

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petition :  
of :  
Sheldon Kaufman and Patricia Kaufman :  
  
for Redetermination of a Deficiency or for Refund :  
of New York State and New York City Personal :  
Income Taxes under Article 22 of the Tax Law and :  
Chapter 46, Title T of the Administrative Code of :  
the City of New York for the Years 1979 and 1980. :

AFFIDAVIT OF MAILING

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In the Matter of the Petition :  
of :  
Kenneth M. Lynch :  
  
for Redetermination of a Deficiency or for Refund :  
of New York State and New York City Personal :  
Income Taxes under Article 22 of the Tax Law and :  
Chapter 46, Title T of the Administrative Code of :  
the City of New York for the Years 1979 and 1980. :

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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 7th day of November, 1985, he served the within notice of Decision by certified mail upon Kenneth M. Lynch, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Kenneth M. Lynch  
540 73rd St.  
Brooklyn, NY 11209

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.

Page 2  
Affidavit of Mailing

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  
7th day of November, 1985.

David Parchuck

Ernie A. Hagedorn  
Authorized to administer oaths  
pursuant to Tax Law section 174

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 7th day of November, 1985, he served the within notice of Decision by certified mail upon Murray M. Weinstein, the representative of the petitioners in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Murray M. Weinstein  
225 Broadway, Rm. 1915  
New York, NY 10007

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.

Page 2

Affidavit of Mailing

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  
7th day of November, 1985.

Daniel Parschuck

Robert A. Haggard

Authorized to administer oaths  
pursuant to Tax Law section 174

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

November 7, 1985

Kenneth M. Lynch  
540 73rd St.  
Brooklyn, NY 11209

Dear Mr. Lynch:

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 & 1312 of the Tax Law and Chapter 46, Title T of the Administrative Code of the City of New York, 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  
Murray M. Weinstein  
225 Broadway, Rm. 1915  
New York, NY 10007  
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petition :  
of :  
Sheldon Kaufman and Patricia Kaufman :  
  
for Redetermination of a Deficiency or for Refund :  
of New York State and New York City Personal :  
Income Taxes under Article 22 of the Tax Law and :  
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AFFIDAVIT OF MAILING

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In the Matter of the Petition :  
of :  
Kenneth M. Lynch :  
  
for Redetermination of a Deficiency or for Refund :  
of New York State and New York City Personal :  
Income Taxes under Article 22 of the Tax Law and :  
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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 7th day of November, 1985, he served the within notice of Decision by certified mail upon Sheldon & Patricia Kaufman, the petitioners in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Sheldon & Patricia Kaufman  
20 Rickland Dr.  
Randolph, NJ 07869

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.

Page 2  
Affidavit of Mailing

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  
7th day of November, 1985.

David Parchuck

James A. Hagan  
Authorized to administer oaths  
pursuant to Tax Law section 174

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

November 7, 1985

Sheldon & Patricia Kaufman  
20 Rickland Dr.  
Randolph, NJ 07869

Dear Mr. & Mrs. Kaufman:

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 & 1312 of the Tax Law and Chapter 46, Title T of the Administrative Code of the City of New York, 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.

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

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative  
Murray M. Weinstein  
225 Broadway, Rm. 1915  
New York, NY 10007  
Taxing Bureau's Representative



STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petition  
of  
SHELDON KAUFMAN and PATRICIA KAUFMAN  
for Redetermination of a Deficiency or for  
Refund of New York State and New York City  
Personal Income Taxes under Article 22 of the  
Tax Law and Chapter 46, Title T of the  
Administrative Code of the City of New York  
for the Years 1979 and 1980.

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DECISION

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In the Matter of the Petition  
of  
KENNETH M. LYNCH  
for Redetermination of a Deficiency or for  
Refund of New York State and New York City  
Personal Income Taxes under Article 22 of the  
Tax Law and Chapter 46, Title T of the  
Administrative Code of the City of New York  
for the Years 1979 and 1980.

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Petitioners, Sheldon Kaufman and Patricia Kaufman, 20 Rickland Drive, Randolph, New Jersey 07869, filed a petition for redetermination of a deficiency or for refund of New York State and New York City personal income taxes under Article 22 of the Tax Law and Chapter 46, Title T of the Administrative Code of the City of New York for the years 1979 and 1980 (File No. 45291).

Petitioner, Kenneth M. Lynch, 540 73rd Street, Brooklyn, New York 11209, filed a petition for redetermination of a deficiency or for refund of New York State and New York City personal income taxes under Article 22 of the Tax Law and Chapter 46, Title T of the Administrative Code of the City of New York for the years 1979 and 1980 (File No. 45290).

A consolidated hearing was held before Dennis M. Galliher, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on March 14, 1985 at 9:15 A.M., with all briefs to be submitted by July 10, 1985. Petitioners appeared by Murray M. Weinstein, Esq. The Audit Division appeared by John P. Dugan, Esq. (Paul A. Lefebvre, Esq., of counsel).

#### ISSUES

I. Whether petitioners have substantiated their entitlement to a business bad debt deduction in the amount of \$31,000.00 each for 1980.

II. Whether the Audit Division properly disallowed the pass-through to petitioners of one-half of the 1980 operating loss claimed as incurred by Cashcav Corporation.

III. Whether a portion of the additional business income attributed to petitioners for 1979 should be cancelled as having been earned in 1978.

IV. Whether penalties asserted should be reduced or cancelled.

#### FINDINGS OF FACT

1. On March 3, 1983, the Audit Division issued to petitioner Kenneth M. Lynch a Notice of Deficiency asserting additional tax due for the years 1979 and 1980 in the aggregate amount of \$7,016.78, plus penalty [Tax Law section 685(b)] and interest. On the same date, the Audit Division issued a Notice of Deficiency to petitioners Sheldon and Patricia Kaufman, asserting additional tax due for the years 1979 and 1980 in the aggregate amount of \$9,388.86, plus penalty [Tax Law section 685(b)] and interest.<sup>1</sup>

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1 Patricia Kaufman's name appears by virtue of having filed a joint New York State Income Tax Resident Return with petitioner Sheldon Kaufman. Accordingly, all references to petitioners herein shall, unless otherwise noted, be references solely to Sheldon Kaufman and Kenneth Lynch.

2. The aforementioned notices of deficiency were issued, in part, as the result of a sales tax audit of Cashcav Corporation d/b/a Amber Bar and Grill ("Cashcav"), as well as audits of petitioners' tax returns. Prior to commencement of the instant hearing, sales tax and corporation franchise tax deficiencies pending against Cashcav as a result of the sales tax audit were reduced and resolved. More specifically, the amount of additional unreported taxable sales by Cashcav, as found on audit, was reduced thus serving to reduce the amounts of the noted sales tax and corporation franchise tax deficiencies against Cashcav based thereon. In turn, the Audit Division agreed to reduce the instant income tax deficiencies asserted against petitioners, insofar as related to the Cashcav audit. Since the reduced deficiencies against Cashcav were agreed to, it is only the reduced deficiencies against petitioners which remain at issue. A revised computation of the deficiencies against petitioners, as submitted by the Audit Division, is as follows:

Petitioners Sheldon and Patricia Kaufman:

	<u>1979</u>	<u>1980</u>			
Additional Business Income - per Hearing:					
1980 (sic) (\$7,798.00 divided by 2)	\$ 3,899.00	-0-			
Subchapter S Loss previously disallowed		\$11,448.00			
Deduction for Bad Debt Disallowed		31,000.00			
Net Adjustment	\$ 3,899.00	\$42,448.00			
Taxable Income previously stated	97,251.00	41,490.00			
Corrected Taxable Income	<u>\$101,150.00</u>	<u>\$83,938.00</u>			
	<u>City</u>	<u>State</u>	<u>City</u>	<u>State</u>	<u>Total</u>
Maximum Tax		\$11,199.70		\$8,471.03	
City Income Tax	\$3,949.45		\$3,209.33		
Tax previously computed	3,781.00	10,670.00	1,384.00	3,754.00	
Additional Tax Due	<u>\$ 168.45</u>	<u>\$ 529.70</u>	<u>\$1,825.33</u>	<u>\$4,717.03</u>	<u>\$7,240.51</u>

Petitioner Kenneth Lynch:

	<u>1979</u>	<u>1980</u>
Adjusted Taxable Business Income - per Hearing:		
1979 (7798.00 divided by 2)	\$ 3,899.00	-0-
Subchapter S Loss Disallowed		\$11,448.00
Itemized Deductions Disallowed		1,960.00*
Adjustment to Capital Gain		9,908.00
Capital Loss disallowed		3,000.00
Net Adjustment	\$ 3,899.00	\$26,316.00
Taxable Income previously stated	68,721.00	41,148.00
Corrected taxable income	<u>\$72,620.00</u>	<u>\$67,464.00</u>

	<u>City</u>	<u>State</u>	<u>City</u>	<u>State</u>	<u>Total</u>
Maximum Tax		\$7,788.26		\$6,645.66	
City Income Tax	\$2,722.66		\$2,500.95		
Tax previously computed	2,555.00	7,254.76	1,369.36	3,716.28	
Additional Tax Due	<u>\$ 167.66</u>	<u>\$ 533.50</u>	<u>\$1,131.59</u>	<u>\$2,929.38</u>	<u>\$4,762.13</u>

\* Petitioner Kenneth Lynch concedes and does not contest the Audit Division's disallowance of \$1,960.00 in itemized deductions, pertaining to a portion of his claimed travel and entertainment expenses. Accordingly, such item is not at issue.

In addition, the Audit Division continues to assert interest as well as penalties pursuant to Tax Law section 685(b) against each petitioner.

3. For 1979, petitioners assert that a portion of the additional business income attributed to them per audit (\$7,798.00), as premised on additional sales by Cashcav, was from periods prior to 1979. More specifically, petitioners maintain that additional sales for the quarterly periods ended August 31, 1978 and November 30, 1978 and for the month of December, 1978, deemed additional business income to Cashcav, were improperly deemed constructively received by petitioners in 1979. Rather, petitioners assert, such income was earned and should be deemed constructively received in 1978. By contrast, the Audit Division asserts that since Cashcav operated on a fiscal year ended July 30, any income from July 1, 1978 through June 30, 1979 was properly treated as distributed at the end of such fiscal year and hence was properly includible

in petitioners' tax returns for 1979. Petitioners offered no evidence to support any distributions having been made by Cashcav to petitioners other than as of June 30, 1979.

4. For 1980, petitioners contest the Audit Division's effective disallowance of a claimed business bad debt deduction in the amount of \$62,000.00, asserting that each petitioner should be allowed one-half of such amount, or \$31,000.00, as a miscellaneous itemized deduction for 1980 as more fully described hereinafter. Also, for 1980, petitioners contest the disallowance of each petitioner's share of Cashcav's claimed operating loss for its fiscal year ended "(F/Y/E)" 6/30/80 per its corporate tax return. One-half of such claimed loss of \$22,896.83 was taken by each petitioner in the respective amounts of \$11,448.00. Finally, petitioners allege, solely by brief, that a claimed Subchapter S loss for Cashcav's fiscal year ended June 30, 1981 in the amount of \$18,866.52 should be allowed as a carryback to each petitioners' personal income tax return for the 1979 and 1980 tax years.

5. With respect to the Audit Division's disallowance of petitioners' claimed 1980 loss from Cashcav in the amount of \$22,896.83 (split equally at \$11,488.00 per petitioner), the following facts are found:

a) Cashcav was an electing small business corporation (Subchapter S) for its F/Y/E 6/30/80.

b) Cashcav's returns, as originally filed for the subject fiscal years, reflected losses as follows:

	<u>FYE 6/30/79</u>	<u>FYE 6/30/80</u>
Cashcav total income per return	\$50,871.18	\$35,744.07
Less: deductions per return	61,673.91	58,640.90
Cashcav taxable income (loss)	<u>(\$10,802.73)</u>	<u>(\$22,896.83)</u>

c) Cashcav's income was subsequently increased by additional taxable sales found upon audit:

	<u>FYE 6/30/79</u>	<u>FYE 6/30/80</u>
Cashcav total income per return	\$50,871.18	\$35,744.07
Additional taxable sales per audit	35,329.00	31,206.67
Corrected total income	<u>\$86,200.18</u>	<u>\$66,950.74</u>
Less: deductions per return	61,673.91	58,640.90
Cashcav corrected taxable income	<u>\$24,526.27</u>	<u>\$ 8,309.84</u>

Accordingly, as the result of the audit, Cashcav had no loss in either year, the claimed loss pass-through for 1980 to each petitioner's individual return was disallowed by the Audit Division, and one-half of Cashcav's additional taxable income was added to each petitioner's personal income tax return (\$12,263.13 for 1979 and \$4,154.92 for 1980) as additional business income constructively received from Cashcav.

d) Subsequent to the audit but prior to the hearing, the amount of Cashcav's additional taxable sales found per audit was reduced, thus reducing Cashcav's additional taxable income as follows:

	<u>FYE 6/30/79</u>	<u>FYE 6/30/80</u>
Additional taxable sales per audit	\$35,329.00	\$31,206.67
Additional taxable sales cancelled	16,728.00	14,777.00
Corrected Additional Taxable Sales	<u>\$18,601.00</u>	<u>\$16,429.67</u>

e) Accordingly, Cashcav's corrected taxable income was recomputed as follows:

	<u>FYE 6/30/79</u>	<u>FYE 6/30/80</u>
Cashcav Total Income per return	\$50,871.18	\$35,744.07
Corrected Additional Taxable Sales	18,601.00	16,429.67
Corrected Total Income	<u>\$69,472.18</u>	<u>\$52,173.74</u>
Less: deductions per return	61,673.91	58,640.90
Cashcav corrected taxable income (loss)	<u>\$ 7,798.27</u>	<u>\$(6,467.16)</u>

f) In keeping with the foregoing, Cashcav had no loss for its F/Y/E 6/30/79 and one-half of its income for such year was added to each petitioner's

return as additional business income (\$3,899.13). For 1980, Cashcav had a loss, but in the amount of \$6,467.16 rather than \$22,896.83 as originally claimed. The Audit Division's recomputation, unlike its original statements of audit changes, adds no additional business income to petitioners' returns for 1980. However, the recomputation continues to disallow each petitioner's claim of one-half of Cashcav's loss of \$22,896.83. There is no allowance made for the fact that while Cashcav's claimed loss of \$22,896.83 was substantially diminished, there nonetheless remains (as the result of reducing the amount of additional taxable sales per audit) a loss of \$6,467.16, (\$3,233.58 per petitioner).

7. With respect to the issue of the claimed business bad debt (\$31,000.00 per petitioner), the following facts are found:

a) In September, 1977, each of the petitioners had purchased a one-third interest in Cashcav from its then-owners Anthony Cavaliere, Jr. and John Cashman. The purchase agreement between petitioners and Mr. Cashman provided that petitioners were purchasing a total of 50 shares representing all of Mr. Cashman's shares in Cashcav and constituting one-half of Cashcav's issued and outstanding shares. The purchase price was \$8,000.00 plus the assumption of all debts of the corporation listed in a Schedule "A" attached to the purchase agreement. Said Schedule A listed debts of \$20,694.52, inclusive of a back sales tax liability of \$7,570.08. The purchase agreement between petitioners and Mr. Cavaliere, while not offered in evidence, allegedly provided that each petitioner was to purchase 8-1/3 shares of Cashcav's stock from Mr. Cavaliere, thus vesting equal ownership of Cashcav in Mssrs. Lynch, Kaufman and Cavaliere. The purchase price paid by petitioners to Mr. Cavaliere was not specified. In addition to the purchase agreement provisions, the two sellers each signed

agreements to indemnify petitioners for any pre-existing debts and taxes of Cashcav which were not set forth on the aforementioned Schedule A.

b) From September 11, 1977 to March 7, 1979, the total of old debts and taxes which had accrued prior to the purchase date were (exclusive of the Schedule A figure), approximately \$62,758.00. These back liabilities were paid by petitioners on an ongoing basis, and neither Cashman nor Cavaliere made any payments against their personal liability to the taxpayers on this sum of \$62,758.00. In or about February, 1979, Mr. Cavaliere, at a conference with petitioners and with their attorney (who was also Mr. Cavaliere's attorney), agreed to the amount of his liability to the taxpayers and gave to each of them a promissory note in the amount of \$31,000.00.

c) Efforts by petitioners to collect from Mr. Cavaliere proved fruitless. In August, 1980, Mr. Cavaliere filed a bankruptcy petition, listing the two taxpayers as unsecured creditors (in the amount of \$31,000.00 each), and their claims were discharged in such bankruptcy proceeding. With regard to the disposition of Mr. Cavaliere's one-third ownership interest in Cashcav, Mr. Kaufman testified that

"[W]hen he (Cavaliere) declared bankruptcy, Mr. Lynch and I assumed the balance of the corporation (Cashcav) as 50/50 partners, and that was in August of 1980, I believe."

d) Efforts to collect against Mr. Cashman were not detailed by petitioners' testimony other than as follows:

"Q. Did you pursue Mr. Cashman for these obligations?

A. To the extent it was possible to pursue him. He apparently... when he sold the business he was just interested in getting out. It was impossible to pursue. It was impossible to collect from.

One of the selling points was that in case anything did go wrong, and we suspected there might have been based on past inconsistencies in the way they were handling their taxes and whatnot, by having



Mr. Cavaliere around so we could count on somebody to make these good.

Cashman was never available. I don't even know if we know his address or where he could be located today."

e) Petitioners assert that the debt owing from Cashman and Cavaliere was a business bad debt, based on the fact that this liability to petitioners was the consequence of a business transaction, to wit the purchase of the Cashcav stock by petitioners, as further reflected in the indemnification agreements. Petitioners maintain that the purchase price of the stock would have been reduced by the lesser value of the corporate stock if a true balance sheet of the corporation had been disclosed by the sellers. The Audit Division asserts, by contrast, that this liability from Cashman and Cavaliere was not a debt from them to the taxpayers but was merely a series of capital contributions by the petitioners to the corporation, and that any liability was owed to the petitioners by the corporation.

f) Each petitioner treated the item differently on his return. Mr. Kaufman deducted \$31,000.00 as a miscellaneous itemized deduction on Schedule A of Federal Form 1040 as a "business bad debt". Mr. Lynch treated the item as a non-business bad debt, claiming the \$31,000.00 as a short-term capital loss, on Schedule D of his Form 1040, and producing a maximum capital loss deduction of \$3,000.00.

8. Petitioners also contest the imposition of the negligence penalties [Tax Law §685(b)] asserting that the adjustments involved are technical.

#### CONCLUSIONS OF LAW

A. That in accordance with Findings of Fact "6a - f", the loss sustained by Cashcav for its fiscal year ending June 30, 1980 was not \$22,896.83, as claimed, but was \$6,467.16 following recomputation. The Audit Division's denial

of each petitioner's claimed \$11,448.00 loss pass-through was, at the time of audit, proper. However, in view of the recomputation subsequent to audit, petitioners are each entitled to a loss pass-through in the reduced amount of \$3,233.58 (see Finding of Fact "6-f").

B. That as to the question of petitioners' entitlement to a loss carryback premised on Cashcav's alleged net operating loss for its fiscal year ended June 30, 1981, there has been no showing that amended returns or a claim for refund was filed and denied (or not acted upon within six months and thus deemed denied). Accordingly, no decision is made with regard to such issue of loss carrybacks.

C. That Internal Revenue Code section 166 allows a deduction for any bona-fide debt obligation which, during a given tax year, becomes worthless (or in some cases, partially worthless). Said section also provides for a distinction between the tax treatment of business versus non-business bad debts, such that a business bad debt is deductible in full in the year it becomes worthless while a non-business bad debt is deductible as a short-term capital loss, subject to offset against capital gains and to carryforward provisions. Finally, Code section 166(d)(2) defines a non-business debt to be a debt other than:

"(A) a debt created or acquired (as the case may be) in connection with a trade or business of the taxpayer; or

(B) a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business."

D. That the burden of proof is upon the taxpayers to establish that a bad debt became worthless in the year in which it was deducted [5 Mertens, Law of Federal Income Taxation, §30.79; Tax Law §689(e)].

E. That petitioners have failed to sustain the burden of proving entitlement to a bad debt deduction for 1980. While Mr. Cavaliere's liability via the promissory notes was discharged by bankruptcy, there remains the question of how his one-third ownership interest in Cashcav devolved to petitioners and what, if any, benefit inured to petitioners as a result thereof. More importantly, however, is the lack of evidence concerning what efforts, if any, were undertaken to collect against Mr. Cashman. Other than general testimony that he was "never available", there is no showing of any efforts to collect against Mr. Cashman as one of the parties jointly and severally liable under the indemnification agreements for the amounts paid by petitioners. Accordingly, based on all the facts and circumstances presented, petitioners have not proven the worthlessness of the debt and have not proven entitlement to a bad debt deduction.

F. That petitioners have not shown such facts or circumstances as would warrant reduction or cancellation of the penalties imposed pursuant to Tax Law section 685(b). Accordingly, such penalties, as recomputed, are sustained.


G. That the petitions of Sheldon Kaufman and Patricia Kaufman and of Kenneth M. Lynch are granted to the extent indicated in Conclusion of Law "A", but are in all other respects denied, and the notices of deficiency, as reduced and recomputed prior to hearing and as further recomputed in accordance herewith, are sustained.


DATED: Albany, New York

STATE TAX COMMISSION

NOV 07 1985

  
PRESIDENT

  
COMMISSIONER

  
COMMISSIONER