STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition of **CARDINALD AND PAULETTE T. DONALD** for Redetermination of a Deficiency or for Refund of New York State and New York City Personal Income Tax under Article 22 of the Tax Law and the Administrative Code of the City of New York for the Year 2016.	:	DECISION DTA NO. 830593

Petitioners, Cardinald and Paulette T. Donald, filed an exception to the determination of the Supervising Administrative Law Judge issued on July 3, 2024. Petitioners appeared pro se. The Division of Taxation appeared by Amanda Hiller, Esq. (Maria Matos, Esq., of counsel).

Petitioners did not file a brief in support of their exception. The Division of Taxation filed a letter brief in opposition. Petitioners filed a letter brief in reply. Petitioners' request for oral argument was denied. Petitioners' reply brief was received on September 4, 2024, which date began the six-month period for issuance of this decision.

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

ISSUE

Whether petitioners established that they are real estate professionals and are entitled to claim a deduction in the amount of $16,426.00 for losses incurred from rental real estate activities for the tax year 2016.

FINDINGS OF FACT

We find the findings of fact as determined by the Supervising Administrative Law Judge.

Those findings of fact appear below.

1. Petitioners, Cardinald and Paulette T. Donald, filed a New York State resident income tax return, form IT-201, for the year 2016 (return). Petitioners' return reflects federal adjusted gross income of $193,030.00 and New York State adjusted gross income of $172,408.00.

2. Attached to the return was federal schedule E, of form 1040, supplemental income and loss, on which petitioners claimed a deduction in the amount of $16,426.00 for losses from rental real estate activities for three rental properties located in Brooklyn, New York: one unit located at 766 East 56th Street[1] and two units located at 65 Chester Street. The Division of Taxation (Division) conducted an audit of the return to determine whether petitioners qualified as real estate professionals and, if so, whether they were entitled to the claimed deduction.

3. By letter dated September 26, 2019, the Division requested that petitioners provide documentation demonstrating that they qualified as real estate professionals. This letter included a federal schedule E rental real estate loss questionnaire that requested information concerning petitioners' occupations such as: a description of their occupations that were NOT related to rental real estate activities, the total number of hours worked in that occupation during the tax year, the physical address of all rental properties listed on federal schedule E and the number of rental units in each property, the dates that all units were rented and the name of the property manager. Additionally, the Division requested a list of services performed and hours attributable to those services such as: appointment books, calendars or narrative summaries to support hours claimed, any other records to support the hours attributable to the rental activities and a copy of form 8582, passive activity loss limitations, if such form was filed with the Internal Revenue Service (IRS). Petitioners were requested to submit a response to the letter within 30 days.

[1] Petitioners reside in a second unit in the East 56th Street property.

4. On January 22, 2020, after no documentation was submitted by petitioners, the Division issued a statement of proposed audit changes that disallowed the claimed rental real estate loss deduction and stated, in pertinent part, that:

> "Since you have not verified that you qualify as a real estate professional, and your modified adjusted gross income (MAGI) is greater than $150,000.00, the rental real estate loss claimed on line 26 of your federal schedule E is considered passive, and subject to the passive activity loss (PAL) rules. The PAL rules state that losses from passive activities are limited to any passive income and cannot offset non-passive income.
>
> Based on your federal schedule E, you had no net passive income reported. Therefore, the passive rental loss has been disallowed in full. Any unused or disallowed passive loss can be carried forward to the following tax year on Form 8582.
>
> If you feel that you meet the real estate professional qualifications and the material participation tests, please provide the following information:
>
> - a description of your occupation that is not related to your rental real estate activities, along with a record or summary of the total number of hours worked in that occupation during the tax year
>
> - a list of the services performed for each rental property and hours attributable to those services
>
> - a daily hour/work log, calendar, or any other records to support those hours[.]"

5. On March 9, 2020, the Division issued a notice of deficiency, assessment number L-051188566, to petitioners in the amount of $1,690.00 in total New York State and New York City taxes due, plus interest for the year 2016 (notice).

6. On April 2, 2020, petitioners filed a request for conciliation conference (request) with the Division's Bureau of Conciliation and Mediation Services (BCMS) in protest of the notice.

7. At the hearing, the Division presented the testimony of Bryan Kafka, an employee of the Division. His title is Tax Technician II and he works in the personal income tax audit division in audit group 2. The auditor was assigned to the audit of petitioners.

8. The auditor explained that petitioners' tax return was flagged by audit because petitioners claimed a deduction for rental real estate losses, yet they also reported form W-2 wage income from what appeared to be full-time employment unrelated to real estate activities. The auditor explained that he focused on whether petitioners met the requirements to qualify as real estate professionals such that they could claim the loss reported on their return.

9. As stated in findings of fact 3 and 4, the auditor explained the information requested from petitioners. He testified that no documentation was received until after petitioners filed a request for conciliation conference.

10. The auditor recounted that, on May 18, 2020, petitioners submitted work logs to demonstrate that they qualified as real estate professionals. A two-page document entitled "Cardinald Donald Real Estate Hours" has three columns: date of service, hours and service description. With respect to the listed date of service, it simply provided month and year. The total hours reported were 1,907 broken down by a summary of hours for each listed month of service for the year. The description of services was general in nature and referenced a particular property. The other document is two pages in length and is titled "Paulette Donald Real Estate Hours." The document has three columns: date of service, hours and service description. Similarly, there is no specific day in any month listed as date of service, only the month and year. She reported many more dates of service, but only claimed 1,764 hours worked on the properties. The description of services was general in nature and referenced a particular property.

11. With respect to their form W-2 wage income employment, Mr. Donald reported that he worked as an electrician during 2016 for 1,680 hours employed by Five Star Electric Corp., located in Ozone Park, New York, and E-J Electric Installation Co., located in Long Island City,

New York. Mrs. Donald reported that she worked as a dietician with the New York City Health and Hospitals Corporation during 2016 for 1,680 hours. Petitioners did not provide any substantiation of the claimed hours worked in their non-real estate occupations and the auditor found it irregular for petitioners to both report the identical number of hours worked

12. The auditor reviewed the work logs and determined that they lacked detailed information regarding what service was provided on which particular date. For example, he mentioned that for January, Mr. Donald claimed 218 hours for snow and garbage removal. These hours would be in addition to petitioner's full-time employment as an electrician. The auditor explained that based upon his experience, the claimed hours simply are not credible. In reviewing February and March, Mr. Donald claimed 190 hours and 211 hours, respectively, for snow and garbage removal. The auditor explained that he looked at aerial views of the properties on Google Maps and, in his assessment, the properties did not have a front yard and the backyards were tiny. The auditor determined that the number of hours claimed as service on these properties did not align with the size of the properties.

13. In reviewing the work log for Mrs. Donald, the auditor noted that she reported 182 hours of service hours for January. The auditor said that it would be highly improbable for her to work on the properties for this number of hours since she, too, had full-time employment in addition to her claimed work hours. Additionally, the auditor noted that in reviewing the months of January, February and March, petitioners failed to submit any receipts or other documentation to demonstrate what work was provided to account for service hours in the amounts reported.

14. On March 1, 2021, after a delay due to the COVID-19 pandemic, BCMS sent petitioners a letter that scheduled the conciliation conference for April 5, 2021. In response to this letter, petitioners submitted a new set of work logs for 2016.

15. The second set of work logs submitted by petitioners were each six pages in length, with the same three columns. In the second set of work logs, the date of service included the day of the month. However, the claimed service hours were drastically reduced. The second work log reported that Mr. Donald worked only 943 hours on the properties in 2016, rather than the originally reported 1,907 hours. For Mrs. Donald, her second work log indicated that she worked only 880 hours on the properties in 2016, rather than the originally reported 1,764 hours.

16. On June 11, 2021, a conciliation order, CMS No. 000319738, was issued that denied the request and sustained the notice issued to petitioners.

17. On August 6, 2021, petitioners filed a timely petition with the Division of Tax Appeals in protest of the conciliation order.

18. Both petitioners testified at the hearing. Mrs. Donald explained that she was not aware that there was a record keeping requirement. She explained that managing the properties was ongoing. She stated that her tenants often failed to pay their rent and she was forced to take legal actions which required her frequent appearance in court. Mr. Donald testified that he performed the snow and garbage removal, and he did some plumbing work. He stated that he did not create either work log. He explained that he would tell his wife how much time he spent maintaining the properties, but he did not provide any details on how this information was relayed to her and whether it was contemporaneously conveyed. Mrs. Donald confirmed that she was responsible for the paperwork.

THE DETERMINATION OF THE SUPERVISING ADMINISTRATIVE LAW JUDGE

The Supervising Administrative Law Judge began her determination by setting forth that the issue presented was whether petitioners met their burden of proving entitlement to a deduction for real estate activities. The Supervising Administrative Law Judge noted that

deductions are matters of legislative grace and that petitioners bear the burden of demonstrating that they have met all the requirements.

Under the Internal Revenue Code (IRC), taxpayers are allowed deductions for certain business and investment expenses. However, according to the Supervising Administrative Law Judge, IRC (26 USC) § 469 (a) generally disallows passive activity losses. The Supervising Administrative Law Judge stated that a passive activity is any trade or business in which a taxpayer does not materially participate. Rental activity is treated as a passive activity under the IRC unless the taxpayer materially participates in the rental activities as a real estate professional.

According to the Supervising Administrative Law Judge, in order for a taxpayer to qualify as a real estate professional under the Code, such taxpayer must demonstrate that more than one-half of the personal services performed in trades or businesses by the taxpayer in a taxable year were performed in real property trades or businesses and consist of more than 750 hours of services performed in those activities during the taxable year.

The Supervising Administrative Law Judge noted that a presumption of correctness attached to the notice of deficiency issued to petitioners; as such, they bear the burden of showing by clear and convincing evidence that the Division's determination was incorrect or erroneous. The Supervising Administrative Law Judge found that the two sets of work logs submitted by petitioners to the Division and at their BCMS conference failed to meet this standard. The Supervising Administrative Law Judge noted the first set of work logs contained less detailed information than the second set of work logs and the number of hours reported as having been devoted to rental activities varied widely between the sets of work logs. Thus, the

Supervising Administrative Law Judge concluded that petitioners' submitted work logs were unreliable.

The Supervising Administrative Law Judge next turned to petitioners' testimony for purposes of meeting the clear and convincing evidentiary standard. She found that a taxpayer's credible testimony can meet this standard in the absence of documentary evidence meeting that standard but found that the testimony offered in this case failed to establish by clear and convincing evidence that petitioners qualified as real estate professionals. Accordingly, the Supervising Administrative Law Judge concluded that the Division properly disallowed the rental real estate losses, denied the petition and sustained the Division's notice of deficiency.

ARGUMENTS ON EXCEPTION

On exception, petitioners argue that the work logs they initially submitted to the Division were "misleading" and that they actually worked a different number of hours on their real estate rental activities than indicated in the first work log. They state that it is unrefuted that they spent time maintaining their rental properties and ask this Tribunal to reconsider the Supervising Administrative Law Judge's determination that they did not bear their burden of proving their entitlement to a deduction for real estate rental activity losses as real estate professionals.

The Division argues that the Supervising Administrative Law Judge correctly determined that petitioners did not bear their burden of demonstrating entitlement to a deduction for their losses from real estate rental activity and urges us to affirm the Supervising Administrative Law Judge's determination. According to the Division, the work logs submitted by petitioners should be deemed unreliable given the large discrepancies between the two sets of documents in the number of hours worked. The Division asserts that petitioners have failed to show by clear and

convincing evidence that the notice of deficiency issued by the Division was incorrect or erroneous and should thus be sustained.

OPINION

The question presented is whether petitioners have sufficiently established they are entitled to a deduction for claimed business expenses related to their rental real estate activities in tax year 2016.

In order to be eligible for the claimed deduction against ordinary income, petitioners must show they were engaged as real estate professionals and thus not subject to the passive activity loss rules under IRC (26 USC) § 469 (a) as they relate to petitioners' claim. Under the passive activity rules, petitioners would not be eligible for a deduction for losses stemming from passive activities generated by their real estate rental activities, which are per se passive (***see*** IRC [26 USC] § 469 [c] [2] [the term "passive activity" includes any rental activity]) unless they qualify as real estate professionals (***see*** IRC [26 USC] § 469 [c] [7]).

Pursuant to an audit by the Division that included a request by the Division for petitioners to submit a federal schedule E rental real estate loss questionnaire to determine if petitioners qualified as real estate professionals under the IRC, petitioners failed to provide any information or documentation backing up their claim, resulting in the Division issuing a notice of deficiency denying the claimed deduction.

Subsequently, during a conciliation conference held before BCMS, the Division received a completed schedule E rental real estate loss questionnaire and, subsequent to that, received additional information relating to petitioners' hours of work performed in their real estate rental activities, much of which contradicted the initial information provided prior to the BCMS conference.

It is well established that a presumption of correctness attaches to a notice of deficiency (***see Leogrande v Tax Appeals Trib.***, 187 AD2d 768 [3d Dept 1992], ***lv denied*** 81 NY2d 704 [1993]; ***Tavolacci v State Tax Commn.***, 77 AD2d 759 [3d Dept 1980]). In challenging the Division's determination, therefore, the burden of proof is on petitioners to establish by clear and convincing evidence that the Division's notice of deficiency is incorrect or erroneous (Tax Law § 689 [e]; ***see also Matter of Suburban Restoration Co. v Tax Appeals Trib. of State of N.Y.***, 299 AD2d 751 [3d Dept 2002]).

The Division correctly recognizes that certain business and investment deductions are allowable under IRC (26 USC) §§ 162 and 212, but also asserts that passive activity losses, as described at IRC (26 USC) § 469, are disallowed pursuant to IRC (26 USC) § 469 (a) and (d). The Division argues that IRC (26 USC) § 469 (a) generally disallows any passive activity loss for the taxable year over the aggregate income from all passive activities for the year and that rental activity is a per se passive activity. The Division also acknowledges that "an exception to the per se activity rule is provided where a taxpayer qualifies as a real estate professional (IRC [26 USC] § 469 [c] [7]).

The law in this matter is clear and not in dispute and the determinative factor is, therefore, whether petitioners established by clear and convincing evidence that they were engaged as real estate professionals in relation to the work performed for which the claimed deductions are based (***see Matter of Kirkpatrick***, Tax Appeals Tribunal, May 2, 2024, citing ***Moss v Commr***, 135 TC 365, 368 [2010]).

As the findings of fact indicate, petitioners initially claimed to have worked on their three rental properties a combined total of 3671 hours (approximately 71 hours per week combined) in tax year 2016 while, in addition, both also worked separate, unrelated full-time jobs. Petitioners

subsequently amended their combined property related work hours to 1823 (approximately 35 hours per week).

Petitioners testified at their hearing that the work performed primarily involved snow and garbage removal and some plumbing work. They kept no contemporaneous records of the work performed or, in fact, any records at all. The Division's auditor testified in relation to the properties that they were quite small with no front yards and very small backyards and thus questioned whether the amount of claimed work was even possible.

In light of what appeared to be contradictory claims of hours worked and a lack of any contemporaneous documentation related to work performed, the Supervising Administrative Law Judge found that the evidence submitted by petitioners was unreliable and thus held that petitioners did not establish by clear and convincing evidence that they were real estate professionals and therefore not entitled to the claimed deduction.

We, too, find the information provided by petitioners to be inconsistent, unreliable, and uncorroborated while lacking in meaningful specificity and credibility. Petitioners, therefore, did not meet the required evidentiary burden (Tax Law § 689 [e]; ***see also Matter of Strachan***, Tax Appeals Tribunal, June 28, 2018).

We also note that petitioners attempted to submit to this Tribunal additional documents to consider on exception. However, we have not considered these documents in rendering this decision, consistent with our decision in ***Matter of Schoonover*** (Tax Appeals Tribunal, August 15, 1991), where we held that "[i]n order to maintain a fair and efficient hearing system, it is essential that the hearing process be both defined and final. If the parties are able to submit additional evidence after the record is closed, there is neither definition nor finality to the hearing

. . . ." For these reasons we must follow our policy of not allowing the submission of evidence after the closing of the record.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Cardinald and Paulette T. Donald is denied;

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

3. The petition of Cardinald and Paulette T. Donald is denied; and

4. The notice of deficiency dated March 9, 2020 is sustained.

DATED: Albany, New York
February 27, 2025

/s/ Jonathan S. Kaiman
Jonathan S. Kaiman
President

/s/ Cynthia M. Monaco
Cynthia M. Monaco
Commissioner

/s/ Kevin A. Cahill
Kevin A. Cahill
Commissioner