STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
MICHAEL AND JUDITH LACHER	:	DETERMINATION DTA NO. 823953
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 Years 2001 through 2004.	:	

Petitioners, Michael and Judith Lacher, filed a petition 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 years 2001 through 2004.

On April 8, 2013, petitioner Michael Lacher, appearing pro se and on behalf of his spouse, petitioner Judith Lacher, and the Division of Taxation, by Amanda Hiller, Esq. (Peter B. Ostwald, Esq., of counsel), waived a hearing and agreed to submit this matter for a determination based on documents and briefs filed by August 13, 2013, which date began the six-month period for the issuance of this determination. After review of the evidence and arguments presented, Timothy Alston, Administrative Law Judge, renders the following determination.

ISSUES

I. Whether petitioners' personal income tax liability for the years at issue was resolved by an agreement detailed in a letter dated August 1, 2008 from the Office of the District Attorney of the County of New York to petitioners' former representative.

II. If not, whether additional tax due as asserted herein should be sustained.

FINDINGS OF FACT

1. In 2004, the Division of Taxation (Division) began a withholding tax audit of the Law Offices of Michael A. Lacher, LLP, a law practice solely owned by petitioner Michael Lacher.[1] The audit was triggered because the law practice was issuing W-2 forms to its employees indicating the withholding of tax, but was not filing withholding tax returns or paying withholding tax to the State of New York. The Division's investigation soon revealed that the practice also had not filed any federal or New York partnership returns for the 2001 through 2003 period then under review. This led to an audit of the income and expenses of the law practice and ultimately, given the flow-through of partnership income to partners, an audit of petitioner's personal income tax returns. The audit period eventually included the years 2001 through 2005.

2. In September 2005, petitioner,[2] through his representative, provided the Division with copies of the law practice's federal partnership returns (Form 1065) for the years 2001 through 2004. The 2001-2003 returns were dated May 16, 2005 and the 2004 return was dated June 20, 2005.

3. The Division also reviewed the law practice's 2001 through 2004 New York partnership returns (Form IT-204) during the audit. The 2004 return was filed in June 2005 and its 2001-2003 New York partnership returns were filed in November 2005.

4. In addition, the Division reviewed the law practice's general ledger and bank statements

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[1] The law practice is referred to in the record variously as the Law Offices of Michael A. Lacher, LLP, Michael Lacher, LLP and Michael A. Lacher, P.C. Although the law practice apparently held itself out as a partnership and filed partnership tax returns, petitioner was the only "partner" during the 2001-2003 period. In 2004, the record indicates that the practice added a partner, but petitioner continued to maintain a 100 percent share of profits, losses and capital. Whether the practice properly filed returns as a partnership during any or all of the years at issue (***see*** Treas Reg § 301.7701-3) was not addressed on audit.

[2] "Petitioner" refers to Michael Lacher throughout this determination. Judith Lacher is a petitioner in this matter solely because she filed joint returns with her spouse for the years at issue.

for the audit period.

5. The Division found that expenses as reported on the law practice's general ledger were substantially less than expenses as reported on the partnership tax returns. Petitioner's representative explained that these differences resulted from year-end adjusting entries. The Division reviewed such entries and observed that they were mostly round numbers and that there was no indication in the general ledger that these year-end adjusting entry expense amounts were actually paid. The Division requested substantiation of the year-end adjusting entries, but none was provided. The Division therefore disallowed the year-end adjusting entries in calculating the law practice's audited deductible expenses. Instead, the Division used the general ledger entries exclusive of the year-end adjusting entries to calculate audited deductible expenses, along with a 50 percent subtraction for meals and entertainment as reported in the general ledger (to conform with the Internal Revenue Code's 50 percent limitation on the deductibility of such expenses) and the addition of depreciation expense as reported on the return (because such expense was not included in the general ledger).

6. Next the Division determined the law practice's audited net income for the years at issue by subtracting audited deductible expenses (determined as described above) from gross receipts as reported in the general ledger. After adjusting for income previously reported on petitioner's personal income tax returns as flow-through income from the law practice, the Division determined the difference to be additional taxable income from the law practice. The calculations with respect to the specific years at issue are summarized below.

7. For the 2001 tax year, audited net income from the law practice was determined to be $352,417.23. Petitioner did not report any flow-through partnership income on his 2001 New York personal income tax return. The Division therefore determined that all of the audited net

income of the law practice was additional taxable income to petitioner for 2001.

8. For the 2002 tax year, audited net income from the law practice was determined to be $703,585.66. Petitioner reported $165,000.00 in partnership income on his 2002 New York personal income tax return. The Division therefore determined that $538,585.66 of the audited net income of the law practice was additional taxable income to petitioner for 2002.

9. For the 2003 tax year, audited net income from the law practice was determined to be $241,526.20. Petitioner reported $160,000.00 in partnership income on his 2003 New York personal income tax return. The Division therefore determined that $81,526.20 of the audited net income of the law practice was additional taxable income to petitioner for 2003.

10. For the 2004 tax year, audited net income from the law practice was determined to be a loss of $99,956.74 with a guaranteed payment of $185,109.00 to petitioner. Petitioner reported $164,935.00 in partnership income on his 2004 New York personal income tax return. The Division therefore determined that a loss of $79,782.74 was allowable to petitioner for tax year 2004.

11. Petitioner offered neither evidence nor argument to refute the audit determinations and calculations noted in Findings of Fact 5 through 10.

12. The general ledger listed an account titled “Loans and Exchanges - MAL” from which, as explained by petitioner’s representative on audit, personal expenses of petitioner were paid. Amounts paid through this account totaled $316,862.00 in 2001, $736,125.00 in 2002, $535,136.00 in 2003 and $508,893.00 in 2004. According to petitioner’s representative, the law practice classified these amounts as loans to petitioner. The Division requested contemporaneous documentation of any loan agreements. None was provided. Consequently, the Division determined that the “Loans and Exchanges - MAL” transactions were not loans, but

were properly classified as distributions to petitioner.

13. To determine the extent to which such distributions were taxable income to petitioner, the Division requested documentation to substantiate petitioner's basis in the Law Offices of Michael A. Lacher, LLP. Petitioner provided no such substantiation. The Division therefore determined petitioner's basis in the law practice to be zero as of the start of 2001, the first year of the audit period. The Division then added the law practice's audited net income (calculated as noted above) to the basis and subtracted therefrom the amounts paid to petitioner as reported in the "Loans and Exchanges-MAL" account to arrive at the ending basis for each of the years at issue. Pursuant to such calculations the Division determined that petitioner received distributions of $290,594.00 in excess of basis in 2003 and $508,893.00 in excess of basis in 2004. The Division determined that such distributions were additional taxable income for the 2003 and 2004 tax years.

14. The Division issued to petitioner a Consent to Field Audit Adjustment dated October 2, 2008, that set forth the Division's calculation of additional personal income due for the years at issue. The Division also provided petitioner's representative with copies of spreadsheets detailing its audit calculations. The Consent and spreadsheets were discussed with petitioner's representative during a conference call on November 12, 2008. During that conference call the Division again requested substantiation for the adjusting entries and petitioner's basis in the law practice. No such substantiation was provided.

15. Based on the audit determinations and calculations discussed above, and consistent with the Consent to Field Audit Adjustment, on February 5, 2009, the Division issued to petitioners, Michael and Judith Lacher, a Notice of Deficiency asserting additional New York State and New York City income tax due for the years 2001 through 2005 in the total amount of

$236,290.00, plus interest and fraud penalty pursuant to Tax Law § 685(e) for the years 2001 through 2005. As broken down by tax year and by New York State and City income tax components, the tax liability as asserted in the statutory notice is as follows:

Year	State/City	Tax Amount
2001	State	$25,457.00
2001	City	$12,731.00
2002	State	$40,125.00
2002	City	$21,227.00
2003	State	$32,361.00
2003	City	$18,997.00
2004	State	$37,249.00
2004	City	$22,376.00
2005	State	$16,728.00
2005	City	$9,039.00

16. Pursuant to a Conciliation Order dated July 30, 2010, the statutory notice was modified by the cancellation of the deficiency with respect to the 2005 tax year. The notice was in all other respects sustained.

17. With its submission of evidence herein, the Division advised that its assertion of fraud penalty was withdrawn and asserted negligence penalties pursuant to Tax Law § 685(b)(1) and (2).

18. In May 2008, the nonpayment of withholding tax by the Law Offices of Michael A. Lacher, LLP (***see*** Finding of Fact 1), was referred to the District Attorney of the County of New York for further investigation and possible prosecution. By letter dated August 1, 2008 the Assistant District Attorney assigned to the matter advised petitioner's representative that the

District Attorney's office had "closed its investigation into the non-payment of New York State/New York City payroll [withholding] tax for the period of April 1, 2001 through March 31, 2007, owed by [petitioner]" because there was an "insufficient basis for further proceedings and in consideration of. . . [certain] representations and undertakings by [petitioner]." Specifically, the letter notes that petitioner had satisfied the outstanding withholding tax liability by making payments totaling $328,226.00 and had put into place safeguards to insure compliance with withholding tax requirements going forward. The letter concludes its recitation of the terms of the closing of the investigation by noting:

> Therefore, this Office will refer back for civil review to State Tax [the Division] an inquiry relating to Michael Lacher's 2005 New York personal income tax return. However, Michael Lacher has agreed to file an amended 2005 personal income tax return on or before September 30, 2008, if required by State Tax.

19. Petitioner did subsequently file an amended 2005 return that was accepted as filed by the Division. The acceptance of petitioner's filed amended return was the basis for the cancellation of the asserted 2005 deficiency in the Conciliation Order (***see*** Finding of Fact 16).

20. Petitioner submitted a copy of an email dated June 19, 2008 from the assistant district attorney assigned to the criminal investigation to petitioner's representative that discussed the withholding tax due from petitioner under the settlement as compared to the withholding tax and penalties due if no agreement was reached. The email refers only to petitioner's liability for withholding tax and makes no reference to his liability for personal income taxes.

21. Petitioner executed several consents extending the period of limitations for assessment of New York State and City personal income tax for the years under audit. The next to last such consent was signed by petitioner's representative on June 22, 2007 and extends the limitations period for the years 2001 through 2003 to July 22, 2008. The last such consent in the record was

signed by petitioner on April 23, 2008 and extends the limitations period for the years 2001 through 2004 to May 22, 2009.

22. Petitioner submitted copies of Schedule K-1 of federal Form 1065 (Partner's Share of Income, Credits, Deductions, Etc.) reporting his interest in the law practice for the years 2001 through 2004. The K-1's submitted report a capital contribution of $1,127,408.00 during 2001 and capital account balance at the end of the years 2001 through 2004 of $923,576.00, $803,016.00, $779,795.00, and $663,122.00, respectively.

SUMMARY OF PETITIONER'S POSITION

23. Petitioner contends that the August 1, 2008 letter of the District Attorney details a settlement agreement concerning all of petitioner's outstanding New York tax liabilities with respect to the years 2001 through 2005 and therefore encompasses the liability at issue in the present matter. Petioner notes that he fulfilled his obligations as referenced in the letter; that is, he paid the withholding tax liability and he filed an amended 2005 New York return. In support of his contention regarding the settlement, petitioner asserts that there was no further extension of the statute of limitations beyond July 22, 2008 and that any prior extensions were subsumed in the settlement agreement. Accordingly, petitioner asserts that the Division should be estopped from abandoning the agreement described in the August 1, 2008 letter by its assertion of liability for the years 2001 through 2004 in the statutory notice and in the present matter. Petitioner further contends that the Division should bear the burden of proof on this issue.

24. With respect to the audit, petitioner complains that no worksheets supporting the audit calculations were provided to him and that the audit worksheets in evidence are reconstructions that are prejudicial to him. Petitioner also notes a transpositional error in the auditor's calculations for 2001, where, in one workpaper, additional taxable income is listed as

$532,417.23, but where the calculations clearly indicate that such additional taxable income should be $352,417.23. Petitioner also asserts that the amounts paid out of the account "Loans and Exchanges - MAL" represented amounts paid for petitioner's personal expenses (and are therefore loans) and amounts paid to petitioner as reimbursement for business expenses. Accordingly, petitioner contends that such amounts should not be considered partnership distributions. Petitioner further contends that the Division improperly failed to give him credit for contributions to the law practice's capital account and points to the K-1's submitted in evidence as proof of such contributions. Petitioner also claims that he provided all information and details of the "Loans and Exchanges - MAL" account during the audit.

CONCLUSIONS OF LAW

A. Preliminarily, and contrary to his contention, petitioner bears the burden of proof on all issues in the present matter, including his claim that his personal income tax liability for the years 2001 through 2004 was resolved by agreement of the parties (Tax Law § 689[e]; 20 NYCRR 3000.15[d][5]).

B. As to petitioner's assertion that the August 1, 2008 letter of the District Attorney details a resolution of his 2001 through 2004 income tax liability and that the Division should be estopped from abandoning that agreement, the doctrine of estoppel is not applicable to governmental acts absent a showing of exceptional facts which require its application to avoid a manifest injustice (***Matter of Sheppard-Pollack v. Tully***, 64 AD2d 296 [3d Dept 1978]; ***Matter of Turner Construction Co. v. State Tax Commn.***, 57 AD2d 201 [3d Dept 1977]). This general rule is particularly applicable with respect to the Division of Taxation, for public policy favors full and uninhibited enforcement of the Tax Law (***Matter of Turner Construction Co. v. State Tax Commn.***). Exceptions to this rule "have indeed been rare and limited to unusual fact

situations" (***Matter of Harry's Exxon Serv. Sta.***, Tax Appeals Tribunal, December 6, 1988).

C. Petitioner's contention that the agreement described in the August 1, 2008 letter settled petitioner's New York State and City personal income tax liability for the years at issue is unsupported by the evidence in the record and is therefore rejected. While a valid agreement as to petitioner's personal income tax liability for the years 2001 through 2004 might well estop the Division from asserting liability against petitioner for those years by the issuance of a Notice of Deficiency (***see Matter of 1555 Boston Road Corp. v. Finance Administrator of the City of New York***, 61 AD2d 187 [2d Dept 1978]; ***see also*** Tax Law 681[f]), petitioner has not shown that such an agreement was made.

The August 1, 2008 letter refers only to a payroll tax investigation and "an inquiry relating to" petitioner's 2005 New York return. It makes no reference to petitioner's 2001 through 2004 personal income taxes. The letter thus does not purport to resolve petitioner's personal income tax liability for the years at issue herein. Contrary to petitioner's contention, there is no language in the letter to support his claim that the letter "expressly limited further civil review" to petitioner's 2005 New York return. The letter states that "an inquiry relating to [petitioner's] 2005 New York personal income tax return" is being referred back to the Division and that petitioner "has agreed to file an amended 2005 personal income tax return . . . if required by [the Division]." This simply indicates that the District Attorney would not be considering criminal charges with respect to the 2005 return and that resolution of petitioner's personal income tax liability for 2005 would rest with the Division. Nothing in this language suggests that the 2001-2004 years were resolved by the settlement agreement or the filing of the amended 2005 return or that the Division was precluded in any way from further examination of the 2001-2004 tax years.

Petitioner offered no evidence from anyone involved in the negotiation of the settlement agreement, such as his former representative, to support his contention that the agreement was

intended to encompass his 2001-2004 personal income tax liability. Indeed, although petitioner argues that the August 1, 2008 letter settled the years at issue, there is no evidence in the record that petitioner himself was directly involved in the settlement negotiations and, in any event, petitioner declined to make any factual assertions on this point by either sworn testimony or affidavit. Moreover, the June 19, 2008 email submitted by petitioner provides no support to his argument as that document refers only to the withholding tax settlement and makes no reference to petitioner's personal income tax liability.

Additionally, petitioner's contention that there was no extension of the limitations period after July 22, 2008 is incorrect. On April 23, 2008, petitioner executed a consent extending the limitations period for the 2001 through 2004 tax years until May 22, 2009 (***see*** Finding of Fact 21). As discussed above, the August 1, 2008 letter did not encompass petitioner's 2001-2004 personal income tax liability. Consequently, the August 1, 2008 letter had no effect on the consent executed by petitioner on April 23, 2008.

D. Turning to the asserted deficiency at issue, pursuant to Tax Law § 681(a), where the Division examines a return and determines that there is a deficiency of income tax, it may issue a notice of deficiency to the taxpayer. Such a determination requires only a rational basis (***see e.g***. ***Matter of Estate of Gucci***, Tax Appeals Tribunal, July 10, 1997 citing ***Matter of Atlantic & Hudson***, Tax Appeals Tribunal, January 30, 1992). The taxpayer bears the burden of proving that the deficiency is erroneous (***see Matter of Gilmartin v. Tax Appeals Tribunal***, 31 AD3d 1008 [3d Dept 2006]; Tax Law § 689[e]).

E. Petitioner's complaint that no worksheets supporting the audit calculations were provided during the audit is inconsistent with the record (***see*** Finding of Fact 14) and is therefore rejected.

As to petitioner's complaint that the audit worksheets in evidence are reconstructions and

are prejudicial to petitioner, the asserted deficiency in the present matter is premised on the Division's treatment of certain entries in the law practice's books and records. If the audit workpapers inaccurately reflect such entries, it was incumbent upon petitioner to introduce evidence, such as the records themselves, to demonstrate the Division's error. Petitioner offered no such evidence.

Petitioner's complaint regarding the transpositional error in the Division's workpapers is specious. As the Division correctly notes, this typographical error was not carried through the Division's audit calculations and had no impact on the calculation of the asserted deficiency.

Turning to the more substantive audit issues, petitioner offered no evidence, and made no argument, to refute the Division's disallowance of the year-end adjusting entries in its calculation of the law practice's audited deductible expenses. This audit adjustment is therefore sustained.

Regarding the Division's audit finding of taxable partnership distributions, petitioner contends that the payments from the "Loans and Exchanges - MAL" account were loans or reimbursement, but offered no documentation in support of either such contention. Petitioner's claim that he provided all information and details of the "Loans and Exchanges - MAL" account during the audit is unsupported by the record and, in any event, the record in this matter is devoid of any such information and details. As to the issue of petitioner's basis in the partnership, petitioner submitted copies of K-1's purporting to show such basis. Petitioner did not, however, offer any substantiation for the amounts listed on the K-1's. Considering petitioner's failure to substantiate the year-end adjusting entries and the "Loans and Exchanges - MAL" account payments, and also considering petitioner's record of failure with respect to his withholding tax obligations, this lack of substantiation compels the conclusion that petitioner has failed to establish any basis in the partnership as of the start of the 2001 tax year. Petitioner has thus

failed to refute the Division's audit determination that the amounts paid from the "Loans and Exchanges - MAL" account were partnership distributions to petitioner and that petitioner's basis in the partnership was zero as of the start of 2001.

F. Pursuant to Internal Revenue Code § 731(a), partnership distributions of money to a partner are recognized as gain to the extent that such distributions exceed basis. In light of Conclusion of Law E, the Division's determination of additional taxable income for the 2003 and 2004 tax years resulting from such distributions is sustained.

G. The petition of Michael and Judith Lacher is denied and the Notice of Deficiency dated February 5, 2009, as modified by the Conciliation Order dated July 30, 2010 canceling the deficiency with respect to the 2005 tax year (***see*** Finding of Fact 16) and by the Division's withdrawal of fraud penalty and assertion of negligence penalties herein (***see*** Finding of Fact 17), is sustained.

DATED: Albany, New York
January 30, 2014

/s/ Timothy Alston
ADMINISTRATIVE LAW JUDGE