STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
MYRA MAYO	:	DETERMINATION DTA NO. 826259
for Redetermination of a Deficiency or for Refund of New York State and New York City Personal Income Tax under Article 22 of the Tax Law and the New York City Administrative Code for the Years 2009 through 2011.	:	

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

A hearing was held before Arthur S. Bray, Administrative Law Judge, in New York, New York, on July 22, 2015 at 10:30 A.M., with all briefs due by November 23, 2015, which date began the six-month period for the issuance of this determination. Petitioner appeared pro se. The Division of Taxation appeared by Amanda Hiller, Esq. (Kent Gebert, Esq., of counsel).

ISSUE

Whether it was proper for the Division of Taxation to assert a deficiency of personal income tax without first performing certain steps including sending an "inquiry letter" or conducting an audit.

FINDINGS OF FACT

1. Petitioner, Myra Mayo, filed a New York State Resident Income Tax Return for the year 2009 wherein she reported wage income of $63,426.78. Petitioner's tax return included a federal Schedule C, Profit or Loss From Business, that reported a loss from the business of "[p]hotography products and services" in the amount of $50,692.00.

2. Petitioner filed a New York State Resident Income Tax Return for the year 2010 wherein she reported wage income of $66,210.29. Petitioner's tax return included a federal Schedule C that reported a loss from the photography business in the amount of $45,848.00.

3. Petitioner filed a New York State Resident Income Tax Return for the year 2011 wherein she reported wages in the amount of $71,461.38. As in the prior years, petitioner's return included a federal Schedule C that reported a loss from the photography business in the amount of $48,718.21.

4. In the course of its activities, the Audit Division of the Division of Taxation (Division) ascertained that certain taxpayers were filing returns with false business losses on a federal Schedule C in order to eliminate their taxable income. In order to determine who was engaging in this activity, the Division generated computer reports that listed more than a thousand taxpayers. Petitioner's name was included in these reports.

5. It was the Division's opinion that petitioner was not carrying on a business for profit. In particular, the Division considered it questionable that an individual would engage in a business, year after year, that incurred substantial losses.

6. The Division issued a document to petitioner labeled "New York State tax bill, statement of proposed audit change," dated January 24, 2013, explaining that the Division

disallowed the business loss claimed on her income tax return for 2009 because it was unable to verify the business loss. The document advised petitioner that, if she disagreed with the Division's determination, she should "submit documentation, including canceled checks, receipts, business bank accounts records, etc. to substantiate the business loss claimed on your return and a detailed description of the income and expenses." In addition to the foregoing, the Division imposed penalties pursuant to Tax Law § 685(b)(1) and (2) for negligence and Tax Law § 685(p) for substantial understatement of her tax liability.

7. On January 23, 2013 and January 16, 2013, the Division issued statements of proposed audit change to petitioner for the tax years 2010 and 2011, respectively. In each instance, the documents were labeled, in part, "New York State tax bill" and explained that the Division was unable to verify the business losses reported on the respective returns. For the year 2011, the Division also stated that it was unable to verify the federal adjustments to income for student loan interest. For each year, the Division disallowed the business losses and for 2011 the Division disallowed the claimed federal adjustment to income. For the year 2010, penalties were imposed pursuant to Tax Law § 685(b)(1) and (2) for negligence and Tax Law § 685(p) for substantial understatement of her tax liability. For the year 2011, a penalty was imposed pursuant to Tax Law § 685(p) for substantial understatement of her tax liability. Each of the latter two statements advised petitioner that if she disagreed, she should submit documentation to substantiate the business loss claimed on her return along with a detailed description of the income and expenses.

8. Petitioner was not advised that an audit had been initiated until she received the statements of proposed audit changes. The statements also stated that, "You received this bill

because: We reviewed your income tax return and any response to our inquiry letter and found that you have a balance due." In fact, petitioner did not receive an inquiry letter and, as a result, did not respond to the same. Because of health concerns, she found it difficult to respond to the statements of proposed audit changes by providing any substantiation of her business losses.

9. On or about February 10, 2013, petitioner mailed a letter to the Division stating that she has supporting documentation for every year she filed taxes and that she found it puzzling that the Division made a determination without asking to examine her documentation before making a decision. Petitioner stated that she believed that every audit first requires a request for back-up documentation prior to making a determination. The letter also stated that she is a very busy mother of two who had the flu for a week during this period. She works, operates a business and manages a household. Therefore, she requested more time to respond. Petitioner also pointed out that many businesses are not successful in their first year and that photographers needed time to develop their work and market themselves to become known. She has wanted a photography business for a long time and the process is not quick or easy. Petitioner notes that there had been a growth in revenues during the years 2009 through 2012 and that, as a result of cutting costs, she expected profitability in 2014 if not in 2013. With respect to the Division's request for canceled checks and business bank account records, petitioner explained that she experienced a number of difficulties with banks in the past and that, as a result, she prefers using cash for revenues and expense transactions. She finds that operating with cash is simple, reliable, free of fees and offers ease of use. Petitioner's letter stated that it included annual summaries, prepared by her accounting firm, of her expenses. However, the exhibit in the record does not include these summaries.

10. On April 23, 2013, the Division mailed a response to petitioner's letter stating that, based upon the substantial losses from the business since 2005, the Division determined that the business was not carried on for profit. After reciting some of the factors that are taken into account in determining whether petitioner was carrying on an activity for profit, the Division noted that petitioner did not provide any evidence of sales tax collection or any invoices or receipts that corresponded to the reported sales. The Division further noted that it could not verify the cash payments of any of petitioner's expenses. Consequently, the Division considered the assessments to be correct.

11. On the basis of the statements of proposed audit changes, the Division issued to petitioner a series of notices of deficiency each asserting a deficiency of tax, penalty and interest as follows:

Year	Date Issued	Tax	Interest	Penalty	Balance Due
2009	04/02/13	$6,200.28	$1,543.58	$1,490.30	$9,234.16
2010	05/22/13	$7,510.95	$1,276.57	$1,408.22	$10,195.74
2011	03/04/13	$6,238.35	$425.30	$623.80	$7,287.45

12. The Division did not conduct an examination of petitioner's books and records prior to the issuance of the notices of deficiency.

13. The Division conducts audits in a number of different ways depending on the situation and the information presented. When the Division issued the statements of proposed audit changes, it was in the process of conducting an audit and offering petitioner an opportunity to submit documentation.

CONCLUSIONS OF LAW

A. Petitioner has raised numerous arguments regarding the audit procedure that was employed in this case. Relying upon information obtained from the Division's website, petitioner submits that the required procedure was not followed and, therefore, the notices of deficiency must be canceled. According to petitioner, an audit must be conducted in the following prescribed fashion. Initially, an inquiry letter is sent notifying a taxpayer of an impending audit. Thereafter, the Division will ask the taxpayer for information. A follow-up letter will be sent if there is no response. After an analysis of the documentation, the Division will issue a statement of proposed audit changes. A taxpayer may challenge the findings. A notice of deficiency may only be issued on the basis of an examination. Petitioner surmises that when the Division sent the statement of proposed audit changes to her, the audit was concluded and, since the audit was concluded, she did not have to submit any documentation. According to petitioner, there was no examination of books and records and without an examination, there cannot be a determination of a deficiency. In this vein, petitioner maintains that statements of audit changes are not inquiry letters or a request, but a bill to be paid. Further, even if they were an inquiry letter, she did not have sufficient time to respond. On the basis of the foregoing, petitioner believes that the notices of deficiency are invalid and should be canceled. Petitioner posits that the Division is precluded from contesting the accuracy of the information on its website and that inquiry letters are required by due process.

B. Petitioner's reliance upon the Division's website to conclusively fix how an audit must be conducted in all cases is misplaced. The information set forth on the website is generic and

not intended to provide tax advice to all taxpayers in all situations.[1] As the testimony of the auditor explained, there are many different ways of conducting an audit depending upon the circumstances. This conclusion is particularly evident in this case.

C. It is a settled principle of law that there is no requirement that the Division request and examine books and records before issuing a notice of deficiency to assert a deficiency of personal income tax (***Matter of Ragozin***, Tax Appeals Tribunal, July 22, 1993). The only element that is required is that there be a rational basis for the issuance of the notice of deficiency (***see Matter of Fortunato***, Tax Appeals Tribunal, February 22, 1990).

D. Nearly identical arguments to those raised by petitioner were presented in ***Ragozin***. In that case, the taxpayer received a Statement of Audit Changes asserting a deficiency of personal income taxes based upon a discrepancy between the amounts reported on the federal return and the New York return. Thereafter, the taxpayer sent a letter to the Division that explained that the adjustment was based upon a purported federal audit of the taxpayer's 1987 income tax return. However, the taxpayer insisted that a federal audit of his 1987 return did not take place. Subsequently, the Division issued a notice of deficiency which was challenged on the ground that there was no basis for the assessment. Prior to and at the hearing, the representative for the Division requested that petitioner provide him with a copy of his federal return in order to try to resolve the discrepancy between the federal return and the state return. Petitioner refused to provide the return contending that the deficiency must be canceled because it was based on a purported federal audit that never occurred. Petitioner also refused

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[1] Petitioner's reliance upon the phrase "applicable published guidance" to support her position is misplaced. This phrase, found in Tax Law § 3030(c)(5)(B)(iv), applies to an application for costs, which is not at issue in the current matter.

to address the basis for the deficiencies. Following a hearing, the administrative law judge concluded that the Division is not required to request and examine books and records before asserting a deficiency of personal income tax, that a notice of deficiency must have a rational basis, and, that the discrepancy between the federal and state returns provided the rational basis for the issuance of the notice of deficiency. On appeal, the Tax Appeals Tribunal found no reason for modifying the determination of the administrative law judge and affirmed for the reasons stated in the determination.[2]

E. As set forth above, the question presented is whether the Division had a rational basis for issuing the notices of determination. Here, it is clear that the Division had a rational basis for concluding that further review of petitioner's returns was necessary because petitioner's repeated reporting of substantial losses may support a conclusion that petitioner was not operating the business for profit. Since petitioner did not offer any documents to support her reporting of income and expenses, it was rational for the Division to proceed by issuing notices of deficiency (***see*** 20 NYCRR 158.1[a]).

F. Relying upon Tax Law §§ 681 and 697(b)(1), petitioner contends that the Division was required to conduct an audit. This position is mistaken as neither section requires an audit. Rather, Tax Law § 681 authorizes the issuance of a notice of deficiency and Tax Law § 697(b)(1) authorizes the Division to conduct an audit. Neither section requires an audit in all instances.

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[2] A new issue was raised on appeal regarding whether the statement of audit changes and notice of deficiency were properly mailed. The Tribunal declined to consider this issue since it was raised for the first time on appeal.

G. Petitioner received a series of documents labeled "New York State tax bill." Petitioner has focused upon this language to support her argument that the audit was concluded without giving her an opportunity to be heard. Petitioner submits that the statement of proposed audit changes was not a request or an inquiry letter but a bill to be paid. Unfortunately, petitioner's argument overlooks the remainder of the document. Directly below the term "tax bill," the document is further identified as a "Statement of *proposed* audit change (emphasis added)." The third page of the document asked petitioner to substantiate the business loss and provide a detailed description of the income and expenses. It is evident from the Division's inquiry that the audit was not concluded at the time the statement of proposed audit changes was issued and that the Division was withholding a decision on whether petitioner was properly reporting her income and expenses until it had an opportunity to review her supporting documentation. Accordingly, petitioner's argument that the Division reached its decision without giving her an opportunity to respond is rejected as contrary to the evidence.

H. Petitioner contends that she has the substantiation to prove her income and expenses, but she did not need to produce it because an inquiry letter was never sent and an audit was not conducted. However, as set forth above, petitioner had an opportunity to offer supporting documentation and chose not to utilize it prior to the issuance of the notices of deficiency, after the notices of deficiency were issued or at the hearing. Under the circumstances, petitioner failed to satisfy her burden of proof of establishing that the notices were incorrect and, therefore, the notices of deficiency must be sustained (***see Matter of Geller***, Tax Appeals Tribunal, August 20, 1998).

I. Petitioner presented evidence and argument pertaining to the years 2012, 2013 and 2014 in an attempt to show that the proper approach is to send an inquiry letter at the outset of an audit. This argument is also without merit. As set forth above, there is no prescribed way that the Division must proceed in all cases. Regardless of what occurred with respect to the years 2012, 2013 and 2014, there is no requirement that a notice of deficiency be preceded by an audit or an inquiry letter. Further arguments pertaining to the years 2012 through 2014 will not be addressed because they are beyond the scope of the petition.

J. Petitioner submits that she did not receive 30 days to respond to the Statement of Proposed Audit Changes for 2009 and therefore the statement is invalid. According to petitioner, this makes the Notice of Deficiency invalid. This argument is also without merit. The New York State Tax Law does not make any provision for a statement of proposed audit changes and, therefore, there is no legal requirement that a taxpayer have 30 days to respond to such statement.

K. Petitioner maintains that a lack of profit motive is not in issue because a lack of a profit motive was not mentioned in the statement of proposed audit changes, notice of deficiency or answer. The record shows that the Division requested substantiation of petitioner's income and expenses in the statement of proposed audit adjustment. This request is permitted by Tax Law § 658(a) and 20 NYCRR 158.1. If such records had been forthcoming, the Division could have explored whether the income and expenses were substantiated and then whether petitioner was operating her business for profit (***see, e.g., Matter of Temple***, Tax Appeals Tribunal, July 8, 2004). However, having failed to produce

books and records, the question of whether petitioner was operating for profit was never reached and petitioner has not demonstrated any prejudice.

L. Petitioner states that Tax Law § 3003 requires the Division to state the basis for the adjustment and give 30 days to respond. In fact, this section expressly provides that an inadequate description does not invalidate a notice. Moreover, it does not require that the taxpayer be given any particular period of time for responding to a statement of proposed audit changes.

M. Petitioner argues that the Division violated Tax Law § 3004, which requires the Division to explain the audit process before the audit starts. Petitioner's position is mistaken. Tax Law § 3004(a)(1) requires that the Division describe the rights of the taxpayer and the obligations of the Division. Here, the statements of proposed audit changes clearly state what petitioner should have done if she disagreed with the proposed audit changes. Accordingly, the requirements of this section have been satisfied.

N. Petitioner contends that the conduct of the conciliation conferee reflected a bias in favor of the Division. The concerns regarding the conciliation conference will not be addressed because conciliation conferences are in the nature of settlement negotiations and not subject to review in the Division of Tax Appeals (Tax Law § 170[3-a][f]; ***see Matter of Petak v. Tax Appeals Tribunal***, 217 AD2d 807 [1995]; ***Matter of Sandrich, Inc.***, Tax Appeals Tribunal, April 15, 1993).

O. Petitioner points out that while the case was pending collection action was commenced against her.[3] Collection activities will also not be addressed because they are

[3] The representative for the Division caused the collection action to stop pending the proceeding before the Division of Tax Appeals.

beyond the jurisdiction of the Division of Tax Appeals (***Matter of Hogan***, Tax Appeals Tribunal, November 25, 2009).

P. As set forth above, penalties were imposed pursuant to Tax Law § 685(b)(1) and (2) for negligence and additional interest on a deficiency or portion of a deficiency attributable to negligence, and Tax Law § 685(p) for a substantial understatement of tax liability. In order for the penalties to be abated, petitioner is required to establish reasonable cause as well as the absence of willful neglect (***see Matter of Baird v. State Tax Commn.,*** 102 AD2d 958 [1984]; ***Matter of Miller v. State Tax Commn.,*** 94 AD2d 841 [1983]). Petitioner did not meet her burden. The record shows that petitioner has not produced any documentation with regard to her income and expenses. As a result, the imposition of penalties must be sustained (***Matter of Karlinsky***, Tax Appeals Tribunal, March 23, 1989).

Q. Petitioner contends that the penalties and interest are excessive and violate constitutional guarantees against excessive fines. Petitioner's asserted liability for penalty and interest is based on the statutes cited above. In effect, this argument asserts that the statues are unconstitutional on their face. This argument may not be addressed because the Tax Appeals Tribunal's enabling legislation does not encompass such a challenge (***Matter of Unger***, Tax Appeals Tribunal, March 24, 1994; ***Matter of Fourth Day Enters.***, Tax Appeals Tribunal, October 27, 1988.)

R. The petition of Myra Mayo is denied and the notices of deficiency, dated March 4, 3013, April 2, 2013 and May 22, 2013 are sustained together with such penalties and interest as are lawfully due.

DATED: Albany, New York
April 21, 2016

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE