

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petition :  
of :  
William & Catherine Whitman :  
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 - 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 20th day of January, 1984, he served the within notice of Decision by certified mail upon William & Catherine Whitman, the petitioners in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

William & Catherine Whitman  
Foster Rd. RD #1  
Vestal, NY 13850

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  
20th day of January, 1984.

David Parchuck

James A. Hagelberg  
pursuant to Tax Law section 174

Authorized to administer oaths

STATE OF NEW YORK

STATE TAX COMMISSION

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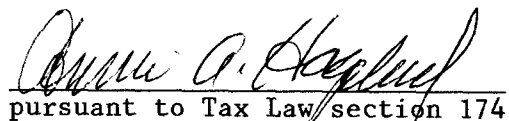
David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 20th day of January, 1984, he served the within notice of Decision by certified mail upon Frederick A. Griffin, the representative of the petitioners in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

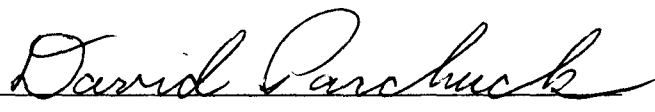
Frederick A. Griffin  
Kramer, Wales & McAvoy  
P.O. Box 2043  
Binghamton, NY 13902

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  
20th day of January, 1984.

  
pursuant to Tax Law section 174

  
Authorized to administer oaths

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

January 20, 1984

William & Catherine Whitman  
Foster Rd. RD #1  
Vestal, NY 13850

Dear Mr. & Mrs. Whitman:

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, 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  
Frederick A. Griffin  
Kramer, Wales & McAvoy  
P.O. Box 2043  
Binghamton, NY 13902  
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petition	:	
of	:	
WILLIAM AND CATHERINE WHITMAN	:	DECISION
for Redetermination of Deficiencies or for	:	
Refund of Personal Income Tax under Article 22	:	
of the Tax Law for the Years 1973, 1974 and	:	
1975.	:	

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Petitioners, William and Catherine Whitman, Foster Road, RD #1, Vestal, New York 13850, filed a petition for redetermination of deficiencies or for refund of personal income tax under Article 22 of the Tax Law for the years 1973, 1974 and 1975 (File Nos. 19243 & 20243).

A small claims hearing was held before John F. Koagel, Hearing Officer, at the offices of the State Tax Commission, 164 Hawley Street, Binghamton, New York 13901, on February 9, 1983 at 9:15 A.M. with all briefs to be submitted no later than June 24, 1983. Petitioners appeared by Kramer, Wales and McAvoy (Frederick A. Griffin, Esq., of counsel). The Audit Division appeared by John P. Dugan, Esq. (James F. Morris, Esq., of counsel).

ISSUES

I. Whether losses incurred by petitioner William Whitman in his moving and construction activities during 1973, 1974 and 1975 were allowable as business losses or not allowable as activities not engaged in for profit.

II. Whether real property owned by petitioner William Whitman was rented at its fair market value thus making rental losses allowable during 1973, 1974 and 1975.

III. Whether adjustments made as a result of a source and disposition of funds audit conducted for the year 1974 duplicate adjustments made by disallowing the business and rental losses described in Issues I and II above.

IV. Whether petitioners were entitled to itemized deductions claimed for tax years 1973 and 1975.

FINDINGS OF FACT

1. Petitioners William T. and Catherine Whitman timely filed joint New York State income tax resident returns for tax years 1973, 1974 and 1975. On said returns William T. Whitman (hereinafter petitioner) listed his occupation as "Staff Asst" and his wife's (Catherine Whitman) as housewife. Among other minor items, all three returns showed wage or salary income earned by petitioner at International Business Machines Corporation ("IBM"), combined losses resulting from petitioner's separate businesses of moving and construction and rental losses.

2. On January 24, 1977, as a result of a field audit, petitioners were issued a revised Statement of Audit Changes for the tax year 1974; the record is void as to what was revised. Page one of the three page Statement explained the audit as follows:

"The recent audit of your 1974 New York State Income tax return has resulted in the adjustments shown on the attached schedule and your tax is recomputed below:

Source and distribution of funds resulted in additional income in the amount of \$8,481.30.

Business losses claimed have been disallowed per attached schedule.

Taxable Income per Return	\$ 990.00
Source and Disposition Adjustment	8,481.30
Losses disallowed adjustment	10,545.34
Corrected Taxable Income	<u>\$20,016.64</u>

Tax on above	\$1,402.00
Tax paid on original return	<u>19.80</u>

Additional Tax Due

\$1,382.20"

Page two of the Statement explained, in detail, the above losses disallowed adjustment as follows:

1974

"Since you have not shown that the claimed loss resulted from a transaction entered into for profit or was incurred in a trade or business, the Schedule C loss is disallowed. Expenses have been allowed only to the extent of the income received.

When property is rented for less than its fair rental value, expenses attributable to such rental are allowable only to the extent of the income received. You may not deduct a loss from such a rental. Taxes and interest must be taken first against the income. The remainder of the taxes and interest shows the income has been allowed as itemized deduction.

Computation of gain from sale of stock under the IBM stock option plan is attached.

Since the gas tax expenses claimed appears to be excessive and has not been supported by acceptable evidence, an estimated mileage of 10,000 miles have been allowed.

	<u>Shown on Return</u>	<u>Corrected</u>	<u>Adjustment</u>
Schedule C Loss	(\$9,348.00)	\$ -0-	\$ 9,348.00
Rental Loss	(\$1,864.00)	-0-	1,864.00
Ordinary Income - Stock Sale	265.00	29.93	(235.07)
Sale of Stock-Loss	(178.00)	(55.59)	122.41
Gas Tax	118.00	62.00	56.00
Tax & Interest from Schedule E			\$ (610.00)
Adjustment			\$10,545.34"

Page three of the Statement reflected the details of the above source and disposition of funds audit adjustment of \$8,481.30.

Accordingly, on June 27, 1977, based on the above Statement, petitioners were issued a Notice of Deficiency showing additional personal income tax due for 1974 in the amount of \$1,382.20 plus interest of \$258.47 for a total of \$1,640.67.

3. Petitioner failed to provide the auditor with the records he required to do an audit for the years 1973 and 1975, therefore on January 14, 1977

petitioners were issued a Statement of Audit Changes which reflected additional personal income tax due of \$659.20 plus interest for 1973 and \$773.61 plus interest for 1975. The Statement reflected the following adjustments based on the audit of 1974: Schedule "C" business losses were disallowed as transactions not entered into for profit in the amounts of \$10,759.00 and \$9,072.00 for 1973 and 1975 respectively and rental losses of \$1,918.00 for 1973 and \$1,326.00 for 1975 were disallowed as petitioners did not show that the rental property was rented for its fair rental value. In addition, petitioners' itemized deductions in the amounts of \$2,313.00 and \$3,288.00 for 1973 and 1975 respectively were disallowed and replaced with the standard deduction of \$2,000.00 for each year. Subsequently, on April 11, 1977, petitioners were issued a Notice of Deficiency for 1973 and 1975, based on the adjustments made in the Statement, for tax in the amount of \$1,432.81 plus interest of \$212.81 for a total of \$1,645.62.

4. For all three years at issue petitioner was a full time employee of IBM with salary income of \$16,588.00 for 1973, \$16,832.00 for 1974 and \$17,784.00 for 1975. During nights and weekends petitioner was engaged in a construction operation and a moving operation. The combined losses for both were reflected in the above disallowed Schedule "C" losses.

5. During the years at issue petitioner owned several vehicles and pieces of equipment which included a van truck, a caterpillar, a pickup truck, a dump truck, a backhoe and a semi trailer. These vehicles and equipment were used for both the construction business and the moving business where possible and were depreciated for federal and state tax purposes. Petitioner testified that the vehicles and equipment were purchased from money he earned at IBM and from borrowing, and that some stock was sold in 1973, 1974 and 1975 to keep the businesses operating.

6. For both the construction and moving businesses petitioner maintained sales and cash receipts journals, sales slips, purchase invoices and a business checking account. The auditor deemed the records for the construction operation inadequate as the income and expenses were not kept separately by job.

7. Construction jobs consisted of building sidewalks, porches, patios, etc. The moving jobs consisted of moving household goods.

8. Petitioner's construction and moving businesses were both registered with the local county clerk as Ace Construction Company and Ace Moving Company; they were both listed in the local telephone book. Ace Construction Company was a registered sales tax vendor.

9. All construction and moving jobs were done personally by petitioner with the aid of his son, who was approximately 16 years old in 1974. Some subcontracting was done, on occasion, such as hauling dirt away from a construction site.

10. Petitioner estimated construction jobs by looking at potential sites and rendering either a verbal or written estimate. Moving jobs were estimated using an hourly rate, and on occasion a flat rate estimate was given. Petitioner never charged for estimates.

11. Petitioner began the construction business in 1969 and the moving business in 1971. Prior to entering the construction business, petitioner consulted an attorney. From 1969 through 1975 petitioner never showed a profit from either venture. Both businesses were discontinued in 1979. Petitioner still owns some of the vehicles and equipment which were used in the businesses. Petitioner testified that when he retires from IBM, for which he becomes eligible in approximately four years from the date of this hearing, that he may again begin business.



12. It was the position of the Audit Division that petitioner was not engaged in the construction and moving business for a profit. This conclusion was drawn from the facts that a profit was never realized from either business, that gross income represented a small percentage of the expenses for each year, that petitioner had a full time job elsewhere, that the business ventures were only part time, that the write off of the business losses resulted in petitioner acquiring the vehicles and equipment for his personal use at public expense and that the main intent of petitioner was to derive personal pleasure from the activities engaged in.

13. Petitioner is a graduate of a technical high school where he took mainly technical, mechanical and shop courses.

14. Petitioner served two years in the U.S. Army where he obtained the rank of Sergeant. He served in a combat engineer unit and was Division Engineer Supply Sergeant where he handled and distributed all building materials. Petitioner's employment with IBM has included several duties over the years which have included installing parts, working with specifications and blueprints, working with computer hardware and software and doing cost estimates. Petitioner was trained by IBM for some of his job duties. Even though petitioner has demonstrated that his civilian and military occupations are related to construction, there is no indication that petitioner has ever been physically engaged in doing construction work in connection therewith.

15. Petitioner's father, who is now deceased, was a building contractor and his uncle and grandfather were both licensed carpenters. This family background was partly responsible for petitioner's desire to construct things.

16. Petitioner testified that he was engaged in the moving and construction business for a profit and that he received at least 40 telephone calls per week

related to his business. However, during 1974, petitioner did only 17 jobs for a total gross income of \$2,774.00. Petitioner reasoned that overestimating the cost of jobs, poor weather and the rising cost of materials accounted for such a low percentage of estimated jobs actually acquired. Petitioner testified that based on his family's background, his schooling, his military experience and his civilian job experience that he felt that he could make a profit in the construction and moving ventures.

17. During the years at issue, petitioner owned two pieces of real property, one being his home and the other being a piece of rental property acquired prior to 1973 at a purchase price of \$15,500.00. Petitioner rented the house for \$100.00 per month during the three years at issue herein (petitioner's 1975 federal Schedule "E" shows yearly rental income of \$1,140.00). This income was the only income used to compute the rental losses at issue. In addition, the tenant had, at the rental property, a business telephone for petitioner's construction and moving businesses with which she acted as an answering service for petitioner; the only consideration for this being the low rent paid.

Petitioner presented no documentary or other evidence to establish the fair rental value of the rental property in question, the number of calls taken by the answering service or the value of such service.

18. Part of the total adjustment made for 1974 consisted of additional income of \$8,481.30 computed from a source and disposition of funds indirect audit method (see Finding of Fact "2"). Prior to the hearing held herein, it was agreed at a pre-hearing conference that this adjustment should be reduced to \$4,988.48 to acknowledge three additional factors, not known at the time of the audit, totaling \$3,492.82. At the hearing held herein, it was agreed that this adjustment should be further reduced to \$4,253.98 as a \$734.50 transfer

between bank accounts was considered as a disposition only rather than as a source and disposition. Petitioner presented no documentary or other evidence to further refute the results of the source and disposition of funds audit.

19. Petitioner argued that the source and disposition of funds audit performed for tax year 1974 was a duplication of the result arising from disallowing the rental, construction business and moving business losses.

20. Petitioner presented no substantiation for the itemized deductions claimed for tax years 1973 and 1975 which were disallowed, by reason of non-substantiation, by the Audit Division.

21. Petitioner did not contest the remaining adjustments made by the Audit Division for tax year 1974.

#### CONCLUSIONS OF LAW

A. That section 612(a) of the New York State Tax Law provides for conformity with the laws and regulations of the United States (Internal Revenue Code) with respect to the issues addressed herein.

B. That Internal Revenue Code section 183(a) and 183(b) provides that in the case of an activity engaged in by an individual, if such activity is not engaged in for profit, no deduction attributable to such activity shall be allowed except:

(1) the deductions which would be allowable for the taxable year without regard to whether or not such activity is engaged in for profit, and

(2) a deduction equal to the amount of the deductions which would be allowable for the taxable year only if such activity were engaged in for profit, but only to the extent that the gross income derived from such activity for the taxable year exceeds the deductions allowable by reason of paragraph (1).

C. That Internal Revenue Code section 183(d) provides in pertinent part that:

"Presumption. -- If the gross income derived from an activity for 2 or more of the taxable years in the period of 5 consecutive taxable years which ends with the taxable year exceeds the deductions attributable to such activity then, unless the Secretary establishes to the contrary, such activity shall be presumed for purposes of this chapter for such taxable year to be an activity engaged in for profit."

Section 183(d) provides criteria for forming a presumption that an activity was engaged in for profit. It does not, however, provide criteria for a converse presumption. Accordingly, section 183(d) may not be used as the sole authority for determining that an activity was not engaged in for profit.

D. That Internal Revenue Code section 183(c) defines an "activity not engaged in for profit" as:

"Any activity other than one with respect to which deductions are allowable for the taxable year under section 162 or under paragraph (1) or (2) of section 212."

E. That Internal Revenue Code section 162(a) provides in pertinent part that with respect to trade or business expenses:

"There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business."

F. That section 689(e) of Article 22 of the New York State Tax Law provides that in any case before the Tax Commission under Article 22, the burden of proof shall be upon the petitioner except for certain issues not present in the instant case.

G. That Internal Revenue Code regulation section 1.183-2(b) provides that in determining whether an activity is engaged in for profit all facts and circumstances with respect to the activity are to be taken into account.

H. That petitioners have sustained their burden of proof to show that petitioner was engaged in the construction and moving businesses for profit; that petitioners' schedule "C" losses are to be allowed for 1973, 1974 and

1975. Petitioner kept business records, advertised as businesses normally do, and had an answering service. The contracting business was registered for sales tax and the businesses had assumed names. Petitioner's work experience, both civilian and military, was mostly all related to construction activities; his salary with IBM was respectable and his duty and title in the military indicated some degree of responsibility. Petitioner spent nights and weekends doing the moving and construction work and although he may have derived some personal pleasure from successfully completing a job there is no evidence that he undertook the construction and moving activities for recreational purposes. Based on the above and the speculative nature of the contracting business, petitioner could reasonably have expected to make a profit from his ventures. Moreover, the source and disposition of funds audit conducted for 1974 indicated unaccounted for income, although not pinpointed to the construction and moving businesses, which leaves a question as to how much the losses really were.

I. That petitioners have not sustained their burden of proof with regards to the rental losses incurred for 1973, 1974 and 1975; therefore, these losses are disallowed. Petitioners presented no evidence concerning what the fair rental value was, nor did they attempt to show the amount of the true monthly rental charge which included both the \$100.00 per month cash plus the value of the answering service. There was no evidence presented to show how much, if any, the property appreciated, its current value, or if it has potential for future appreciation. In addition, the low fixed cash rental charge and the much higher fixed expenses give the impression that petitioners' rental property investment had a built in impossibility of profit (C.B. Nicolette v. Commissioner, 38 TCM 845).

J. That the source and disposition of funds audit adjustments made for the year 1974 do not duplicate the adjustments disallowing the business and rental losses; the disallowance of the losses re-categorized expenses from business to personal, while the source and disposition of funds audit revealed that total expended monies, personal or business or both, were unaccounted for. Therefore, the source and disposition of funds audit adjustment for the year 1974, as reduced in the amount of \$4,253.98, is sustained (Finding of Fact "19", supra).

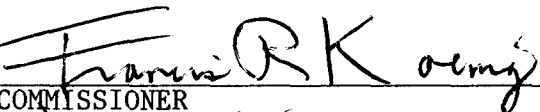
K. That petitioners have not sustained their burden of proof to show that they are entitled to itemized deductions greater than the allowed standard deduction for the years 1973 and 1975; that the adjustments made by the Audit Division with respect thereto are sustained.

L. That the petition of William and Catherine Whitman is granted to the extent indicated in Conclusions of Law "H" and "J" above; that in all other respects the petition is denied and the Notices of Deficiency dated April 11, 1977 and June 27, 1977 are sustained, together with such additional interest as may be lawfully owing.

DATED: Albany, New York  
JAN 20 1984

STATE TAX COMMISSION

  
PRESIDENT

  
COMMISSIONER

  
COMMISSIONER