

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
of	:	
<b>ALEXANDER AND CHRISTINA LES</b>	:	<b>DETERMINATION</b> <b>DTA NO. 827190</b>
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Year 2009.	:	

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Petitioners, Alexander and Christina Les, filed a petition for redetermination of a deficiency or for refund of personal income tax under article 22 of the Tax Law for the year 2009.

A hearing was held before Barbara J. Russo, Administrative Law Judge, in New York, New York, on January 11, 2017 at 10:30 A.M., with all briefs to be submitted by May 10, 2017, which date began the six-month period for the issuance of this determination. Petitioner appeared by Greenberg & Merola, LLP (Jerry A. Merola, Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (Tobias A. Lake, Esq., of counsel).

***ISSUES***

- I. Whether petitioners have established that petitioner Christina Les qualifies as a real estate professional.
- II. Whether petitioners have substantiated claimed business expense deductions.

***FINDINGS OF FACT***

1. Petitioners, Alexander and Christina Les, jointly filed a New York nonresident and part-year resident personal income tax return (form IT-203) for the year 2009. Petitioners' form

IT-203 reflects wage income in the amount of \$212,888.00 for federal purposes and \$191,394 for New York State purposes, federal adjusted gross income of \$140,646.00 (federal amount) and \$193,754.00 (New York amount), and a New York State adjusted gross income of \$191,394.00.<sup>1</sup> Petitioners claimed a deduction of \$84,934.00 from rental real estate activities.

2. Attached to petitioners' form IT-203 for the year 2009 was form Schedule E, wherein they claimed a deduction in the amount of \$84,934.00 for losses from rental real estate activities. Petitioners listed three properties, to wit: 336 6<sup>th</sup> Street, Saddle Brook, New Jersey, which petitioners reported as a two family home;<sup>2</sup> 254 Wilson Avenue, Paramus, New Jersey, which petitioners reported as a single family home; and 464 Dewey Avenue, Unit A, Paramus, New Jersey, which petitioners reported as "rental property 1000." The Schedule E reports income and expenses for the three properties as follows:

	336 6 <sup>th</sup> Street	254 Wilson Ave	464 Dewey Ave	TOTALS
Rents Received	\$14,400.00	\$44,400.00	\$39,350.00	\$98,150.00
Advertising	\$723.00	\$401.00	\$0.00	\$1,124.00
Auto and Travel	\$723.00	\$0.00	\$0.00	\$723.00
Insurance	\$0.00	\$971.00	\$903.00	\$1,874.00
Legal & Professional Fees	\$900.00	\$0.00	\$0.00	\$900.00
Mortgage Interest	\$11,443.00	\$42,097.00	\$21,037.00	\$74,577.00

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<sup>1</sup> Form W-2 Wage and Tax Statements attached to petitioners' return indicates that Alexander Les received wages from Barclays Capital in the amount of \$191,394.00 and from Advance Dermatology of New Jersey in the amount of \$3,089.00, and that Christina Les received wages from Paige Applebaum Farkas in the amount of \$18,405.00. Petitioners testified that Mrs. Les, and not Mr. Les, worked for Advanced Dermatology of New Jersey and submitted a compensation report to that effect (*see* Finding of Fact 17), but the only Form W-2 in the record is from Advance Dermatology of New Jersey and lists Mr. Les as the employee and contains his social security number. There was no explanation for the discrepancy.

<sup>2</sup> Petitioners used half of the two-family home at 336 6<sup>th</sup> Street as their primary residence in 2009. However, on line 2 of the Schedule E, which asks whether the properties were for personal use, petitioners answered "no" for all three properties.

Repairs	\$1,167.00	\$5,465.00	\$3,287.00	\$9,919.00
Taxes	\$3,802.00	\$14,291.00	\$10,841.00	\$28,934.00
Utilities	\$130.00	\$0.00	\$0.00	\$130.00
Depreciation expense	\$6,309.00	\$21,541.00	\$37,296.00	\$65,146.00
Total Expenses	\$24,954.00	\$84,766.00	\$73,364.00	\$183,084.00
Income or Loss	(\$10,554.00)	(\$40,366.00)	(\$34,014.00)	(\$84,934.00)
Total Income or Loss				(\$84,934.00)

3. The Division of Taxation (Division) conducted an audit of petitioners' return to determine whether either petitioner qualified as a real estate professional and, if so, whether they were entitled to the claimed deduction. By letter dated September 17, 2012, the Division requested that petitioners provide documentation demonstrating that either qualified as a real estate professional. The letter stated that "[i]f you're married, be sure to include this same information about your spouse." The letter requested information concerning petitioners' occupation such as: a description of their occupation that was NOT related to the 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 or superintendent. Additionally, for each rental activity, the Division requested a list of services performed and hours attributable to those services, 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. Petitioners did not timely respond to the Division's initial request for information and on November 6, 2012, the Division issued a statement of proposed audit changes (Statement) denying the claimed deductions and calculating tax due in the amount of \$1,598.69 plus interest.

The Statement explained, in part, as follows:

"Your 2009 New York State income tax return has been selected for review. In our letter dated 09/17/12, we requested information and documentation to substantiate the rental real estate loss claimed on federal Schedule E, Supplemental Income and Loss. We have not received a reply.

As our inquiry letter stated, all rental real estate activities are by default, passive activities. Therefore, losses from rental activities are subject to the passive activity loss (PAL) rules. The PAL rules state that losses from passive activities are not permitted to offset nonpassive income. There are two exceptions to the PAL rules that would allow rental real estate losses to offset nonpassive income.

1. If you are a real estate professional AND you materially participated in each rental activity, you are allowed the rental losses in full.
2. If your modified adjusted gross income (MAGI) is less than \$100,000, then you are permitted a special allowance to deduct \$25,000 of rental losses against nonpassive income. However, this special allowance is reduced by \$1 for every \$2 your MAGI increases above \$100,000. The special allowance is phased-out when your MAGI is greater than \$150,000.

Please note, to qualify as a real estate professional you must meet all three of the following tests.

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.
3. 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.

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You have not sent a reply to our inquiry letter; therefore, we cannot verify that you qualify as a real estate professional. Since we cannot verify that you are a real estate professional and your MAGI is greater than \$150,000, your rental loss is limited to the amount of passive income reported on your return. A review of

your return indicated you did not report any passive income. As a result, the rental loss has been suspended in full. The suspended loss may be eligible to be carried forward.”

The Statement provided that if petitioners disagreed with the determination, they could provide the requested documentation and the Division would again review the claim. The Statement further notified petitioners that if they did not respond by December 6, 2012, a notice of deficiency would be issued.

5. Petitioners did not respond to the Statement within the time provided, and on December 24, 2012 the Division issued a notice of deficiency, notice number L-038806229, asserting tax due for the year 2009 in the amount of \$1,598.69 plus interest.

6. By letter dated February 17, 2013, petitioner, Alexander Les, responded to the Division’s September 17, 2012 request for information. Mr. Les stated that, “I am a real estate professional and am entitled to claim the full amount of loss in 2009. My profession consists of selling and buying homes in the real estate world. . . . I have purchased, construct (sic), managed and sold homes in the real estate business.” The letter makes no reference to petitioner Christina Les or her qualifications as a real estate professional. Mr. Les submitted documents with his letter including real estate listings of various homes for sale;<sup>3</sup> a proposal and bill in the amount of \$2,568.00, dated May 14, 2009, to Mr. Les from Tree Surgeons for the Wilson Avenue property; an illegible one-page document stating “Multiple Listing Service” at the top of the document; correspondence, dated March 31, 2009, from John Gregory Duch, Esq. to Henry C. Walentowicz, Esq., regarding an inspection report of 464 Dewey Avenue; the first page of a contract for sale of 464 Dewey Avenue from Alexander Les and Anthony Polifronia to Josephine Cadicina; a

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<sup>3</sup> Mr. Les testified that the listings were emails of various property listings that petitioners reviewed to determine if they were interested in looking at the properties.

proposal, dated May 1, 2009, from Greg Tanzer Sprinklers and Outdoor Design to Alexander Les for sprinkler installation at the Dewey Avenue property; a letter, dated January 29, 2009, from AS Appraisal Systems, Inc., to Alexander Les regarding an appraisal of the Dewey Avenue property; correspondence, dated November 4, 2009, from the Saddle Brook, New Jersey Zoning Board of Adjustment to Alexander Les regarding the 6th Street property; Saddle Brook Zoning Board of Adjustment resolution of approval, dated December 7, 2009, in the Matter of the Application of Alexander Les, regarding an application for bulk variances relating to 336 6th Street; Saddle Brook Zoning Board of Adjustment resolution of denial, dated August 3, 2009, in the Matter of the Application of Alexander Les, regarding an application for bulk variances relating to 336 6th Street; zoning letter of denial, dated July 13, 2009, from Saddle Brook, New Jersey, Building Department to Alexander Les regarding the 6th Street property; appeal for variance, notice of hearing and affidavit of service of notice, dated July 16, 2009, from applicant Christina Les regarding the 6<sup>th</sup> Street property; two invoices from Greg Tanzer Sprinklers to Alexander and Christina Les, dated October 17, 2009 and April 21, 2009, each in the amount of \$80.25;<sup>4</sup> a receipt, dated May 25, 2009, in the amount of \$395.00 from ListBuyOwner.com to Alexander Les for a flat fee real estate multiple listing service; emails from Yesenia Laureano to Alexander Les, dated July 7, 2009, July 29, 2009, and August 5, 2009, regarding an advertising order; emails, dated May 23, 26, and 27, 2009, between Alexander Les and List Buy Owner Realty regarding the 6<sup>th</sup> Street rental property; one page of an illegible apartment lease; a federal truth in lending disclosure statement signed by petitioners on February 8, 2007, regarding the Wilson Avenue property; a proposal for architectural services for the Dewey Avenue property

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<sup>4</sup> The invoices do not specifically state the property location where the services were provided but do reference petitioners' home address at 336 6<sup>th</sup> Street.

from RA Puzzo Architect, Inc. to petitioners, dated March 20, 2006; a residential lease agreement for the Dewey Avenue property from December 1, 2008 through November 30, 2009, between Alexander Les as landlord and Christopher DiGirolomo; a facsimile, dated July 22, 2008, from Ming Tilley to Alexander Les regarding a lease for the Wilson Avenue property; a lease application, dated July 21, 2008, from Omar Al Oyaidi for the Wilson Avenue property, listing Alexander Les as landlord; a window guard notification, dated July 21, 2008, listing Mr. Al Oyaidi as tenant and Alexander Les as Owner Representative; a two-year lease, from August 1, 2008 through July 31, 2010, between Omar and Hoda Al Oyaidi as tenants and Alexander Les as landlord for the Wilson Avenue property; a declarations page for a homeowners insurance policy for the Wilson Avenue property for the period August 15, 2006 through August 15, 2007, listing petitioners as the insured; a construction line of credit approval letter from Wawel Savings Bank, dated September 13, 2006, to petitioners regarding the Wilson Avenue property; correspondence, dated March 5, 2007, from Wawel Savings Bank to Alexander Les and Anthony Polifronia regarding an amendment to a January 22, 2007 commitment letter for a construction line of credit for the Dewey Avenue property; and a proposal for architectural services for the Wilson Avenue property from RA Puzzo Architect, Inc. to Alexander Les dated September 21, 2005.

7. The Division sent correspondence dated April 29, 2013 in response to Mr. Les's letter, again explaining the passive activity loss rules and the requirements to qualify as a real estate professional. The correspondence explained that:

“[i]n order to be considered a real estate professional, one spouse ALONE must meet both of the following requirements:

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 Alexander purchases, constructs, manages and sells homes in the real estate business. However, there is no indication of the amount of hours spent in this occupation or the amount of hours spent working at Barclay's.

In order to determine if you meet the real estate professional tests, we must compare the amount of time you spend in all your activities. Since you did not provide all the requested information, we are unable to determine if you meet the real estate professional tests or the material participation requirement.

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In our inquiry letter, we requested you provide a list of services performed on each property and the hours attributable to those services. You did not provide this requested documentation.”

Based on the foregoing, the Division sustained the assessment.

8. On May 27, 2013, Mr. Les sent correspondence in response to the Division in an effort to explain his real estate activities, stating that, “Since 2005 I have been actively involved in building my own real estate development business. I search for raw land or ‘knock downs’ that I can develop on speculation and sell for a profit. In 2009 I owned three properties that I had demolished and developed. These properties were 252 Wilson Ave Paramus, 464 Dewey Ave #A Saddle Brook, and 464 Dewey Ave #B Saddle Brook.”<sup>5</sup> The correspondence describes Mr. Les’s involvement with the properties and estimated time as follows (the letter did not provide the specific dates or year when such activities were performed):

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<sup>5</sup> Petitioners’ Schedule E attached to their nonresident and part-year resident income tax return does not list 464 Dewey Avenue #B (*see* Finding of Fact 2). Mrs. Les testified that 464 Dewey Avenue #B was sold in 2009. Additionally, listed on the Schedule E, but absent from Mr. Les’s May 27<sup>th</sup> letter is the 336 6<sup>th</sup> Street property. There was no explanation for the discrepancy.



Description of Activity <sup>6</sup>	Estimate of Hours Worked
Searching for potential property locations on the internet and speaking with sellers	1 - 2 each weekday
Driving past potential properties, attending open houses and discussing properties with sellers	6 - 10 each weekend
Applying for variance approval with each municipality's zoning board of adjustment	30 hours per variance <sup>7</sup>
Appearing before and negotiation with each town's zoning board of adjustment	10 hours per applications <sup>8</sup>
Identifying, hiring and working with architects throughout design and construction stages of each project	20 hours per project <sup>9</sup>
Identifying, hiring and working with civil engineers through design and construction stages of each project	15 hours per project <sup>10</sup>
Identifying, hiring and working with a general contractor through design and construction stages of each project	5 hours per week per property <sup>11</sup>
Select interior finishing features including kitchen cabinets, appliances, bathroom fixtures, tiles, flooring, wall colors, counter tops and landscape design	4 hours per week <sup>12</sup>

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<sup>6</sup> The letter did not identify at which address each activity was performed.

<sup>7</sup> The letter does not indicate how many variances were applied for in 2009. During the hearing, petitioners admitted that the only variance requested in 2009 pertained to their personal residence at 336 6<sup>th</sup> Street.

<sup>8</sup> See footnote 7.

<sup>9</sup> Petitioners admitted during the hearing that the only architect hired in 2009 was in relation to petitioners' personal residence. Petitioners further admitted that they did not have any properties constructed in 2009.

<sup>10</sup> Petitioners admitted during the hearing that no civil engineers were hired in 2009.

<sup>11</sup> Petitioners admitted that they did not have any properties constructed in 2009.

<sup>12</sup> Petitioners did not build any new construction in 2009 that required such activities.

List properties for sale or rent, taking calls of interested parties, setting appointments, meeting potential buyers and negotiating prices <sup>13</sup>	5 hours per week per property
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Mr. Les further stated in the correspondence that, “In 2008, after the real estate market crashed, I was unable to sell my properties and needed to put them up for rent in order [sic] generate cash flow and avoid defaulting on my loans. This also meant that I would need to become a landlord, property manager and handyman for these properties. Performing all three of these function [sic] for all three properties easily requires 6-10 hours a week.” Mr. Les listed the following additional activities he performed without identifying the specific hours or properties for each activity: list properties for rent; show properties to potential tenants; identify tenants and perform all necessary financial and background checks; negotiate prices and lease terms; collect and deposit all rents; write all checks associated with service providers, mortgage holders, insurance providers, water bills and property tax payments; maintain books and records for each property; appeal property tax valuations when assessments are not in line with market prices; inspect all repair requests/issues and determine if and what professional is needed; perform all minor repairs that do not require a licensed professional; travel associated to and from all properties, home supply stores and banks; identify, negotiate and pay all maintenance professionals including landscapers, snow removal, sprinklers and pest control; refinance loans; and security deposit inspections. The correspondence does not mention Christina Les or any real estate activities performed by her.

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<sup>13</sup> In describing these activities, Mr. Les stated in the correspondence that, “I manage the entire process myself.”

9. The Division reviewed the information provided by Mr. Les and responded by letter dated September 3, 2013, stating that it considered the assessment correct. The correspondence reiterated the requirements for qualifying as a real estate professional in order to be entitled to the deduction claimed, and explained that in order to be considered a real estate professional, one spouse alone must meet both of the requirements. The correspondence again explained that in order to determine if more than half of either petitioner's personal services were in real property businesses, the Division must compare the amount of time the petitioners spent in all activities, and stated that:

“In 2009, you received wages of \$191,394.00 from Barclay's Capital and \$3,089 from Advance Dermatology of New Jersey. In addition to these two jobs you worked, you reported on your return that you had three rental properties. You did not report any business income or loss from the homes you stated you purchased, constructed, managed and sold. Therefore, you MUST indicate the amount of time you spent on EACH of the above activities.

Additionally, we requested you provide a list of services performed and hours attributable to those services for each of your rental properties. This information is required to determine if you meet the real estate professional qualifications.

As a result, the assessment is sustained.”

10. By letter dated September 27, 2013, Mr. Les responded to the Division's September 3, 2013 correspondence disagreeing with the Division's determination. Mr. Les enclosed with this letter copies of the same documents he sent to the Division on February 17, 2013 (*see* Finding of Fact 6) and requested that the Division review his case further.

11. The Division responded by letter dated November 12, 2013, stating that the information Mr. Les provided was not sufficient to make an adjustment to the assessment and again explaining that one spouse alone must meet the requirements to qualify as a real estate professional. The letter further stated, in part:

“You have sent three letters in protest of the above assessment. However, you have not provided the information necessary to determine if you qualify as a real estate professional. Additionally, we spoke on the telephone on 10/22/13 and I explained the above real estate professional tests and stated that we must compare the amount of time you spent in ALL activities to determine if you meet the real estate professional tests for tax year 2009. Therefore, you must provide the number of hours you worked at Barclay’s and Advanced Dermatology of NJ. Additionally, you must provide a list of services you performed on each rental property and the hours attributable to those services. You have failed to provide the above requested information and documentation. Therefore, we cannot determine if you qualify as a real estate professional for tax year 2009.”

12. By letter dated December 26, 2013, both petitioners responded to the Division, stating for the first time that Christina Les meets the requirements to qualify as a real estate professional. The letter states that in 2009 Mrs. Les’s personal services included approximately 1,334 hours in real property activities and 915 hours at a doctor’s office. The letter described Mrs. Les’s real property activities as follows:

Property	Description of Activities	Hours Worked
464 Dewey Ave #A	Collect and deposit rents, resolve bounced check issues <sup>14</sup>	18
	Pay bills (collect invoices, write checks, mail payments)	36
	Record expenses, bookkeeping and reconciliation	36
	Field phone calls from tenants	24
	Travel time to/from property	24
	Time at property discussing tenant issues	24

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<sup>14</sup> On cross examination during the hearing, petitioners did not know how many bounced check issues related to each property and could not identify any specific instances of bounced checks.

	Home store visits	36
	Identify, meet, evaluate quotes, hire service professional	36
	Resolve service provider disputes/errors	6
	Review property value against municipal assessment	20
	Request and review multiple property insurance quotes <sup>15</sup>	5
	Renegotiate/resign annual lease agreement	5
464 Dewey Ave #B <sup>16</sup>	Pay bills (collect invoices, write checks, mail payments)	12
	Resolve service provider disputes/errors	3
	Record expenses, bookkeeping and reconciliation	12
	Travel time to/from property	12
	Time showing property to potential buyers/open houses	50
	Book appointments with realtors and prospective buyers	10
	Pick up/drop off legal documents at attorney's office	5
	Home store visits	5

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<sup>15</sup> Christina Les is not a named insured on the insurance policy for the 464 Dewey Street property. Rather, the policy for the period October 27, 2008 through October 27, 2009 lists Alexander Les and Anthony Polifronio as the named insured.

<sup>16</sup> Petitioners' Schedule E attached to their nonresident and part-year resident income tax returns does not list 464 Dewey Avenue #B (*see* Finding of Fact 2).

	Identify, meet, evaluate quotes, hire service professionals	12
	Review property value against municipal assessment	20
	Request and review multiple property insurance quotes	5
254 Wilson Ave	Collect and deposit rents, resolve bounced check issues <sup>17</sup>	18
	Pay bills (collect invoices, write checks, mail payments)	36
	Record expenses, bookkeeping and reconciliation	36
	Field phone calls from tenants	54
	Travel time to/from property	48
	Time at property discussing tenant issues	54
	Home store visits	24
	Identify, meet, evaluate quotes, hire service professionals	36
	Resolve service provider disputes/errors	6
	Review property value against municipal assessment	20
	Request and review multiple property insurance quotes	5

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<sup>17</sup> See footnote 14.

	Renegotiate/resign annual lease agreement	5 <sup>18</sup>
336 6 <sup>th</sup> Street	Collect and deposit rents, resolve bounced check issues <sup>19</sup>	18
	Pay bills (collect invoices, write checks, mail payments)	18
	Record expenses, bookkeeping and reconciliation	36
	Field phone calls from tenants	12
	Time at property discussing tenant issues	24
	Home store visits	24
	Identify, meet, evaluate quotes, hire service professionals	24
	Resolve service provider disputes/errors	6
	Review property value against municipal assessment	20
	Request and review multiple property insurance quotes	5
	Renegotiate/resign annual lease agreement	5

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<sup>18</sup> The lease for the 254 Wilson Avenue property was for a two year term, running from August 1, 2008 through July 31, 2010. During the hearing, Mrs. Les admitted that her claim of spending 5 hours in 2009 renegotiating and resigning the annual lease for this property was incorrect.

<sup>19</sup> *See* footnote 14.

In addition to the above, petitioners also stated that Mrs. Les spent 16 hours a month researching new real estate ventures and 16 hours a month for travel related to new real estate ventures.

13. The Division sent a letter to petitioners, dated April 17, 2014, stating that it reviewed the information petitioners provided, but that the assessment was considered correct. The Division noted that in petitioners' three letters prior to their December 26, 2013 letter, petitioners stated that Alexander Les was the real estate professional, and that petitioners stated for the first time, in the December 26, 2013 letter, that Christina Les was the real estate professional. The Division concluded that because the December 26, 2013 letter contradicts petitioners' prior representations, the assessment was correct.

14. By undated correspondence from petitioners' representative, received by the Division on March 19, 2015, petitioners provided additional documentation. The same documentation was submitted by petitioners during the hearing. For the 6<sup>th</sup> Street property, petitioners provided: Home Depot invoice/quote in the amount of \$36.33, dated September 19, 2009, to Alexander Les; a quote from Garfield Lumber & Millworks in the amount of \$3,599.63, dated October 27, 2009;<sup>20</sup> invoice dated September 30, 2009 from Angel Contractors to Alexander Les showing a balance due in the amount of \$91.52 for landscaping services;<sup>21</sup> an invoice, dated May 19, 2009, in the amount of \$395.00 from ListBuyOwner.com to Alexander Les for a flat fee real estate multiple listing service; an email to Alexander Les, dated July 29, 2009, regarding an advertisement placed with North Jersey Media Group; a lease between Alexander Les, as

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<sup>20</sup> According to petitioners' representative's correspondence, the quote was for the 6<sup>th</sup> Street property deck lumber. Petitioners admitted that the deck was for their personal residence.

<sup>21</sup> The invoice lists multiple invoices with various amounts from April 29, 2009 through September 30, 2009.



landlord, and Maryann Liebman, as tenant, for the term September 1, 2009 through August 31, 2010, signed by Alexander Les; a lease between Alexander Les and Christina Les, as landlords, and Heidi Scarnaty, as tenant, for the term April 1, 2008 through March 30, 2009, signed only by Alexander Les and the tenant; an invoice for a location survey from Lapatka Associates, Inc., to Alexander Les, dated April 30, 2009, in the amount of \$518.00;<sup>22</sup> invoices from Direct Buy to Alexander Les, dated October 12, 2009, in the amount of \$226.48 and \$192.00 for a lock replacement and outdoor light, respectively; petitioners' 2009 mortgage interest statements from Chase in the amount of \$1,790.98 and \$5,484.00 and from Hudson City Savings Bank in the amount of \$23,652.66; invoice in the amount of \$337.53, dated August 26, 2009, for paint, referencing "Emin PTA;" a cover sheet to the attention of Alexander Les and attached apartment application from Maritza Perez; a Best Buy receipt, dated November 11, 2009, in the amount of \$1,591.56, for Alexander Les's purchase of two Whirlpool washing machines and a dryer; an invoice, dated August 28, 2009, from Sunshine, Atkins, Minassian, Tafuri, and D'Amato, P.A., to Alexander Les in the amount of \$350.00 for consultation services; invoice, dated December 14, 2009, from Audio Edge to Alexander Les in the amount of \$170.00; and a zoning letter of denial, dated July 13, 2009, from the Town of Saddle Brook building department to Alexander Les.

For the Dewey Avenue property, petitioners submitted a lease between Alexander Les, as landlord, and Christopher DiGirolamo, as tenant, for a one-year term from December 1, 2008 through November 30, 2009; window guard notification, dated November 5, 2008, and signed by Alexander Les; State Farm insurance declaration page to Alexander Les and Anthony Polifronio

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<sup>22</sup> The invoice states that it is for "Project Location 464 Dewey St., Saddle Brook, NJ." However, handwriting at the top of the invoice states "6<sup>th</sup> St. location survey receipt" and the correspondence from petitioners' representative states that the invoice is for the 6<sup>th</sup> Street property.

for a policy effective October 27, 2008 through October 27, 2009, listing the named insured as “Partnership”; invoice number 18386, dated September 30, 2009, from Angels Contractors to Alexander Les for landscaping services in the amount of \$428.00;<sup>23</sup> 2009 mortgage interest statement and account statement from Wawel Savings Bank for Alexander Les and Anthony Polifronio; check, dated May 6, 2009, from petitioners to Township of Saddle Brook in the amount of \$2,115.15 for property tax; invoice dated November 25, 2009 from Greg Tanzer Sprinklers to Alexander Les in the amount of \$80.25; water bills, dated March 4, 2009, in the amounts of \$.70 and \$139.73 and September 3, 2009 in the amount of \$287.80; and the same correspondence, dated January 29, 2009, from AS Appraisal Systems, Inc., to Alexander Les that was previously submitted (*see* Finding of Fact 6).

For the Wilson Avenue property, petitioners submitted correspondence, dated February 2, 2009, from Hudson City to petitioners regarding a mortgage late payment; petitioners’ 2009 mortgage interest statement from Hudson City Savings Bank in the amount of \$42,100.56; facsimile dated July 22, 2008 from Ming Tilley to Alexander Les regarding a lease for the Wilson Avenue property; the same lease application from Mr. Al Oyaidi and window guard notification signed by Alexander Les, dated July 21, 2008, and two-year lease, from August 1, 2008 through July 31, 2010, between Omar and Hoda Al Oyaidi as tenants and Alexander Les as landlord that were previously submitted (*see* Finding of Fact 6); an email dated November 11, 2009 from Christopher DiGirolamo to Alexander Les regarding a mortgage refinance; invoices dated May 11, 2009 and October 30, 2009 from Greg Tanzer Sprinklers to Alexander Les in the

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<sup>23</sup> This invoice number is included in the invoice petitioners submitted for the 6<sup>th</sup> Street Property. Although petitioners included this invoice for their submission pertaining to the Dewey Avenue property, there is no reference to that address and the only address listed is the billing address for Mr. Les at 336 6<sup>th</sup> Street.

amount of \$203.30 and \$90.95, respectively; and the proposal and bill from Tree Surgeons to Alexander Les that was previously submitted (*see* Finding of Fact 6).

Petitioners also submitted receipts for 2009 from Home Depot, Lowes, and GE Appliances totaling \$1,105.30.<sup>24</sup> The receipts do not specify which property they pertain to, except one that contains a handwritten notation of “Lawn 336 6<sup>th</sup> Street,” which is petitioners’ home residence. The receipts do not indicate the name of the purchaser.

15. Petitioners paid the amount of tax due as set forth in the notice of deficiency for 2009, plus interest, and subsequently requested a refund.

16. The Division issued a notice of disallowance, dated September 19, 2014, denying petitioners’ request for a refund in the amount of \$2,247.17 for tax year 2009.

17. Christina Les received wage income in 2009 from Paige Applebaum Farkas, MD. Mrs. Les testified that Dr. Farkas sold her practice some time in 2009 to Advanced Dermatology of New Jersey, and that Mrs. Les then worked there. There is no Form W-2 in the record for Mrs. Les from Advanced Dermatology of New Jersey. As noted above, the only Form W-2 for 2009 is from Advance Dermatology of New Jersey, which lists the employee as Mr. Les, rather than Mrs. Les (*see* Footnote 1). There was no explanation for the discrepancy. Petitioners submitted a Paychex of New York, LLC, compensation report for Advanced Dermatology of New Jersey, from October 25, 2009 through December 19, 2009, listing Christina Les as an employee, and indicating that she was paid at a rate of \$22.50 an hour for 135.07 hours during that period. No time sheet, compensation report, or other documentation was submitted to substantiate petitioner’s hours worked for Paige Applebaum Farkas, MD.

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<sup>24</sup> The amount listed on one of the receipts was not legible and thus is not included in the total amount.

18. Alexander Les worked full time, approximately 40 to 50 hours per week, for Barclays Capital. Petitioners concede that due to Mr. Les's hours worked at Barclays in comparison with his hours spent on real estate activities, he did not qualify as a real estate professional for 2009.

19. The Dewey Avenue property was owned by Alexander Les and Anthony Polifronic in 2009.

20. During the hearing, petitioners presented bank statements from their joint account for 2009. The statements appear to indicate both personal and real estate activities. Included with the statements were copies of some deposits and canceled checks. The deposits include a copy of a deposit slip dated April 25, 2009, with only Alexander Les's name; checks dated May 26, 2009 and July 24, 2009 for the Wilson Avenue property rent, and dated April 24, 2009, July 31, 2009, and August 17, 2009 for the Dewey Avenue property rent, all payable to Alexander Les and signed by Alexander Les. A total of 68 canceled checks are attached to the statements from December 23, 2008 through November 24, 2009.<sup>25</sup> Of the 68 canceled checks, 31 were signed by Alexander Les, 35 were signed by Christina Les, and 2 did not have legible signatures. Thirty of the total canceled checks had a handwritten notation indicating that they were related to real estate activities, 18 of which were signed by Alexander Les, and 12 of which were signed by Christina Les.

21. Petitioners were given additional time subsequent to the hearing to submit spreadsheets that petitioners contend were created for record keeping in 2009. During the hearing, Mr. Les testified that the spreadsheets "detailed all the activity we did for the year, as well as all the receipts we could find for the year with those properties," and that entries in the

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<sup>25</sup> No canceled checks were submitted into the record for December 2009.

spreadsheets would specify expenses, stating that, “[s]pecifically, if it was Home Depot, if it was Lowe’s, if it was the attorney, whatever it was, whatever the dollar that was spent.” Within the time provided subsequent to the hearing, petitioners submitted a one-and-a-half page spreadsheet for the Dewey Avenue property and a one-page spreadsheet for the Wilson Avenue property. No spreadsheet was submitted for the 6<sup>th</sup> Street property and there was no explanation for the omission. The spreadsheets state as follows:

<b>464 Dewey Ave.</b>		<b>254 Wilson Ave.</b>	
Description	Amount	Description	Amount
Jan rent	(2,900.00)	Jan 09 rent	(3,700.00)
PSE&G A Dec 2008 Final	76.20	Sprinkler winterization	101.65
PSE&G B Dec 2008	100.25	Feb 09 rent	(3,700.00)
4Q08 tax overpayment	(960.53)	1Q09 taxes	3,537.90
Condo exemption application	112.00	1Q09 State Farm insurance	380.25
PSE&G B Jan 2009	128.59	Tax advice	300.00
Feb rent	(2,900.00)	2Q09 Tower Insurance	370.00
Mar rent	(2,900.00)	State Farm cancellation refund	(345.56)
April rent	(2,900.00)	Mar 09 rent	(3,700.00)
May rent	(2,900.00)	Apr 09 rent	(3,700.00)
Insurance	451.74	Hudson City loan	31,572.00
PSE&G B Feb 2009	100.05	May 09 rent	(3,700.00)
1Q09 taxes	4,230.16	June 09 rent	(3,700.00)
Water Bill A	139.73	July 09 rent	(3,700.00)
Water Bill B	0.70	2Q09 taxes	3,537.90
PSE&G B Mar 2009	125.00	Greg Tanxer Sprinkler	203.30

<b>464 Dewey Ave.</b>		<b>254 Wilson Ave.</b>	
Resale c/o	100.00	Tower insurance 2 <sup>nd</sup> installment	283.20
PSE&G B Apr 2009	138.37	Aug 09 rent	(3,700.00)
Insurance	451.74	3Q09 taxes	3,829.15
Lapatka - closing survey	518.00	Tree removal	2,400.00
Lowes	88.16	Lowes light bulbs	65.87
Sprinklers	1,700.00	Sept 09 rent	(3,700.00)
Unit B Sale - 2Q09 Taxes - closing & master deed - realty transfer fee - Lapatka survey - recording fees - Wawel loan repayment	2,789.03 3,700.00 4,463.00 409.00 75.00 (425,000.00)	Hudson City mortgage modification processing fee	101.10
Water escrow received	(300.00)	Oct 09 rent	(3,700.00)
Escrow refund	(5,000.00)	Nov 09 rent	(3,700.00)
State Farm refund	(210.00)	4Q09 taxes	3,386.29
Wawel interest toward principal	(4,969.30) and (5,030.70)	Sprinkler winterization	90.95
PSE&G B May 2009	38.23	Hudson City loan Oct	3,508.35
Budz final payment	31,600.00	Tower Insurance - 3rd	283.20
Warranty	1,620.00	Hudson City loan Nov	3,508.35
Angel's Lawn cleanup	428.00	Dec 09 rent	(3,700.00)
June 2009 rent	(3,000.00)	Hudson City loan Dec	3,508.35
July 2009 rent	(2,900.00)		
State Farm insurance	116.78		
3Q09 taxes (½ duplex)	2,274.50		
Aug 2009 rent	(3,000.00)		
Sept 2009 rent	(2,900.00)		
Oct 2009 rent	(2,900.00)		

Nov 2009 rent	(2,900.00)	
Dec 2009 rent	(2,899.00)	
Water bill	287.80	
State Farm insurance	204.00	
4Q09 taxes (½ duplex)	2,269.08	
Sprinkler winterization	80.25	
Outside lantern globes	30.00	
Wamu int on 110k	3,709.20	

There was no explanation for the discrepancies between the income and expenses indicated in the spreadsheets and those as reported on petitioners' 2009 Schedule E (*see* Finding of Fact 2).

#### ***CONCLUSIONS OF LAW***

A. The question to be addressed in the present matter is whether petitioners are entitled to claim a deduction in tax year 2009 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 taxpayers bear the burden of demonstrating that they have 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]). In the case of a joint tax return, either spouse may satisfy both requirements for a real estate professional, but the requirements are satisfied only if either one separately satisfies such requirements (IRC § 469 [c] [7] [B] [ii]).

The regulation at 26 CFR § 1.469-5T (f) (4) explains 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 and determine if more than one-half of the personal services performed by the taxpayer are performed in real property trades or businesses. Although petitioners initially contended during the audit that Mr. Les was a real estate professional, petitioners now concede that Mr. Les did not qualify as a real estate professional for 2009, due to the hours he worked for Barclays Capital in comparison to his time spent on real estate activities.

Petitioners now contend, instead, that Mrs. Les qualified as a real estate professional for 2009, arguing that she worked only part-time in her occupation outside of real estate activities. However, petitioners have not met their burden of proving the number of hours Mrs. Les worked in her occupation outside of the real estate activities and their description of the hours Mrs. Les worked is plagued with inconsistencies. In correspondence petitioners sent to the Division (*see* Finding of Fact 12) and subsequently presented into the record at the hearing, petitioners stated that Mrs. Les worked 915 hours at a doctor’s office in 2009. During the hearing, Mrs. Les testified that she worked 18 hours per week in 2009 (i.e., 936 hours) for an unnamed dermatology office that was purchased by Advanced Dermatology of New Jersey sometime in late 2009. In contrast, petitioners presented into the record a compensation report from

Advanced Dermatology indicating that from October 25, 2009 through December 19, 2009, Mrs. Les was compensated for 135.07 hours. Extrapolating the 135.07 hours from the six-week compensation report over the whole year for 2009 results in 1170.61 hours. Finally, in petitioners' brief, they claimed that, "Mrs. Les worked part time in the office of Advanced Dermatology of New Jersey for about 30 hours per week or 915 hours per year." Obviously, 30 hours per week does not equal 915 hours per year ( $30 \times 52 = 1560$ ). There was no explanation in the record for the various discrepancies of the number of hours Mrs. Les worked for the dermatology office. Moreover, although petitioners contend that Mrs. Les first worked for another dermatology office that was bought out at some point in 2009 by Mrs. Les's subsequent employer, Advanced Dermatology of New Jersey, and submitted a compensation report indicating she was employed by Advanced Dermatology, the only form W-2 wage and tax statement Mrs. Les received in 2009 was from Paige Applebaum Farkas. The form W-2 attached to petitioners' 2009 return from Advance Dermatology of New Jersey lists Alexander Les as the employee and lists his social security number. Petitioners provided no explanation for the inconsistencies. As such, petitioners have failed to establish the number of hours Mrs. Les worked in her occupation outside of the real estate activities and have not met their burden of proving that more than one-half of the personal services she performed during 2009 were performed in real property trade or businesses.

E. Petitioners have also failed to establish the number of hours Mrs. Les spent in real property trades or businesses in which she materially participated. Petitioners' testimony in this regard is simply not credible.

The determination of whether testimony is credible rests with the trier of facts, "who has the opportunity to view the witnesses first hand and evaluate the relevance and truthfulness of

their testimony” (*Matter of Spallina*, Tax Appeals Tribunal, February 27, 1992). A determination of testimonial credibility rests on the twin components of “competency,” which is the “[o]ppportunity and capacity to perceive combined with capacity to recollect and communicate,” and “veracity,” which is the “truthfulness of the witness” (*Matter of Impath*, Tax Appeals Tribunal, January 8, 2004). As noted by the Tribunal,

“Any additional evidence relied on in support of specific testimony given, referenced to refresh the recall of a witness, or otherwise augmenting the testimony given concerning a claim of event, date, time and place, can itself offer insight as to whether the witness’s recall is credible and correct . . . . So too, careful and objective review of such evidence and of any accompanying testimony or other evidence may reveal significant inconsistencies weighing against the likelihood that the testimony, though honestly given, might through the fallibility of human memory, simply be incorrect or not clear and convincing evidence. It is against this background that the evidence in this case, including the testimonial evidence, must be evaluated” (*Matter of Robertson*, Tax Appeals Tribunal, September 23, 2010).

A review of petitioners’ testimony in light of the other evidence in the record reveals a lack of credibility. First, it is noted that although petitioners resided at the 6<sup>th</sup> Street property in 2009 and rented out half of it, on the Schedule E attached to their 2009 return petitioners listed the property as a “2 Family Home” and inaccurately responded “No” to the question of whether it was used for personal use.

It must also be noted that petitioners’ position as to which spouse qualified as the real estate professional changed during the course of the audit. Petitioners first contended, in their three initial responses to the Division, that Mr. Les was the real estate professional, and made no reference to Mrs. Les having any real estate activities. Indeed, in the letter to the Division dated May 27, 2013, with regard to the activities of listing properties for sale or rent, taking calls of interested parties, setting appointments, meeting potential buyers and negotiating prices, Mr. Les unequivocally stated that, “I manage the entire process by myself.” In contrast, in petitioners’

letter to the Division dated December 26, 2013, they contended for the first time that Mrs. Les qualified as a real estate professional, and listed the same activities that Mr. Les had claimed he performed on his own (*compare* Findings of Fact 8 and 12).

Further inconsistencies can be found between the statements made in petitioners' correspondence and testimony. For example, with regard to the 6<sup>th</sup> Street property, petitioners claim that Mrs. Les spent 18 hours collecting and depositing rents and resolving bounced check issue; 18 hours paying bills; 36 hours recording expenses, bookkeeping and performing reconciliations; 24 hours for home store visits; and 24 hours identifying, meeting, evaluating quotes and hiring service professionals, among other activities. Yet petitioners did not present any spreadsheet for the 6<sup>th</sup> Street property indicating that any bills were paid, any rents were deposited, or any other form of bookkeeping for income and expenses, despite Mr. Les's testimony that the spreadsheets "detailed all the activity we did for the year, as well as all the receipts we could find for the year with those properties," and that entries in the spreadsheets would specify expenses (*see* Finding of Fact 21).

Petitioners' testimony regarding other claimed real estate activities similarly lacks credibility and is contradicted by documentary evidence. Specifically, in petitioners' correspondence to the Division dated May 27, 2013, Mr. Les claimed that he applied for variance approval with each municipality's zoning board of adjustment. During the hearing, in describing her real estate activities, Mrs. Les testified that she was the one to apply for a variance. Yet the Zoning Board of Adjustment resolutions in the record pertaining to the variance list only

Alexander Les, and in later testimony both petitioners admitted that the only variance applied for in 2009 pertained to their personal residence.<sup>26</sup>

Additionally, for each property, Mrs. Les claimed to have spent 18 hours collecting and depositing rents and resolving bounced check issues. Yet Mrs. Les could not identify a single instance of an actual bounced check. The only rent checks in the record were made payable to and signed by Alexander Les, and the only deposit slip in the record contains Mr. Les's, and not Mrs. Les's, name. Mrs. Les also claimed to have spent a total of 102 hours paying bills, collecting invoices, writing checks and mailing payments for the various properties, yet the invoices submitted list Mr. Les, rather than Mrs. Les, and the documentary evidence shows only 12 checks written by Mrs. Les in relation to the rental properties. It is simply inconceivable that writing 12 checks would take 102 hours.

Petitioners claim that Mrs. Les spent 120 hours for recording expenses, bookkeeping and reconciliations, consisting of 36 hours for the Dewey Avenue #A property, 12 hours for Dewey Avenue #B, 36 hours for the Wilson Avenue property, and 36 hours for the 6<sup>th</sup> Street property. When asked to describe the type of bookkeeping, Mrs. Les testified that she used spreadsheets for "bookkeeping regarding anything that needed to be done with the homes. Changing light bulbs, smoke detectors, stuff like that was recorded. Whatever we spent on our travel to the little stores to get whatever we needed, stuff like that." Petitioners were given additional time following the hearing to provide the bookkeeping spreadsheets. As noted above, petitioners provided only a one-and-a-half page spreadsheet for the Dewey Avenue property and a one-page

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<sup>26</sup> It is also noteworthy, that in describing her real estate activities, Mrs. Les often referred to "we," such as: "we did a lot of driving . . . we did have to see what houses were worth, and we needed to figure out what - - because our taxes were very high at that time so we needed to see - - we needed to get other comps. So we were doing a lot of driving. We did stuff like that," until her attorney asked a leading question of, "When was 'we,' because he is at work?" In response, Mrs. Les revised her testimony, stating, "He was at work so it was me. It was me, yeah. I did a lot of that daytime stuff where things are closed at 4:00 that he didn't get to."

spreadsheet for the Wilson Avenue property. No spreadsheet was submitted for the 6<sup>th</sup> Street property. The income and expenses listed on the spreadsheets are inconsistent with the amounts reported on petitioners' Schedule E and contrary to petitioners' testimony, do not detail all the claimed expenses. Petitioners' claim that Mrs. Les spent 120 hours on bookkeeping is not credible in light of the documentary evidence that consisted of less than three pages of spreadsheets, with little information or detail and no evidence of bookkeeping for the 6<sup>th</sup> Street Property.

With regard to petitioners' claim that Mrs. Les spent a total of 108 hours on the various properties identifying, meeting, evaluating quotes and hiring service professionals, such contention is contradicted by the documentary evidence. Specifically, all the invoices from service professionals contained in the record list Alexander Les as the purchaser, except for two which list both Mr. and Mrs. Les (*see* Findings of Fact 6 and 14). Similarly, although petitioners claim that Mrs. Les spent time renegotiating and re-signing annual leases, the leases contained in the record are signed only by Mr. Les. Additionally, the correspondence from tenants regarding the leases were addressed only to Mr. Les (*id.*).

Regarding the remaining activities petitioners claimed Mrs. Les performed, their testimony lacked any specificity or detail as the tasks performed and time spent, and consisted of merely broad, general claims without any documentary support. Based on the inconsistencies in the testimony and documentary evidence, the lack of support for the claimed hours worked in real estate activities, and the failure to prove the time Mrs. Les worked outside of real estate activities, petitioners have failed to meet their burden of proof.

F. Finally, it is noted that in addition to failing to satisfy the requirements to qualify as a real estate professional, petitioners failed to substantiate the expenses claimed for the rental

properties. As noted above, the expenses contained in the spreadsheets submitted by petitioners are inconsistent with those reported on petitioners' 2009 Schedule E, and petitioners did not provide documentary evidence or credible testimony supporting all of the claimed expenses.

G. Accordingly, the petition of Alexander and Christina Les is denied and the Notice of Disallowance, dated September 19, 2014, is sustained.

DATED: Albany, New York  
November 2, 2017

/s/ Barbara J. Russo  
ADMINISTRATIVE LAW JUDGE