

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
LIZET RUBINOS	:	
	:	DETERMINATION
	:	DTA NO. 826859
for Redetermination of a Deficiencies 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 2010 and 2011.	:	

Petitioner, Lizet Rubinos, filed a petition for redetermination of a deficiencies 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 2010 and 2011.

A hearing was held before Barbara J. Russo, Administrative Law Judge, in New York, New York, on April 14, 2016, at 10:30 A.M., with all briefs to be submitted by September 1, 2016, 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. (Christopher O'Brien, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation properly disallowed expense deductions from Subchapter S losses reported by petitioner for tax years 2010 and 2011.

II. Whether petitioner has established grounds for abatement of penalties in this matter.

FINDINGS OF FACT

1. Petitioner, Lizet Rubinos, timely filed New York State resident income tax returns for the years 2010 and 2011. On petitioner's 2010 return, she reported wage income in the amount of \$16,166.00, business loss of \$343.00, and loss from an S Corporation in the amount of \$1,356.00, resulting in total federal adjusted gross income of \$14,467.00. Attached to petitioner's 2010 return was a Schedule K-1 from Lizet Rubinos, Inc., reporting petitioner as the sole shareholder and showing a business loss of \$1,356.00. Also attached to petitioner's 2010 return was a Schedule C, Profit or Loss from Business, on which petitioner listed her sole proprietorship by the name of "Philips-Van Heusen Corp.," listed the principal business as "tailor," reported gross income of \$1,500.00, deducted expenses for depreciation of \$1,843.00, and reported a net loss in the amount of \$343.00.

Petitioner's 2011 return reported wage income in the amount of \$37,597.00 and partnership income from Rubinos Holdings in the amount of \$46.00. Line 6 of the return, business income or loss, is blank. Attached to the 2011 return was a Schedule K-1 for Rubinos Holdings, and a Schedule E, reporting income of \$46.00 from the partnership Rubinos Holdings and no income or loss from the S Corporation Lizet Rubinos, Inc. Also attached to petitioner's 2011 return was a Schedule C for Philips-Van Heusen Corp., which reported gross income of \$15,357.00, depreciation expenses of \$4,400.00, tentative profit of \$10,957.00, and expenses for business use of home in the amount of \$10,957.00, resulting in zero net profit. Petitioner attached Form 8829, Expenses for Business Use of Your Home, to the 2011 return, wherein she reported that 40.03% of her home was used exclusively for business.

2. The Division of Taxation (Division) audited petitioner's 2010 and 2011 income tax returns and the 2010 and 2011 New York S corporation franchise tax returns for Lizet Rubinos, Inc. By correspondence dated March 25, 2013, the Division requested that petitioner provide the following: the exact address of all property owned by the S Corporation; a copy of the federal form 1120S, U.S. Income Tax Return for an S Corporation (S Corporation return); a detailed explanation of the exact nature of the business; copies of the documents that were used to calculate the income reported on the S Corporation return, including all books and records as well as a description of the source and nature of the income; detailed documentation such as sales slips, invoices, bank statements or receipts, supporting the expenses claimed on the S Corporation return; a breakdown of the amount reported on the S Corporation return, line 19, "Other Deductions," including verifiable documentation to support the amount claimed; a description of assets or property being depreciated or amortized, including a detailed schedule showing the depreciation or amortization calculation, a description of what method was used and the computation for determining the depreciable basis, and an explanation of how the property is used in petitioner's business; and copies of any licenses, registrations or certifications that were required for the business.

3. Petitioner did not respond to the Division's request for information, and by correspondence dated April 29, 2013, the Division informed petitioner, as shareholder of Lizet Rubinos, Inc., that the expenses claimed on the New York S Corporation returns for 2010 and 2011 had been disallowed. The correspondence further stated that any adjustments made to the S Corporation returns might result in adjustments to petitioner's personal income tax returns. The correspondence stated that if petitioner disagreed with the determination, she could provide the requested documentation for the Division to review.

4. Petitioner did not provide the requested information and on May 7, 2013, the Division issued statements of proposed audit change (Statement) to petitioner for the years 2010 and 2011.

5. The Statement for 2010 stated, in part, as follows:

“A 2010 audit conducted on Lizet Rubinos, Inc. resulted in the disallowance of the expenses reported on Lizet Rubinos Inc.’s 2010 S-corporation return. This ultimately resulted in the increase of the income reported on the return.

Since an S-corporation is considered a flow-through entity, meaning all income or loss is reported on the shareholder’s personal income tax returns, any adjustments to the S-corporation return directly result in adjustments to the shareholder’s personal income tax return.

The figure reported on your 2010 personal income tax return from the above S-corporation has been adjusted to reflect the changes made to Form CT-3-S, filed for the above S-corporation for tax year 2010.

Your corrected Federal Adjusted Gross Income is \$97,684.00.

The above adjustment resulted in the disallowance of the New York Earned Income Credits claimed on your return.”

The Statement asserted tax due for 2010 in the amount of \$9,265.79, plus penalties in the amount of \$2,054.82 pursuant to Tax Law § 685(b)(1), (2), and (p), and interest.

6. The Statement for 2011 contained similar language to the 2010 Statement (*see* Finding of Fact 5), but instead referenced the 2011 audit conducted on Lizet Rubinos, Inc., which resulted in the disallowance of the expenses reported on the 2011 S Corporation return. Based on the disallowance, the Division adjusted petitioner’s 2011 personal income tax return, and determined corrected federal adjusted gross income in the amount of \$108,488.00. The Statement asserted tax due for 2011 in the amount of \$7,703.62, plus penalties in the amount of \$1,438.29 pursuant to Tax Law § 685(b)(1), (2), and (p), and interest.

7. The Division issued a Notice of Deficiency to petitioner, dated June 24, 2013, asserting tax due in the amount of \$9,265.79, plus interest and penalties for tax year 2010.

8. The Division issued another Notice of Deficiency to petitioner, dated June 24, 2013, asserting tax due in the amount of \$7,703.62, plus interest and penalties for tax year 2011.

9. During the tax years at issue Lizet Rubinos, Inc., was an S corporation for both federal and New York State income tax purposes. All of the stock of Lizet Rubinos, Inc., was owned by petitioner. All of the income and losses of Lizet Rubinos, Inc., passed through for income tax purposes to petitioner and were required to be reported on her personal income tax returns for the years at issue.

10. Lizet Rubinos, Inc., is a tailoring business that makes and alters clothing for photo shoots on commercial fashion shows and makes or alters costumes for Broadway tours. Petitioner testified that the work is seasonal, and that for larger jobs, she hires additional contractors for the S corporation, who bring their own sewing machines and other equipment to the job.

11. The only documentation presented by petitioner during the hearing were three emails regarding her former accountant, John Cisneros, CPA. Petitioner did not present any documentation during the hearing to substantiate the claimed S corporation expenses, and was granted additional time following the hearing to submit such documentation. Within the time provided following the hearing, petitioner provided the following for tax year 2010: Form 1120S, US Income Tax Return for an S Corporation for Lizet Rubinos, Inc.; Chase Bank statements for Lizet Rubinos, Inc.; a one-page schedule attached to the Chase Bank statements wherein petitioner listed expense categories and amounts by month; a copy of a check register for the Chase Bank account; TD Bank statements for Lizet M. Rubinos; a one-page schedule attached to the TD Bank statements wherein petitioner listed expense categories and amounts by month; a copy of the check register for the TD Bank account; a two-page customer balance

detail; forms 1099-MISC, miscellaneous income returns issued from Lizet Rubinos, Inc., to various individuals reporting nonemployee compensation; four invoices billed to Lizet Rubinos, Inc., for payments to some of the individuals included in the 1099-MISC forms; and a copy of her residential apartment lease.

12. The 2010 Federal S Corporation return for Lizet Rubinos, Inc., reported gross receipts of \$81,861.00, less deductions totaling \$83,217.00 (consisting of depreciation in the amount of \$20,582.00 and other deductions in the amount of \$62,635.00), for a total reported loss of \$1,356.00.

13. Attached to the 2010 S Corporation return was a 2010 Asset Detail Report for the claimed depreciation in the amount of \$20,582.00. The Asset Detail Report lists depreciation for automobiles as follows:

Description	Date Acquired	Cost/ Basis	Business Use	Prior Depreciation	Current Depreciation	Date Sold	Sales Price	Gain/Price
2007 Toyota - in service 2007 ¹	01/07	16,000	100	8,192		01/10	8,500	692
Nissan Rogue - in service 2009 ²	10/09	35,000	100	6,870	13,300			

¹ Attached to petitioner's 2010 personal income tax return, in a 2010 Asset Detail Report to the Schedule C for Philips-Van Heusen Corp., petitioner reported the same 2007 Toyota, indicating that the vehicle was put in service for the Schedule C business in 2007, and claiming depreciation for the vehicle as a deduction to the Schedule C business income for 2010 in the amount of \$1,843.00. The Asset Detail Report for the Schedule C business also shows prior depreciation of \$11,392.00. Petitioner claims on the Asset Detail Report to the Schedule C that the Toyota was used 100% for the business of Philips-Van Heusen Corp., while claiming on the S Corporation Asset Detail Report that the Toyota was used 100% for the business of Lizet Rubinos, Inc.

² Included in the record is a Retail Agreement to Provide Insurance indicating that petitioner and Imre Nemeth were the purchasers of the Nissan Rogue. It is further noted that for 2011, petitioner claimed depreciation for the Nissan as a deduction from her Schedule C business income, and reported that the vehicle was used 100% for the Schedule C business (*see* Finding of Fact 18).

Mitsubishi - in service 2009	01/09	3,000	100	1,050	780			
Mazda - in service 2010	01/10	32,510	100		6,502			
Form totals		86,510		16,112	20,582		8,500	692

14. Attached to the 2010 S Corporation return was a detail for Line 19 - Other Deductions, which broke down the claimed other deductions totaling \$62,635.00 by expense category. The business expense deductions reported on the 2010 S Corporation return for other deductions differ in both amount and expense categories from those petitioner listed on the schedules attached to the submitted bank statements. The expenses listed by petitioner on the Chase and TD Bank schedules total \$84,404.69, compared with the total expenses for “other deductions” of \$62,635.00 reported on the S Corporation return. Petitioner provided no explanation for the discrepancies. The expense categories and amounts as listed on the 2010 S Corporation return in comparison with those listed on the schedules petitioner attached to the bank statements for 2010 are as follows:

Expense	Amount Listed on S Corporation Return	Amount Listed on Chase Bank Schedule	Amount Listed on TD Bank Schedule
Accounting	\$1,500.00		
Auto Expense:			
Gas	\$2,685.00	\$1,182.59	\$246.47
Insurance	\$2,914.00		
Repairs/Maintenance	\$67.00		
Auto Finance		\$6,000.00	
Bank Charges	\$285.00	\$99.00	

Check			\$3,300.00 ³
Dues & Subscriptions	\$145.00		
Entertainment & Promotion	\$3,024.00		
Ipad		\$803.50	
Insurance		\$2,914.30	
Laundry & Cleaning	\$320.00		
Meals	\$510.00 (\$1,019.00 at 50%)	\$700.00	\$431.74
Media Research	\$98.00		
Office Expense	\$2,872.00	\$667.83	
Outside Service	\$42,727.00		
Park		\$206.00	\$189.50
Petty Cash		\$1,118.00	\$1,523.35
Postage	\$96.00	\$52.78	\$121.80
Professional Fee		\$1,174.50	\$895.00
Rent			\$13,600.00 ⁴

³ On the schedule attached to the TD Bank statements, petitioner indicated “check” expenses for February as “#350 - \$700 Amex2,” March as “#353 - \$400 Amex2,” April as “#358 - \$830.00 Amex2,” May as “#362 - \$600 Amex2,” June as “#364 - \$100 Amex 2,” and July as “#367 - \$700 Amex2,” totaling \$3,300.00 for 2010. A review of the TD Bank check register with the corresponding check numbers reveals the following: check number 350 in the amount of \$700.00 paid to Imre Nemeth for “Amex,” check number 353 in the amount of \$400.00 paid to Imre Nemeth for “Amex,” check number 358 in the amount of \$830.00 paid to Imre Nemeth for “Amex & Airline Tix,” check number 362 in the amount of \$600.00 paid to Imre Nemeth for “Amex & Car,” check number 364 in the amount of \$100.00 paid to Imre Nemeth for “Amex,” and check number 367 in the amount of \$700.00 paid to “IM” for “Amex.” There was no testimony or documentary evidence presented as to the business purpose for these expenses.

⁴ On the schedule attached to the TD Bank statements, petitioner claimed rent expenses for the months of February, March, May, July, September, October, November and December 2010, in the amount of \$1,700.00 per month, totaling \$13,600.00. The check register shows payments to Alejandra Rubinos for these amounts. Petitioner did not provide any testimony or documentary evidence regarding the business purpose for rent expenses in relation to Lizet Rubinos, Inc. Petitioner submitted a copy of her residential apartment lease which provides that she and another individual, Imre Nemeth, are cotenants of a three-bedroom residential apartment with monthly rent of \$1,700.00. The landlord listed on the lease is Alejandra Rubinos. The lease provides that “[n]o retail, commercial or professional use of the Premises is allowed unless the Tenant receives prior written consent of the Landlord” According to petitioner’s claim for the earned income credit, along with petitioner and Mr. Nemeth, petitioner’s daughter resided at the apartment in 2010, and petitioner’s daughter and son resided with her and Mr. Nemeth in

Self		\$12,110.00	
Software		\$703.43	
Supplies	\$97.00	\$23.66	\$242.99
Telephone ⁵	\$2,024.00	\$703.43	\$1,456.28
Tolls		\$357.37	\$600.00
Travel	\$2,283.00		
Transportation	\$988.00	\$1,519.85	\$45.00
1099		\$32,089.75	

15. The 1099-MISC forms, bank record of check payments to the individuals listed on the 1099-MISC forms, and invoices reflect the following payments for 2010:

1099-MISC Recipient	Nonemployee Compensation per 1099-MISC	Record of Check Payment	Invoice Information	Invoice Date	Invoice Amount
Raul Zevallos	\$1,897.00	\$1,897.00	None		
Belkie E Soto	\$3,200.50	\$3,200.50	for Jen Kao Show	9/11/10	\$3,200.50
Erin B Roth	\$940.00	\$940.00	None		
Manuel Rivera	\$1,968.00	\$1,968.00	None		
Arias Mejias	\$2,100.00	\$2,100.00	None		
Francisca Jimenez	\$980.00	\$980.00	for Jen Kao Show	9/11/10	\$980.00
Soule Golden	\$3,330.00	\$1,440.00	None		

2011. It is further noted that on petitioner's 2010 Schedule C for the business "Philips-Van Heusen Corp.," petitioner claimed 40.03% business use of her home, and carried over an expense in the amount of \$3,752.00 from 2010 to her 2011 personal income tax return, whereon she deducted an expense for business use of her home totaling \$10,957.00 (including the 2010 carry over) on the 2011 Schedule C for Philips-Van Heusen Corp.

⁵ On the schedules attached to the Chase and TD Bank statements, this expense category is listed as "mobile," which apparently refers to a mobile (or cellular) telephone.

Artie J. Brown	\$550.00	\$550.00	None		
Malynda Hasandocaj	\$720.00	\$420.00	for Bloomingdale Photo Shoot	12/11/10	\$300.00
Siria Lemagne	\$840.00	\$840.00	None		
Consuelo Minchola	\$1,890.00	\$1,890.00	None		
Paulina Rodriguez	\$2,170.00	\$2,170.00	None		
Alejandra Rubinos	\$18,095.00	\$18,095.00	for Jen Kao Show	11/30/10	\$13,193.75
Frances Torres	\$610.00	\$610.00	None		
Grace Zhang	\$1,230.00	\$1,230.00	None		
TOTALS	\$40,520.50	\$38,330.50			\$17,674.25

16. The two-page customer balance detail for 2010, which also contains the written label “Income Summary” indicates accounts receivable amounts totaling \$18,568.75 and balance totaling \$20,068.75. At the end of the document is handwriting stating, “invoice total: 92,534.80” and “payment received: 73,966.55.” No backup documentation was provided and there is no explanation why the amounts are inconsistent with the amount reported as gross receipts on the 2010 Federal S Corporation return for Lizet Rubinos, Inc. (*see* Finding of Fact 12).

17. Within the time provided following the hearing, petitioner provided the following for tax year 2011: an amended Schedule K-1 for Lizet Rubinos, Inc., reporting petitioner as 100% shareholder and reporting no income or loss; a 2011 Asset Detail Report for petitioner’s Schedule C business; invoices dated March 3, 2011 from Marsh & Fried Holdings, LP, in the

amount of \$1,670.00 for the preparation of petitioner's 2010 personal income tax return, and in the amount of \$1,200.00 for the preparation of Lizet Rubinos, Inc.'s, 2010 S Corporation return;⁶ Chase Bank statements for Lizet Rubinos, Inc.; a one-page schedule attached to the Chase Bank statements wherein petitioner listed expense categories and amounts by month; a copy of a check register for the Chase Bank account; TD Bank statements for Lizet M. Rubinos; a one-page schedule attached to the TD Bank statements wherein petitioner listed expense categories and amounts by month; a copy of the check register for the TD Bank account; a two-page customer balance detail; forms 1099-MISC, miscellaneous income returns issued from Lizet Rubinos, Inc., to various individuals reporting nonemployee compensation for 2011; six invoices billed to Lizet Rubinos, Inc., for payments to some of the individuals included in the 1099-MISC forms; a copy of a Retail Agreement to Provide Insurance, dated September 29, 2009, to Nissan Motor Acceptance Corporation, listing petitioner and Imre Nemeth as purchasers of a 2010 Nissan Rogue; and a press release from the New York County District Attorney stating that tax preparer John Cisneros was indicted for preparing fraudulent tax returns between 2009 and 2014. Petitioner did not submit the 2011 Form 1120S, U.S. Income Tax Return for Lizet Rubinos, Inc., and such return is not a part of the record herein.

18. The 2011 Asset Detail Report submitted by petitioner is the same as that attached to her 2011 personal income tax return as a detail to her Schedule C business, Philips-Van Heusen Corp., and lists the following:

⁶ There is no evidence of a payment of the invoice for the preparation of the corporate return in the check registers or bank statements submitted. Petitioner also submitted an invoice dated October 15, 2012 for the preparation of Lizet Rubinos, Inc.'s, 2011 S Corporation return. Since the invoice date is subsequent to the years at issue herein, it will not be considered in rendering this determination.

Description	Date Acquired	Cost/Basis	Business Use	Prior Depreciation	Current Depreciation	Date Sold	Sales Price	Gain/Price
2010 Nissan - in service 2011 ⁷	01/11	22,000	100		4,400			
2007 Toyota - in service 2007	01/07	16,000	100	13,235				
Form totals		38,000		13,235	4,400			

Petitioner deducted depreciation expenses in the amount of \$4,400.00 on the 2011 Schedule C for Philips-Van Heusen Corp. There is no evidence in the record as to whether petitioner claimed depreciation for any vehicles as a deduction to the S Corporation’s income for 2011, as petitioner failed to submit the 2011 S Corporation return into the record.

19. The expense schedules submitted by petitioner for 2011, attached to the bank statements for the Chase and TD Bank accounts, list the following expenses:

Expense	Amount Listed on Chase Bank Schedule	Amount Listed on TD Bank Schedule
Tolls	\$326.50	\$585.00
Transportation	\$580.30	
Meals & Entertainment	\$1,687.97	\$337.76
Petty Cash	\$1,362.00	\$1,899.70
Check		\$20,619.00 ⁸

⁷ The Nissan was purchased by petitioner and Imre Nemeth and in 2010 petitioner reported that the vehicle was used 100% for her S Corporation (*see* Finding of Fact 13). For 2011, petitioner reported that it was used 100% for the Schedule C business.

⁸ On the schedule attached to the TD bank statements for 2011, petitioner indicated “check” expenses as follows: January “#379 - \$219 Union dues;” February “#380 - \$1700 Rent” and “#383 - \$1700 Rent;” April “#386 - \$1700 Rent;” May “#387 - \$1700 Rent;” June “#388 - \$1700 Rent” and “#389 - \$1700 Rent;” July “#391 - \$1700 Rent;” September “#392 - \$1700 Rent” and “#393 - \$1700 Rent;” October “#394 - \$1700 Rent,” and December

Professional Fee	\$1,715.00	
Park	\$1,906.91	
Supplies	\$57.46	
Mobile	\$1,624.79	
Gas	\$1,476.51	
Forms 1099	\$37,205.69	
Auto Finance	\$6,000.00	
Postage	\$75.67	
Insurance	\$2,975.30	
Self	\$5,000.00	
Bank Fee	\$22.00	
Auto Registration	\$135.00	
Auto Maintenance	\$2,309.16	
Dues	\$135.00	
Equipment	\$300.00	
Travel	\$171.71	
Laptop	\$16,320.04	
Total expenses claimed on post-hearing submission ⁹	\$81,387.01	\$23,441.46

20. The 1099-MISC forms, bank record of check payments to the individuals listed on the 1099-MISC forms, and invoices reflect the following payments for 2011:

“#397 - \$1700 Rent” and “#398 - \$1700 Rent.” The check register for the TD Bank account indicates that the claimed rent expenses were paid to Alejandra Rubinos. The rent appears to be for petitioner’s residential apartment (*see* Footnote 4). In addition to claiming the residential rent as an expense deduction for Lizet Rubinos, Inc., petitioner also claimed a portion of the rent as a deduction in 2011 for the business use of her home for her Schedule C business, Philip-Van Heusen Corp. (*id.*)

⁹ It is noted that petitioner did not submit the 2011 Form 1120S, U.S. Income Tax Return for Lizet Rubinos, Inc., and as such, it is unknown whether the expenses claimed on the schedules submitted by petitioner in her post-hearing submission are consistent with amounts claimed on the S Corporation return.

1099-MISC Recipient	Nonemployee Compensation per 1099-MISC	Record of Check Payments	Invoice Information	Invoice Date	Invoice Amount
Alejandra Rubinos	\$11,327.50	\$11,327.50	- Givenchy, Bally, Reed, Krakross - Reed Kakoff Show	8/24/11 11/20/11	\$5,280.00 \$4,097.50
Jen Rong Chen	\$1,412.50	\$1,412.50	- Yigal Fashion Show - Jen Kao Show and Sherri Hill Show	6/30/11 9/14/11	\$287.50 \$1,125.00
Paulina Rodriguez	\$943.90	\$943.90	None		
Soule Golden	\$2,965.50	\$2,965.50	None		
Maylinda Hasandacaj	\$855.00	\$855.00	None		
Clara Reyes	\$875.00	\$875.00	Jen Kao Show	9/8/11	\$875.00
Lydia Witt	\$760.00	\$760.00	None		
Livia Barrant	\$2,006.13	\$2,006.13	None		
Paula Redinger	\$720.00	\$720.00	Sherri Hill Project	9/19/11	\$720.00
Caitlin Evans	\$6,419.32	\$6,419.32	None		
TOTALS	\$28,284.85 ¹⁰	\$28,284.85			\$12,385.00

21. The two-page customer balance detail submitted by petitioner for 2011 contains the handwritten label “Income Summary” and indicates accounts receivable amounts totaling

¹⁰ It is noted that the total amount of nonemployee compensation based on the 1099-MISC forms submitted for 2011 differs from the amount of claimed “1099” expenses listed by petitioner on the schedule attached to the 2011 Chase bank statements (*see* Finding of Fact 19). Petitioner provided no explanation for the discrepancy.

\$8,824.50. At the end of the document is handwriting that states, “invoiced: \$60,660.48” and “payments received: \$69,374.73.” No backup documentation was provided to support the claimed income amount.

CONCLUSIONS OF LAW

A. 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 Matter of Leogrande v. Tax Appeals Tribunal*, 187 AD2d 768 [3d Dept 1992], *lv denied* 81 NY2d 704 [1993]; *Matter of Tavolacci v. State Tax Commn.*, 77 AD2d 759 [3d Dept 1980]; Tax Law § 689[e]). Petitioner carries the burden of proof to overcome the tax assessments in this proceeding, and accordingly, it is incumbent upon her to prove entitlement to the business deductions of her wholly-owned Subchapter S corporation and the losses resulting therefrom (Tax Law § 689[e]).

B. 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 (IRC) 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, Lizet Rubinos, Inc., filed as an S Corporation for federal and state tax purposes and as a result the S Corporation's income and losses are passed through to its shareholders and

are taken into account by them in determining their individual tax liability (Tax Law § 617). Such was the case here, where petitioner reported the losses from her S Corporation on her personal income tax returns for the years at issue. In this case, then, in order to maintain the deductions for the business expenses claimed by Lizet Rubinos, Inc., 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]).

C. 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]). Moreover, IRC § 274(d) applies a more strict substantiation requirement for certain business expenses, including, among other things, expenses for travel, tolls, meals, entertainment, 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]).

D. Petitioner argues that she relied on her former accountants, Mr. Cisneros and others, to provide her records to the Division. She contends that her former accountants assured her that the matters were being taken care of, but that they then became unresponsive to her calls. It is clear from the record that the Division made written requests for the records of petitioner’s S Corporation and that no records were provided during the audit. As a result of petitioner’s and her representative’s failure to provide any records to support the S Corporation’s claimed expenses, the Division denied the expenses reported on the S Corporation’s returns for the years at issue, which in turn resulted in the issuance of the notices of deficiency against petitioner. Petitioner was given the opportunity to present records during the hearing in this matter, at which time she presented only three emails regarding her former accountants, and gave very limited testimony regarding her business. Petitioner requested and was given additional time subsequent to the hearing to present documentation to support her claimed expenses. Petitioner provided limited, and largely unorganized, documentation within the time allowed after the hearing, as described in Findings of Fact 11 through 21.

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]).

The Tribunal’s finding is particularly on point here, where petitioner not only did not provide records during the audit (albeit, perhaps due to the inattentiveness or neglect of her former representative) but also failed to provide any meaningful testimony and documents during the hearing in an effort to explain and substantiate the claimed deductions. The records submitted post-hearing were incomplete and could not be traced in large part to the corporate tax returns. The bank statements were without explanations that connected the expenditures noted therein to a business function of Lizet Rubinos, Inc. Both the S Corporation’s and petitioner’s personal bank accounts appeared to be used interchangeably for both personal and claimed business expenses, and the deductions were unsubstantiated by any additional source documentation, save for a few invoices as noted (*see* Findings of Fact 11, 15, 17 and 20).

Many of the deductions are, at best, highly suspect due not only to lack of substantiation but also blatantly improper reporting methods by double-claiming certain expenses as both a deduction for the Schedule C business and the S Corporation. Specifically, petitioner claimed rent expenses on the S Corporation return for the months of February, March, May, July,

September, October, November and December 2010, in the amount of \$1,700.00 per month, totaling \$13,600.00. For 2011, petitioner claimed rent expenses for the S Corporation totaling \$20,400.00. The evidence in the record shows that the rent is for petitioner's residential apartment, which she shares with Imre Nemeth and her children. While claiming 100% of the residential rent as a business deduction for the S Corporation for eight months in 2010, and twelve months in 2011, she also claimed a deduction for a portion of the rent for her Schedule C business, Philips-Van Heusen Corp., claiming that 40.03% of the home was used for its business purposes. Petitioner failed to provide any evidence supporting her claim that the residential apartment was used to any extent for either business, and improperly double-deducted the same unsubstantiated expenses for both businesses. As such, claimed deductions for rent expenses is disallowed.

Similarly, petitioner claimed deductions for depreciation of multiple vehicles, and failed to provide the requested support for the deductions including an explanation of how the property was used in petitioner's business. Petitioner reported that some of the same vehicles were used 100% for the business purpose of her Schedule C business while at the same time used 100% for the S Corporation. In particular, for 2010 petitioner reported that a 2007 Toyota was used 100% for her Schedule C business since 2007, and claimed a depreciation deduction against the Schedule C business's income for 2010. Yet on the 2010 Asset Detail Report for the S Corporation, the same Toyota was reported as being in service for the S Corporation since 2007, was used 100% for the S Corporation, and was sold by the S Corporation in 2010. Petitioner also claimed a depreciation deduction on the 2010 S Corporation return for a Nissan Rogue, claiming 100% business use of the vehicle for the S Corporation. The record shows that this vehicle was owned individually by petitioner and Imre Nemeth, rather than being owned by the S

Corporation, thus evidencing a disregard for corporate formalities. Additionally, on the 2011 Asset Detail Report for the Schedule C business, petitioner reported a depreciation deduction for what appears to be the same Nissan, claiming that it was used 100% for her Schedule C business, Philips-Van Heusen Corp. Given petitioner's failure to meet her burden of proving a business purpose for the vehicles, or that the vehicles were property of the S Corporation for depreciation purposes, all depreciation deductions claimed by the S Corporation for the years at issue are disallowed.

E. With regard to the remaining claimed expenses, the types and dollar amounts of each of the S Corporation's claimed business expenses have been reviewed in light of the substantiating documentary evidence provided by petitioner and the limited testimony presented by her at hearing. In many instances, where a given claimed expense amount appears as a credit card charge or check payment on the bank statements provided, the same could be viewed as either a personal expense or a business expense. As noted above, petitioner provided little testimony at hearing, describing only that she sometimes hired contractors as temporary help to perform seasonal work for the S Corporation. No other business purposes was described for the other claimed expenses.

Careful review of all of the evidence submitted results in the allowance of claimed business expenses for nonemployee compensation as documented by the 1099-MISC, miscellaneous income returns issued by Lizet Rubinos, Inc., that are supported by the bank statements and check registers showing that payment was, in fact, made by the S Corporation. Specifically, petitioner has met her burden of proving that Lizet Rubinos, Inc., incurred expenses for nonemployee compensation in the amounts of \$38,330.50 for 2010, and \$28,284.85 for 2011. Petitioner's testimony that she hired temporary contractors for the S corporation to do seasonal

work, together with the documentary evidence consisting of the 1099-MISC returns supported by the check payments confirming the amounts paid, establishes the business purpose and amount of the expense claimed.

F. Regarding the remaining claimed expenses, petitioner provided no evidence to show the business purpose for the expenses in relation to the S Corporation. Other than the bank statements and check registers, no source documentation such as invoices, ledgers, logs, or other evidence was provided to substantiate the business purpose and claimed amounts. In addition, petitioner failed to meet the heightened requirements of IRC § 274(d) to substantiate the listed business expenses, including, among other things, expenses for travel, tolls, meals, entertainment, and cellular telephone expenses (IRC §§ 274[d][4]; 280F[d][4][A]). Accordingly, the claimed expenses of petitioner's S Corporation for all remaining categories, other than nonemployee compensation as discussed in Conclusion of Law E, are disallowed.

G. Penalties were imposed by the Division pursuant to Tax Law § 685(b)(1) and (2) for negligence or intentional disregard of Article 22 of the Tax Law, and Tax Law § 685(p), for substantial understatement of the income tax liability for each of the tax years in issue. The penalties imposed under Tax Law § 685(p) may be waived, in full or in part, if there was reasonable cause for the understatement and the taxpayer acted in good faith. Petitioner did not allege the impropriety of such penalties, nor introduce any evidence to support their abatement. Petitioner contends that she relied upon her accountants and assumed they were taking care of her tax matters, but has not shown that she made any effort to ensure that the S Corporation's records were provided to the Division, despite repeated requests sent by the Division to petitioner during the audit. Petitioner also presented no evidence of pursuing other efforts to provide the requested records after she was unable to contact her former accountants. Petitioner was given

the opportunity both during the hearing and within time allowed following the hearing to provide the requested documentation to support the claimed expenses, yet failed to provide complete records. Indeed, petitioner failed to even provide the S Corporation return for 2011, from which the flow-through deductions arose. As such, petitioner has failed to show reasonable cause for the understatement and that she acted in good faith, and accordingly the penalties are proper.

H. The petition of Lizet Rubinos is granted to the extent provided in Conclusion of Law E, but is otherwise denied, and the notices of deficiency dated June 24, 2013, as modified in accordance with Conclusion of Law E, are sustained.

DATED: Albany, New York
February 23, 2017

/s/ Barbara J. Russo
ADMINISTRATIVE LAW JUDGE