607



APR 11 1984

APR 12 1984

CERTIFIED

P 440 976 945

MAIL

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

April 6, 1984

Gerald W. Earl
34 Park Ave.
Rochester, NY 14607

Dear Mr. Earl:

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, a proceeding in court to review an adverse decision by the State Tax Commission may be instituted only 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
Jack M. Battaglia
Suite 1111, First Federal Plaza
Rochester, NY 14614
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

| | | |
|--|---|----------|
| In the Matter of the Petition | : | |
| of | : | |
| GERALD W. EARL | : | DECISION |
| for Redetermination of a Deficiency or for | : | |
| Refund of Personal Income Tax under Article 22 | : | |
| of the Tax Law for the Years 1973 through 1975 | : | |
| and Unincorporated Business Tax under Article 23 | : | |
| of the Tax Law for the Year 1975. | : | |

Petitioner, Gerald W. Earl, 34 Park Avenue, Rochester, New York 14607, 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 through 1975 and unincorporated business tax under Article 23 of the Tax Law for the year 1975 (File No. 22462).

A formal hearing was held before Julius Braun, Hearing Officer, at the offices of the State Tax Commission, One Marine Midland Plaza, Rochester, New York 14604, on October 28, 1981 at 4:30 P.M. and continued to conclusion on December 8, 1982 at 9:15 A.M., with all briefs to be submitted by October 15, 1983. Petitioner Gerald W. Earl appeared by Jack M. Battaglia, Esq. The Audit Division appeared by Paul B. Coburn, Esq., (Thomas Sacca, Esq., of counsel).

ISSUES

I. Whether the Audit Division's use of the "Net Worth" method to reconstruct income was proper.

II. Whether the net worth method properly reflected income received by petitioner from the construction of a Day Care Center.

III. Whether the amount for "Accounts Receivable - Jerry Earl Enterprises, Inc." was overstated on the net worth statement for 1975.

IV. Whether petitioner is entitled to a demolition loss for 1974.

V. Whether petitioner is entitled to carryback to the years in issue net operating losses incurred in 1976, 1977 and 1978.

VI. Whether petitioner is entitled to deduct a loss attributable to his investment in the partnership of Orsini & Earl.

VII. Whether the Audit Division sustained its burden of proof as to the increase in the amount of its Notice of Deficiency based on a revised Statement of Net Worth.

FINDINGS OF FACT

1. On April 14, 1978, the Audit Division issued a Statement of Audit Changes to Gerald W. Earl (hereinafter "petitioner") proposing personal income tax for the years in issue of \$12,987.08, plus penalties, pursuant to section 685(b) of the Tax Law, and interest. Said statement also proposed unincorporated business tax due for 1975 of \$3,078.96, plus penalties, pursuant to section 685(a)(1) and (2) and section 685(b) of the Tax Law, and interest. The total tax, penalty and interest due for all years amounted to \$21,132.33. The personal income tax for 1973 resulted in an overpayment of \$772.11 which was offset against the tax due for 1974 and 1975. The statement had the words "Revision of Form IT-38FA¹ Dated May 25, 1977" written above petitioner's name. Accordingly, a Notice of Deficiency was issued on April 14, 1978.

2. On December 20, 1976, petitioner signed a "Consent Fixing Period of Limitation upon Assessment of Personal Income and Unincorporated Business Taxes" for taxable year 1973 until April 15, 1978.

3. Petitioner maintained no formal business books or records. He maintained one checking account for his two corporations, a partnership of which he was a

¹ This Statement of Audit Changes was not part of petitioner's file.

member, an apartment complex at 1232 Mt. Hope Avenue, other rental properties owned, expenses incurred in his unincorporated business and his personal living expenses. He did not maintain a separate checking account for his personal living expenses. In October of 1977, the Audit Division, using a Net Worth Statement, reconstructed petitioner's adjusted gross income for the years in issue resulting in an overpayment for 1973 and income tax deficiencies for 1974 and 1975 as follows:

| | <u>12/31/72</u> | <u>12/31/73</u> | <u>12/31/74</u> | <u>12/31/75</u> |
|--|--------------------|---------------------|---------------------|---------------------|
| <u>Assets</u> | | | | |
| Cash on hand | \$ 1,000.00 | \$ 1,000.00 | \$ 1,000.00 | \$ 1,000.00 |
| Business checking account | | | | |
| Central Trust Co. | 1,454.00 | 54,787.00 | 71,484.00 | 4,842.00 |
| Loans receivable - Red Carpet Enterprises, Inc. | 6,937.00 | 16,137.00 | 38,616.00 | 26,972.00 |
| Loans receivable - Jerry Earl Enterprises, Inc. | | (5,539.00) | 66,250.00 | 66,304.00 |
| Loans receivable - Joseph Kennedy | | | 8,629.00 | 8,200.00 |
| Investments 1180-1182 & 1132-1138 Mt. Hope Ave. properties | | 10,243.00 | 17,450.00 | 17,450.00 |
| Investments - partnership Orsini & Earl | 2,687.00 | 3,725.00 | 50,753.00 | 50,753.00 |
| Accounts receivable - Day Care Center | | | | 2,000.00 |
| Transportation & other equipment | | 4,000.00 | 4,808.00 | 4,808.00 |
| Salvage value of equipment | | 1,400.00 | 1,400.00 | 1,400.00 |
| Land - 288 Dartmouth St. | 5,000.00 | 5,000.00 | | |
| Rental properties & improvements | 65,383.00 | 65,383.00 | 40,930.00 | 44,848.00 |
| Total Assets | <u>\$82,461.00</u> | <u>\$156,136.00</u> | <u>\$301,320.00</u> | <u>\$228,577.00</u> |
| <u>Liabilities</u> | | | | |
| Due to partnership - Orsini & Earl | | | | |
| (a) Hub House transactions | (14,462.00) | 88,853.00 | 66,048.00 | 66,048.00 |
| (b) Other than Hub House | 13,763.00 | 15,838.00 | 15,838.00 | 15,838.00 |
| Loans payable | 25,474.00 | | 3,100.00 | 3,100.00 |
| Depreciation - transportation and other equipment | | 750.00 | 1,993.00 | 2,824.00 |
| Depreciation - rental properties | 27,154.00 | 30,332.00 | 18,325.00 | 20,448.00 |
| Deferred income - Dartmouth property | | | 10,211.00 | 9,820.00 |
| Mortgage payable | 22,707.00 | 21,250.00 | 867.00 | |
| Deferred income - Day Care Center | | | 122,835.00 | |
| Total Liabilities | <u>\$74,636.00</u> | <u>\$157,023.00</u> | <u>\$239,217.00</u> | <u>\$118,078.00</u> |

| | | | | |
|--|-------------|----------------------|---------------------|---------------------|
| Net worth | \$ 7,825.00 | \$ (887.00) | \$ 62,103.00 | \$110,499.00 |
| Net worth at beginning of year | | 7,825.00 | (887.00) | 62,103.00 |
| Increase (decrease) in net worth | | <u>\$ (8,712.00)</u> | <u>\$ 62,990.00</u> | <u>\$ 48,396.00</u> |
| Add: personal living expenses | | 9,750.00 | 9,180.00 | 14,229.00 |
| Less: capital gain deduction and nontaxable portion of installment mortgage payments | | | (3,456.00) | (195.00) |
| AGI per audit | | <u>\$ 1,038.00</u> | <u>\$ 68,714.00</u> | <u>\$ 62,430.00</u> |
| AGI per amended return | | 36,411.00 | 21,559.00 | (5,819.00) |
| Understatement (overstatement) of AGI | | (35,373.00) | 47,155.00 | 68,249.00 |
| Deficiency (Refund) | | \$ (772.11) | \$ 6,294.27 | \$ 7,464.92 |

Unincorporated business tax due for 1975 was computed to be \$3,078.96

4. On July 25, 1979, the statement of net worth was revised and showed an increase in the personal income and unincorporated business tax deficiencies for 1974 and 1975 as follows:

| | <u>12/31/72</u> | <u>12/31/73</u> | <u>12/31/74</u> | <u>12/31/75</u> |
|------------------------------------|--------------------|---------------------|---------------------|---------------------|
| <u>Assets</u> | | | | |
| Cash on hand | \$ 1,000.00 | \$ 1,000.00 | \$ 1,000.00 | \$ 1,000.00 |
| Business checking account | | | | |
| Central Trust Co. | 1,454.00 | 54,787.00 | 63,855.00 | 4,842.00 |
| Loans receivable - Red Carpet | | | | |
| Enterprises, Inc. | 6,937.00 | 16,137.00 | 38,616.00 | 26,972.00 |
| Loans receivable - Jerry Earl | | | | |
| Enterprises, Inc. | | (5,539.00) | 66,250.00 | 95,594.00 |
| Mortgage receivable - | | | | |
| Joseph Kennedy | | | 8,629.00 | 8,200.00 |
| Investments 1180-1182 & 1132-1138 | | | | |
| Mt. Hope Ave. properties | | 10,243.00 | 17,450.00 | 17,450.00 |
| Investments - partnership | | | | |
| Orsini & Earl | 11,930.00 | (6,520.00) | 54,242.00 | 54,242.00 |
| Accounts receivable - | | | | |
| Day Care Center | | | | 2,000.00 |
| Transportation & other equipment | | 4,000.00 | 4,808.00 | 4,808.00 |
| Salvage value of equipment | | 1,400.00 | 1,400.00 | 1,400.00 |
| Rental properties & improvements | 65,383.00 | 65,383.00 | 40,930.00 | 44,848.00 |
| Land - 288 Dartmouth St. | 5,000.00 | 5,000.00 | | |
| Deferred expenses - Day Care | | | | |
| Center | | | 17,828.00 | |
| Total Assets | <u>\$91,704.00</u> | <u>\$145,891.00</u> | <u>\$315,008.00</u> | <u>\$261,356.00</u> |
| <u>Liabilities</u> | | | | |
| Due to partnership - Orsini & Earl | | | | |
| (a) Hub House transactions | (14,462.00) | 104,251.00 | 93,515.00 | 93,515.00 |
| (b) Other than Hub House | 13,763.00 | (4,652.00) | (4,652.00) | (4,652.00) |

| | | | | |
|--|--------------------------|----------------------|---------------------|----------------------------------|
| Loans payable | 25,474.00 | | 3,100.00 | 3,100.00 |
| Depreciation - transportation and other equipment | | 750.00 | 1,993.00 | 2,842.00 |
| Depreciation - rental properties | 27,154.00 | 30,332.00 | 18,325.00 | 20,448.00 |
| Deferred income - Dartmouth property | | | 10,211.00 | 9,820.00 |
| Mortgage payable | 22,707.00 | 21,250.00 | 867.00 | |
| Deferred income - Day Care Center | | | 125,535.00 | |
| Total Liabilities | <u>\$74,636.00</u> | <u>\$151,931.00</u> | <u>\$248,894.00</u> | <u>\$125,055.00</u> ² |
| Net worth | \$17,068.00 ³ | \$ (6,040.00) | \$ 66,114.00 | \$136,301.00 |
| Net worth at beginning of year | | 17,068.00 | (6,040.00) | 66,114.00 |
| Increase (decrease) in net worth | | <u>\$(23,108.00)</u> | <u>\$ 72,154.00</u> | <u>\$ 70,187.00</u> |
| Add: personal living expenses | | 9,750.00 | 9,180.00 | 14,229.00 |
| Less: capital gain deduction and nontaxable portion of installment mortgage payments | | | (3,456.00) | (195.00) |
| AGI per audit | | <u>\$(13,358.00)</u> | <u>\$ 77,878.00</u> | <u>\$ 84,221.00</u> |
| AGI per amended return ⁴ | | <u>36,411.00</u> | <u>21,559.00</u> | <u>5,819.00</u> |
| Understatement (overstatement) of AGI | | <u>\$(49,769.00)</u> | <u>\$ 56,319.00</u> | <u>\$ 90,040.00</u> |
| Deficiency (Refund) | | \$ (772.11) | \$ 7,668.87 | \$ 10,815.29 |

Unincorporated business tax due for 1975 was recomputed to be \$4,277.46.

5. The Audit Division's net worth calculation is based, in part, upon a net worth audit of the partnership "Orsini & Earl". A deficiency issued to the partnership was the subject of a hearing before the State Tax Commission. At the hearing, the Audit Division and petitioner herein agreed that "all the testimony in connection with the determination of deficiency in the Orsini & Earl matter will be incorporated by reference into this hearing". The decision in the matter of Orsini & Earl issued by the State Tax Commission on May 6, 1983, concluded (1) that expenses incurred in the construction of the 1232 Mt. Hope Avenue apartment complex were erroneously charged to expenses of the

² The correct amount for total liabilities as of December 31, 1975 is \$125,073.00.

³ The purpose of computing the net worth for 12/31/72 (not in issue) was to determine the beginning net worth for 12/31/73.

⁴ The AGI per amended return does not include the net operating loss deduction.

partnership rather than to construction projects of Gerald Earl, personally, and (2) the partnership failed to report net income of \$121,523.00 from construction of Hub-House projects.

6. Petitioner reported his income on the "Completed Contract Basis".⁵ In 1974 and 1975, he received income and incurred expenses as follows in connection with construction of a Day Care Center which was completed in 1975.

| | <u>1974</u> | <u>1975</u> | <u>TOTAL</u> |
|-------------------|---------------------|-----------------------|---------------------------------|
| Gross Receipts | \$289,850.00 | \$ 98,529.10 | \$388,379.10 |
| Expenses Paid | 182,142.63 | 123,292.08 | 305,434.71 |
| Net Profit (Loss) | <u>\$107,707.37</u> | <u>(\$ 24,762.98)</u> | <u>\$ 82,944.39⁶</u> |

The information as to income received was furnished by the Committee Chairman of the Day Care Center and as to expenses incurred, by petitioner's accountant. Petitioner asserted that (1) the net profit computed by the auditor for the Audit Division of \$83,041.64 be reduced by \$24,665.36 (petitioner arrived at this amount by subtracting the net profit realized of \$83,041.64 from the difference between deferred income and deferred expenses for 1974) and (2) direct overhead expenses of \$14,054.35 were omitted by the auditor in computing the net profit for the Day Care Center. Petitioner testified that these overhead costs were paid by him personally out of his checking account and that the Audit Division had in its possession the checks and ledgers showing how they were charged out. Petitioner did not contest the amounts for income and expenses which were furnished by the chairman of the Day Care Center and his accountant, respectively.

⁵ Under this method a taxpayer reports income and deducts costs properly allocable to a particular contract in the tax year in which the contract is completed.

⁶ The difference between the Day Care Center net income of \$83,041.64, as determined by the auditor, and the net income shown on the original Profit and Loss Statement prepared by the auditor of \$82,944.39 appears to be attributable to mathematical errors.

7. Petitioner asserted that Accounts Receivable - Jerry Earl Enterprises, Inc., as shown on the net worth statement for 1975, contains \$18,500.00 in expenses which should have been charged to his unincorporated business but which were erroneously charged to the corporation. The auditor for the Audit Division testified that checks were requested but not furnished by petitioner and therefore, it was assumed that said amount was used to pay corporate expenses. At the hearing, petitioner submitted a list of his checks for the period July 1, 1975 through December 31, 1975, which he claims were previously given to the Audit Division. He also submitted a reconciliation of his checking account for the period July 1, 1975 to December 31, 1975 showing a larger checking account balance as of December 31, 1975 than that computed by the Audit Division. The auditor later examined these checks and, based on said examination, the Audit Division maintained that these payments were made for expenses incurred on behalf of petitioner's two corporations, personal living expenses and investments. Petitioner contended that none of these checks were written on behalf of Jerry Earl Enterprises, Inc.; however, one of the checks listed represented payment for the New York Franchise Taxes due of said corporation. Petitioner did not submit any reliable documentary evidence to show that these expenses were related to his unincorporated business and not to Jerry Earl Enterprises, Inc.

8. Petitioner stated that he did not receive the revised Net Worth Statement dated July 25, 1979 for the years 1973 through 1975 showing a larger tax due than the tax shown due on the Notice of Deficiency dated April 14, 1978 and therefore, the burden of proof as to whether expenses of \$18,500.00 were paid for the benefit of Jerry Earl Enterprises, Inc. is on the Audit Division.

9. The amounts shown on the net worth statement for Account Receivable - Jerry Earl Enterprises, Inc. for 1973 and 1974 also include amounts allegedly spent for construction of two buildings owned by said corporation which were located at 1232 Mt. Hope Avenue and 20 Cook Street. The Audit Division asserted that petitioner spent \$75,000.00 and \$72,294.00 in 1973 and 1974 respectively, based on an "economic proposal" received from petitioner which projected the total cost of said property. The projected total cost determined by the auditor of \$247,000.00 was reduced by (1) capital investments made of \$50,718.00, (2) \$41,240.00 which the auditor later determined was not spent by petitioner to purchase the Cook Street property, and (3) expenses paid by the corporation of \$7,748.00, resulting in a total cost to Gerald W. Earl for 1973 and 1974 of \$147,294.00. During the hearing held herein, petitioner submitted his own proposal showing a projected cost of \$114,174.28 which he contended more accurately reflected the cost of construction and acquisition of property. Petitioner allocated 52.203 percent of the projected cost to 1973 and the balance to 1974. The amount computed by petitioner included an item for \$27,000.00 which represented "work estimated to complete three additional units - which were never done". Petitioner, who was general contractor for the project, testified that the amount of \$27,000.00 was never expended for the three apartments. The auditor for the Audit Division testified that he had no direct proof that the amount he arrived at of \$147,294.00 was spent on the properties located on Mt. Hope Avenue and Cook Street.

10. Petitioner contended that he was not given credit for a demolition loss which he incurred in 1974 on property purchased at 1180-1182 Mt. Hope Avenue on October 4, 1973. He testified that the property cost \$12,747.00 of which \$10,000.00 was allocated to the building. Demolition costs amounted to

\$3,270.00, resulting in a total claimed loss of \$13,270.00. He asserted that he acquired this property for the purpose of using it as rental property, but as a result of vandalism, which rendered the property unsalvagable, he decided to demolish said property. Petitioner submitted a copy of a check dated September 25, 1974 made payable to Jim Frederico Wrecking Co., in the amount of \$3,270.00, which he contended represented the cost of demolishing the building. Petitioner did not carry insurance on the building and he did not notify the Police Department at the time the building was vandalized.

11. On September 18, 1981, petitioner filed an amended "Perfected Petition" in which he stated for the first time that he incurred net operating losses in tax years 1976, 1977 and 1978 which, when carried back to the years in issue, would reduce if not eliminate any tax deficiency. He also filed amended New York State income tax resident returns for 1973 and 1974 on January 15, 1982, and for 1975, on December 8, 1982 showing the application of the net operating loss deduction in Schedule A of each return. Petitioner did not submit any evidence as to whether net operating loss carrybacks were claimed for Federal income tax purposes, allowed by the Internal Revenue Service for same years, or whether claims for refund were filed and refunds later received. Petitioner asserted that Audit Division had ample time in which to audit the net operating loss carrybacks and make a determination as to their validity and since it failed to do so, such losses must be taken into account in computing the deficiencies for the years in issue.

12. Petitioner asserted that upon termination of the partnership Orsini & Earl in 1973, he (1) did not receive any assets from the partnership and, as a result, he sustained a loss of \$54,000.00 on his investment and (2) did not

receive a distributive share of partnership income of \$54,242.00⁷ for 1974 as indicated by the Audit Division. He testified that since the partnership was terminated⁸ in 1973 and there were outstanding liabilities of \$86,180.00, the net worth should reflect his share of said liabilities in the amount of \$43,090.00 (50% of \$86,180.00) and eliminate the amount of \$54,242.00 shown as an asset on the statement of net worth. The petition filed by Gerald W. Earl in 1978, on behalf of the partnership Orsini & Earl, stated, in part, that "The partnership terminated on December 31, 1973, at which time the partner, Gerald W. Earl, assumed and paid for all of the outstanding liabilities of the partnership, and the distributions to Gerald W. Earl on termination of the partnership were less than the basis for his partnership interest which was at least \$75,058.00 at the time of termination of the partnership."

CONCLUSIONS OF LAW

A. That use of the net worth method of reconstructing taxable income is justified whenever books and records are inadequate and do not disclose the correct amount of taxable income (see Holland v. United States, 348 U.S. 121 (1954)). Where books and records do not clearly reflect taxable income, the Audit Division's reconstruction of income will be presumed to be correct with the burden of proof upon the petitioner to disprove the Division's computation. Tax Law §689(e).

⁷ The amount of \$54,242.00 does not represent petitioner's distributive share of partnership income for 1974. Petitioner's distributive share for 1974 is 50% of the net profit of Orsini & Earl of \$121,523.00, or \$60,762.00, and if adjusted by the profit for 1972 of \$11,930.00 and the loss for 1973 of \$18,450.00, results in his investment in Orsini & Earl of \$54,242.00.

⁸ It should be noted that the decision rendered by the State Tax Commission in the Matter of Orsini & Earl, dated May 6, 1983, which has been incorporated by reference into this hearing (Finding of Fact "5" supra) recognized the existence of said partnership for 1974 and concluded that a partnership continues in existence for the purpose of winding up its business affairs.

B. That petitioner's argument that the difference between the amounts of deferred income and deferred expenses on the revised statement of net worth for 1974 of \$107,707.00 be reduced by expenses of \$24,665.36 to correspond with the net income determined by the Audit Division of \$83,041.64 is without merit because petitioner failed to consider the income received and expenses paid in 1975 when the project was completed (see Finding of Fact "6" supra). Therefore, the additional expenses claimed by petitioner are not allowable.

C. That petitioner has not sustained his burden of proof imposed by section 689(e) of the Tax Law to show that additional overhead expenses of \$14,054.55 were directly attributable to the Day Care Center. Therefore, said expenses are not allowable.

D. That the adjustments made for 1974 to "Deferred expenses - Day Care Center" and "Investments - partnership Orsini & Earl" resulted in an increase in the Notice of Deficiency for said year and places the burden of proof upon the Audit Division [Tax Law §689(e)(3)]; however, as mentioned in Conclusion of Law "B", the Audit Division properly determined the net income of the Day Care Center by reducing the difference between the amounts for deferred income and deferred expenses by income and expenses in 1975, thereby arriving at a net profit of \$83,041.64. The adjustment made to Investments - partnership Orsini & Earl was based on an audit of the partnership for 1974 which resulted in a net profit of \$121,523.00, of which petitioner's share was \$60,762.00 (see Matter of Orsini & Earl, State Tax Commission, May 6, 1983). Said amount was adjusted by the profit and loss for 1972 and 1973 as shown in footnote "7" on page 10 and resulted in an investment in Orsini & Earl of \$54,242.00 as of December 31, 1974 and 1975. Therefore, the Audit Division sustained its burden of proof imposed by section 689(e)(3) of the Tax Law.

The adjustments made for 1975 to Accounts Receivable - Jerry Earl Enterprises, Inc., as shown on the revised Net Worth Statement, also resulted in an increase in the Notice of Deficiency and places the burden of proof upon the Audit Division (Tax Law §689(e)(3)). While the \$18,500.00 mentioned in Finding of Fact "7" supra, may have been used to pay corporate expenses, the Audit Division has failed to sustain its burden of proof to show that the \$18,500.00 was a corporate expense. Therefore, the amount shown on the revised net worth statement for 1975 of \$95,594.00 is to be reduced by \$18,500.00.

The Audit Division has not sustained its burden of proof imposed by section 689(e)(3) of the Tax Law to show that \$27,000.00 was spent for the three apartments mentioned in Finding of Fact "9" supra; however, petitioner has failed to sustain his burden of proof in regard to other adjustments made to the two buildings mentioned and therefore, said other adjustments are sustained. The Audit Division is directed to reduce the total projected costs determined by audit of \$147,294.00 by \$27,000.00 and the resulting balance is to be allocated between 1973 and 1974 in the same ratio as allocated by petitioner. The amounts shown on the revised statement of net worth for 1973 and 1974 for Accounts Receivable - Jerry Earl Enterprises, Inc. should, accordingly, be adjusted.

E. That the loss claimed by petitioner due to demolition of property at 1180-1182 Mt. Hope Avenue is not allowable since petitioner failed to sustain his burden of proof imposed by section 689(e) of the Tax Law to show that the demolition of said property occurred as a result of a plan formed subsequent to the acquisition of the building (I.R.C. section 165(a)). Therefore, petitioner is neither entitled to a demolition loss nor is he entitled to a reduction in his net worth.

F. That section 687(d) of the Tax Law provides:

"A claim for credit or refund of so much of an overpayment as is attributable to the application to the taxpayer of a net operating loss carryback shall be filed within three years from the time the return was due for the taxable year of the loss..."

Petitioner's claims for credit or refund of personal income taxes for 1973, 1974 and 1975, based on net operating loss carrybacks from 1976, 1977 and 1978, were required to be filed by April 15, 1980, April 15, 1981 and April 15, 1982, respectively. Since petitioner did not assert his claims for credit or refund until September 18, 1981 when he filed his perfected petition, his claims for 1973 and 1974 are untimely and, therefore, are denied. For tax year 1975, petitioner's claim for credit or refund was timely filed since he asserted said claim in his amended perfected petition filed on September 18, 1981, which is prior to the expiration of time (April 15, 1982) provided for in section 687(d) supra; however, for New York State income tax purposes, New York adjusted gross income is defined as Federal adjusted gross income with certain modifications not applicable here [Tax Law §612(a)]. New York taxpayers are permitted to carry back or carry forward operating losses only insofar as such items are, for Federal income tax purposes, deducted from gross income to arrive at adjusted gross income (see Berg v. Tully, 92 A.D.2d 436, 461 N.Y.S.2d 562). Since petitioner has not shown that his Federal adjusted gross income for 1975 included a net operating loss deduction, said deduction cannot be allowed in computing his New York adjusted gross income. Therefore, petitioner's claim for refund for 1975 is denied.

G. That petitioner submitted no documentary evidence to substantiate payment of his share of partnership liabilities referred to in Finding of Fact "12" supra, or to show that a loss was incurred on disposition of the partnership


assets. Therefore, petitioner has not sustained his burden of proof imposed by section 689(e) of the Tax Law to show that he incurred a loss on his investment in the partnership Orsini & Earl for the years in issue.

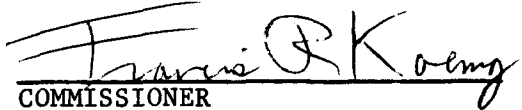
H. That the petition of Gerald W. Earl is granted to the extent shown in Conclusion of Law "D", supra; and that, except as so granted, the petition is in all other respects denied.

DATED: Albany, New York

STATE TAX COMMISSION

APR 06 1984


PRESIDENT


COMMISSIONER


COMMISSIONER