STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
MARIA J. GARCIA	:	DETERMINATION 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 a petition 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.

A hearing was held before Winifred M. Maloney, Administrative Law Judge, on April 22, 2015 at 10:30 A.M., with all briefs to be submitted by September 11, 2015, which date began the six-month period for issuance of this determination. Petitioner appeared by Carter & Associate Attorneys, PLLC (Damon Carter, Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (Alejandro Taylor, Esq., of counsel).

ISSUE

Whether petitioner established grounds for the abatement of penalties imposed under Tax Law former § 685(aa)(1).

FINDINGS OF FACT

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. In addition to tax preparation services, the company provided the following services: money transfers, sales of money orders, phone calls, international phone calls, and documentation.

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.

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 of Taxation issued three statements of proposed audit changes to petitioner for the years 2009, 2010 and 2011, Assessment ID numbers L-038866425-8, L-038866438-5 and L-038866442-2, respectively. In the computation section, each document 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 (Assessment ID no. L-038866425-8) assessed penalty in the amount of $205,000.00 for the year 2009, the second Notice of Deficiency (Assessment ID no. L-038866438-5) assessed penalty in the amount of $334,000.00 for the year 2010, and the third Notice of Deficiency (Assessment ID no. L-038866442-2) 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 (number L-038866425-8) recomputed penalty of $199,000.00 for the year 2009, Notice of Deficiency (number L-038866438-5) recomputed

penalty of $329,000.00 for the year 2010, and Notice of Deficiency (number L-038866442-8) 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. He further stated that there was a large use of department resources to audit those 678 returns.

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 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 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 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.

SUMMARY OF THE PARTIES' POSITIONS

22. Petitioner claims that she simply misunderstood the applicable law, and that once the Division notified her of her errors, she expeditiously corrected those errors. As such, she contends the imposition of the maximum penalty is not warranted. While petitioner understands that she made a mistake, she further contends that the Division's assessments are excessive, and requests a reduction.

23. The Division argues that, as the conditions under Tax Law former § 685(aa)(1) have been met, the tax preparer penalty was properly imposed. As such, the Division maintains that the statutory notices, as modified by the Conciliation Order (CMS No. 257292), should be sustained.

CONCLUSIONS OF LAW

A. Tax Law former § 685(aa) provides:

"Tax preparer penalty.– (1) If:

> (A) any part of any understatement of liability with respect to any return or claim for refund is due to a position for which there was not a reasonable belief that the tax treatment in that position was more likely than not the proper treatment,
>
> (B) any person who is an income tax preparer with respect to such return or claim knew (or reasonably should have known) of such position, and

> (C) such position was not disclosed as provided in subsection (p) of this section or there was no reasonable basis for the tax treatment of that position, such person shall pay a penalty of up to one thousand dollars with respect to such return or claim unless it is shown that there is reasonable cause for the understatement and such person acted in good faith."

B. As noted above, the Division conducted audit reviews of approximately 3,000 personal income tax returns filed for the years 2009, 2010 and 2011 because PPR expense adjustments were claimed, but no personal property rental income amounts were reported on the returns. 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 of the same, one of whom was petitioner. After its audit of 678 personal income tax returns prepared by petitioner for the years 2009, 2010 and 2011, the Division concluded that there was no basis for claiming the PPR expense adjustments on those returns. After further audit review, the Division determined that the maximum tax preparer penalty under Tax Law former § 685(aa)(1) should be imposed against petitioner for the years 2009, 2010 and 2011. Notices of deficiency were issued to petitioner assessing penalty in the amount of $205,000.00, $334,000.00 and $139,000.00 for the years 2009, 2010 and 2011, respectively, i.e., total penalty assessed in the amount of $678,000.00 for the three years.

C. It is well established that the notices of deficiency issued by the Division are presumed to be correct until the contrary is established, and the burden of showing that such notices are incorrect rests upon the petitioner (Tax Law § 689[e]; ***Matter of Leogrande v. Tax Appeals Tribunal***, 187 AD2d 768, 769 [1992], ***lv denied*** 81 NY2d 704 [1993]; ***Matter of Tavolacci v. State Tax Commn.***, 77 AD2d 759, 760 [1980]).

D. Petitioner claims the assessments are excessive and should be reduced. While petitioner does not dispute the Division's right to penalize her for errors made by claiming the

PPR expense adjustments on her clients' tax returns for the three years at issue, she contends the maximum penalty of $1,000.00 for each such improper return is not warranted because the record clearly shows that she simply misunderstood the applicable law, and after being notified of her errors, she expeditiously corrected those returns.

Petitioner's argument is meritless. The record supports the Division's determination that petitioner lacked a reasonable belief that the tax position claimed was more likely than not the proper tax treatment of residential real estate rent expenses. Petitioner is an experienced tax preparer, who seeks out additional training and participates in industry events where she networks with other tax preparers. However, petitioner merely performed cursory research into the proper treatment of the position she claimed on 22% of the tax returns she filed for the years 2009 through 2011. In addition, although she paid rent for her residence during the period 2009 through 2011, petitioner relied upon her tax preparer's advice and did not claim PPR expense adjustments for such residential real estate rental expenses on her personal income tax returns for the years 2009, 2010 and 2011. Clearly, petitioner chose to subject her clients to the risks of understating their tax liabilities while insulating herself from any such risks. Claiming PPR expense adjustments for her clients on 678 returns while taking a different tax reporting position for herself on her personal income tax returns shows petitioner's lack of reasonable belief that residential real estate rent expenses qualified as PPR expense adjustments and also demonstrates that she did not act in good faith. Petitioner failed to prove by clear and convincing evidence that the Division's determinations were erroneous or improper. As such, I find the Division properly imposed the maximum tax preparer penalty for each return on which the PPR expense adjustment was claimed for the years 2009, 2010 and 2011.

E. The petition of Maria J. Garcia is denied, and notices of deficiency (L-038866425-8, L-038866438-5 and L-038866442-2) dated January 24, 2013, as modified by the Conciliation Order (CMS No. 257292) dated December 20, 2013, are sustained.

DATED: Albany, New York
March 10, 2016

/s/ Winifred M. Maloney
ADMINISTRATIVE LAW JUDGE