STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
MICHAEL STRACHAN	:	DETERMINATION DTA NO. 826530
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law and the New York City Administrative Code for the Year 2009.	:	

Petitioner, Michael Strachan, filed a petition for redetermination of a deficiency or for refund of personal income tax under article 22 of the Tax Law and the New York City Administrative Code for the year 2009.

A hearing was held before Donna M. Gardiner, Administrative Law Judge, in New York, New York, on February 5, 2016 at 10:00 A.M., with all briefs to be submitted by July 26, 2016, which date began the six-month period for the issuance of this determination. Pursuant to Tax Law § 2010(3), this period was extended for three months. Petitioner appeared by The Eisman Law Firm, PC (Clyde Jay Eisman, Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (Tobias A. Lake, Esq., of counsel).

ISSUE

Whether petitioner has established that he is a real estate professional and is entitled to claim a deduction in the amount of $73,769.00 for losses incurred from rental real estate activities for the tax year 2009.

FINDINGS OF FACT

1. Petitioner, Michael Strachan, is a New York resident and filed a New York personal income tax return (form IT-201) for the year 2009. Petitioner's form IT-201 reflects a federal adjusted gross income of $243,644.00 and a New York State adjusted gross income of $236,727.00.

2. Attached to his form IT-201 for the year 2009 was form Schedule E, wherein petitioner claimed a deduction in the amount of $73,769.00 for losses from rental real estate activities. The Division of Taxation (Division) conducted an audit of his return to determine whether petitioner qualified as a real estate professional and, if so, whether he was entitled to the claimed deduction.

3. By letter dated October 15, 2012, the Division requested that petitioner provide documentation demonstrating that he qualified as a real estate professional. This letter requested information concerning petitioner's occupation such as: a description of his occupation that was NOT related to his rental real estate activities, the total number of hours worked in that occupation during the tax year, the physical addresses of all rental properties listed on federal Schedule E and the number of rental units in each property, the dates that all units were rented, and the name of the property manager. Additionally, the Division requested a list of services performed and hours attributable to those services such as: appointment books, calendars, or narrative summaries to support hours claimed, any other records to support the hours attributable to the rental activities and a copy of Form 8582, Passive Activity Loss Limitations, if such form was filed with the Internal Revenue Service (IRS).

4. Petitioner submitted the following to the Division on audit: a letter dated October 20, 2012, which stated that petitioner was the lead architect for a company called OMG BI

(Omnicom Media Group or OMG).[1] The letter set forth that petitioner worked 37.5 hours per week, for a total of 1,950 hours, which included his vacation time. Petitioner stated that he performed real estate activities such as tenant interviews and service appointments during hours spent working for OMG. Through his employment at OMG, petitioner was responsible for seven employees who reported directly to him, and these seven employees also had OMG employees who reported to them, and as a result, petitioner claimed that he had a lot of free time to do other things during his full-time work schedule at OMG.

5. Petitioner provided a second letter to the Division, also dated October 20, 2012, that stated that none of petitioner's rental properties had a property manager. Petitioner argues that he was solely responsible for all management and repair work. Petitioner's response stated that the only property for which he kept a detailed work log was for the 665 Pennsylvania Avenue, Brooklyn, property, because this property required most of his time due to its size. Attached to this letter were work logs in the form of Microsoft Excel spreadsheets that petitioner claims reflected the amount of time that he spent doing work to his various properties.

6. The work logs submitted by petitioner consist of five spreadsheets, each with the address of one of petitioner's five rental properties listed at the top of the page. These work logs state the number of hours worked at each location as follows:

Property location in Brooklyn	Hours worked for 2009
665 Pennsylvania Avenue	2,089
970 East 32nd Street	95
1386 East 37th Street	86
Property location in Orlando, FL	Hours worked for 2009

[1]Petitioner testified that he was director of global business intelligence at OMG.

8074 Old Grove Road	12
6595 Grosvenor Lane	82

7. After reviewing the documentation provided, the Division denied the claimed deductions and issued a Statement of Proposed Audit Changes to petitioner, dated January 23, 2013, for tax in the amount of $9,056.63 plus interest, which explained that rental real estate activities are generally passive activities and losses therefrom are not permitted to offset nonpassive income. This Statement of Proposed Audit Changes (Exhibit D) stated that in order for rental real estate losses to offset nonpassive income, a taxpayer must either be a real estate professional or have a modified adjusted gross income of less than $150,000.00. As set forth in Finding of Fact 1, petitioner's modified adjusted gross income exceeded $150,000.00, thus, petitioner must establish that he was a real estate professional in order to claim the deductions.

8. The Statement of Proposed Audit Changes set forth the requirements to be considered a real estate professional, and it specifically addressed the documents reviewed and the Division's reasons for concluding that petitioner failed to establish that he was a real estate professional, in pertinent part, as follows:

> "1. More than half of your personal services must be in real property businesses.
>
> 2. You must work more than 750 hours annually in real property businesses. Additionally, you must materially participate in EACH separate rental real estate activity unless a written election was filed with the ORIGINAL RETURN to treat all real estate rentals as one single activity.
>
> You stated in your reply that you worked at OMG BI as a lead architect for 1,725 hours, if vacation time is not included. You also stated that you interviewed tenants and made service appointments while working at OMG BI. The hours you spent interviewing tenants and making service appointments while working at OMG BI cannot be claimed.
>
> In our inquiry letter, we requested you provide the dates each rental unit in each property was rented. You stated that all units were rented 100% of the time or

vacant during tenant transition. We need to know the actual dates each unit was rented.

You provided a summary of hours worked on each rental property; however, there is not enough detail in the summary to determine if the hours are allowable. Therefore, we need a more detailed time log of the activities that you performed for each rental property. An acceptable time log would include an entry for each day and it would include the date you performed the activity, a description of the activity and the amount of time spent on the activity. You are required to provide proof of the activities performed and hours attributable to those activities as indicated in federal regulation 1.469-5T(f)(4).

Please note that the following hours are not allowed to be claimed:

- travel time (analogous to personal commute)
- work which may have been performed by a contractor or other person
- renovation time if the property was not leased at that time

In order to determine if you meet the real estate professional tests for 2009, we must compare the amount of time you spent on your main job to the amount of time you spent on your rental properties. Since we are unable to determine the amount of time you spent on your rental properties, we are unable to determine if you meet the real estate professional tests. Additionally, you must also materially participate in each separate rental property" (Exhibit D).

9. By letter dated February 3, 2013, petitioner provided additional documentation, consisting of 55 pages, in response to the Statement of Proposed Audit Changes. This response, Exhibit L, contained more detailed information regarding the properties than the initial response provided by petitioner in October of 2012 to the Division's request for information. The last 16 pages of this exhibit reflect the year-end summary of transactions for card member "Michael F. Strachan" from "Blue from American Express/January 1, 2009 to December 31, 2009." Petitioner refers to this year-end summary as receipts, which is not accurate. The year-end summary merely reflects amounts charged to his credit card. Although the vendor is displayed in the summary, there is no way to determine what each charge reflects. In other words, without the ability to review receipts, it is unclear what was purchased, making it impossible to determine if

it related to the claimed real estate activities. Moreover, petitioner did not testify whether this credit card was exclusively used for the rental properties.

After reviewing this packet of documents, the Division concluded that this submission contained information that was significantly different from the work logs submitted on October 20, 2012.

10. A Notice of Deficiency, No. L-039021137, dated April 2, 2013, was issued to petitioner for additional tax due in the amount of $9,056.63 plus interest. No penalty was assessed.

11. The Division issued petitioner a Notice of Assessment Resolution dated April 15, 2013. This correspondence reiterated the requirements for qualifying as a real estate professional in order to be entitled to the deduction claimed. Moreover, the correspondence further explained the Division's position, in pertinent part, as follows:

> "According to the time logs provided with your protest dated 02/03/13, the total time you spent working on the rentals was 1,483 hours. In your original reply dated 10/20/12, you stated you spent 2,364 hours working on the rentals and 1,725 hours spent working at [OMG]. Additionally, the hours you stated for each property in your protest did not match the hours claimed in your original reply.
>
> Based on the time provided in your protest, you would not meet test one of the real estate professional qualification. Additionally, we noted numerous discrepancies between the time logs.
>
> In the original time log provided, you stated that you renovated all units in your rental property at 665 Pennsylvania Ave, Brooklyn for six of the twelve months in 2009. However, the renovations were not listed in the time log provided with your protest. In the original time log provided, you stated that you spent 15 hours in January and 20 hours in February on an eviction for the property at 665 Pennsylvania Ave, Brooklyn; however, the listing of tenants sent with your protest showed the eviction was in October.
>
> The original time log for 665 Pennsylvania Ave, Brooklyn did not list any time for snow removal, but the protest listed many hours for snow removal.

> The time log provided with your protest stated you were in Florida on 12/30/09 & 12/31/09, however, the protest also stated that you were in Brooklyn replacing a thermostat, working with a vendor for smoke detector and boiler service. The time log provided with your original reply stated you were in Florida on 07/09/09, however, the protest stated you were in Brooklyn replacing windows and snaking sewer lines.
>
> Based on the above information, the hours listed in both time logs are questionable" (Exhibit N, unnumbered page 2).

12. By letter dated April 17, 2013, petitioner responded to the Notice of Assessment Resolution. Petitioner's correspondence sought to clarify the discrepancies between the work logs submitted on October 20, 2012 and the documents submitted on February 3, 2013.

13. On August 7, 2013, a conciliation conference was held by the Bureau of Conciliation and Mediation Services (BCMS) and, by order dated August 8, 2014, the Notice of Deficiency was sustained in full. After receiving the conciliation order, petitioner sent further correspondence to the Division that stated, in pertinent part:

> "I later found out that the NYS Audit agent went to [a] federal IRS agent in the same complex and presented [an] old incorrect log that I have always disputed (it was sent to the state audit in error from [an] old PC that crashed and was incomplete. I have provided documentations [sic] and receipts with the correct log to prove time spent) the agent would not accept or look at correct log with proof" (Exhibit P).

This was the first time that petitioner blamed a computer malfunction for the discrepancies between the two logs submitted on audit. Moreover, no receipts were provided.

14. Petitioner testified at the hearing. He addressed the issue regarding the two work logs presented and, in fact, submitted a third set of documents that he claimed were the most reliable. When asked why the initial log was only five pages in length, petitioner testified several times that he misunderstood the request for information by the Division. Petitioner stated that he thought that the Division was requesting summaries and not detailed information. This

contention is not credible. The Division asked for detailed documentation on numerous occasions. The Division explained exactly how the submitted information fell short of the proof required. At no point was there any miscommunication - the Division's requests for documents was clear and petitioner failed to comply.

15. Petitioner also claimed to keep very detailed logs, by inputting information contemporaneously into his cellphone, which he then entered into an Excel spreadsheet. He claimed that he was unable to print out the spreadsheet due to the fact that the output would be wide, i.e. wider than standard letter-sized paper. Petitioner states that he converted the information to a PDF format in order to print it. Moreover, petitioner stated that the Division required that the information be presented to it in paper form and it could not be supplied through email communication.

16. Petitioner proposed 20 findings of fact which have been renumbered and substantially incorporated into the findings of fact except for fact number 4, which is deemed irrelevant to the tax year 2009 and fact numbers 5, 8, 11 - 14, which are not properly included in the findings of fact, as they are more in the nature of conclusions to be reached in this determination. Moreover, fact numbers 15, 16 and 18 contain information set forth in exhibits submitted into evidence and, rather than reproduce the language in its entirety, this information has been summarized and referred to in the Findings of Fact above where necessary.

CONCLUSIONS OF LAW

A. This case involves whether petitioner is entitled to claim a deduction for real estate activities. "Whether and to what extent deductions shall be allowed depends upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed" (***New Colonial Ice Co. v. Helvering***, 292 US 435, 440 [1934]). The taxpayer bears the burden of

demonstrating that he has met all the requirements necessary to be entitled to the claimed deductions (***see Moss v. Commissioner of Internal Revenue***, 135 TC 365 [2010]).

B. Taxpayers are allowed deductions for certain business and investment expenses under Internal Revenue Code (IRC) §§ 162 and 212. Section 469(a) of the IRC generally disallows any passive activity loss, defined as the excess of aggregate losses from all passive activities for the taxable year over the aggregate income from all passive activities for the year (***see*** IRC § 469[d][1]). A passive activity is any trade or business in which the taxpayer does not materially participate (IRC § 469[c][1]). For the purposes of section 469 and to the extent provided in regulations, a trade or business includes any activity with respect to which expenses are allowable as a deduction under section 212 (IRC § 469[c][6][B]). Rental activity is usually treated as a per se passive activity regardless of whether the taxpayer materially participates (IRC § 469[c][2], [4]). Material participation is defined as involvement in the operations of the activity that is regular, continuous, and substantial (IRC § 469[h][1]).

C. An exception to the rule that a rental activity is per se passive is found in IRC § 469(c)(7). If the taxpayer qualifies as a real estate professional, the taxpayer's rental real estate activity is treated as a trade or business subject to the material participation requirements of section 469(c)(1) (***see*** Treas Reg § 1.469[e][1]).

A taxpayer may qualify as a real estate professional if:

> "(i) more than one-half of the personal services performed in trades or businesses by the taxpayer during such taxable year are performed in real property trades or businesses in which the taxpayer materially participates, and
>
> (ii) such taxpayer performs more than 750 hours of services during the taxable year in real property trades or businesses in which the taxpayer materially participates" (IRC § 469[c][7][B]).

Only time spent in those businesses in which the taxpayer materially participates count toward the requisite 750 hours. A taxpayer materially participates in an activity if he or she works on a regular, continuous and substantial basis in operations (IRC § 469[h][1][A] - [C]).

The regulation at 26 CFR § 1.469-5T(f)(4) provides the types of proof to be used in determining the extent of an individual's participation in an activity as follows:

> "The extent of an individual's participation in an activity may be established by any reasonable means. Contemporaneous daily time reports, logs, or similar documents are not required if the extent of such participation may be established by other reasonable means. Reasonable means for purposes of this paragraph may include but are not limited to the identification of services performed over a period of time and the approximate number of hours spent performing such services during such period, based on appointment books, calendars, or narrative summaries."

D. As set forth above, in order to determine whether a taxpayer qualifies as a real estate professional, the inquiry begins with a description of a taxpayer's occupation that is not related to the real estate activities. This analysis allows the Division to understand what a taxpayer's primary employment involves on a day-to-day basis and, then, to view the claimed real estate tasks and duties, in an effort to view a full picture of both income producing activities.

Petitioner states that his occupation at OMG required roughly 1,700 hours of his time, excluding vacation days and holidays from a 37.5 hours per week schedule for a 52-week work year. Petitioner further argues that since his job did not require his full attention for 37.5 hours/week, he was able to perform many tasks for his real estate activities. However, any work performed during his OMG work day cannot be counted towards satisfying his time requirement to qualify as a real estate professional (***see Moss v. Commissioner of Internal Revenue***).

In reviewing the exhibits, there are three different work logs that became increasingly more detailed as time went by. For this reason, it is determined that the work logs are simply

unreliable. It cannot be found that the information contained within the logs was contemporaneously maintained. It is inconceivable that petitioner's recollection of purchases and repairs on five rental properties would be clearer in 2016, when he testified, rather than in 2012 and 2013 when presenting the information on audit. For this reason, it is determined that petitioner's testimony lacked credibility.

Likewise, petitioner's testimony with respect to changing the format of his Excel spreadsheet in order to print the information does not make any sense (***see*** Finding of Fact 15). There is ample ability to print out Excel spreadsheets. The only reason to change document formats is if the recipient of an email does not have the software to open a document. Since petitioner stated that the Division would not accept email transmissions, his explanation for his failure to supply the requested, detailed information is without merit.

E. Accordingly, the petition of Michael Strachan is denied and the Notice of Deficiency, No. L-039021137, dated April 2, 2013 is sustained.

DATED: Albany, New York
February 9, 2017

/s/ Donna M. Gardiner
ADMINISTRATIVE LAW JUDGE