

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :
of :
DOMINIQUE SIMONNEAUX : **DETERMINATION**
 : **DTA NO. 826252**
for Redetermination of a Deficiency or for Refund :
of New York State and New York City Personal :
Income Taxes under Article 22 of the Tax Law :
and the New York City Administrative Code :
for the Years 2009 through 2011. :
:

Petitioner, Dominique Simonneaux, filed a petition for redetermination of a deficiency or for refund of New York State and New York City personal income taxes under Article 22 of the Tax Law and the New York City Administrative Code for the years 2009 through 2011.

A hearing was held before Dennis M. Galliher, in New York, New York, on June 10, 2015, at 10:30 A.M., with all briefs to be submitted by October 2, 2015, which date commenced the six-month period for issuance of this determination. Petitioner appeared by EisnerAmper, LLP (Michael Lopez, CPA). The Division of Taxation appeared by Amanda Hiller, Esq. (Tobias Lake, Esq., of counsel).

ISSUE

Whether petitioner has established entitlement to certain expenses, claimed to have been incurred in the operation of a business known as Les Petits Chapelais, Inc., that were disallowed by the Division of Taxation upon audit.

FINDINGS OF FACT

1. Petitioner, Dominique Simonneaux, was born and raised in France, and is from a large extended family, many of whose members still reside there. Petitioner came to this country as a modern dance student in an exchange program. Petitioner studied at and earned an honors program bachelor's degree from Hunter College.

2. Petitioner owns and operates a small, high-end, infant and children's clothing and accessories boutique known as Les Petits Chapelais, Inc. (the Store). This business came about over a number of years, commencing in the mid-1990s when petitioner, then pregnant for her first child, and her sister, Natalie, both of whom have backgrounds in art and who were then both in New York, began collaborating to create designs for clothing for petitioner's expected child. Their aim was to create specific items for petitioner's child, focused on unique and appealing designs crafted of quality fabrics and materials. These items became popular with friends and, by extension, with acquaintances and beyond.

3. Petitioner's sister returned to France after the birth of petitioner's child and established her own infant and children's clothing business there. Petitioner remained in New York and was a wholesale supplier of these infant and children's items to boutique retail stores in New York and elsewhere.

4. Petitioner was offered the opportunity to take over a retail boutique clothing store whose owner was moving to the West Coast, and on September 11, 2001 she opened for business at 142 Sullivan Street in lower Manhattan selling infant and children's clothing. Most of the items to be sold came from small scale designer/manufacturers in Europe, including petitioner's sister, Natalie.

5. Despite the severe business difficulties in lower Manhattan following the World Trade Center terrorist attacks, petitioner kept the Store open. About two years after opening, petitioner moved the Store to new premises located about one and a half blocks from its prior premises. Approximately one month later, a chimney fire at these premises caused significant damage, including the loss of a substantial amount of the Store's inventory. Petitioner continued to operate her business, and thereafter relocated the Store to leased premises on Thompson Street in lower Manhattan.

6. In 2005, petitioner incorporated the business as Les Petits Chapelais, Inc., and made elections under the Internal Revenue Code (IRC) and the New York State Tax Law to be taxed as a small business corporation.¹ Petitioner is the corporation's president and sole owner. By 2009, the Store was a retail seller only, as opposed to a wholesale seller. During the years at issue here, 2009 through 2011 (the audit period), the Store operated in leased premises located at 86 Thompson Street in Manhattan.

7. The Store's receipts (sales) and its payments (expenses) were initially handled largely through its TD Bank checking account and its American Express (Amex) account.² Receipts and payments were reflected by electronic funds transfers and, in some instances, by the issuance of checks from the Store's checking account. Tax returns for both the Store and for petitioner were prepared on the basis of the records petitioner supplied to the bookkeeping, accounting and tax service providers she hired. Such records included bills and receipts for expenses, bank and

¹ In short, and pursuant to such elections, the results of the operation of the Store flow through to petitioner and are reported on her annual personal income tax returns.

² At some point, petitioner opened a Commerce Bank account and a MasterCard account for suppliers who did not utilize Amex accounts.

credit card statements, and invoices for purchases of goods to be sold in the Store. Petitioner did not personally maintain any general ledger, journal or other system for tracking the Store's cost of goods sold, business expenses, or a specific log to track travel, meals or entertainment expenses, or to specifically distinguish business costs and expenses from personal costs and expenses. Instead, she gave all of the records to the bookkeeping, accounting and tax firms she retained. She stated her understanding and belief that such records were kept and maintained by such firms, and were organized via use of the commonly available and widely used computerized accounting software program QuickBooks. Petitioner noted that any questions raised by the bookkeepers and accountants concerning the same (e.g., information and explanations relating to the nature and proper categorization of items and amounts) were directed to and addressed by petitioner. Petitioner candidly admitted that she had no formal training, knowledge or expertise concerning accounting or tax matters.

8. For some years prior to those at issue, petitioner's accounting and tax services were provided by an individual who had provided such services for petitioner and her former husband. As of 2009, the Store's, and petitioner's, bookkeeping, accounting and tax services were being provided by one Max Kleynburd, who prepared and filed both a Form 1120S (U.S. Income Tax Return for an S Corporation) on behalf of the Store, and a Form IT-201 (New York Resident Income Tax Return) on behalf of petitioner. Thereafter, following a disagreement between petitioner and Mr. Kleynburd over the proper categorization of the Store's goods for sale as assets (per Mr. Kleynburd) versus inventory (per petitioner), and upon the recommendation of a bookkeeper and friend, petitioner engaged the bookkeeping, accounting and tax preparation services of one John Cisneros for both the Store and herself. Mr. Cisneros, in turn, filed an

amended corporation return (Form 1120S) for the Store for 2009, and an amended personal income tax return (Form IT-201-X) for petitioner for 2009, and also thereafter filed corporation returns (Forms 1120S and CT-3-S) for the Store and personal income tax returns (Form IT-201) for petitioner for the years 2010 and 2011.³ As before, petitioner provided all of the Store's business records, as well as her personal records, to Mr. Cisneros and his employees in order to maintain the Store's books and records and prepare tax returns for the Store and for petitioner.

9. By a letter dated December 3, 2012, the Division of Taxation (Division) advised petitioner that the Store's corporation tax returns had been selected for review for the years 2009 through 2011, and requested that petitioner provide documents in support of the income and expenses reported thereon.

10. By a letter dated January 24, 2013, the Division advised petitioner that since she had not provided the information requested, as noted above, the expenses claimed on the Store's returns for the years at issue had been disallowed. In turn, the impact of such disallowances resulted in additional income (net profit) that was carried over to petitioner's personal income tax returns for the years in issue, resulting in additional tax due for each of such years.

11. On March 20, 2013, the Division issued to petitioner three notices of deficiency, asserting additional tax due in the respective amounts of \$14,835.67 (Notice No. L-039041715-4) for 2009, \$15,719.91 (Notice No. L-039041716-3) for 2010, and \$26,457.47 (Notice No. L-039041717-2) for 2011, plus interest and (for each year) a negligence penalty (Tax Law § 685[b][1]), penalty interest (Tax Law § 685[b][2]), and a penalty for substantial understatement

³ Mr. Cisneros listed the firm for which he worked as Metropolitan Financial Service, for the years 2009 and 2011, and as Marsh & Fried Holdings, LP, for the year 2010, each listing an address at 11 Broadway, Suite 521, in Manhattan.

of liability (Tax Law § 685[p]). A separate statement of proposed audit change, explaining and detailing the computation of the amounts set forth on the notices of deficiency, had been issued to petitioner for each of the foregoing years on February 1, 2013.

12. Petitioner challenged the notices of deficiency by requesting a conciliation conference with the Division's Bureau of Conciliation and Mediation Services (BCMS). Petitioner appeared at the conference, held on September 25, 2013, by Mr. Cisneros, who provided the Division with profit and loss statements and some (unspecified) accompanying documentation. No revisions to the asserted liabilities resulted from the conciliation conference, and a Conciliation Order (CMS No. 256932) dated February 14, 2014, was issued indicating that the notices of determination were sustained. At the same time, however, the Division's auditor continued review of the documents submitted at conference.

13. On or about January 4, 2014 (i.e., after the conciliation conference but before issuance of the Conciliation Order), and based upon her inability to obtain information or records from Mr. Cisneros, petitioner retained her current representative. On or about February 4, 2014, petitioner's representative provided the Division with a significant amount of additional documentation (totaling some 2,835 pages) including bank statements, Master Card and American Express credit card statements listing a variety of receipts and payments, invoices and receipts for merchandise purchases (store inventory), together with accompanying reconstructed profit and loss statements based thereon for each of the years in issue (Exhibits 3-a, b, c). Pursuant to permission granted at hearing, petitioner also provided a reconstructed general ledger

for each of the years at issue (reconstructed on the basis of the foregoing items).⁴

14. The foregoing merchandise purchase invoices were obtained by petitioner from her various suppliers, most of whom are located in Europe. Petitioner's original records had been given over to her former representative, Mr. Cisneros, in connection with the preparation of the Store's, and petitioner's, tax returns, as described (*see* Finding of Fact 7). As the post-audit and post-BCMS proceedings went forward, petitioner became unable to locate Mr. Cisneros. She stated that he had "disappeared" and that his offices had been "locked." Specifically, petitioner testified: "Once Mr. Cisneros' office was locked, I had to reach to my three years paperwork. So I went back to all my bank and credit card statements and I looked at every name of every supplier and I reached out, I went to my e-mail and I retraced all those three years and whatever I missed, I reached out to [my suppliers] to receive by e-mail the original [in]voices. And I made a photocopy of all of it."

15. As of the date of hearing in this matter, the parties do not disagree as to the amount of gross income (sales) reported by the Store for each of the years at issue, as follows:

⁴ Petitioner's post-hearing submission of the reconstructed general ledgers was accompanied by the previously submitted profit and loss statements (Exhibits 3-a, b, c), by certain bank and credit card statements (previously submitted as part of Exhibit 7), and by a relatively small number of cancelled checks. These items, including the noted cancelled checks, were clearly anticipated for submission in substantiation of claimed expenses, as discussed during the course of the hearing (*see* transcript of proceedings at pp 81, 82 and 146). Such items are accepted into evidence, and have been marked as Exhibit 8-a, b, c. Also submitted were "pro-forma" personal income tax returns reflecting petitioner's calculations of her liability for each of the audit years assuming the expenses claimed and the resulting amounts of net profit from the Store are accepted as substantiated in total. These pro-forma returns merely represent calculations of liability under assumed facts, do not constitute evidence of the deductibility of the expenses claimed, and are not included in the record as such, but rather are included only as part of petitioner's post-hearing brief. Finally, petitioner submitted a letter dated August 11, 2015 with an attached press release dated July 24, 2015, offered "as further evidence" and relating to petitioner's former representative (Mr. Cisneros). No provision was made for such submission, post-hearing or otherwise, and therefore the July 24, 2015 press release is not included in the record, and its content as well as the observations made with respect thereto in the August 11, 2015 letter accompanying the same are, and have been, properly disregarded.

YEAR	2009	2010	2011
Income (Sales)	\$373,500.37	\$408,808.33	\$481,536.82

Rather, the parties' dispute concerns two areas, consisting of:

- a) the dollar amount of merchandise purchases allowable as cost of goods sold in reduction of the store's income (sales) so as to arrive at its gross profit,⁵ and
 - b) the amount of claimed business expenses, substantiated as ordinary and necessary business expenses incurred in the operation of the Store, that are allowable as deductions further reducing the store's gross profit so as to arrive at its net profit for purposes of inclusion in petitioner's income in computing her personal income tax liability for each of the years at issue.
- Each area of dispute will be addressed in turn.

Merchandise Purchases

16. Included in connection with the foregoing documentation noted in Finding of Fact 13 was a summary list of merchandise purchased by the Store during each of the years at issue (*see* Exhibit J), allegedly constituting, together with merchant account fees paid, the amount of cost of goods sold that is allowable in reduction of the Store's sales in order to arrive at its annual gross profit. The Division does not dispute the amounts set forth in the profit and loss statements that are claimed as merchant account fees. However, the Division's review of the list of merchandise purchased, in connection with invoices and payment records supplied by petitioner, revealed what the auditor viewed as duplicate invoice amounts, indicating a doubling (and in one instance

⁵ The accounting term "cost of goods sold" is typically understood to mean the result calculated based on a concern's beginning inventory, plus its purchases (to arrive at goods available for sale), less its ending inventory, to result in its "cost of goods sold." As reflected in the parties' presentations herein, the term "cost of goods sold" is more generically applied to mean the Store's claimed merchandise purchases, plus its merchant account fees paid, less any merchandise purchases disallowed by the Division as duplicate (i.e., double counted) purchases.

a tripling) of the amount of some of the Store’s claimed merchandise purchase invoices. The Division’s calculations of the Store’s audited and allowable cost of goods sold is as follows:

YEAR	2009	2010	2011
Merch. purch. (Ex J)	\$194,382.33	\$235,088.65	\$312,197.11
+ Merch acc’t fees (Ex 8)	\$9,599.40	\$11,181.23	\$14,964.42
Total merch. purch.	\$203,981.73	\$246,269.88	\$327,161.53
- Dup. purchases (Ex K)	(\$34,227.57)	(\$25,317.39)	(\$41,353.08)
Audited cost of goods sold	\$169,754.16	\$220,952.49	\$285,808.45

17. The amount of total merchandise purchases, above, is as determined upon the auditor’s review of petitioner’s most recent (February 4, 2014) profit and loss statements, general ledgers and related documentation described in Finding of Fact 13. In contrast, the Store’s reported cost of goods sold amounts, consisting of its claimed merchandise purchases plus its merchant account fees, have varied dramatically over time and on different submissions, as follows:

YEAR	1120S (Ex. O)	Amd’d 1120S (Ex. E-1, 2, 3)	P&L Stmt (9/13) (Ex. I)	2 nd P&L Stmt (2/14) (Ex. 3-a, b, c)
2009	\$170,711.00	\$226,836.00	\$141,677.00	\$214,201.00
2010	\$274,810.00	-----	\$54,000.00	\$271,297.00
2011	\$266,704.00	-----	\$0.00	\$291,297.00

18. The foregoing cost of goods sold amounts vary as to their presentation (or inclusion) of merchant account fees therein. Review of the most recent profit and loss submission (Exhibit 3-a, b, c; resubmitted as part of Exhibit 8-a, b, c), which serves as the starting point upon which the Division’s audit results are based, reflects that the amounts of such merchant account fees are included in the total claimed cost of goods sold. The Division’s audit calculations, in turn,

accept that merchant account fees may properly be included in cost of goods sold.⁶ The differences between petitioner's claimed merchandise purchase amounts (Exhibit 3-a, b, c), versus (audited) total merchandise purchases (in each instance including therein claimed merchant account fees) (Exhibit L), were not specifically addressed or clarified in any manner at hearing or otherwise. They would appear to result from unsubstantiated claimed merchandise purchases (2009 and 2010), and from additional substantiated merchandise purchases (2011). Such differences are set forth as follows:

YEAR	Claimed Cost of Gds Sold (incl. merch. acct. fees)	Total Merch. Purch. (incl. merch. acct. fees)	Difference
2009	\$214,201.15	\$203,981.73	(\$10,219.42)
2010	\$271,297.01	\$246,269.88	(\$25,027.13)
2011	\$291,297.07	\$327,161.53	\$35,864.46

19. With no further explanation provided, the amounts of total merchandise purchases (including therein merchant account fees), as set forth in column three (above), will serve as the proper starting point to be used in determining the store's gross profit (*see* Finding of Fact 16). It is against such amounts that any further reductions (e.g., alleged duplicate purchase invoices) have been applied in arriving at the Store's annual gross profit amounts (*see* Findings of Fact 16, 20 and 21), from which any substantiated and allowable business expenses will thereafter be deducted in order to arrive at the Store's annual net profit amounts.

20. The Division's audit review resulted in the further disallowance and resulting reduction to the Store's foregoing total merchandise purchases in the amounts of \$34,227.57 (for

⁶ For 2011, the store's amount of merchant account fees initially claimed was \$21,261.18 (*see* Exhibit I). This amount appears to have been reduced, in petitioner's profit and loss submission of February 4, 2014 (Exhibit 3-c), to the \$14,964.42 amount accepted and included, post-audit, by the Division.

2009), \$25,317.39 (for 2010), and \$41,353.08 (for 2011) (*see* Finding of Fact 16; Exhibit K).

These disallowed amounts result from the auditor's discovery of identical (matching) invoices, bearing the same invoice date, number and total dollar amount reported, in petitioner's reconstruction of merchandise costs (i.e., cost of goods sold). The particular vendors, and claimed but disallowed amounts, are set forth on Exhibits J and K, and reflect: a) 9 duplicate cost amounts claimed, 1 triplicate cost amount claimed and 1 vendor credit claimed as a cost for 2009; b) 12 duplicate cost amounts claimed for 2010; and c) 12 duplicate cost amounts and 2 partial duplicate cost amounts claimed for 2011.⁷

21. The Store's audited gross profit amounts (the starting point for calculating net profit to be carried over to petitioner's personal income tax returns), as based on the foregoing amounts of sales income (*see* Finding of Fact 15) versus audited cost of goods sold (merchandise purchases plus merchant account fees, less alleged duplicate purchase invoice amounts; *see* Finding of Fact 16), are as follows:

YEAR	2009	2010	2011
Income (Sales)	\$373,500.37	\$408,808.33	\$481,536.82
Cost of Goods Sold	\$169,754.16	\$220,952.49	\$285,808.45
Gross Profit	\$203,746.21	\$187,855.84	\$195,728.37

⁷ The auditor allowed the claimed cost of merchandise only once, and disallowed (thus eliminating) the duplicate (and one triplicate) claimed costs for the same invoiced amounts. As an example, two invoices concerning purchases from one of the store's suppliers, Milk on the Rocks, each reflecting identical items ordered and bearing the same invoice number, order date and total amount due (\$5,184.50) are included in the record (*see* Exhibit 7, pages 5 - 10). The full invoice amount (\$5,184.50) appears twice as claimed cost of goods sold (merchandise cost) on petitioner's reconstructed merchandise cost listing (*see* Exhibit J). The auditor allowed the cost only once (*see* Exhibit K). Petitioner testified that, for some of her suppliers, she was allowed to make partial payments over time so as to arrive at the total invoice amount due for her orders from those suppliers (*see* Finding of Fact 22). The invoices for Milk on the Rocks reflect that payment of the total due (\$5,184.50) was to be made in two equal installments of \$2,568.25, thus indicating payment over time as opposed to supporting a conclusion that two payments of \$5,184.50, as claimed (and deducted) under petitioner's reconstructed cost of goods sold, actually occurred.

22. On the issue of duplicated invoices, petitioner stated that the Store paid many vendors over time and in partial amounts so as to arrive at the full amount due for a given order (invoice), such that what appear to be duplicated payments (or duplicate invoices) may result from such repeated partial payments. She further noted that inclusion of multiple copies of the same invoice may have resulted from placing a copy of each such invoice in her substantiating materials to reflect each time a partial payment was made. Petitioner noted finally that review of her reconstructed records “might” or “should” bear out this claim of multiple partial payments as opposed to double-counted payments. Petitioner noted that these pay-over-time arrangements reflect trust resulting from her long-term relationships with many of the Store’s suppliers.

Claimed Business Expenses

23. In addition to claimed cost of goods sold, a large number of additional items are claimed by petitioner as ordinary and necessary business expenses incurred by the Store during each of the three years in issue. As with the Store’s claimed cost of goods sold, the amounts of its claimed business expenses have varied dramatically over time and on the different submissions. The reconstructed profit and loss statements for each of the years in question (Exhibit 3-a, b, c), and the reconstructed general ledgers for each of such years, as submitted post-hearing (*see* Exhibit 8-a, b, c; Finding of Fact 13, n 4), reflect petitioner’s most recent iteration of such claimed business expenses. It is this iteration of such expenses upon which the auditor made the Division’s final review and adjustments (allowances of a portion of claimed business expenses) relative to and in reduction of the amount of tax asserted as due on the notices of deficiency (*see* Exhibits L and N). The types and dollar amounts of the Store’s claimed business expenses are as follows:

REF.	EXPENSE	2009	2010	2011
a	Advertising	\$0.00	\$0.00	\$0.00
b	Alarm	\$1,236.88	\$1,076.70	\$1,076.66
c	Automobile	\$0.00	\$0.00	\$0.00
d	Bank service fees	\$91.58	\$117.15	\$98.53
e	Clothing	\$0.00	\$0.00	\$0.00
f	Employee commissions	\$3,023.97	\$3,685.41	\$8,428.23
g	Computer/Internet	\$452.55	\$1,324.06	\$2,340.17
h	Depreciation	\$0.00	\$0.00	\$0.00
I	Disability insurance	\$0.00	\$60.00	\$61.38
j	Donations	\$0.00	\$200.00	\$450.00
k	Dues/Subscriptions	\$210.00	\$135.00	\$429.17
l	Filing fees	\$9.00	\$0.00	\$0.00
m	Fines/Penalties (tax)	\$487.60 (NYS & NYC)	\$141.70 (Federal)	\$0.00
n	Gifts	\$44.65	\$150.00	\$487.56
o	Insurance	\$2,342.51	\$2,438.22	\$2,535.79
p	Interest expense	\$0.00	\$0.00	\$0.00
q	Janitor	\$0.00	\$0.00	\$0.00
r	Legal fees	\$0.00	\$675.00	\$0.00
s	Local travel	\$1,205.15	\$1,312.61	\$2,259.27
t	Meals/Entertainment	\$17.36	\$155.19	\$2,800.40
u	Miscellaneous	\$0.00	\$0.00	\$100.00
v	Corp. tax (NYC)	\$1,275.00	\$7,141.00	\$175.00
w	Corp. Tax (NYS)	\$325.00	\$0.00	\$25.00
x	Office supplies	\$801.01	\$2,296.84	\$1,379.00
y	Officer salaries	\$22,000.00	\$0.00	\$0.00
z	Payroll processing fees	\$638.58	\$723.53	\$729.57
aa	Postage	\$1,729.76	\$1,415.47	\$4,997.33
bb	Printing	\$150.00	\$317.00	\$97.98

cc	Professional fees	\$2,915.09	\$0.00	\$0.00
dd	Accounting fees	\$3,040.00	\$2,437.50	\$8,460.00
ee	Real property taxes	\$1,498.60	\$2,831.11	\$4,659.76
ff	Rent expense	\$69,574.52	\$73,605.16	\$82,911.35
gg	Repairs/maintenance	\$32.57	\$5,356.06	\$2,344.10
hh	Employee salaries	\$11,477.67	\$10,083.09	\$10,762.34
ii	Sales tax	\$1,032.07	\$2,934.00	\$15,156.19
jj	Shipping	\$109.97	\$0.00	\$814.18
kk	Supplies	\$4,455.85	\$4,412.25	\$4,532.50
ll	Telephone	\$2,579.76	\$1,604.14	\$1,155.02
mm	Travel	\$7,057.57	\$2,763.65	\$10,998.21
nn	Uniforms	\$0.00	\$0.00	\$0.00
oo	Utilities	\$2,023.68	\$2,335.08	\$2,403.45
pp	Workers' comp. insurance	\$737.36	\$788.54	\$453.70
----	TOTAL	\$147,037.07	\$136,410.83	\$177,269.82

24. Upon review of the foregoing claimed expenses and in light of the supporting documentation submitted by petitioner, the auditor allowed the following expense items and amounts:

Ref.	Expenses Allowed ⁸	2009	2010	2011
y	Officer salaries	\$12,000.00	\$11,602.00	\$18,015.00
hh	Employee salaries	\$11,478.00	\$12,823.00	\$13,015.00
ff	Rent expense	\$79,800.00	\$82,507.00	\$83,149.00
ii	Sales tax	\$1,032.07	\$2,934.00	\$15,156.19

⁸ The category names of two of the expenses, as claimed by petitioner, vary slightly from the category names utilized by the auditor, i.e., claimed "officer salaries" (per petitioner) are referred to by the auditor as "compensation of officers," and claimed "employee salaries" (per petitioner) are referred to by the auditor as "salary & wages." These distinctions, apparently arising from differences in the category names found in the profit and loss statements and general ledgers versus those used in the tax return schedules, are of no consequence in determining the deductibility of such claimed expenses.

-----	Other deductions verified	\$21,930.00	\$0.00	\$0.00
-----	TOTAL ALLOWED	\$126,240.07	\$109,866.00	\$129,335.19

25. Comparison of the amounts allowed by the auditor (*see* Finding of Fact 24) versus those claimed on the reconstructed profit and loss statements and general ledgers (*see* Finding of Fact 23) reveals some differences, as follows:

- a) claimed officer salaries were reduced by \$10,000.00 (for 2009), and were increased by \$11,602.00 (for 2010) and \$18,015.00 (for 2011).
- b) claimed employee salaries were allowed as claimed (for 2009), and were increased by \$2,739.91 (for 2010) and \$2,252.66 (for 2011).
- c) claimed rent expense was increased by \$10,225.48 (for 2009), \$8,901.84 (for 2010) and \$237.65 (for 2011).
- d) claimed sales tax expense was allowed as claimed.

26. For 2009 only, the Division’s allowance of \$21,930.00 of “other deductions verified” (*see* Finding of Fact 24), consisted of \$12,443.00 in claimed business expenses, plus \$9,487.00 of merchant account fees. The latter merchant account fees have already been accounted for and allowed by the Division as an expense included in and increasing cost of good sold (*see* Finding of Fact 16). The \$12,443.00 balance of other deductions verified and allowed by the Division are as follows:

Ref.	Expense Item	Amt. Claimed	Amt. Allowed per verification	Notations
d	Amex fee	\$49.00	\$125.00	Fee for American Express Card
o	Insurance	\$2,343.00	\$2,343.00	-----
b	Outside service	\$2,744.00	\$989.00	Allow security ⁹

⁹ The auditor’s notation “allow security” is viewed herein as relating to the expense category reference “b,” i.e., “alarm,” the notation “Amex fee” is viewed as relating to the expense category reference “d,” i.e., “bank service fees,” and the expense item “decorating exp.” is viewed as relating to the category reference “kk,” i.e., “supplies.”

aa	Postage	\$1,709.00	\$1,709.00	-----
kk	Supplies	\$3,999.00	\$2,666.00	Verified 4 months
ll	Telephone	\$2,104.00	\$984.00	Based on American Express
oo	Utilities	\$4,196.00	\$1,390.00	-----
g	Computer serv. fee	\$411.00	\$916.00	-----
kk	Decorating exp.	\$630.00	\$630.00	-----
z	Payroll serv. fee	\$691.00	\$691.00	-----
	TOTAL	\$18,876.00	\$12,443.00	-----

27. In view of the foregoing allowances, the Division recalculated and reduced the store's net profit amounts (i.e., gross profit less allowable expenses) for each year. Such reduced net profit amounts were then carried over to petitioner's personal income tax returns (in replacement of the net profit amount initially utilized in calculating petitioner's personal income tax liability as asserted under the notices of deficiency [*see* Exhibits D-1, 2, 3; L]), and applied in recalculating petitioner's liability for each of the years at issue (*see* Exhibit N), as follows:

Net profit reduction/revised tax liability¹⁰

Net profit adjustment	2009	2010	2011
Audited gross profit	\$203,746.21	\$187,855.84	\$195,728.37
(-) Expenses allowed	(\$126,240.07)	(\$109,866.00)	(\$129,335.19)
Net profit	\$77,506.14	\$77,989.84	\$66,393.18
Initial net profit	\$119,225.00	\$119,798.00	\$232,214.00
Net profit reduction	(\$41,718.86)	(\$41,808.16)	(\$165,820.82)
Initial tax liability	\$14,835.67	\$15,719.91	\$26,457.47
Reduced tax liability	\$9,987.00	\$10,860.00	\$8,487.00

28. The claimed business expenses set forth on the reconstructed profit and loss

¹⁰ Penalties were likewise reduced, consistent with the auditor's recalculation and reduction of petitioner's asserted tax liabilities (*see* Exhibit N).

statements (*see* Finding of Fact 23), are based on the reconstructed general ledgers. In an effort to be consistent in reconstructing the Store's records, the categorization of such claimed business expenses in the reconstructed profit and loss statements and general ledgers appear to have been made in accordance with the software categorization protocol of the computer program (QuickBooks) by which the records were initially maintained (*see* Finding of Fact 7). The inputs into the program for sales and expense amounts appear to have been based on bank account and credit card statements, and upon merchant invoices for goods purchased by the Store. The precise manner in which such amounts were placed into the various expense categories under the software categorization protocol in reconstructing the general ledgers was not explained, although it appears petitioner's current representative relied upon petitioner's input in such process.

29. Petitioner provided testimony at hearing as to the operation of the Store, and as to many of the claimed business expenses. In her testimony, petitioner stressed that the Store sells a largely unique line of high quality items made by numerous small designers and manufacturers. She explained that she cannot simply "mass order" merchandise, but rather must meet with the individual designers and suppliers to view their designs and items, choose the fabrics (types and colors) to be used, and place individual orders with her various suppliers.

30. Petitioner explained that in the clothing and fashion business, there are two periods or "seasons," fall/winter and spring/summer, and that there are trade shows for each season at which designers and manufacturers present their items to potential purchasers. Most of the store's suppliers are located in Europe, primarily in France and Italy, but also in the Netherlands. Petitioner attends trade shows in Paris, France and in the Netherlands. The leading European

fashion trade show for infant and children's apparel is known as "Playtime Paris." Separate seasonal Playtime Paris trade shows are held annually in Paris, in late January and again in early July. Petitioner traveled to France at these times and attended the Playtime Paris show for each season during each of the years at issue. The duration of her trips to Europe lasted approximately ten days, and in addition to attending the Playtime Paris show, she visited some of her suppliers who she did not see or who were not present at the trade shows.

31. Petitioner has three children, Heloise, Tristan and Paloma, born respectively in 1995, 1997 and 2002, with each being minors during the years in issue. Petitioner has a very large extended family living in France (near Paris), and the children accompanied petitioner on her trips to France. The children typically stayed with petitioner's parents during the summer months, such that petitioner was free to attend to business matters, including attending the trade shows, traveling to visit other suppliers as described, and returning to New York to attend to the Store's business. When petitioner traveled during these trips, she stayed with friends or family and did not, generally, incur hotel or other lodging costs, or significant meal and entertainment expenses.¹¹

32. One of the Store's designers/suppliers is petitioner's sister, Natalie, who lives in the western part of France (Chavagne). Petitioner visits her sister's studio to review designs and to order products. Petitioner also receives merchandise ordered from various other suppliers at her sister's studios, where petitioner is able to check the orders for completeness and quality, repack smaller suppliers' orders into larger "batches," and arrange for the payment of import duties and

¹¹ Petitioner noted that there were initial audit questions concerning her ability to pay the ongoing living costs for herself and her children, in light of the limited amounts of net profit reported by the Store during the years in issue. Petitioner averred, and it is not challenged by the Division, that she received substantial amounts (\$73,000, \$90,000 and \$72,000) of nontaxable child support during the respective years at issue.

shipping of the merchandise to the Store in New York. In this regard, petitioner noted that there is a large UPS shipping facility located near her sister's studio, and that petitioner utilizes this facility for merchandise shipping.

33. Petitioner testified that the foregoing trips to attend the Playtime Paris trade shows in France were, for her, 100 percent working trips. She also, typically, took an additional trip to France in August. Petitioner described this trip as involving about 75 percent business and 25 percent spending time with her family. Petitioner visited her sister's studios in Chavagne, as described above, as part of her August trips to France, and presumably her children returned to New York with her at the end of such trips.

34. Petitioner testified with regard to many of the specific claimed business expenses (*see* Finding of Fact 23), as follows:¹²

b) alarm: the store had an alarm system, for which petitioner recalled making a recurring payment of between \$200.00 and \$250.00 per month. The records submitted reflect recurring payments to "DGA Security Systems" for "protection/security s[ervices]."

d) bank service fees: petitioner had no specific recall of the claimed expense amounts, other than the generic statement that the same likely represented "lateness in my payments."

f) employee commissions: the Store's employees were compensated on the basis of an hourly wage, plus commissions on their sales. Petitioner described this arrangement as, in her view, "a fair thing to do." Review of the substantiating documents provided reveals that the listed names of the Store's employees are consistent in both expense categories (i.e., employee commissions [ref. f]) and employee salaries [ref. hh]), as well as on those checks labeled as "commissions" and submitted as part of the record, post-hearing.

g) computer/internet: due to lack of available space, petitioner did not have a computer at the Store during the years in issue. Instead, petitioner utilized a computer at her home to

¹² The lower case reference letters correspond to the same lower case "Ref." letters for such claimed expenses as set forth in chart form earlier (*see* Findings of Fact 23, 24 and 26).

communicate with the Store's designers and suppliers, and with its approximately 2,500 person customer base. In the latter area, petitioner provides notice to the store's customers, via computer (e-mail), of various promotions, upcoming sales, new designs and merchandise for new seasons, and the like. She also used the computer to track shipments and deliveries via the United States Postal Service (USPS) and United Parcel Service (UPS). Petitioner acknowledged, on cross examination, that she utilized the computer to "say hello" to her sister (who is also a designer/supplier to the store), but stressed that the computer is devoted to business use, noting that her children did not use the computer petitioner used for business matters. Petitioner also testified to a computer "crash" resulting in the need and cost to replace the computer and to pay for data recovery services in connection therewith.

i) disability insurance: the record includes no testimony or other information as to this claimed expense.

j) donations: the record includes no testimony or other information concerning the amounts claimed or to whom any donations were made.

k) dues/subscriptions: petitioner described payments made for inclusion in a Soho/Tribeca area "map" (presumably as part of an area-centered business advertisement effort), and subscriptions to various infant and children "fashion magazines." The record contains no further detail in this area.

l) filing fees: this fee for 2009 (only) was described generically as an annual corporate registration fee paid to the New York State Secretary of State.

m) finances and penalties: petitioner candidly admitted she could not recall specifically what these amounts involved.

n) gifts: petitioner made reference to having made gifts to the Store's postal carrier and to the UPS delivery service persons, as well as to the Store's employees. The record contains no further detail in this area.

o) insurance: the Store's insurance is required to be in force (with confirming notice of coverage to be supplied to the landlord). Insurance is acquired through an insurance broker (Schraeter & Schraeter) and is paid via electronic funds transfers as reflected on the Store's bank account statements.

r) legal fees: petitioner's testimony was clear as to the reason for retaining an attorney, i.e., lease problems including late fees, water and electrical problems (*see* Finding of Fact 33-r), and the substantiating documents show two payments to one Jamel Oeser-Swat for legal services in 2010 (*but see* Finding of Fact 34 [cc]).

s) local travel: this category of expense included petitioner's travel costs to and from the

Store, via the metro, from her home on Manhattan's upper west side to the Store's location in lower Manhattan. Petitioner also noted travel expenses were incurred for trips by petitioner and by other Store employees to the New York City mid-town fashion district in connection with deliveries to that area, as well as trips to purchase supplies for the Store from stores such as Home Depot and Staples. The record, however, includes no additional detail or information separating or specifically identifying the costs, times or dates of any of these types of travel.

t) meals/entertainment: petitioner's testimony provided no specific details concerning this claimed expense, but rather only the general statement that the same included meals for herself when she worked late at the Store and, at least for the year 2011, where such claimed expense was significantly greater than for other years (*see* Finding of Fact 23), included petitioner treating the Store's employees to birthday dinners at restaurants and "possibly tickets to shows" for herself and the Store's employees.

v & w) taxes: the record includes no specific information concerning these claimed expenses.

x) office supplies: petitioner explained that significant amounts of items such as notebooks, sales order forms, tape, gift wrap, bags, tissue paper, staples and the like are necessary to operate a retail boutique business such as the Store. She also noted, in similar testimony, that supplies purchased of necessity include cleaners and sprays to clean the store areas generally, and specifically to clean windows and other display areas.

y) officer salaries: the Division's auditor allowed amounts that are consistent with the amounts claimed on the Store's tax returns, noting that such amounts, if disallowed, would be "double counted" as income since the same are also included as income on a taxpayer's personal income tax returns.

z) payroll processing fees: the store utilized the services of a payroll processing firm (initially Comp-U-Pay and later PayChecks) to account for its employee payroll and payroll tax matters. Petitioner noted that she has no expertise or capability to perform this function on her own (*see* Finding of Fact 7).

aa) postage: petitioner offered general testimony that the Store "ship[s] a lot [of merchandise]" via USPS and UPS, such that postage expenses would necessarily be incurred in operating a retail store. The record, however, sets forth little additional detail concerning the same.

bb) printing: petitioner described incurring printing costs for such items as business cards, postcards and copying.

cc) professional fees: this expense, claimed for 2009 only, was described in petitioner's testimony as involving retaining the services of an attorney concerning disputed matters

with the store's landlord (lease problems including late fees, water and electrical problems; *see* Finding of Fact 34-r). In contrast, however, canceled checks (numbered 801 and 802 and dated October 10, 2009 [\$915.09] and October 31, 2009 [\$2,000.00], respectively) for this claimed expense are drawn as payable to "Global Energy Innovations" and bear the handwritten notation "accounting." The record includes no invoice or other billing from, or information about, the named payee, Global Energy Innovations.

dd) bookkeeping/accounting/tax preparation fees: as described, petitioner retained others to perform these services (*see* Finding of Fact 7), and explained that she had no training or expertise, and no particular competence, in such matters. The claimed fees were paid to Mr. Cisneros, via the various bookkeepers in his office and in connection with petitioner's provision of the Store's records (and her records) to the bookkeepers and, in turn, to Mr. Cisneros.

ee) real estate taxes: the store's real estate taxes were payable quarterly and were required to be paid to the store's landlord (Pasquale LLC). Payments were initially made by check, as part of and included in the Store's rent payments, but at some point thereafter petitioner changed and made such payments via separate checks issued to the landlord.

gg) repairs/maintenance: petitioner testified that the store hired contractors to repair significant damages, resulting from a water leak at the premises of an upstairs tenant that caused a ceiling collapse, electrical damages to the Store and its 24-hour window display lighting, as well as buckling of wood areas in the store (including in its display areas). The work performed included replacement of the ceiling, and hiring a wood restoration specialist.

jj) shipping: the record contains no significant detail as to this claimed expense, beyond general testimony that the same pertained to merchandise deliveries to the store via delivery services including Federal Express, UPS and DHL.

kk) supplies: as distinguished from "office supplies," petitioner explained that the store purchased and used large inventory storage containers in which merchandise to be sold was kept and stored in the basement of the store's premises. Petitioner also noted this category of expense also included the purchase of display lighting used in the store's windows and other display areas, the purchase of display and storage shelving, and the purchase of a stereo system for the store in replacement of one that was damaged due to the water leak from the upstairs tenant's premises (*see* Finding of Fact 34 [gg]).

mm) travel: as described, petitioner, accompanied by her children, traveled to France each year (*see* Findings of Fact 31 through 33). Petitioner's testimony on this expense was somewhat inconsistent, noting at one point her belief that she reimbursed the store for her

children's air fare costs, at least for one of the years in issue,¹³ and at another point her belief that such costs were properly considered business expenses since her children were too young to leave at home alone when she traveled to Europe (the position also espoused in petitioner's post-hearing briefs). The record includes evidence of payment for air fare to and from Paris for petitioner and for her children at a cost of \$1,125.00 per ticket (*see e.g.*, American Express Statement at Exhibit 7, page 278; resubmitted post-hearing as part of Exhibit 8-a and identified at H-9 thereof).

ll) telephone and internet: the testimony in this area was general, and to the effect that the Store utilized a "landline" telephone with a different number than that in service at petitioner's home, but that petitioner mainly utilized her cellular phone and conducted both business and personal matters, without any particular documented distinction (dollar amounts or time) by which personal versus business use could be discerned.

oo) utilities: the Store's utility services were purchased from Consolidated Edison and paid via electronic funds transfers from its bank account. In addition to such regular and recurring payments by electronic funds transfer, the record also includes regular payments, categorized as utilities payments, by check to either Porian Everett or to Brian Everett. Such amounts, paid in regular increments of \$40.00, \$60.00 or \$80.00, and totaling \$520.00 (2009), \$504.00 (2010) and \$280.00 (2011), were included in the total amount of claimed utility expenses. The record includes no detail explaining such recurring amounts paid or who the recipients were (beyond the foregoing names), or the "utilities" services they allegedly provided.

pp) workers' compensation: the record, including petitioner's testimony, reflects regular payments for Store employees (for four full-time equivalent positions), and for petitioner, made by the Store to the New York State Insurance Fund for the provision of workers' compensation insurance.

CONCLUSIONS OF LAW

A. The first issue presented is whether the Division properly disallowed some of the store's claimed expenses, consisting of: a) claimed merchandise purchases (cost of goods sold), and b) other claimed business expenses, in its determination of the store's net profit to be carried over and reported as business income subject to tax on petitioner's personal income tax returns

¹³ It would appear likely that any such claimed reimbursement would have incurred in the year 2010, given the significant difference in claimed travel expenses for this year as opposed to the other two years in issue (*see* Finding of Fact 23 at ref. "mm").

for the years at issue.

B. 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 demonstrate, by clear and convincing evidence, that the deficiency assessment is erroneous (*see Matter of O'Reilly*, Tax Appeals Tribunal, May 17, 2004; *see also* 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 Tivolacci v. State Tax Commn.*, 77 AD2d 759 [3d Dept 1980]).

C. The adjusted gross income of a New York resident is federal adjusted gross income, with certain modifications not applicable in this case (Tax Law § 612[a]). Section 62(a)(1) of the Internal Revenue Code defines the adjusted gross income as an individual's gross income minus certain deductions. Among the deductions permitted are expenses that are "ordinary and necessary" for the production of income in carrying on a trade or business (IRC § 162[a]). An ordinary expense is one that is common and acceptable (*Welch v. Helvering*, 290 US 111, 114 [1933]). A necessary expense is considered to be one that is appropriate and helpful in conducting a trade or business (*Heineman v. Commr.*, 82 TC 538, 543 [1984]). As noted, the Store made elections whereby the results of its operation flow through to petitioner and are reported on her annual personal income tax returns (*see* Finding of Fact 6, n 1). In this case, then, in order to maintain the deductions for the Store's cost of goods sold and for its business expenses that result in the Store's net profit, as carried over to petitioner's New York returns, petitioner has the double burden of (1) demonstrating entitlement to the deductions and (2) substantiating the amounts of the deductions (*see* Tax Law § 658[a]; § 689[e]; 20 NYCRR 158.1; *Matter of Macaluso*, Tax Appeals Tribunal, September 22, 1997, *confirmed* 259 AD2d 795

[1999]).

D. As noted, Tax Law § 689(e) places the burden upon petitioner to establish entitlement to the claimed deductions for business expenses. The Cohan rule (*Cohan v. Commissioner*, 39 F2d 540, 544 [2d Cir 1930]), permits courts to make an approximation of an allowable amount when the taxpayer is unable to substantiate the full business expense deducted (*see e.g. Lerch v. Commissioner*, 877 F2d 624 [7th Cir 1989]). However, as discussed by the Tax Appeals Tribunal in *Matter of Hamsho* (Tax Appeals Tribunal, October 25, 1990), the Cohan rule is not obligatory, and deductions may be limited or completely disallowed where the taxpayer has provided no basis to make a reasonable estimation (*see e.g. Pfluger v. Commissioner*, 840 F2d 1379 [7th Cir 1988], *cert denied* 487 US 1237 [1988]; IRC § 274[d]; *see Sanford v. Commissioner*, 50 TC 823, 827 [1968]).¹⁴

E. Unfortunately, this matter proceeded at the initial stages without the benefit of petitioner's records. In this respect, the record bears out that petitioner's former representative,

¹⁴ IRC § 274(d) applies a more strict substantiation requirement for certain business expenses, including, among other things, expenses for travel, tolls, and cellular telephone expenses (IRC §§ 274[d][4]; 280F[d][4] [A]). As stated by the U.S. Tax Court in *Ong v. Commissioner* (TC Memo 2012-114 [4-19-2012]):

“To substantiate a deduction attributable to such expenses, a taxpayer must maintain adequate records or present corroborative evidence to show the following: (1) the amount of the expense; (2) the amount of each business use and total use (e.g., mileage for automobiles and time for other listed property); (3) the time (i.e., date of the expenditure or use); (4) the business purpose of the expense or use. Sec. 274(d); sec. 1.274-5T(b)(6), Temporary Income Tax Regs., 50 Fed. Reg. 46016 (Nov. 6, 1985). In the absence of evidence establishing the elements of the expenditure or use, deductions are to be disallowed entirely. Sec. 274(d); *Sanford v. Commissioner*, 50 T.C. 823, 827 (1968), *aff'd per curiam*, 412 F.2d 201 (2d Cir 1969); *see also* sec. 1.274-5T(a), Temporary Income Tax Regs., *supra*.”

The specific intent of IRC § 274 (d) and the regulations is to limit the application of the Cohan rule (*Sanford*, 50 TC at 827; *Rodriguez v. Commissioner*, TC Memo 2009-22 [2009]). This more limited view impacts the amounts of any allowable expenses claimed herein such as travel expenses, cellular telephone expenses, and the like (*see* Conclusion of Law J-II, mm).

Mr. Cisneros, did not provide records to the Division, as requested, prior to audit review and issuance of the notices of deficiency at issue herein. Thereafter, his submission of records in connection with the BCMS conference proceeding was, apparently, very limited. In fact, it was not until petitioner's current representative became involved, after issuance of the notices, that any attempt to provide comprehensive records was undertaken. In this respect, it is worth noting that petitioner's ability to provide her original records was severely hampered by her inability to locate or communicate with her former representative, to whom such records had been furnished and in whose care they were entrusted (*see* Finding of Fact 7). Nonetheless, petitioner made yeoman efforts to obtain records in replacement of the originals, including purchase records from her many suppliers, as well as duplicate copies of bank and credit card statements. The record reflects that she was largely successful in obtaining many records concerning the merchandise she purchased from many of her suppliers. At the same time, and not surprisingly, she was less successful in obtaining records, such as bills or invoices, for the numerous other expenses she incurred in the operation of the Store's business.

F. Against this backdrop, it must be noted that it is neither practical nor reasonable to expect the conduct of an audit to be undertaken or performed in the course of a formal hearing.

On this score, the Tax Appeals Tribunal has stated:

“[The] failure to produce documentation concerning the transactions at issue during the audit is unfortunate since that was the appropriate time for adequate consideration by both parties of the documents and the nature of the transactions they represent. The formal nature of the hearing before the Administrative Law Judge operates against such discussion and analysis. While such documents can be reviewed post-hearing by the Administrative Law Judge, again the bilateral review and consideration that can occur during audit is absent” (*Matter of Jenkins Covington, Inc.*, Tax Appeals Tribunal, August 25, 1988, *confirmed* 195 AD2d 625 [1993], *lv denied* 82 NY2d 664 [1994]).

G. The Tribunal's observation is particularly apropos in instances where a taxpayer (or representative) affirmatively chooses not to make records available for review upon audit, or chooses not to expend the effort to do so until such time as the audit has concluded and proceedings such as those here have been undertaken. The potential negative consequences of such actions are clear and obvious. At the same time, however, such consequences as are likely to stem from affirmative choice or delay in supplying records may, appropriately, be tempered to some degree under circumstances such as the present case. That is, the taxpayer here did not fail to maintain records or willingly choose not to provide the same. Rather, she was unable to supply original records due to her inability to locate or communicate with her former representative, or to gain access to his premises in order to access such records (*see* Finding of Fact 14). Here, it appears clear that petitioner was represented, in the first instance, by an individual into whose custody and care the Store's business records (and petitioner's personal records) were entrusted, and who was at best inattentive, in fact unavailable, and allegedly, not entirely scrupulous. Thus, review of petitioner's testimony regarding the claimed business expenses of the Store must be viewed against this background of considerations.

Merchandise Purchases

H. The only issue presented as to merchandise purchases concerns the Division's reduction of claimed merchandise purchase amounts based on what the auditor perceived to be multiple identical purchase invoices included in petitioner's substantiating materials that appear to have been counted more than once in arriving at the Store's claimed total merchandise purchases. Petitioner maintains that such invoices reflect ongoing partial payments of the total invoice (order) amount, rather than a situation where she included and counted the same purchase

invoices more than once in calculating merchandise purchases (*see* Finding of Fact 22). Review of the substantiating materials (invoices) together with the payment information provided (credit card statements and other materials) does not present a clear reflection in support of petitioner's claim. Petitioner was allowed a period of time, post-hearing, within which to provide a process, or "roadmap," by which such partial payments could be traced through to each of the invoices. Unfortunately, the materials provided are not organized in such a fashion as to make the same apparent. The Tribunal's observations about the efficacy of conducting an audit during the course of a hearing, as noted above (*see* Conclusion of Law G), are particularly relevant on this issue. Without any clear manner of reconciling claimed (but unspecified) partial payments to the multiple purchase invoices, it cannot be concluded that petitioner has met her burden of establishing that the invoices challenged by the Division were, in fact, not double counted in arriving at claimed merchandise purchases. Accordingly, the amount of audited cost of goods sold, as set forth at Finding of Fact 16 (i.e., after elimination of the duplicate purchases), may not be further adjusted (increased). Thus, for purposes of this determination, the Store's gross profit amounts for each of the years at issue will be those calculated and set forth at Finding of Fact 21. In turn, the Store's net profit amount for each of the years at issue will be based upon such gross profit amounts, less any allowed (and allowable) claimed business expenses, as discussed hereinafter.

Claimed Business Expenses

I. The types and dollar amounts of each of the Store's claimed business expenses, as set forth above (*see* Finding of Fact 23 a - pp) have been reviewed in light of: a) the substantiating documentary evidence provided by petitioner; b) the Division's review and allowance of some of

such claimed expenses (in part or in whole) in consideration of such documentation (*see* Findings of Fact 24 - 26); and c) in view of petitioner's testimony at hearing as described above (*see* Findings of Fact 14, 29 - 34). Review of the testimony and documentary evidence submitted reveals that while petitioner was able to obtain many invoices from her various suppliers (concerning merchandise purchases included as cost of goods sold), she was unable to obtain many receipts or invoices concerning her other claimed business expenses. In many instances, where a given claimed expense amount appears on a credit card statement, the same could be viewed as either a personal expense or a business expense. As described, petitioner testified at some length concerning the claimed other business expenses, describing such expense items and how they related to the conduct of the Store's business. Petitioner's testimony and recall was, in some instances, lacking in specifics as to dollar amounts, times and places. At the same time, however, her testimony, as a general matter, was clearly candid, forthright, truthful and credible.

J. Careful review of all of the evidence submitted results in the allowance of certain claimed business expenses in addition to those recognized and allowed by the Division upon its review. The reference letters previously assigned to each of the claimed expense types is matched herein for ease of review. Any allowances different from, or in addition to, those already recognized by the Division, and any differences between the amounts set forth as challenged herein versus those set forth in earlier submissions, are also noted, as appropriate. Of the types of expense listed at Finding of Fact 23, no amounts were claimed for: a) advertising, c) automobile, e) clothing, h) depreciation, p) interest expense, q) janitor, or nn) uniforms, and none have been allowed herein. The remaining types of listed expenses are addressed as follows:

b) alarm: petitioner testified to a recurring monthly payment of \$200.00 to \$250.00 for the alarm system. Even the lowest (\$200.00 per month)

amount results in a higher annual amount than is claimed for any of the years at issue. However, in light of recurring payments, as appearing in petitioner's documents, to "DGA Security Systems" for "protective/security services," coupled with the Division's notation "allow security" (*see* Finding of Fact 26), it is appropriate to allow the claimed "alarm" expense amounts for each year as reasonable and necessary (for 2009, this results in an increase of \$247.88 to the amount allowed by the Division for such year [*compare* Findings of Fact 23 and 26]).

d) bank service fees: the evidence provides no specifics on these claimed amounts and are therefore not allowable, save for the Division's allowance of \$125.00 as "fee for American Express Card" for 2009 (*see* Finding of Fact 26).

f) employee commissions: petitioner's testimony (*see* Finding of Fact 34-f) coupled with the matched names of the recipients of the claimed amounts supports allowance of this expense for each year in issue.

g) computer/internet: petitioner's testimony was clear in describing that the computer was used nearly entirely (if not entirely) for business purposes, including the direct point that her children do not use the business computer (*see* Finding of Fact 34-g). The amounts claimed are reasonable, noting in such regard her testimony as to expenses incurred due to a system crash, computer replacement and data recovery. Accordingly, the amounts claimed are allowed.

i) disability insurance: the record includes no support for this claimed expense and the same is, therefore, disallowed.

j) donations: the record includes no support for this claimed expense and the same is, therefore, disallowed.

k) dues and subscriptions: while there is testimony regarding various children's fashion magazines and payments for an area directory, the same clearly lacks specificity. Accordingly, the claimed expense for such amounts is disallowed.

l and m) filing fees and fines/penalties (tax): while there is some testimony regarding these items, the same lacks specificity. It would appear that obtaining substantiating information regarding these items should have been an easily accomplished matter, yet none was provided. Accordingly, the claimed expenses for such amounts are disallowed.

n) gifts: petitioner's testimony was clear in her recall of having made gifts

to those one would expect to be recipients, such as delivery people and employees. The amounts claimed are clearly reasonable and are, therefore, appropriately allowed.

o) insurance: the Division allowed this expense for 2009. Coupling petitioner's testimony (*see* Finding of Fact 34-o), with the manner in which insurance was obtained and paid for supports allowing this expense, as claimed, for each of the years in issue.

r) legal fees: petitioner's testimony was clear as to the person (attorney) retained and the reason for retaining an attorney (*see* Finding of Fact 34-r), and the evidence shows two payments to one Jamel Oeser-Swat for legal services in 2010. Accordingly, this claimed expense is properly allowed.

s) local travel: petitioner's testified that local travel included both her personal commuting expense as well as claimed travel to make deliveries and to obtain office supplies. None of the evidence provides any basis to distinguish or allocate between the personal local travel and any local business travel, or to determine the amount of the claimed expenses appropriately assigned to either. Accordingly, this claimed expense is properly disallowed.

t) meals and entertainment: petitioner's testimony reveals that this claimed expense included amounts for personal meals and for tickets to shows (*see* Finding of Fact 34-t). There is no evidence from which to discern whether any of these claimed expense amounts had a business purpose so as to be allowable. Accordingly, this claimed expense is properly disallowed.

u) miscellaneous: the record includes no evidence to support allowance of this expense (claimed only for 2011).

v and w) corporation tax: while there is some testimony regarding these items, the same lacks specificity. As with ref items "l" and "m" above, it would appear obtaining substantiating information regarding these items should have been an easily accomplished matter, yet none was provided. Moreover, since the Store was an electing subchapter S corporation, there is no apparent basis upon which there would be corporation tax in any event. Accordingly, the claimed expenses for such amounts are disallowed

x) office supplies: petitioner's testimony established convincingly that the items underlying these claimed expenses were necessary to the successful operation of a retail business such as the Store and were reasonable in

amount. Such expenses claimed are therefore allowed.

y) officers' salaries: these amounts were allowed by the Division as described in Finding of Fact 24, and thus are properly allowed herein (*see* Finding of Fact 24-y). It is specifically recognized that the amounts so allowed are less than that appearing as claimed (for 2009) and greater than those claimed for 2010 and 2011 (noting that no amounts were claimed for either 2010 or 2011 on the profit and loss statements provided [*compare* Finding of Fact 23-y with 24-y]).

z) payroll processing fees: the amount claimed was allowed by the Division for 2009 (*see* Finding of Fact 26-z). Given this allowance coupled with the testimony (*see* Findings of Fact 7, 34-z), it is appropriate to likewise allow the amounts claimed for 2010 and 2011 on the same basis. It is noted that the amount allowed by the Division for 2009 (\$691.00) slightly exceeds the amount shown as claimed at Finding of Fact 23-t, with no explanation provided.

aa) postage: the auditor allowed postage as claimed (\$1,709.00) for 2009 (*see* Finding of Fact 26-aa). The amount claimed for 2010 was slightly lower than that claimed for 2009 (\$1,415.47), while the amount claimed for 2011 was significantly greater (\$4,997.33). It is reasonable to accept, in light of the testimony, that the Store incurred postage costs in each year. At the same time, there is no testimony explaining the significant increase for 2011. Accordingly, it is reasonable to allow the amount claimed for 2010 (\$1,415.47) and for 2011, to allow \$1,562.26, representing the average of the two amounts allowed for 2009 and 2010 (i.e., $\$1,709.00 + \$1,415.47 = \$3,124.47 \div 2 = \$1,562.26$). It is noted that the amount allowed by the Division for 2009 (\$1,709.00) is slightly less than the amount shown as claimed at Finding of Fact 23-aa (\$1,729.76), with no explanation provided.

bb) printing: petitioner's testimony describing this expense supports allowance of the amounts claimed as clearly reasonable and necessary.

cc) professional fees: the testimony on this claimed expense was entirely inconsistent and leaves no basis upon which to accept or allow this expense (*see* Finding of Fact 34-cc), and the same is therefore disallowed.

dd) accounting fees: petitioner's testimony concerning the accounting fees and the manner in which the accounting matters for the Store were handled supports allowance of the amounts claimed. No conclusion is made herein as to the "value" ultimately derived from the manner in which such services were performed by petitioner's former accountant during the years

at issue.

ee) real property taxes: the evidence, including petitioner's testimony concerning the manner in which real property taxes were paid to the landlord (Pasquale, LLC) coupled with the cancelled checks supports allowance of the amounts claimed.

ff) rent expense: the Division allowed this expense based on its review of the lease for the Store premises (*see* Finding of Fact 24-ff). It is noted that the amounts allowed by the auditor exceed the amounts claimed (*compare* Finding of Fact 23-ff and Exhibit 8-a, b, c *to* Finding of Fact 24-ff). A copy of the lease was not included in evidence. The noted amount differences presumably result from the terms of the lease as reviewed by the auditor.

gg) repairs/maintenance: petitioner's testimony concerning the significant damage resulting from the leak in the premises above the Store supports allowance of the amounts claimed (*see* Finding of Fact 34-gg).

hh) employee salaries: the auditor allowed these claimed expenses. It is noted that the amounts allowed by the auditor exceed the amounts claimed (*compare* Finding of Fact 23-hh and Exhibit 8-a, b, c, *to* Finding of Fact 24-hh). The increased amount allowed is not explained in the record.

ii) sales tax: the auditor allowed the amounts claimed by petitioner (*see* Finding of Fact 24-ii).

jj) shipping: while it would appear some cost for shipping would have been incurred by the Store, the testimony provides no basis upon which to assign any amount to this category for any of the years in issue and the claimed amounts are therefore disallowed.

kk) supplies: petitioner's testimony regarding these claimed expenses supports allowance of the same. The items involved included storage containers for merchandise not on display, display shelving and lighting, and the purchase of a replacement sound system for the Store, all of which items are clearly reasonable and necessary to allow for the operation of a retail establishment such as the Store. It is specifically noted that the amount allowed by the Division as "decorating expense" (*see* Finding of Fact 26-kk) is included as part of the amount herein allowed for supplies (*see* Finding of Fact 26, n 9).

ll) telephone expense: the auditor allowed a portion (\$984.00) of the claimed telephone expense for 2009 (only), with the notation "based on

American Express” (*see* Finding of Fact 26-ll).¹⁵ Given that the use of a telephone is clearly necessary for the operation of a retail business such as the Store, as is tacitly evident from the auditor’s allowance, is reasonable to allow a portion of the claimed expense for each year. The allowable portion shall be based on the percentage of claimed cost allowed by the auditor for 2009 ($\$984.00 \div \$2,104.00 = 46.77\%$), and shall be calculated by applying such percentage to the claimed telephone costs for 2010 (\$1,604.14) and 2011 (\$1,155.02) (*see* Finding of Fact 23-ii). As calculated, the allowable amount shall be \$750.26 (for 2010) and \$540.20 (for 2011).

mm) travel: based on petitioner’s testimony, it is concluded that business travel to and from France was an ordinary and necessary expense of conducting the Store’s business. At the same time, the record includes no details as to any other travel expenses. Further, for at least one of the years, it appears that petitioner included the flight costs for her children as part of the Stores’s claimed travel expenses, under the position that she could not leave her children alone at home while she traveled to Europe (*see* Finding of Fact 34-mm). The described circumstances, while likely difficult, do not serve to convert personal expenses to deductible business expenses. Thus, only petitioner’s travel expenses may be allowed as business expenses. Based on the evidence provided, it is appropriate to allow 100% of the airfare cost of two round trip Paris/New York flights and 75% of the airfare cost of one additional round trip Paris/New York flight (the mixed business/family August trip) as business expenses. At a cost of \$1,125.00 per round trip flight, the allowable amount for each year shall be \$3,093.75, with the further proviso that the allowable amount for 2010 shall be capped at the lesser amount claimed for such year, i.e., \$2,763.65 (*see* Findings of Fact 23-mm and 34-mm).

oo) utilities: the evidence in the record supports allowance of the amounts paid to Consolidated Edison for the provision of utilities, as is born out by the Division’s allowance of a portion of such claimed expense for 2009 (only) (*see* Finding of Fact 26-oo).¹⁶ However, the amounts claimed also include recurring payments to two individually-named recipients (Brian Everett and Porian Everett), with no evidence or explanation in the record

¹⁵ The \$2,579.76 amount claimed for 2009, per Exhibit 8-a (*see* Finding of Fact 23-ll) exceeds the \$2,104.00 amount claimed, as set forth on the Division’s review calculations for such year (*see* Finding of Fact 26-ll). This difference was not addressed or explained in the record.

¹⁶ The \$2,023.68 amount claimed for 2009, per Exhibit 8-a (*see* Finding of Fact 23-oo) is less than the \$4,196.00 amount claimed, as set forth on the Division’s review calculations for such year (*see* Finding of Fact 26-oo). This substantial difference in the amount claimed was not addressed or explained in the record.

concerning the named recipients or the purpose for such payments. Accordingly, allowable utilities expense amounts for each year shall be \$1,503.68 (for 2009), \$1,831.08 (for 2010) and \$2,123.45 (for 2011), calculated as the amounts claimed (*see* Finding of Fact 23-oo) less the amounts paid to the two named individuals (*see* Finding of Fact 34-oo).

pp) workers' compensation insurance: review of the evidence reflects payments to the New York State Insurance Fund for workers' compensation insurance (*see* Finding of Fact 34-pp), and the amounts claimed therefore are properly allowable.

K. In view of the foregoing, the amounts of claimed business expenses that are allowable in reduction of the Store's gross profit amounts (*see* Finding of Fact 21) are the following:

REF.	EXPENSE	2009	2010	2011
a	Advertising	\$0.00	\$0.00	\$0.00
b	Alarm	\$1,236.88	\$1,076.70	\$1,076.66
c	Automobile	\$0.00	\$0.00	\$0.00
d	Bank service fees	\$125.00	\$0.00	\$0.00
e	Clothing	\$0.00	\$0.00	\$0.00
f	Employee commissions	\$3,023.97	\$3,685.41	\$8,428.23
g	Computer/Internet	\$452.55	\$1,324.06	\$2,340.17
h	Depreciation	\$0.00	\$0.00	\$0.00
I	Disability insurance	\$0.00	\$0.00	\$0.00
j	Donations	\$0.00	\$0.00	\$0.00
k	Dues/Subscriptions	\$0.00	\$0.00	\$0.00
l	Filing fees	\$0.00	\$0.00	\$0.00
m	Fines/Penalties (tax)	\$0.00 (NYS & NYC)	\$0.00 (Federal)	\$0.00
n	Gifts	\$44.65	\$150.00	\$487.56
o	Insurance	\$2,342.51	\$2,438.22	\$2,535.79
p	Interest expense	\$0.00	\$0.00	\$0.00
q	Janitor	\$0.00	\$0.00	\$0.00
r	Legal fees	\$0.00	\$675.00	\$0.00

s	Local travel	\$0.00	\$0.00	\$0.00
t	Meals/Entertainment	\$0.00	\$0.00	\$0.00
u	Miscellaneous	\$0.00	\$0.00	\$0.00
v	Corp. tax (NYC)	\$0.00	\$0.00	\$0.00
w	Corp. Tax (NYS)	\$0.00	\$0.00	\$0.00
x	Office supplies	\$801.01	\$2,296.84	\$1,379.00
y	Officer salaries	\$12,000.00	\$11,602.00	\$13,015.00
z	Payroll processing fees	\$691.00	\$723.53	\$729.57
aa	Postage	\$1,709.00	\$1,415.47	\$1,562.26
bb	Printing	\$150.00	\$317.00	\$97.98
cc	Professional fees	\$0.00	\$0.00	\$0.00
dd	Accounting fees	\$3,040.00	\$2,437.50	\$8,460.00
ee	Real property taxes	\$1,498.60	\$2,831.11	\$4,659.76
ff	Rent expense	\$79,800.00	\$82,507.00	\$83,149.00
gg	Repairs/maintenance	\$32.57	\$5,356.06	\$2,344.10
hh	Employee salaries	\$11,478.67	\$12,823.00	\$13,015.00
ii	Sales tax	\$1,032.07	\$2,934.00	\$15,156.19
jj	Shipping	\$0.00	\$0.00	\$0.00
kk	Supplies	\$4,455.85	\$4,412.25	\$4,532.50
ll	Telephone	\$984.00	\$750.26	\$540.20
mm	Travel	\$3,093.75	\$2,763.65	\$3,093.75
nn	Uniforms	\$0.00	\$0.00	\$0.00
oo	Utilities	\$1,503.68	\$1,831.08	\$2,123.46
pp	Workers comp. insurance	\$737.36	\$788.54	\$453.70
-----	TOTAL	\$130,232.45	\$145,138.68	\$169,179.88

L. In light of the conclusions set forth above, the Store's net profit amounts are recalculated as follows:

YEAR	2009	2010	2011
Income (Sales)	\$373,500.37	\$408,808.33	\$481,536.82
- Cost of Goods Sold	(\$169,754.16)	(\$220,952.49)	(\$285,808.45)
Gross Profit	\$203,746.21	\$187,855.84	\$195,728.37
- Expenses Allowed ¹⁷	(\$130,232.45)	(\$145,138.68)	(\$169,179.88)
Net Profit	\$73,513.76	\$42,717.16	\$26,548.49

M. The recalculated net profit amounts set forth above are to be carried over to petitioner's personal income tax returns, and used by the Division in recalculating and reducing petitioner's tax liability for the years at issue, consistent with the manner of recalculation and reduction performed earlier by the Division (*see* Finding of Fact 27).

N. The petition of Dominique Simonneaux is granted to the extent provided above at Conclusions of Law J and K, as the same are summarized in Conclusion of Law L but is otherwise denied; the notices of deficiency, dated March 20, 2013, as initially modified by the Division (*see* Finding of fact 27) are to be further modified as directed herein in accordance with Conclusions of Law L and M; and the notices, as so modified, together with penalties (as recalculated) and interest, are sustained.

DATED: Albany, New York
April 14, 2016

/s/ Dennis M. Galliher
ADMINISTRATIVE LAW JUDGE

¹⁷ It is recognized that the amount of business expenses allowed for 2010 exceeds those shown as claimed on the Store's reconstructed profit and loss statement for 2010 (*compare* Finding of Fact 23 *to* Conclusions of Law J and K). This difference is attributable to including amounts allowed by the Division for certain items where no expense amount was claimed by petitioner (e.g., officer salaries; *compare* Findings of Fact 24-y and 25 *to* Finding of Fact 23-y), and to certain items where the expense allowed by the Division was greater than the expense claimed by petitioner (e.g., employee salaries, rent expense; *compare* Finding of Fact 24-hh, ff and 25 *to* Finding of Fact 23-hh, ff).