STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
MARIA J. GARCIA	:	DECISION DTA NO. 826043
for Redetermination of Deficiencies or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law for the Years 2009 through 2011.	:	

Petitioner, Maria J. Garcia, filed an exception to the determination of the Administrative Law Judge issued on March 10, 2016. Petitioner appeared by Damond J. Carter, Esq. The Division of Taxation appeared by Amanda Hiller, Esq. (Alejandro Taylor, Esq., of counsel).

Petitioner filed a brief in support of her exception. The Division of Taxation filed a brief in opposition. No reply brief was filed. Oral argument was not requested. The six-month period for the issuance of this decision began on June 1, 2016, the date that petitioner's reply brief was due.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUE

Whether the imposition of tax preparer penalties imposed under Tax Law former § 685 (aa) (1) is proper.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for findings of fact 1, 2 and 10, which have been modified to more clearly and precisely reflect the record. The Administrative Law Judge's findings of fact and the modified findings of fact are set forth below.

1. In the years 2010, 2011 and 2012, petitioner, Maria J. Garcia, was a New York State registered tax return preparer who prepared personal income tax returns. Petitioner offered tax preparation services through her company, F & G Multiservices, Corp., located in Bronx, New York. Other services offered by the company included money transfers and the sales of money orders and phone cards.

2. For tax years 2009, 2010 and 2011, petitioner prepared a total of approximately 3,000 personal income tax returns for her clients. For tax years 2009, 2010 and 2011, petitioner prepared 205 returns, 334 returns and 139 returns, respectively, on which taxpayers reported personal property rental (PPR) expense adjustments but no rental income for such activities. The PPR expense adjustments reduced the taxpayers' federal adjusted gross income and the taxpayers' reported New York taxable income. The PPR expense adjustments were not related to any rental of personal property by petitioner's clients. Rather, the PPR expense adjustments consisted of petitioner's clients' personal residential rental expenses.

3. The Division of Taxation (Division) processes all incoming personal income tax returns through a computer program that determines whether they should be selected for audit review. A member of the Fraud Analysis and Selection Team (FAST) in the Division's Income/Franchise Desk Audit Division reviews a spreadsheet of the returns filed the previous week for unusual reporting patterns.

4. In February 2012, Jesse Knapp, a Tax Technician I in FAST, noticed a rise in PPR

expense adjustments claimed on personal income tax returns filed for the year 2011. Because Mr. Knapp had never before seen the PPR expense adjustment claimed on income tax returns and was unfamiliar with such federal adjustment to income, he and a colleague researched the qualifications for claiming the PPR expense adjustment. Their research revealed that a PPR expense adjustment can only be claimed up to the amount of income reported on the other income line for personal property rental income. As a result of their research, it was determined that further investigation of those personal income tax returns was necessary, and audit inquiry letters were sent to taxpayers who claimed the PPR expense adjustment on their 2011 income tax returns. Subsequently, the Division issued statements of proposed audit changes to taxpayers who had claimed PPR expense adjustments on income tax returns filed for the years 2009 and 2010.

5. Approximately 3,000 personal income tax returns filed for the years 2009, 2010 and 2011 were subject to audit review because PPR expense adjustments were claimed, but no personal property rental income amounts were reported. As part of its audit investigation of the claimed PPR expense adjustments, the Division matched the tax returns on which that federal adjustment to income was claimed to the particular tax preparers who prepared them, by their preparer tax identification numbers. The Division found that most of those tax preparers were located in the Bronx and Brooklyn. One of the tax preparers identified by the Division was petitioner.

6. In February 2012, the Division sent audit inquiry letters to 139 of petitioner's clients regarding the PPR expense adjustments claimed on their 2011 personal income tax returns. It also conducted audit reviews of 539 returns prepared by petitioner for the years 2009 and 2010 on which the taxpayers claimed PPR expense adjustments. The Division received some

responses from individual taxpayers regarding the validity of the PPR expense adjustment taken. Some of those responses included a lease agreement for the rental of an apartment. The Division concluded that there was no basis for claiming the PPR expense adjustments on those 678 personal income tax returns prepared by petitioner for the years 2009, 2010 and 2011.

7. On December 7, 2012, the Division issued three statements of proposed audit changes to petitioner for the years 2009, 2010 and 2011. In the computation section, each statement of proposed audit changes states, in relevant part, the following:

> "Based on a review of your filing history as a tax preparer, we have determined that you have repeatedly prepared returns for taxpayers reporting federal adjustments to income identified as personal property rental (PPR) expenses. Audits conducted on these returns have established no proof of entitlement to these deductions.
>
> In order to claim PPR expense, an individual must report the rental income received from the activity. We have audited [205, 334 and 139] returns prepared by you that reported PPR expense, but no rental income for the activity.
>
> As a preparer, you should have reasonably known the proper tax treatment for reporting PPR expense as a federal adjustment to income.
>
> Therefore, a penalty has been imposed under 685(aa) of the New York State Tax Law. The penalty is $1,000 for each return reporting the understatement of liability based on the claim for PPR.
>
> This penalty applies to the returns you prepared for the taxpayers on the enclosed attachment."

8. On January 24, 2013, the Division issued three notices of deficiency assessing the penalty amounts proposed by the December 7, 2012 statements of proposed audit changes. Specifically, the first notice of deficiency (L-038866425) assessed penalty in the amount of $205,000.00 for the year 2009, the second notice of deficiency (L-038866438) assessed penalty in the amount of $334,000.00 for the year 2010, and the third notice of deficiency (L-038866442)

assessed penalty in the amount of $139,000.00 for the year 2011. These three notices of deficiency assessed penalty in the total amount of $678,000.00.

9. Petitioner requested a conciliation conference before the Bureau of Conciliation and Mediation Services (BCMS), which was conducted on August 15, 2013. By Conciliation Order dated December 20, 2013 (CMS No. 257292) the conciliation conferee recomputed the statutory notices as follows: notice of deficiency L-038866425 recomputed penalty of $199,000.00 for the year 2009, notice of deficiency L-038866438 recomputed penalty of $329,000.00 for the year 2010, and notice of deficiency L-038866442 recomputed penalty of $139,000.00 for the year 2011.

10. At the hearing, the Division submitted a 21-page list containing information regarding 678 returns prepared by petitioner for the years 2009, 2010 and 2011. Information on this list included, among other things, the tax year, the processing year, the taxpayer's first name and last initial, federal adjusted gross income reported on the return, the federal adjustment to income reported on the return, the specific amount of the PPR expense claimed on the return, the refund requested on the return, and the refund allowed after the audit of the return. This list was used by Mr. Knapp to investigate petitioner's tax preparation activities and to issue the assessments for tax preparer penalties. According to Mr. Knapp, total taxable income that was subtracted from these taxpayers' returns for those three years was approximately $5,400,000.00, with an average PPR expense adjustment claimed of about $8,000.00 per return.

11. Review of the 21-page list indicates the following:

a. for tax year 2009, federal adjusted gross income amounts reported on 205 returns ranged from $9,892.00 to $87,318.00, the PPR expense adjustments claimed on those returns ranged from $1,200.00 to $15,100.00, refunds were requested on 194 returns, and a refund was

allowed in part after audit on one return;

b. for tax year 2010, federal adjusted gross income amounts reported on 334 returns ranged from $0.00 to $67,884.00, the PPR expense adjustments claimed on those returns ranged from $600.00 to $32,000.00, refunds were requested on 315 returns, and refunds were allowed in part after audit on two returns; and

c. for tax year 2011, federal adjusted gross income amounts reported on 139 returns ranged from $13,290.00 to $131,301.00, the PPR expense adjustments claimed on those returns ranged from $3,200.00 to $16,800.00, refunds were requested on 139 returns, and refunds were allowed in part after audit on 53 returns.

Further review of this list reveals that some of petitioner's clients claimed the PPR expense adjustment on two or all three of the returns they filed for the years 2009, 2010 and 2011.

12. The Division submitted three of the affected returns, i.e., one for each tax year. In reviewing each of them, Mr. Knapp identified the erroneously claimed PPR expense adjustment, and petitioner as the preparer of the returns.

13. The Division also submitted pages from Internal Revenue Service Publication 17, Your Federal Income Tax for Individuals (Publication 17) including instructions for years 2009, 2010 and 2011. The pages from each Publication 17 included the cover page, the table of contents page, and the relevant pages from Chapter 12, Other Income. The section entitled "**Rents from Personal Property**" in Chapter 12 of each Publication 17 contains the following information and instructions:

> "If you rent out personal property, such as equipment or vehicles, how you report your income and expenses is generally determined by:
>
> - Whether or not the rental activity is a business, and

- Whether or not the rental activity is conducted for profit.

Generally, if your primary purpose is income or profit and you are involved in the rental activity with continuity and regularity, your rental activity is a business. See Publication 535, Business Expenses, for details on deducting expenses for both business and not-for-profit activities.

Reporting business income and expenses. If you are in the business of renting personal property, report your income and expenses on Schedule C or Schedule C-EZ (Form 1040). The form instructions have information on how to complete them.

Reporting nonbusiness income. If you are not in the business of renting personal property, report your rental income on Form 1040, line 21. List the type and amount of the income on the dotted line next to line 21.

Reporting nonbusiness expenses. If you rent personal property for profit, include your rental expenses in the total amount you enter on Form 1040, line 36. Also enter the amount and 'PPR' on the dotted line next to line 36.

If you do not rent personal property for profit, your deductions are limited and you cannot report a loss to offset other income. See *Activity not for profit*, under *Other Income*, later."

14. To determine whether a tax preparer penalty is warranted, the Division uses the following three criteria: first, the Division looks at the egregiousness of the improper position; second, it takes into consideration the audit success rate based upon that position; and third, the Division looks at the total number of returns on which that position was claimed. According to Mr. Knapp, quite often the Division does not pursue tax preparer penalties. On a yearly basis, FAST reviews at least 100 different preparers with varying issues. However, the Division has imposed the tax preparer penalty against only 54 preparers.

15. It was determined to impose the maximum penalty under Tax Law former § 685 (aa) (1) against petitioner because the Division believed that the due diligence needed to review the personal property rental expense and its proper treatment was relatively low; the audit success rate on the income tax returns reviewed was extremely high, and it was done on 678 returns over three years, i.e., approximately 22% of all returns prepared by petitioner for the years

2009, 2010 and 2011.

16. In 1990, petitioner emigrated from the Dominican Republic, where she studied accounting. Upon her arrival in the United States, she took English courses. To support her family, petitioner worked in a factory, then as a home health aide. In early 2000, petitioner went to Jackson Hewitt to learn how to prepare taxes because of her background in accounting in the Dominican Republic. At that time, she began doing tax preparation with Jackson Hewitt. In December 2002, she started her own business, F & G Multiservices, Corp., which remains open. In December 2003, petitioner successfully completed the Jackson Hewitt basic income tax course. Over the years, petitioner has taken tax courses from, among others, H & R Block, Key Accounting of New York All Tax Solutions, LLC, and the Latino Association of Tax Preparers, Inc. In 2009, petitioner went to her first Internal Revenue Service (IRS) nationwide tax forum. Since then, she has continued to attend IRS sponsored courses and seminars to learn about new tax laws and credits, and to obtain required continuing professional education credits. Petitioner has also completed self-study web seminars to improve her knowledge. In addition, petitioner took three or four courses to prepare for the IRS registered tax return preparer test. On December 7, 2012, after six months of study and test preparation, petitioner passed the IRS registered tax return preparer test.

17. Petitioner heard about deducting personal residential real estate rental expenses as a PPR expense adjustment during a networking break at a tax seminar she attended. Before beginning to claim PPR expense adjustments on her clients' returns in 2009, petitioner reviewed Publication 17 and the instructions for Form IT-201. Because she found the information in those documents to be limited, petitioner contacted her tax software provider, Drake Software, asked questions and also reviewed the self-help information in the software. Based upon the guidance

she received from the software provider, petitioner concluded that personal residential real estate rental expenses could be deducted as a PPR expense adjustment but should not be duplicated on Schedule E, the schedule used for a rental real estate business. She then began claiming the PPR expense adjustments on income tax returns that she prepared for the years 2009, 2010 and 2011.

18. In early 2012, petitioner's clients began receiving audit inquiry letters regarding PPR expense adjustments claimed on their 2011 income tax returns. They returned to petitioner with the audit inquiry letters. She called the software provider who said that there was nothing wrong with claiming the PPR expense adjustment. Petitioner then called the New York State Department of Taxation and Finance and learned that it was improper to claim personal residential real estate rent paid as a PPR expense adjustment. Thereafter, petitioner explained to her clients that the residential real estate rent they paid was not deductible, and that amended returns should be filed for the year 2011. Subsequently, petitioner prepared amended returns for the year 2011 for 128 clients. She did not charge those clients for preparing the amended returns. Later, clients began receiving statements of proposed audit changes for the years 2009 and 2010. Petitioner paid the penalty and interest assessed against some of her clients, but, due to financial constraints, was unable to do so for all clients who returned to her. Petitioner believes that all of her affected clients have repaid the amounts erroneously refunded to them for the years 2009, 2010 and 2011.

19. At the hearing, petitioner explained that she did not intend to defraud New York State. Petitioner further explained that the first return on which she took the PPR expense adjustment was filed electronically, and she believed the return was correctly prepared because it was not rejected and returned to her. Petitioner pointed out that she received a letter from the IRS in 2010 regarding the due diligence required for claiming the earned income credit, but nothing about personal property rental expenses.

20. At the hearing, petitioner testified that she paid rent for her residence during the period 2009 through 2011, but relied upon her third-party tax preparer's advice in not making claims for the PPR expense adjustment on her personal income tax returns for the years 2009, 2010 and 2011. According to petitioner, her own tax preparer acknowledged hearing about the PPR expense adjustment, but petitioner's personal income tax return was already filed.

21. Pursuant to its request to submit post-hearing additional evidence, the Division submitted petitioner's New York State personal income tax returns for the years 2009, 2010 and 2011, as well as F & G Multiservices, Corp.'s federal and state corporate tax returns for the years 2009, 2010 and 2011. Review of petitioner's personal income tax returns for the years 2009, 2010 and 2011 reveals that the only federal adjustments to income claimed on each of those returns was one-half of the self-employment tax.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge explained that notices of deficiency issued by the Division are presumed to be correct until the contrary is proven by petitioner.

The Administrative Law Judge then noted that at issue was a tax preparer penalty. The Administrative Law Judge explained that such penalty was provided for in a situation where a tax preparer filed a return for a client that understated tax liability and where the return contained a position for which: (1) "there was not a reasonable belief that the tax treatment in that position was more likely than not the proper treatment (Tax Law former § 685 [aa] [1] [A]); (2) petitioner "knew (or reasonably should have known) of . . ." the position taken on the returns (Tax Law former § 685 [aa] [1] [B]); and (3) there was no disclosure on the return or any "reasonable basis for the tax treatment of that position" (Tax Law former § 685 [aa] [1] [C]). The Administrative Law Judge explained that petitioner did not actually contest the Division's right to assess such penalties against her, but rather asserted that the maximum penalty of $1000.00 for each return

was unwarranted. Such assertion was based upon petitioner's contention that the understatement of tax liability on her clients' returns was unintentional, as well as her efforts to correct her errors when she was informed of them.

The Administrative Law Judge concluded that petitioner had not proven, as required by Tax Law former § 685, that it was more likely than not that the position she took on 22% of the tax returns she filed for the years in issue, i.e., that personal residential rental expenses were deductible, represented a correct position. The Administrative Law Judge based this conclusion on the fact that while petitioner was an experienced tax preparer, she conducted only minimal research into whether she was correct regarding this rental expense issue, which was included on almost a quarter of the returns she filed. Furthermore, the Administrative Law Judge found the fact that petitioner did not attempt to deduct her own personal residential rental expenses on her personal income tax returns showed a lack of belief that this position was a reasonable one.[1]

SUMMARY OF ARGUMENTS ON EXCEPTION

Petitioner, citing ***Matter of Malba Cove Props., Inc. v Tax Appeals Trib. of the State of N.Y.***, 113 AD3d 891 (2014), argues that the repeal of Tax Law former § 685 (aa), which expired and was deemed repealed on July 1, 2015**,** cannot be retroactively applied to the periods at issue herein. Petitioner posits that this is the correct interpretation because the Division's claim for the amount at issue does not vest until there has been a final legal determination on petitioner's protest. As there has been no such final legal determination, petitioner asserts that the Division of Tax Appeals cannot issue a determination or decision applying Tax Law former § 685 (aa) in this case.

[1] While the Administrative Law Judge did not address in particular the requirements that petitioner knew of the position taken on the returns and did not disclose such position on the face of the returns in the conclusions of law, such conclusions can be inferred from the findings of fact as set forth by the Administrative Law Judge.

Petitioner also argues that her due process rights have been violated because, although Tax Law § 689 (e) clearly states that petitioner has the burden of proof in these proceedings, there is nothing in the statute or Division of Tax Appeals regulations clearly articulating the degree of proof required to meet such burden.

In response, the Division, citing General Construction Law § 93, argues that as the penalty at issue was incurred prior to the repeal of Tax Law § 685 (aa), it must be enforced just as if the statute had not been repealed. The Division also asserts that ***Malba Cove*** is inapposite because the issue in that case was when a certain transfer took place, as the ability to apply the relevant taxing statute depended upon whether that date fell before or after the repeal of the statute. The Division argues that, in the present matter, the conduct of petitioner that caused the Division to assert the penalties occurred prior to the expiration of the statute and, therefore, the Division of Tax Appeals has jurisdiction over this matter.

The Division responds to petitioner's due process argument by pointing to the Administrative Law Judge's clear recitation of the degree of proof required to meet petitioner's burden of proof in the determination (i.e., the Administrative Law Judge's conclusion that petitioner had not proven by clear and convincing evidence that the Division's notices were erroneous or improper).

Finally, although petitioner did not raise any objections to the substantive determination of the Administrative Law Judge on exception, the Division addresses this issue by asserting that the Administrative Law Judge correctly determined that petitioner lacked a reasonable belief that the position she reported on 678 tax returns was a reasonable position. Furthermore, the Division posits that the Administrative Law Judge correctly inferred that petitioner failed to act in good faith from her failure to take the same position on her own personal income tax returns that she took on her clients' returns. Thus, the Division concludes that the Administrative Law Judge's

determination should be affirmed.

OPINION

At issue in this case is the appropriateness of penalties asserted by the Division against petitioner as a tax preparer for violations of Tax Law former § 685 (aa). The Administrative Law Judge found that petitioner prepared returns for her clients that contained a position on the issue of the PPR expense deductions: (1) for which "there was not a reasonable belief that the tax treatment in that position was more likely than not the proper treatment (Tax Law former § 685 [aa] [1] [A]); (2) of which petitioner "knew (or reasonably should have known) of . . ." the position taken on the returns (Tax Law former § 685 [aa] [1] [B]); and (3) for which there was no disclosure on the return or any "reasonable basis for the tax treatment of that position (Tax Law former § 685 [aa] [1] [C]). On exception, petitioner does not argue that any of these findings or conclusions of the Administrative Law Judge are incorrect. Nor does petitioner argue, as she did before the Administrative Law Judge, that she was simply mistaken in her interpretation of the Tax Law and therefore should not be subject to the maximum penalties allowed. Rather, petitioner asserts several new arguments on exception. As the new arguments raised by petitioner do not require an additional factual foundation, the Tribunal will address the new arguments.[2]

The statute governing the outcome of this case, Tax Law former § 685 (aa) expired and was deemed repealed on July 1, 2015 (L.2005, c. 61, pt. N, § 12 [iii]). July 1, 2015 was after the hearing was held on this matter on April 22, 2015, but prior to the March 10, 2016 issuance of the Administrative Law Judge's determination. Petitioner argues that, because the statute at issue

[2] The Tribunal has consistently held that while arguments requiring an additional factual foundation are not allowed on exception, either party may raise new arguments that are strictly legal in nature (***see Matter of Chuckrow***, Tax Appeals Tribunal, July 1, 1993).

was repealed while her case was still before the Division of Tax Appeals, the statute may not be applied to the facts and circumstances of her case. Petitioner's argument lacks any foundation in law.

General Construction Law § 93 provides that:

> The repeal of a statute or part thereof shall not affect or impair any act done, offense committed or right accruing, accrued or acquired, or liability, penalty, forfeiture or punishment incurred prior to the time such repeal takes effect, but the same may be enjoyed, asserted, enforced, prosecuted or inflicted, as fully and to the same extent as if such repeal had not been effected.

The acts of petitioner that are at issue are the filing of certain of her clients' tax returns for the tax years 2009, 2010 and 2011, all of which occurred prior to the commencement of these proceedings. The liabilities asserted by the Division herein were incurred at the time such returns were filed. Thus, the repeal of Tax Law § 685 (aa) effective July 1, 2015, does not affect the actions taken by petitioner in filing the returns or the liabilities incurred based upon those actions. Accordingly, the Division may assert the penalties at issue and the Division of Tax Appeals and this Tribunal are required to provide petitioner with a process to protest such penalties (***see also*** General Construction Law § 94 ["all actions and proceedings . . . commenced under or by virtue of any provision of a statute so repealed, and pending immediately prior to the taking effect of such repeal, may be prosecuted and defended to final effect in the same manner as they might if such provisions were not so repealed."]).

Petitioner has provided no legal authority that would nullify this general rule. We agree with the Division that ***Malba Cove*** is inapposite to the current matter. In ***Malba Cove***, the statute imposing a tax on certain transfers of real property had been repealed. It was clear that if the transfer of the property at issue occurred prior to the statute being repealed, then tax could be imposed; if it occurred after the repeal of the statute, as was ultimately concluded by the court,

then tax could not be imposed (113 AD3d at 892-94). Thus, the question was limited to determining when the transfer occurred. As noted above, in the present case, there is no question that the actions of petitioner that led the Division to assert the penalties and the assertion of the penalties by the Division occurred prior to the repeal of the statute. Therefore, to the extent that ***Malba Cove*** is applicable to the facts herein, it requires a finding that Tax Law former § 685 (aa) remains applicable to this case.

Petitioner also argues that she was deprived of due process of law by the failure of the Division of Tax Appeals to articulate the degree of proof required to meet the burden of proof imposed upon petitioner by Tax Law § 689 (e) (***see also*** 20 NYCRR 3000.15 [d] [5]). Thus, petitioner is apparently arguing that the Due Process Clause of the United States Constitution requires that the New York State Legislature by statute, or the Division of Tax Appeals by regulation, set forth the degree of proof required of all petitioners appearing before the Division of Tax Appeals to meet their burden of proof. The lack of such notice of the degree of proof required constitutes facial challenge to Tax Law § 689 (e) and 20 NYCRR 3000.15 (d) (5), in that every person filing a protest would be entitled to the same relief. We will therefore not rule on this issue, as facial constitutionality is presumed at the administrative level (***Matter of Eisenstein***, Tax Appeals Tribunal, March 27, 2003).

Finally, petitioner has not challenged any of the findings of fact or conclusions of law set forth in the determination of the Administrative Law Judge. Therefore, we decline to address any such issues further, except to add that petitioner, on her clients' returns, utilized a deduction applicable to personal property rental expenses, as was clearly stated in Internal Revenue Service Publication 17, which petitioner reviewed, and applied it to personal residential real estate rental expenses. We cannot find that a tax preparer under these circumstances could have a reasonable

belief that such a position was more likely than not a correct one (Tax Law former § 685 [aa] [1] [A]). Accordingly, we affirm the determination of the Administrative Law Judge based upon the reasons stated therein.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Maria J. Garcia is denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petition of Maria J. Garcia is denied; and

4. The notices of deficiency dated January 24, 2013, as modified by finding of fact 9, are sustained.

DATED: Albany, New York
December 1, 2016

/s/ Roberta Moseley Nero
Roberta Moseley Nero
President

/s/ James H. Tully, Jr.
James H. Tully, Jr.
Commissioner

/s/ Dierdre K. Scozzafava
Dierdre K. Scozzafava
Commissioner