

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition :
of :
LIZET RUBINOS : DECISION
 : DTA NO. 826859
for Redetermination of Deficiencies or for Refund of :
New York State and New York City Personal :
Income Taxes under Article 22 of the Tax Law and the :
Administrative Code of the City of New York for the :
Years 2010 and 2011. :

Petitioner, Lizet Rubinos, filed an exception to the determination of the Administrative Law Judge issued on February 23, 2017. Petitioner appeared pro se. The Division of Taxation appeared by Amanda Hiller, Esq. (Christopher O'Brien, Esq., of counsel).

Petitioner filed a brief in support of her exception. The Division of Taxation filed a letter brief in opposition. Petitioner did not file a reply brief. Oral argument was not requested. The six-month period for the issuance of this decision began on August 3, 2017, the date petitioner's reply brief was due.

ISSUES

I. Whether the Division of Taxation properly disallowed expense deductions resulting in subchapter S losses reported by petitioner for tax years 2010 and 2011.

II. Whether petitioner has established grounds for abatement of penalties in this matter.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge, except findings of fact

1, 14, 15 and 19, which we have modified to more accurately reflect the record. The Administrative Law Judge's findings of fact and modified findings of fact are set forth below.

1. Petitioner, Lizet Rubinos, timely filed New York State resident income tax returns for the years 2010 and 2011. On petitioner's 2010 return, she reported wage income in the amount of \$16,166.00, business loss of \$343.00, and loss from an S corporation in the amount of \$1,356.00, resulting in total federal adjusted gross income of \$14,467.00. Attached to petitioner's 2010 return was a schedule K-1 from Lizet Rubinos, Inc., reporting petitioner as the sole shareholder and showing a business loss of \$1,356.00. Also attached to petitioner's 2010 return was a schedule C, profit or loss from business, on which petitioner listed her sole proprietorship by the name of "Philips-Van Heusen Corp.," listed the principal business as "tailor," reported gross income of \$1,500.00, deducted expenses for depreciation of \$1,843.00, and reported a net loss in the amount of \$343.00.

Petitioner's 2011 return reported wage income in the amount of \$37,597.00 and partnership income from Rubinos Holdings in the amount of \$46.00. Line 6 of the return, business income or loss, is blank. Attached to the 2011 return was a schedule K-1 for Rubinos Holdings, and the second page of a schedule E, reporting income of \$46.00 from the partnership Rubinos Holdings and no income or loss from the S corporation Lizet Rubinos, Inc. Also attached to petitioner's 2011 return was a schedule C for Philips-Van Heusen Corp., which reported gross income of \$15,357.00, depreciation expenses of \$4,400.00, tentative profit of \$10,957.00, and expenses for business use of home in the amount of \$10,957.00, resulting in zero net profit. Petitioner attached federal form 8829, expenses for business use of your home, to the 2011 return, wherein she reported that 40.03% of her home was used exclusively for business.

2. The Division of Taxation (Division) audited petitioner's 2010 and 2011 income tax returns and the 2010 and 2011 New York S corporation franchise tax returns for Lizet Rubinos, Inc. By correspondence dated March 25, 2013, the Division requested that petitioner provide the following: the exact address of all property owned by the S corporation; a copy of the federal form 1120S, U.S. income tax return for an S corporation (S corporation return); a detailed explanation of the exact nature of the business; copies of the documents that were used to calculate the income reported on the S corporation return, including all books and records as well as a description of the source and nature of the income; detailed documentation such as sales slips, invoices, bank statements or receipts, supporting the expenses claimed on the S corporation return; a breakdown of the amount reported on the S corporation return, line 19, "other deductions," including verifiable documentation to support the amount claimed; a description of assets or property being depreciated or amortized, including a detailed schedule showing the depreciation or amortization calculation, a description of what method was used and the computation for determining the depreciable basis, and an explanation of how the property is used in petitioner's business; and copies of any licenses, registrations or certifications that were required for the business.

3. Petitioner did not respond to the Division's request for information, and by correspondence dated April 29, 2013, the Division informed petitioner, as shareholder of Lizet Rubinos, Inc., that the expenses claimed on the New York S corporation returns for 2010 and 2011 had been disallowed. The correspondence further stated that any adjustments made to the S corporation returns might result in adjustments to petitioner's personal income tax returns. The correspondence stated that if petitioner disagreed with the determination, she could provide the requested documentation for the Division to review.

4. Petitioner did not provide the requested information and on May 7, 2013, the Division issued statements of proposed audit change (statement) to petitioner for the years 2010 and 2011.

5. The statement for 2010 stated, in part, as follows:

“A 2010 audit conducted on Lizet Rubinos, Inc. resulted in the disallowance of the expenses reported on Lizet Rubinos Inc.’s 2010 S-corporation return. This ultimately resulted in the increase of the income reported on the return.

Since an S-corporation is considered a flow-through entity, meaning all income or loss is reported on the shareholder’s personal income tax returns, any adjustments to the S-corporation return directly result in adjustments to the shareholder’s personal income tax return.

The figure reported on your 2010 personal income tax return from the above S-corporation has been adjusted to reflect the changes made to form CT-3-S, filed for the above S-corporation for tax year 2010.

Your corrected federal adjusted gross income is \$97,684.00.

The above adjustment resulted in the disallowance of the New York earned income credits claimed on your return.”

The statement asserted tax due for 2010 in the amount of \$9,265.79, plus penalties in the amount of \$2,054.82 pursuant to Tax Law § 685 (b) (1), (2), and (p), and interest.

6. The statement for 2011 contained similar language to the 2010 statement (*see* finding of fact 5), but instead referenced the 2011 audit of Lizet Rubinos, Inc., which resulted in the disallowance of the expenses reported on the 2011 S corporation return. Based on the disallowance, the Division adjusted petitioner’s 2011 personal income tax return, and determined corrected federal adjusted gross income in the amount of \$108,488.00. The statement asserted tax due for 2011 in the amount of \$7,703.62, plus penalties in the amount of \$1,438.29 pursuant to Tax Law § 685 (b) (1), (2), and (p), and interest.

7. The Division issued a notice of deficiency to petitioner, dated June 24, 2013, asserting tax due in the amount of \$9,265.79, plus interest and penalties for tax year 2010.

8. The Division issued another notice of deficiency to petitioner, dated June 24, 2013, asserting tax due in the amount of \$7,703.62, plus interest and penalties for tax year 2011.

9. During the tax years at issue, Lizet Rubinos, Inc., was an S corporation for both federal and New York State income tax purposes. All of the stock of Lizet Rubinos, Inc., was owned by petitioner. All of the income and losses of Lizet Rubinos, Inc., passed through for income tax purposes to petitioner and were required to be reported on her personal income tax returns for the years at issue.

10. Lizet Rubinos, Inc., is a tailoring business that makes and alters clothing for photo shoots on commercial fashion shows and makes or alters costumes for Broadway tours. Petitioner testified that the work is seasonal, and that for larger jobs, she hires additional contractors for the S corporation, who bring their own sewing machines and other equipment to the job.

11. The only documentation presented by petitioner during the hearing were three emails regarding her former accountant, John Cisneros, CPA. Petitioner did not present any documentation during the hearing to substantiate the claimed S corporation expenses, and was granted additional time following the hearing to submit such documentation. Within the time provided following the hearing, petitioner provided the following for tax year 2010: federal form 1120S, US income tax return for an S corporation for Lizet Rubinos, Inc.; Chase Bank statements for Lizet Rubinos, Inc.; a one-page schedule attached to the Chase Bank statements wherein petitioner listed expense categories and amounts by month; a copy of a check register for the Chase Bank account; TD Bank statements for Lizet M. Rubinos; a one-page schedule attached to the TD Bank statements wherein petitioner listed expense categories and amounts by month; a copy of the check register for the TD Bank account; a two-page customer balance detail; forms

1099-MISC, miscellaneous income returns issued from Lizet Rubinos, Inc., to various individuals reporting nonemployee compensation; four invoices billed to Lizet Rubinos, Inc., for payments to some of the individuals included in the 1099-MISC forms; and a copy of her residential apartment lease.

12. The 2010 federal S corporation return for Lizet Rubinos, Inc., reported gross receipts of \$81,861.00, less deductions totaling \$83,217.00 (consisting of depreciation in the amount of \$20,582.00 and other deductions in the amount of \$62,635.00), for a total reported loss of \$1,356.00.

13. Attached to the 2010 S corporation return was a 2010 asset detail report for the claimed depreciation in the amount of \$20,582.00. The asset detail report lists depreciation for automobiles as follows:

Description	Date Acquired	Cost/ Basis	Business Use	Prior Depreciation	Current Depreciation	Date Sold	Sales Price	Gain/Price
2007 Toyota - in service 2007 ¹	01/07	16,000	100	8,192		01/10	8,500	692
Nissan Rogue - in service 2009 ²	10/09	35,000	100	6,870	13,300			

¹ Attached to petitioner's 2010 personal income tax return, in a 2010 asset detail report to the schedule C for Philips-Van Heusen Corp., petitioner reported the same 2007 Toyota, indicating that the vehicle was put in service for the schedule C business in 2007, and claiming depreciation for the vehicle as a deduction to the schedule C business income for 2010 in the amount of \$1,843.00. The asset detail report for the schedule C business also shows prior depreciation of \$11,392.00. Petitioner claims on the asset detail report to the schedule C that the Toyota was used 100% for the business of Philips-Van Heusen Corp., while claiming on the S corporation asset detail report that the Toyota was used 100% for the business of Lizet Rubinos, Inc.

² Included in the record is a retail agreement to provide insurance indicating that petitioner and Imre Nemeth were the purchasers of the Nissan Rogue. It is further noted that for 2011, petitioner claimed depreciation for the Nissan as a deduction from her schedule C business income and reported that the vehicle was used 100% for the Schedule C business (*see* finding of fact 18).

Mitsubishi - in service 2009	01/09	3,000	100	1,050	780			
Mazda - in service 2010	01/10	32,510	100		6,502			
Form totals		86,510		16,112	20,582		8,500	692

14. Attached to the 2010 S corporation return was a detail for line 19 - other deductions, which broke down the claimed other deductions totaling \$62,635.00 by expense category. The business expense deductions reported on the 2010 S corporation return for other deductions differ in both amount and expense categories from those petitioner listed on the schedules attached to the submitted bank statements. The expenses listed by petitioner on the Chase and TD Bank schedules total \$84,404.69, compared with the total expenses for “other deductions” of \$62,635.00 reported on the S corporation return. Petitioner provided no explanation for the discrepancies. The expense categories and amounts as listed on the 2010 S corporation return in comparison with those listed on the schedules petitioner attached to the bank statements for 2010 are as follows:

Expense	Amount Listed on S Corporation Return	Amount Listed on Chase Bank Schedule	Amount Listed on TD Bank Schedule
Accounting	\$1,500.00		
Auto Expense: Gas	\$2,685.00	\$1,182.59	\$246.47
Insurance	\$2,914.00		
Repairs/Maintenance	\$67.00		
Auto Finance		\$6,000.00	
Bank Charges	\$285.00	\$99.00	

Check			\$3,300.00 ³
Dues & Subscriptions	\$145.00		
Entertainment & Promotion	\$3,024.00		
Ipad		\$803.50	
Insurance		\$2,914.30	
Laundry & Cleaning	\$320.00		
Meals	\$510.00 (\$1,019.00 at 50%)	\$1,519.85	\$431.74
Media Research	\$98.00		
Office Expense	\$2,872.00	\$667.83	
Outside Service	\$42,727.00		
Park		\$1,174.50	\$189.50
Petty Cash		\$700.00	\$1,523.35
Postage	\$96.00	\$52.78	\$121.80
Professional Fee		\$1,118.00	\$895.00
Rent			\$13,600.00 ⁴

³ On the schedule attached to the TD Bank statements, petitioner indicated “check” expenses for February as “#350 - \$700 Amex2,” March as “#353 - \$400 Amex2,” April as “#358 - \$830.00 Amex2,” May as “#362 - \$600 Amex2,” June as “#364 - \$100 Amex 2,” and July as “#367 - \$700 Amex2,” totaling \$3,300.00 for 2010. A review of the TD Bank check register with the corresponding check numbers reveals the following: check number 350 in the amount of \$700.00 paid to Imre Nemeth for “Amex,” check number 353 in the amount of \$400.00 paid to Imre Nemeth for “Amex,” check number 358 in the amount of \$830.00 paid to Imre Nemeth for “Amex & Airline Tix,” check number 362 in the amount of \$600.00 paid to Imre Nemeth for “Amex & Car,” check number 364 in the amount of \$100.00 paid to Imre Nemeth for “Amex,” and check number 367 in the amount of \$700.00 paid to “IM” for “Amex.” There was no testimony or documentary evidence presented as to the business purpose for these expenses.

⁴ On the schedule attached to the TD Bank statements, petitioner claimed rent expenses for the months of February, March, May, July, September, October, November and December 2010, in the amount of \$1,700.00 per month, totaling \$13,600.00. The check register shows payments to Alejandra Rubinos for these amounts. Petitioner did not provide any testimony or documentary evidence regarding the business purpose for rent expenses in relation to Lizet Rubinos, Inc. Petitioner submitted a copy of her residential apartment lease which provides that she and another individual, Imre Nemeth, are cotenants of a three-bedroom residential apartment with monthly rent of \$1,700.00. The landlord listed on the lease is Alejandra Rubinos. The lease provides that “[n]o retail, commercial or professional use of the premises is allowed unless the tenant receives prior written consent of the landlord” According to petitioner’s claim for the earned income credit, along with petitioner and Mr. Nemeth, petitioner’s daughter resided at the apartment in 2010, and petitioner’s daughter and son resided with her and Mr. Nemeth in

Self		\$12,110.00	
Software		\$23.66	
Supplies	\$97.00	\$206.00	\$242.99
Telephone ⁵	\$2,024.00	\$703.43	\$1,456.28
Tolls			\$600.00
Travel	\$2,283.00		
Transportation	\$988.00	\$357.37	\$45.00
1099		\$32,089.75	

15. The 1099-MISC forms, bank record of check payments to the individuals listed on the 1099-MISC forms, and invoices reflect the following payments for 2010:

1099-MISC Recipient	Nonemployee Compensation per 1099-MISC	Record of Check Payment	Invoice Information	Invoice	Invoice Amount
Raul Zevallos	\$1,897.00	\$1,897.00	None		
Belkie E Soto	\$3,200.50	\$3,200.50	for Jen Kao Show	9/11/10	\$3,200.50
Erin B Roth	\$940.00	\$980.00 ⁶	None		
Manuel Rivera	\$1,968.00	\$1,968.00	None		
Arias Mejias	\$2,100.00	\$2,100.00	None		
Francisca Jimenez	\$980.00	\$980.00	for Jen Kao Show	9/11/10	\$980.00

2011. It is further noted that on petitioner's 2011 schedule C for the business "Philips-Van Heusen Corp.," petitioner claimed 40.03% business use of her home, and carried over an expense in the amount of \$3,752.00 from 2010 to her 2011 personal income tax return, whereon she deducted an expense for business use of her home totaling \$10,957.00 (including the 2010 carry over) on the 2011 schedule C for Philips-Van Heusen Corp.

⁵ On the schedules attached to the Chase and TD Bank statements, this expense category is listed as "mobile," which apparently refers to a mobile (or cellular) telephone.

⁶ It appears that this transaction was voided in the check register. Petitioner did not offer an explanation for the discrepancy between the 1099-MISC amount and the amount recorded in the check register.

Soule Golden	\$3,330.00	\$1,440.00	None		
Artie J. Brown	\$550.00	\$550.00	None		
Malynda Hasandocaj	\$720.00	\$420.00	for Bloomingdale Photo Shoot	12/11/10	\$300.00
Siria Lemagne	\$840.00	\$840.00	None		
Consuelo Minchola	\$1,890.00	\$1,890.00	None		
Paulina Rodriguez	\$2,170.00	\$2,170.00	None		
Alejandra Rubinos	\$18,095.00	\$18,095.00	for Jen Kao Show	11/30/10	\$13,193.75
Frances Torres	\$610.00	\$610.00	None		
Grace Zhang	\$1,230.00	\$1,230.00	None		
TOTALS	\$40,520.50	\$38,370.50			\$17,674.25

16. The two-page customer balance detail for 2010, which also contains the written label “income summary,” indicates accounts receivable amounts totaling \$18,568.75 and balance totaling \$20,068.75. At the end of the document is handwriting stating, “invoice total: 92,534.80” and “payment received: 73,966.55.” No backup documentation was provided and there is no explanation why the amounts are inconsistent with the amount reported as gross receipts on the 2010 federal S corporation return for Lizet Rubinos, Inc. (*see* finding of fact 12).

17. Within the time provided following the hearing, petitioner provided the following for tax year 2011: an amended schedule K-1 for Lizet Rubinos, Inc., reporting petitioner as 100% shareholder and reporting no income or loss; a 2011 asset detail report for petitioner’s schedule C business; invoices dated March 3, 2011 from Marsh & Fried Holdings, LP, in the amount of

\$1,670.00 for the preparation of petitioner's 2010 personal income tax return, and in the amount of \$1,200.00 for the preparation of Lizet Rubinos, Inc.'s, 2010 S Corporation return;⁷ Chase Bank statements for Lizet Rubinos, Inc.; a one-page schedule attached to the Chase Bank statements wherein petitioner listed expense categories and amounts by month; a copy of a check register for the Chase Bank account; TD Bank statements for Lizet M. Rubinos; a one-page schedule attached to the TD Bank statements wherein petitioner listed expense categories and amounts by month; a copy of the check register for the TD Bank account; a two-page customer balance detail; forms 1099-MISC, miscellaneous income returns issued from Lizet Rubinos, Inc., to various individuals reporting nonemployee compensation for 2011; six invoices billed to Lizet Rubinos, Inc., for payments to some of the individuals included in the 1099-MISC forms; a copy of a retail agreement to provide insurance, dated September 29, 2009, to Nissan Motor Acceptance Corporation, listing petitioner and Imre Nemeth as purchasers of a 2010 Nissan Rogue; and a press release from the New York County District Attorney stating that tax preparer John Cisneros was indicted for preparing fraudulent tax returns between 2009 and 2014. Petitioner did not submit the 2011 federal form 1120S, U.S. income tax return for Lizet Rubinos, Inc., and such return is not a part of the record herein.

18. The 2011 asset detail report submitted by petitioner is the same as that attached to her 2011 personal income tax return as a detail to her schedule C business, Philips-Van Heusen Corp., and lists the following:

⁷ There is no evidence of a payment of the invoice for the preparation of the corporate return in the check registers or bank statements submitted. Petitioner also submitted an invoice dated October 15, 2012 for the preparation of Lizet Rubinos, Inc.'s, 2011 S Corporation return. Since the invoice date is subsequent to the years at issue herein, it will not be considered in rendering this decision.

Description	Date Acquired	Cost/Basis	Business Use	Prior Depreciation	Current Depreciation	Date Sold	Sales Price	Gain/Price
2010 Nissan - in service 2011 ⁸	01/11	22,000	100		4,400			
2007 Toyota - in service 2007	01/07	16,000	100	13,235				
Form totals		38,000		13,235	4,400			

Petitioner deducted depreciation expenses in the amount of \$4,400.00 on the 2011 schedule C for Philips-Van Heusen Corp. There is no evidence in the record as to whether petitioner claimed depreciation for any vehicles as a deduction to the S corporation’s income for 2011, as petitioner failed to submit the 2011 S corporation return into the record.

19. The expense schedules submitted by petitioner for 2011, attached to the bank statements for the Chase and TD Bank accounts, list the following expenses:

Expense	Amount Listed on Chase Bank Schedule	Amount Listed on TD Bank Schedule
Tolls	\$326.50	\$585.00
Transportation	\$580.30	
Meals & Entertainment	\$1,687.97	\$337.76
Petty Cash	\$1,362.00	\$1,899.70
Check		\$20,619.00 ⁹

⁸ The Nissan was purchased by petitioner and Imre Nemeth and in 2010 petitioner reported that the vehicle was used 100% for her S Corporation (*see* Finding of Fact 13). For 2011, petitioner reported that it was used 100% for the schedule C business.

⁹ On the schedule attached to the TD bank statements for 2011, petitioner indicated “check” expenses as follows: January “#379 - \$219 Union dues;” February “#380 - \$1700 Rent” and “#383 - \$1700 Rent;” April “#386 - \$1700 Rent;” May “#387 - \$1700 Rent;” June “#388 - \$1700 Rent” and “#389 - \$1700 Rent;” July “#391 - \$1700 Rent;” September “#392 - \$1700 Rent” and “#393 - \$1700 Rent;” October “#394 - \$1700 Rent,” and December “#397 - \$1700 Rent” and “#398 - \$1700 Rent.” The check register for the TD Bank account indicates that the claimed rent expenses were paid to Alejandra Rubinos. The rent appears to be for petitioner’s residential apartment

Professional Fee	\$1,715.00	
Park	\$1,906.91	
Supplies	\$57.46	
Mobile	\$1,624.79	
Gas	\$1,476.51	
Forms 1099	\$37,205.69	
Auto Finance	\$6,000.00	
Postage	\$75.67	
Insurance	\$2,975.30	
Self	\$5,000.00	
Bank Fee	\$22.00	
Auto Registration	\$135.00	
Auto Maintenance	\$2,309.16	
Dues	\$135.00	
Equipment	\$300.00	
Travel	\$171.71	
Laptop	\$16,320.04	
Total expenses claimed on post-hearing submission ¹⁰	\$81,207.01	\$23,441.46

20. The 1099-MISC forms, bank record of check payments to the individuals listed on the 1099-MISC forms, and invoices reflect the following payments for 2011:

(*see* footnote 4). In addition to claiming the residential rent as an expense deduction for Lizet Rubinos, Inc., petitioner also claimed a portion of the rent as a deduction in 2011 for the business use of her home for her schedule C business, Philip-Van Heusen Corp. (*id.*)

¹⁰ It is noted that petitioner did not submit the 2011 Form 1120S, U.S. income tax return for Lizet Rubinos, Inc., and as such, it is unknown whether the expenses claimed on the schedules submitted by petitioner in her post-hearing submission are consistent with amounts claimed on the S corporation return.

1099-MISC Recipient	Nonemployee Compensation per 1099-MISC	Record of Check Payments	Invoice Information	Invoice Date	Invoice Amount
Alejandra Rubinos	\$11,327.50	\$11,327.50	- Givenchy, Bally, Reed, Krakross - Reed Kakoff Show	8/24/11	\$5,280.00
				11/20/11	\$4,097.50
Jen Rong Chen	\$1,412.50	\$1,412.50	- Yigal Fashion Show - Jen Kao Show and Sherri Hill Show	6/30/11	\$287.50
				9/14/11	\$1,125.00
Paulina Rodriguez	\$943.90	\$943.90	None		
Soule Golden	\$2,965.50	\$2,965.50	None		
Maylinda Hasandacaj	\$855.00	\$855.00	None		
Clara Reyes	\$875.00	\$875.00	Jen Kao Show	9/8/11	\$875.00
Lydia Witt	\$760.00	\$760.00	None		
Livia Barrant	\$2,006.13	\$2,006.13	None		
Paula Redinger	\$720.00	\$720.00	Sherri Hill Project	9/19/11	\$720.00
Caitlin Evans	\$6,419.32	\$6,419.32	None		
TOTALS	\$28,284.85 ¹¹	\$28,284.85			\$12,385.00

21. The two-page customer balance detail submitted by petitioner for 2011 contains the handwritten label “income summary” and indicates accounts receivable amounts totaling

¹¹ It is noted that the total amount of nonemployee compensation based on the 1099-MISC forms submitted for 2011 differs from the amount of claimed “1099” expenses listed by petitioner on the schedule attached to the 2011 Chase bank statements (*see* finding of fact 19). Petitioner provided no explanation for the discrepancy.

\$8,824.50. At the end of the document is handwriting that states, “invoiced: \$60,660.48” and “payments received: \$69,374.73.” No backup documentation was provided to support the claimed income amount.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge began her determination by noting that petitioner bears the burden of proof in showing by clear and convincing evidence that a notice of deficiency issued by the Division is erroneous, citing the Tax Law and relevant case law. Thus, according to the Administrative Law Judge, it is incumbent upon petitioner to prove her entitlement to the deductions claimed by her wholly-owned Subchapter S corporation.

Next, the Administrative Law Judge described the method by which a resident taxpayer’s New York adjusted gross income is determined. The Administrative Law Judge stated that the Tax Law establishes that a resident taxpayer’s New York income is the same as his or her federal adjusted gross income, which is in turn defined as a taxpayer’s gross income less any deductions allowed by the Internal Revenue Code (IRC). IRC (26 USCA) § 162 allows deductions for expenses that are “ordinary and necessary” for the production of income in carrying on a trade or business. The Administrative Law Judge explained that due to pass-through treatment of income and losses incurred by S corporations such as Lizet Rubinos, Inc., petitioner bears the dual burden of demonstrating entitlement to the deductions claimed by the S corporation and also substantiating the amounts of the deductions claimed.

The Administrative Law Judge noted that under the *Cohan* rule, courts are permitted to make an approximation of an allowable amount of business expense deductions when a taxpayer is unable to substantiate the full amount of the business expenses he or she deducted, but they are not required to do so and deductions may be completely disallowed in the absence of a basis for a

reasonable approximation of such expenses (*see Cohan v Commr.*, 39 F2d 540 [2d Cir 1930]). Furthermore, according to the Administrative Law Judge, IRC (26 USCA) § 274 (d) requires a higher substantiation requirement of certain business expenses, including travel, tolls, meals, entertainment and cellular telephone expenses.

The Administrative Law Judge observed that despite being given an opportunity following the hearing to provide business records in support of the business expense deductions claimed by Lizet Rubinos, Inc., petitioner only provided limited and unorganized documentation in support thereof. In light of the fact that petitioner not only failed to provide records during the audit, but also failed to provide any meaningful testimony or documents during the hearing to explain and substantiate the claimed deductions, the Administrative Law Judge found that the records submitted were incomplete and largely could not be traced to the corporate tax returns. The Administrative Law Judge found it noteworthy that petitioner did not connect the expenditures reported in the submitted bank statements to a business function of Lizet Rubinos, Inc., and it appeared that the corporation's and petitioner's personal bank accounts were used interchangeably for personal and claimed business expenses. Furthermore, only a few expenses were supported by additional source documentation, namely the few invoices from contractors submitted for Lizet Rubinos, Inc.

The Administrative Law Judge reasoned that the double-claiming of certain business expenses for the S corporation and the schedule C business cast those claimed deductions as suspect, and specifically cited the multiple claims of residential rent expenses and depreciation on multiple vehicles as improper business deductions. However, after consideration of documents presented and testimony given at the hearing, the Administrative Law Judge did allow the deductions claimed by the S corporation for non-employee compensation. She sustained the

Division's disallowance of the other claimed expenses as petitioner failed to provide any evidence to show the business purpose for the claimed deductions, much less meet the heightened substantiation requirements for certain expenses under IRC (26 USCA) § 274.

Turning next to the question of whether the Division properly imposed negligence and substantial understatement of tax penalties on petitioner, the Administrative Law Judge concluded that it had. The Administrative Law Judge stated that the penalties imposed for substantial understatement of tax could be abated upon petitioner's showing of reasonable cause for the understatement and that she acted in good faith. However, the Administrative Law Judge reasoned that because petitioner failed to introduce any evidence to support abatement of the penalties imposed, petitioner failed to bear her burden of showing reasonable cause and good faith. The Administrative Law Judge found that petitioner's stated reliance on her accountants did not absolve her of her obligation to provide records to the Division when requested pursuant to the audit. Despite being given additional time after the hearing to provide these records, petitioner still failed to provide the requested records to substantiate the claimed deductions.

The Administrative Law Judge thus granted petitioner's request for redetermination of her deficiencies with regard to the deductions stemming from non-employee compensation expenses, but otherwise sustained the notices of deficiency.

OPINION

Because the deficiencies here asserted against petitioner resulted from the disallowance of deductions claimed on Lizet Rubinos, Inc's corporate income tax returns, we start with the pass-through effect of an S corporation on an individual's personal income tax return. An S corporation's loss or income, as adjusted by items of deduction, is passed through to the shareholders for reporting on their personal income tax returns due to the S corporation's status

as a pass-through entity for New York and federal tax purposes (*see* Tax Law § 617; IRC [26 USCA] §§ 1363, 1366). For New York residents, including S corporation shareholders, New York adjusted gross income is defined as federal adjusted gross income with certain state-specific additions and subtractions (Tax Law § 612 [a]). Pursuant to IRC (26 USCA) § 62, federal adjusted gross income is gross income less certain deductions, which include expenses that are “ordinary and necessary” in the carrying on of a trade or business (*see* IRC [26 USCA] § 162 [a]). As noted by the Administrative Law Judge, an “ordinary” business expense is one that is common and acceptable (*Welch v Helvering*, 290 US 111 [1933]), while a “necessary” expense is one that is appropriate and helpful in conducting a trade or business (*Heineman v Commr*, 82 TC 538 [1984]).

In this case, petitioner reported the loss and income for Lizet Rubinos, Inc., for 2010 and 2011, respectively, on her personal income tax returns. The Division audited the corporation’s tax returns and disallowed the business expense deductions claimed therein, resulting in the deficiencies asserted in the notices issued to petitioner. Following an audit, when the Division issues a notice of deficiency to a taxpayer, a presumption of correctness attaches to the notice, and the burden of proof is on the taxpayer to show by clear and convincing evidence that the assessment was erroneous (*see* Tax Law § 689 [e]); *Matter of Leogrande v Tax Appeals Tribunal*, 187 AD2d 768 [3d Dept 1992], *lv denied*, 81 NY2d 704 [1993]; *Matter of Tavolacci v State Tax Commn.*, 77 AD2d 759 [3d Dept 1980]; *Matter of O’Reilly*, Tax Appeals Tribunal, May 17, 2004. Thus, petitioner’s burden of proof is two-fold: she must not only show her entitlement to the business deductions claimed by Lizet Rubinos, Inc., but also substantiate the amounts thereof (Tax Law §§ 658 [a], 689 [e]; 20 NYCRR 158.1; *Matter of Macaluso*, Tax Appeals Tribunal, September 22, 1997, *confirmed* 259 AD2d 795 [3d Dept 1999]).

We agree with the Division that petitioner has failed to bear her burden of proof in demonstrating by clear and convincing evidence that she is entitled to the deductions claimed by Lizet Rubinos, Inc. As observed by the Administrative Law Judge, petitioner failed to provide testimony describing the claimed business deductions or source documentation substantiating those deductions. The few records that petitioner produced were insufficient, as they were mostly summaries of her claimed business deductions, which largely could not be traced back to the corporate tax return or bank statements. Except with respect to non-employee compensation, virtually no additional source documentation was provided in support of petitioner's business deductions. We agree with the Administrative Law Judge that the double-claiming of certain business expenses through Lizet Rubinos, Inc. and on petitioner's schedule C for the same expenses is highly suspect. The corporation's claim of deductions for what appear to be personal expenses casts doubts on their reliability.

We also agree that the *Cohan* rule is not applicable in a situation where the taxpayer has provided no basis for the reviewing tribunal to make a reasonable estimation of the business expenses actually incurred. As described by the Administrative Law Judge, the *Cohan* rule permits courts to make an approximation of an allowable amount of a deduction in cases where the taxpayer is unable to fully substantiate the business expenses claimed (*Cohan v Commr.*; *Lerch v Commr.*, 877 F2d 624 [7th Cir 1989]). However, the rule does not require courts to allow some amount of all claimed but unsubstantiated business expense deductions in every situation. As we held in the *Matter of Hamsho*, where there is no basis upon which to make a reasonable estimation of the value of the deductions claimed, such deductions may be denied altogether (*Matter of Hamsho*, Tax Appeals Tribunal, October 25, 1990; *see also Matter of Schneier*, Tax Appeals Tribunal, November 9, 1989). Petitioner's failure to provide testimony

or source documentation leaves us with no basis on which to estimate her actual business expenses, and thus we are prevented from making reasonable estimates of business expenses in this case. However, to the extent that petitioner has provided supporting documentation for non-employee compensation expenses, we concur with the Administrative Law Judge's determination to allow the deductions claimed for those business expenses in the amounts of \$38,330.50 in 2010 and \$28,284.85 in 2011.

We turn next to petitioner's contention that the penalties imposed in this case should be abated due to her reliance on her accountants before and during the audit. The penalties imposed for substantial understatement of tax can be waived, in full or in part, upon a showing of reasonable cause for the understatement and that the taxpayer acted in good faith (Tax Law § 685 [p]). We agree with the Division that the Administrative Law Judge correctly determined that petitioner did not meet her burden of showing reasonable cause for the substantial understatement of tax for the years at issue. Standing alone and without further evidence, petitioner's reliance on her accountant is insufficient to show reasonable cause for penalty abatement (*Matter of McGaughey*, Tax Appeals Tribunal, March 19, 1998, *confirmed sub nom Matter of McGaughey v Urbach*, 268 AD2d 802 [3d Dept 2000]). In *McGaughey*, we held that a careful weighing of facts and circumstances is necessary to determine whether a taxpayer "acted with ordinary business care and prudence in attempting to ascertain his tax liability and that penalties should be abated" (*see also Matter of Koether*, Tax Appeals Tribunal, December 15, 1994). Petitioner's hiring of an accountant to assist in preparing her income tax return for the tax years here at issue does not absolve her of her duty of exercising ordinary business care and prudence in ascertaining her tax liability. We find that the incomplete documentation of the vast majority of petitioner's claimed business expense deductions, claims for deductions for

residential rent expenses and multiple claims for vehicle expense deductions for both the S corporation and for the schedule C business weigh against a finding of reasonable cause and good faith in this instance. Because there is no evidence in the record indicating that petitioner acted with ordinary business care and prudence, we do not find the requisite reasonable cause here to abate the penalties as imposed.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Lizet Rubinos is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petition of Lizet Rubinos is denied, except with regard to the deductions claimed for non-employee compensation in the amounts of \$38,300.50 in 2010 and \$28,284.85 in 2011 that have been established by supporting documents herein (*see* p. 20 herein); and
4. The notices of deficiency, dated June 24, 2013, are sustained except with respect to the deductions claimed for non-employee compensation in accordance with this decision.

DATED: Albany, New York
February 1, 2018

/s/ Roberta Moseley Nero
Roberta Moseley Nero
President

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

/s/ Anthony Giardina
Anthony Giardina
Commissioner