

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :
of :
DARREN J. FARLOW : DETERMINATION
for the Redetermination of a Deficiency or for Refund : DTA NO. 829259
of New York State and New York City Personal Income :
Tax under Article 22 of the Tax Law and the New York :
City Administrative Code for the Year 2016. :
:

Petitioner, Darren J. Farlow, filed a petition for redetermination of a deficiency or for refund of New York State and New York City personal income tax under article 22 of the Tax Law and the New York City Administrative Code for the year 2016.

A hearing was held before Barbara J. Russo, Administrative Law Judge, on September 22, 2020, with all briefs to be submitted by February 4, 2021, 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. (Stephanie M. Lane, Esq., of counsel).

ISSUE

Whether the Division of Taxation properly disallowed petitioner's claimed business losses for the year 2016.

FINDINGS OF FACT

1. Petitioner timely filed a New York State and City resident income tax return for the year 2016. Petitioner reported wage income from Phoenix Management Services LLC in the amount of \$112,067.00, other income of \$200.00, business losses of \$40,411.00, and a federal adjustment of \$2,000.00, resulting in total federal adjusted gross income of \$69,856.00. From

this amount, petitioner subtracted the standard deduction, a college tuition credit of \$200.00,¹ a New York City school tax credit of \$63.00, and New York State and City tax withheld of \$10,865.00, resulting in a requested refund in the amount of \$5,330.00.

2. Attached to petitioner's 2016 return was a federal schedule C, profit or loss from business. The schedule C stated that petitioner's principal business or profession was "management consulting," listed the business name as "Asia Pacific Investment Partners," and listed the same address for the business as that of petitioner's residence. The schedule C reported gross receipts of \$500.00 and expenses of \$40,911.00, resulting in reported losses of \$40,411.00. The claimed business expenses were as follows:

Expense Description	Amount
Advertising	\$ 1,000.00
Commission and fees	\$ 1,000.00
Depreciation and section 179 expense deduction	\$ 1,500.00
Legal and Professional Services	\$ 350.00
Office Expenses	\$12,392.00
Rent or Lease - Other business property	\$ 2,194.00
Supplies	\$ 500.00
Travel	\$ 1,000.00
Meals and Entertainment	\$ 8,610.00

¹ Petitioner has conceded that he was not entitled to the claimed college tuition credit and such amount is not at issue herein.

Other Expenses: Internet	\$ 4,754.00
Telephones	\$ 4,168.00
Supplies	\$ 3,443.00
Total Expenses	\$40,911.00

3. The Division of Taxation (Division) selected petitioner’s 2016 income tax return for review and by letter dated May 8, 2017, requested that petitioner provide, in part, the following:

“Section 1 – Required information about your business income or loss

If you were self-employed during the tax year listed above, you need to prove your income.

- Send us your Schedule C, Profit or Loss From Business, from your federal income tax return for the tax year listed above.
 - In addition, you must send us all of the following:
 - Detailed documentation, such as sales slips, invoices, bank statements, or receipts, supporting your business income and expenses. Use the actual documents from the time you earned the money or incurred the expenses – estimates are not good enough.
 - Copies of the summary documents that you used to calculate the income and expenses that you reported on your tax return. These documents must cover the entire year.
 - Copies of any license, registration, or certification that you need for your business (taxicab, cosmetology, health or food service, etc.)
 - the enclosed questionnaire (be sure to complete all questions).
- Please note: All documentation must be clearly labeled, categorized and assembled for each type of expense claimed. We do not accept credit card statements without supporting receipts.

Section 2 – Required information about itemized deductions

* * *

College tuition itemized deductions or college tuition credit
If you claimed either of these, send us:

- a copy of federal Form 1098-T, Tuition Statement, and

- copies of your tuition bills with canceled checks and receipts

In addition, if you claimed any federal adjustments to income, such as educator's expenses, college tuition and fees, and moving expenses:

- send us copies of any documentation that supports these claims.”

Enclosed with the letter was a questionnaire for Schedule C business loss.

4. Petitioner responded to the Division's inquiry by correspondence dated May 16, 2017.

In response to the questionnaire for Schedule C Loss, petitioner replied as follows:

1. What year did you start your business? 1996
2. Describe the business and the tasks and responsibilities that you have within the business. Investment Banking Consulting
3. Approximately how much time do you put into this business in an average week? 20 hours
4. How do you market your business? Internet
5. What specific changes have you made over the years in an attempt to improve profitability? Aligned w/another capital firm, Phoenix
6. Were there any circumstances beyond your control that contributed to the losses you are claiming? No
7. Have you ever reported a net profit for your business (yes or no)? Yes
If yes, list for which tax year(s): 1996, 1997
8. Are you employed outside of this business (yes or no)? Yes. If yes, list the number of hours per week you usually work in your other employment.
20 hrs/week

Also included with petitioner's correspondence was a copy of a portion of his 2016 federal income tax return; copies of his 2016 federal schedule A, itemized deductions, and 2016 federal schedule C, profit or loss from business; a copy of his 2016 W-2, wage and tax statement, from Phoenix Management; correspondence from the Internal Revenue Service (IRS) dated May 16, 2016, stating the petitioner owed additional income tax and interest totaling \$1,604.62 for tax year 2013; correspondence from the IRS dated May 16, 2016 stating that petitioner owed

additional income tax and interest totaling \$405.45 for tax year 2012; correspondence from the IRS dated May 15, 2017 stating that “we changed your 2016 Form 1040 to match our record of your estimated tax payments, credits applied from another tax year, and/or payments received with an extension to file. As a result, you are due a refund of \$16,376.00.” The IRS correspondence shows tax owed for 2016 of \$8,753.00, payments made of \$25,129.00, and a refund of \$16,376.00; and copies of “cover receipts” for some purported business expenses. Petitioner stated in the correspondence that “[a]s you can certainly understand, the number of individual receipts for each Cover is substantial and I cannot possibly copy and send each of these. However, I would be most happy to present these to an examiner at an in-person audit in Manhattan, NY where I reside.”

5. The “cover receipts” included with petitioner’s May 16, 2017 correspondence consisted of the following:

- Itinerary confirmation for petitioner from Jet Blue for a roundtrip flight from New York, New York to Fort Myers, Florida in November 2016. The confirmation shows a total fare of 13,200 points + \$11.20. Petitioner handwrote the following notations on the confirmation page: “2016 Travel & Ent \$5740” and

“150
150
25
11
346”

- A one-page account summary from Verizon dated December 4, 2016 for account number *****3131² showing a previous payment of \$104.99 and charges due by December 29, 2016 of \$154.00. Petitioner handwrote the following notation on the account summary: “2016

² The account number has been partially redacted for privacy purposes.

Telephone(s) \$4168” and:

“2016
\$1342
2826
\$4168 – BIZ”

- An invoice from Verizon showing an amount due of \$167.43 for the billing period October 29, 2016 to November 28, 2016 for account number *****-00001.³ Petitioner handwrote the following notation on the invoice: “BIZ 2016 \$2826”

- an email receipt for the amount of \$399.99 from gust.com stating that petitioner “successfully paid for Cinema Interactive Group’s Gust Launch Plan.” Petitioner handwrote the following notation on the email receipt: “Corporate – 2016 \$399,” “Biz-office,” and “2016 Corporate Setup - \$399”

- a statement from New York State Department of Labor dated December 13, 2016 for unemployment insurance benefit debt – receipt of payment, indicating that petitioner had an opening balance of \$6,978.00, an amount paid of \$200.00, and a balance due of \$6,778.00. Petitioner handwrote the following notation on the statement: “2016 Repayment to DOL - \$2100.”⁴

- a payment confirmation from Chase Bank showing that on February 2, 2016, petitioner made a payment in the amount of \$643.52 to NYS Department of Taxation. Petitioner handwrote the following notation on the payment confirmation: “2016 Payment to NYS \$643.52.”⁵

- an invoice from Spectrum showing a previous balance and payment received from

³ The account number has been partially redacted for privacy purposes.

⁴ During the hearing in this matter, petitioner conceded that payments to the Department of Labor were personal and not business expenses.

⁵ During the hearing in this matter petitioner conceded that the tax payments were personal and not

petitioner of \$153.46, and charges due by December 30, 2016 for television and internet services totaling \$153.46. The address listed for the service is petitioner's residential address.

Petitioner handwrote the following notation on the invoice: "Cable 2016 \$1836."

- an email from Network Solutions dated June 23, 2016. The email shows an order confirmation for a one year renewal of domain.com, careersystem.com for the term "2017-08-22" in the amount of \$37.99. The email shows a user name of Darren J. Farlow and credit card holder name of John B. Romano. Petitioner handwrote the following notation on the invoice: "2016 Internet \$2918."

- an invoice from Ebay dated February 20, 2016 showing an amount due of \$6.00. Petitioner handwrote the following notation on the invoice "Office Expenses – Ebay 2016 \$3443."

- an invoice from Manhattan Mini Storage dated December 20, 2016 showing an amount due of \$187.00. Petitioner handwrote the following notation on the invoice: "Storage 2016 \$2194."

- a copy of a check from petitioner dated March 15, 2016, made out to "Cash" in the amount of \$1,000.00. Petitioner handwrote the following notation on the copy: "Prof. Services \$1300 2016" and "Tim Wierzbicki 2016 Consulting/Business Development – East West Institute CDO Search."

- a page with the following typed information: "Broker Fee 1/1/2016 – 12/31/2018 Marcy Bloomstein, DJ Knight Company \$300.00." Petitioner handwrote "paid cash 1/5/16."

- an email receipt to petitioner from Margaret Lynch at stcusa.com dated April 18, 2016 showing charges in the amount of \$634.00 for "Series 79 Training Program." Petitioner handwrote the following notation on the email: "Education/office [illegible] 2016 License

\$3231.”

- an invoice of ConEdison showing charges in the amount of \$21.00 for services at petitioner’s residential address for the billing period November 7, 2016 to December 9, 2016.

Petitioner handwrote the following notation on the invoice: “Utility/Gas 2016 \$255.”

- a claim denial notification from Ameriflex dated November 23, 2016 showing an amount denied of \$1,050.00. The description for the claims denied include “Steven,” “RX,” and “Vision.” Petitioner handwrote the following notation on the claim denial form: “2016 Non-reimbursement medical expenses \$4702.”

- a statement from Simmons Bank for the period November 17, 2016 to December 16, 2016 showing a new balance due of \$584.95 for purchases and fees. Petitioner handwrote the following notations on the statement: “Interest Paid 2016 \$803,” “2016 Simmons [illegible] \$285.71,” “12/25 paid \$259.25,” and “11/1/19 paid 300.09.”

- a JetBlue Rewards MasterCard statement for the period October 12, 2016 to November 11, 2016 showing a prior payment of \$86.00 and no amount due. Petitioner handwrote on the statement “2016 JetBlue I&P \$292.78.”

- a statement from First Premier Bank for the period November 28, 2016 to December 28, 2016 showing purchases and charges of \$475.38. Petitioner handwrote on the statement “2016 I&P \$226.12.”

6. On September 15, 2017, the Division issued an account adjustment notice to petitioner. The account adjustment notice stated that the Division reviewed the information petitioner sent in response to the audit inquiry for 2016 and petitioner’s request for the business loss and college tuition credit had been disallowed.⁶ The account adjustment notice showed that of petitioner’s refund requested in the amount of \$5,330.00, the Division allowed a refund of \$982.52.

7. The Division issued a notice of disallowance to petitioner, dated November 3, 2017, denying the portion of petitioner's refund claim in the amount of \$4,347.00 for the year 2016.

8. During the hearing, petitioner described his schedule C business as management consulting, investment banking consulting and merger acquisition work. He testified that he does capital raising for small and mid-sized businesses. Petitioner further testified that his schedule C business is not affiliated with broker dealers because such affiliation required a registration license, which he did not obtain.

9. The Division introduced into the record petitioner's New York resident income tax returns for the years 2010 through 2016. In 2010, petitioner reported wage and salary income of \$7,500.00 from Socius Capital Group, LLC, \$87,827.26 from ADP TotalSource MI VII LLC, and \$20,000.00 from Ashir Capital Inc. Petitioner deducted business losses of \$25,251.00, and included a schedule C, profit or loss from business, with his 2010 return, wherein he reported his principal business or profession as "Management Consultant," reported no gross income, and reported net business losses of \$25,251.00.

In 2011, petitioner reported wage and salary income of \$53,710.00 from Ashir Capital, Inc., and \$14,656.00 from ADP Total Source. Petitioner deducted business losses of \$23,177.00, and included a schedule C with his 2011 return, reporting his principal business or profession as "Management Consultant," reported gross income of \$9,000.00, reported business expenses of \$32,177.00, and reported net business losses of \$23,177.00.

In 2012, petitioner reported wage and salary income of \$29,443.00 from Lloyd Staffing Inc. Petitioner deducted business losses of \$26,243.00, and included a schedule C with his 2012 return, wherein he reported his principal business or profession as "Management Consultant," reported gross income of \$13,157.00, reported business expenses of \$39,400.00, and reported net

⁶ See footnote 1.

business losses of \$26,243.00.

In 2013, petitioner reported wage and salary income of \$22,777.00 from Lloyd Staffing Inc., and \$38,582.00 from Batten Group. Petitioner deducted business losses of \$21,263.00, and included a schedule C with his 2013 return, wherein he reported his principal business or profession as “Consulting,” reported no gross income, and reported net business losses of \$21,267.00.⁷

In 2014, petitioner reported no wage or salary income and reported unemployment compensation of \$3,950.00. Petitioner deducted business losses of \$12,978.00, and included a schedule C with his 2014 return, wherein he reported his principal business or profession as “Management Consultant,” reported gross income of \$6,870.00, reported business expenses of \$19,848.00, and reported net business losses of \$12,978.00.

In 2015 petitioner reported wage and salary income of \$60,227.00 from Cerebral Palsy International and deducted business losses of \$17,145.00. Petitioner included a schedule C with his 2015 return, wherein he reported his principal business or profession as “Management Consulting,” reported gross income of \$15,000.00, reported business expenses of \$32,145.00, and reported net business losses of \$17,145.00.

10. Petitioner presented no documentary evidence during the hearing. Petitioner was informed by the undersigned administrative law judge that all documents must be presented at the hearing to be considered. The administrative law judge further explained that the only documents in the record with regard to petitioner’s claimed expenses were the exhibits presented by the Division of petitioner’s “cover receipts” and the determination could only be based on the exhibits in the record. Petitioner responded “okay.”

⁷ Petitioner included an additional schedule C for 2013 wherein he reported his business as “Writer” and reported a profit of \$4.00.

CONCLUSIONS OF LAW

A. The adjusted gross income of a New York resident is federal adjusted gross income (FAGI), with certain modifications not applicable in this case (Tax Law § 612 [a]). Section 62 (a) (1) of the Internal Revenue Code (IRC) defines the adjusted gross income as an individual's gross income minus certain deductions. Among the deductions permitted are expenses that are "ordinary and necessary" for the production of income in carrying on a trade or business (IRC [26 USC] § 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]). Deductions are also allowed pursuant to IRC § 212 for expenses incurred "for the management, conservation, or maintenance of property held for the production of income." The test as to whether property is held for the "production of income" within the meaning of IRC § 212 is whether the taxpayer's primary, good faith purpose and intention in engaging in the activity was to make a profit (*Zell v Commissioner*, 763 F.2d 1139, 1142 n.2 [10th Cir 1985]; *Snyder v United States*, 674 F.2d 1359, 1364 [10th Cir 1982]; *Lowry v United States*, 384 F.Supp 257, 261 [1974]).

Petitioner argues that the Division should be required to accept his claimed business deductions, contending that the deductions have been accepted by the IRS and have been "deemed reasonable and customary." Petitioner's argument is without merit. Though FAGI is the computational starting point for determining New York tax liability, New York State is a separate sovereign, and as such, is not bound to accept FAGI as reported to the IRS, nor is it bound to accept a federal determination with respect thereto, or to accept the amounts of any of the component items of income, or of federal adjustment, claimed in arriving at FAGI (*see Matter of Estate of Gucci*, Tax Appeals Tribunal, July 7, 1997, citing *Matter of Atlantic &*

Hudson Ltd. Partnership, Tax Appeals Tribunal, January 30, 1992). Any other conclusion would serve to bind the Division to simply accepting the amounts set forth on federal tax returns, regardless of whether such amounts were ever audited or otherwise challenged by the IRS. Rather, the Division is clearly entitled to conduct its own examination and arrive at its own conclusions. Taxpayers, such as petitioner, in turn, bear the burden of overcoming such conclusions (*see* Tax Law § 689 [e]). Similarly, and in attempting to do so, taxpayers bear the burden of showing entitlement to any deductions or adjustments claimed by producing records that are adequate to substantiate the validity and amounts of any such claimed deductions or adjustments (*see* Tax Law § 658 [a]; 20 NYCRR 158.1 [a]). In sum, the Division may independently examine and challenge any of such component items, as reported to the IRS, so as to verify the accuracy of a taxpayer's income, adjustments and, in turn, the amount of a taxpayer's FAGI.

As noted above, petitioner reported losses for the year at issue from the schedule C business described as "Management Consulting" and deducted those losses from his gross income. Tax Law § 689 (e) places the burden of proof on petitioner to show that he is entitled to the claimed business deductions. In order to maintain the deductions for the business expenses, 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 [3d Dept 1999]).

B. To be entitled to a deduction for substantiated ordinary and necessary expenses petitioner must show that he engaged in the business activities with an actual and honest objective of making a profit (*see Annuzzi v Commissioner*, TC Memo 2014-233 [2014]). If an activity is "not engaged in for profit," deductions are allowable only to the extent of income from

such activity (IRC [26 USC] § 183 [b] [2]; *Matter of Temple*, Tax Appeals Tribunal, July 8, 2004). Resolution of the issue of whether petitioner's activities were engaged in for profit is properly determined based on a review of all of the surrounding facts and circumstances and in consideration of the nine factors set forth in Treas Reg § 1.183-2 [b] (*see Hoag v Commissioner*, TC Memo 1993-348 [1993]). In resolving the factual question, greater weight is given to the objective facts than to the taxpayer's statements of intention (*id.*).

The nine factors listed in the regulations to help determine whether a taxpayer has engaged in an activity for profit are as follows: (1) the manner in which the taxpayer carries on the activity; (2) the expertise of the taxpayer or his advisors; (3) the time and effort expended by the taxpayer in carrying on the activity; (4) expectation that assets used in the activity may appreciate in value; (5) the success of the taxpayer in carrying on other similar or dissimilar activities; (6) the taxpayer's history of income or losses with respect to the activity; (7) the amount of occasional profits, if any, that are earned; (8) the financial status of the taxpayer; and (9) elements of personal pleasure or recreation (Treas Reg § 1.183-2 [b]). The factors listed above are intended as guidelines and are nonexclusive. Accordingly, no single factor or combination of factors is conclusive in indicating a profit objective (*see Ranciato v Commissioner*, 52 F3d 23 [2d Cir 1995]). Additionally, as stated by the court in *Metz v Commissioner*, “[w]hile we organize our analysis by the nine factors listed in the regulation [citation omitted] we don’t use a reasonable-person standard or substitute our own business judgment for what the [taxpayers] could have done better. Our focus is instead on the [taxpayers’] subjective intent and we use the factors to establish that intent” (*Metz v Commissioner*, TC Memo 2015-54 [2015], citing *Wolf v Commissioner*, 4 F3d 709 [9th Cir 1993]).

C. After carefully considering the entire record, focusing on the nine factors noted above,

I conclude that petitioner has not met his burden of proof to establish that the activities related to his reported schedule C business during the year in question were carried on with an actual and honest objective of making a profit. Some of the factors are not relevant to the facts of this case and the evidence in the record is sparse with regard to a number of pertinent factors.

The first factor considers whether the taxpayer engaged in the activity in a businesslike manner (Treas Reg § 1.183-2 [b] [1]). In determining whether the taxpayer conducted the activity in a businesslike manner, the courts have considered whether accurate books were kept, whether the activity was conducted in a manner similar to other comparable businesses and whether changes were attempted in order to make a profit (*Dodge v Commissioner*, TC Memo 1998-89 [1998], *affd* 188 F3d 507 [6th Cir 1999]). Petitioner has presented no evidence as to whether books and records were maintained for the business, whether separate bank accounts were maintained for business and personal use, or the manner in which any business activities were conducted. There is no evidence that petitioner had a specific business plan or that he made any changes to the business over the years in order to make a profit. As such, this factor weighs against petitioner.

The second factor, the expertise of the taxpayer or his advisors, likewise weighs against petitioner. While petitioner presented no evidence that he sought advice or the expertise of professionals in developing the business, petitioner testified that he did not obtain a registration license that would have been required in order for the business to be affiliated with broker dealers.

For the third factor, the time and effort expended by the taxpayer in carrying on the activity, petitioner presented no evidence. In response to the Division's questionnaire for schedule C loss, petitioner stated that he spent 20 hours a week on the schedule C business, and 20 hours a week in his outside employment unrelated to the schedule C business (*see* finding of

fact 4). As such, it appears that petitioner dedicated no more time on his own business than he did on his unrelated employment.

There is no evidence in the record with regard to the fourth factor, expectation that assets used in the activity may appreciate in value, or the fifth factor, the success of the taxpayer in carrying on other similar or dissimilar activities, and such factors do not appear to be relevant herein.

The sixth factor, the taxpayer's history of income or losses with respect to the activity, weighs against petitioner. Courts have recognized that a series of losses which extend beyond the startup period may display a lack of a profit motive (*Annuzzi v Commissioner*; Treas Reg § 1.183-2 [b] [6]). Nevertheless, “If [the] losses are sustained because of unforeseen or fortuitous circumstances which are beyond the control of the taxpayer, such as drought, disease, fire, theft, weather damage, or other involuntary conversions, or depressed market conditions, such losses would not be an indication that the activity is not engaged in for profit” (Treas Reg § 1.183-2 [b] [6]).

In this instance, petitioner’s schedule C business unquestionably sustained a series of losses, as demonstrated by the business expense deductions petitioner claimed on his resident income tax returns for the years 2010 through 2016. Furthermore, such losses cannot be characterized as startup losses, as petitioner stated in his response to the Division’s questionnaire for schedule C loss that he started the business in 1996 (*see* finding of fact 4). Moreover, petitioner stated in his response that there were not any circumstances beyond his control that contributed to the claimed losses (*see id.*).

The seventh factor, the amount of occasional profits, weighs against petitioner, as he has presented no evidence of any profits from his schedule C business.

The eighth factor, the financial status of the taxpayer, weighs against petitioner. The

Treasury Regulations provide that an indication of a profit motive may be discerned when a taxpayer does not have substantial income or capital from sources unrelated to the activity (Treas Reg § 1.183-2 [b] [8]). In this matter, petitioner has substantial income from his wage and salary employment unrelated to his schedule C business and used his claimed business losses to claim a deduction against that income.

Finally, the ninth factor, elements of personal pleasure or recreation, is not relevant to this matter.

An analysis of the factors outlined above weighs against petitioner. In sum, petitioner has simply failed to meet his burden of proof to show that he intended to make a profit from his schedule C business. As such, the Division properly denied the deduction for the claimed business losses.

D. While it has been determined that petitioner has failed to show the requisite profit motive for the activities related to the schedule C business, for purposes of a complete discussion of all the issues, the requirement of proving gross receipts and substantiating business expenses will also be discussed. Assuming, *arguendo*, that petitioner met his burden of proving that his business was engaged in for profit, petitioner has the further burden of proving entitlement to the claimed deductions in excess of revenue and substantiation of the business losses, including the business purpose and amount of each of the claimed expenses.

The starting point for determining a profit or loss from a schedule C business is gross receipts. From that amount allowable expenses are subtracted to determine the net profit or loss. In this case, petitioner has presented no evidence of how he calculated gross receipts for the schedule C business for the year at issue. Petitioner failed to present into the record any documentary evidence or testimony to support his calculation of gross receipts in the amount of \$500.00. As such, it is impossible from the record to determine the actual amount of gross

receipts of the schedule C business for which petitioner claimed losses, and thus impossible to determine if the expenses outweigh the revenue. Petitioner has thus failed to meet his burden of proving the net profit or loss for the schedule C business and the Division properly disallowed the claimed business losses in their entirety.

E. In addition to the requirements of proving that the business was engaged in for profit and the amount of gross receipts, petitioner further bears the burden substantiating the claimed expenses in amount and business purpose. Petitioner failed to present any documentary evidence during the hearing to substantiate his claimed expenses. As such, the only documents to consider were the incomplete “cover receipts” petitioner presented to the Division in response to its inquiry.

After reviewing the limited and incomplete records petitioner provided to the Division, it is determined that petitioner has not met his burden of proving the business purpose and amount for any of the claimed expenses, as discussed below.

a) Advertising – petitioner claimed advertising expenses of \$1,000.00 on his schedule C for 2016. None of the “cover receipts” provided by petitioner indicate advertising expenses. When questioned during the hearing as to whether petitioner had any receipts for advertising expenses, he first responded that he had numerous receipts. However, he failed to put them into the record. Petitioner then responded that advertising would be under internet expenses in his “cover receipts.” However, the invoice petitioner submitted to the Division as a “cover receipt” for his claimed internet expenses shows charges of only \$37.99 for a one year renewal of domain.com from Network Solutions (*see* finding of fact 5), and an invoice from Spectrum showing charges for television, internet and other charges totaling \$153.46. It is further noted that petitioner separately claimed expenses for internet totaling \$4,754.00 under the category of “other expenses” on his schedule C (*see* finding of fact 2). Petitioner presented no evidence as

to how this amount is related to advertising expenses for purposes of his schedule C business. As such, petitioner failed to substantiate both the business purpose and claimed amount of \$1,000.00 for advertising expenses.

b) Commissions and Fees – petitioner claimed expenses for commissions and fees in the amount of \$1,000.00 on his 2016 schedule C. None of the “cover receipts” submitted by petitioner to the Division indicate that they are for “commissions and fees” totaling \$1,000.00 and petitioner presented no testimony or other evidence for this expense. While petitioner provided to the Division a page with typed information stating: “Broker Fee 1/1/2016 – 12/31/2018 Marcy Bloomstein, DJ Knight Company \$300.00” and a handwritten notation “paid cash 1/5/16,” there is no evidence as to the business purposes of this expense. As such, petitioner failed to substantiate both the business purpose and claimed amount of \$1,000.00 for commissions and fees.

c) Depreciation and section 179 expense deduction. Petitioner did not present any evidence for this claimed expense. As such, petitioner failed to substantiate both the business purpose and claimed amount of \$1,500.00 for depreciation and section 179 expenses deductions.

d) Legal and professional services – petitioner claimed \$350.00 for legal and professional services on his 2016 schedule C. Included with petitioner’s “cover receipts” provided to the Division was a copy of a check made out to “cash” in the amount of \$1,000.00. At the top of the photocopy, petitioner handwrote “Professional Services - \$1300 – 2016,” “Tim Wierzbicki,” and “Consulting/Business Development – EastWest Institute CDO Search.” The amount of the check made out to “cash” does not match the amount claimed on petitioner’s schedule C or the amount indicated in petitioner’s handwritten note, and petitioner provided no explanation as to the amount or the business purposes. As such, petitioner failed to substantiate both the business purpose and claimed amount of \$350.00 for legal and professional services.

e) Office expenses – petitioner claimed \$12,392.00 for office expenses on his 2016 schedule C. Petitioner provided the Division with a “cover receipt” that he labeled as “Office Expenses” for 2016 on which he handwrote “\$3443.” The “cover receipt” consisted only of an emailed invoice from Ebay for \$6.00. No explanation was provided as to what this charge was for or how it relates to petitioner’s business, and no evidence was provided to support petitioner’s handwritten notation of “\$3443” for office expenses. As such, petitioner failed to substantiate both the business purpose and claimed amount of \$12,392.00 for office expenses.

f) Other business property – petitioner claimed \$2,194.00 as expenses for other business property. Petitioner offered no evidence to support this claimed expense. As such, petitioner failed to substantiate both the business purpose and claimed amount of \$2,194.00 for other business property.

g) Supplies – petitioner claimed \$500.00 as expenses for supplies on line 22 of his schedule C, and separately claimed additional expenses of \$3,443.00 for supplies under “other expenses” on Part V for line 27A of the schedule C. None of the “cover receipts” petitioner provided to the Division indicate that they are for supplies related to petitioner’s business and petitioner presented no evidence in this regard. As such, petitioner failed to substantiate both the business purpose and claimed amount of \$500.00 for supplies or \$3,443.00 for supplies claimed under “other expenses.”

h) Travel – petitioner claimed \$1,000.00 as travel expenses. Pursuant to IRC § 274, no deduction shall be allowed for any traveling expense (including meals and lodging while away from home):

“unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating the taxpayer's own statement (A) the amount of such expense or other item, (B) the time and place of the travel or the date and description of the gift, (C) the business purpose of the expense or other item, and (D) the business relationship to the taxpayer of the person receiving the benefit.”

The only information petitioner provided for this expense was the “cover receipt” he submitted to the Division which consisted of an itinerary confirmation for petitioner from JetBlue for a roundtrip flight from New York, New York to Fort Myers, Florida in November 2016. The confirmation shows a total fare of 13,200 points + \$11.20. Petitioner handwrote “2016 Travel & Ent \$5740” on the itinerary. Petitioner provided no evidence to show a business purpose for any claimed travel and failed to substantiate the amount claimed. Accordingly, petitioner is not entitled to a deduction for the claimed travel expenses (*see Obayagbona v Commr. of Internal Revenue*, 14856-13S, 2016 WL 6520220, at *6 [TC Nov. 3, 2016]).

i) Meals and Entertainment – Petitioner claimed \$8,610.00 as expenses for meals and entertainment on his 2016 schedule C. Daily meals are an inherently personal expense, and a taxpayer bears a heavy burden in proving that they are deductible (*Moss v Commissioner*, 80 TC 1073 [1983], *affd* 758 F2d 211 [7th Cir 1985]). Although taxpayers may find it necessary to eat meals away from their personal residences because of the demands of their businesses, this circumstance, alone, will not ordinarily provide a basis for the deduction of the cost of these meals (*Coombs v Commissioner*, 67 TC 426 [1977], *affd* 608 F2d 1269 [9th Cir 1979]). IRC § 274 imposes heightened substantiation requirements with respect to deductions for meals and entertainment expenses. No deduction is allowed for meals and entertainment expenses, unless the taxpayer establishes with adequate records or other credible evidence: (1) the amount of the expense; (2) the time and place of the expense, including address or location; (3) the business purpose of the expense; and (4) the business relationship of the taxpayer to the persons receiving the benefit, including the name, title, or other designation sufficient to establish the business relationship to the taxpayer (*see* IRC [26 USC] § 274 [d]; sec. 1.274-5T(b) (3), Temporary Income Tax Regs., 50 Fed. Reg. 46015 [Nov. 6, 1985]). Petitioner did not provide any evidence

to support the claimed amount and has failed to satisfy his burden of proof of establishing the amount or that the expenses claimed for meals and entertainment were in any way related to the claimed business.

j) Other expenses – petitioner claimed other expenses totaling \$12,365.00, consisting of claimed expenses of internet in the amount of \$4,754.00, telephones in the amount of \$4,168.00 and supplies in the amount of \$3,443.00.

With regard to the claimed expense for internet, the invoice petitioner submitted to the Division as a “cover receipt” for his claimed internet expenses shows charges of only \$37.99 for a one year renewal of domain.com from Network Solutions, and an invoice from Spectrum on which petitioner handwrote “Cable 2016 \$1836.” The Spectrum invoice shows charges for TV services of \$90.74, internet services of \$90.74, other charges of \$8.75, and taxes, fees and charges of \$7.98 totaling \$153.46 for December 2016. Petitioner testified that he operated his business out of his home, and offered no evidence supporting the business percentage of internet use and the business use of cable television. As such, petitioner has failed to meet his burden of proving both the amount and business purpose of the claimed internet expenses.

With regard to the claim for telephone expenses, petitioner provided the Division with “cover receipts” consisting of a one-page account summary from Verizon dated December 4, 2016 for account number *****3131 showing a previous payment of \$104.99 and charges due by December 29, 2016 of \$154.00, on which petitioner handwrote “2016 Telephone(s) \$4168,” and an invoice from Verizon showing an amount due of \$167.43 for the billing period October 29, 2016 to November 28, 2016 for account number *****-00001, on which petitioner handwrote “Biz 2016 \$2826.” Petitioner presented no evidence to show that the telephone expenses were related to his business and did not substantiate the amount claimed. It is noted that even if one were to assume the Verizon invoices might indicate a monthly recurring charge,

such amount does not support the amount claimed (i.e., $\$154.00 \times 12 = \$1,848.00$ and $\$167.43 \times 12 = \$2,009.16$ totals $\$3,857.16$ rather than the amount claimed of $\$4,168.00$).

Moreover, IRS Publication 535 states that a taxpayer cannot deduct:

“[t]he cost of basic local telephone service (including any taxes) for the first telephone line you have in your home, even if you have an office in your home However, charges for business long-distance phone calls on that line, as well as the cost of a second line into your home used exclusively for business, are deductible expenses.”

Petitioner testified that his business was operated out of his home and that he used a desk in the corner of his studio apartment. He did not provide any evidence to show that he had a separate telephone line used exclusively for business. Additionally, petitioner did not provide any evidence showing business long-distance phone calls. Based on the lack of evidence supporting the business use of telephone or the amount claimed, petitioner has not met his burden of proving that he is entitled to the claimed expenses.

With regard to the amount claimed for supplies, as determined in Conclusion of Law E, part (g) above, petitioner failed to substantiate both the business purpose and claimed amount of expenses for supplies.

As to the remainder of the “cover receipts” provided by petitioner to the Division, petitioner has not met his burden of proof to show that they relate to a business purpose or that they support the amounts claimed on the schedule C.

F. Petitioner argues that he only provided the Division with “cover receipts” in response to the audit inquiry because his receipts were too numerous to copy and that the Division should have conducted an in-person audit. Petitioner requests that his claimed business deductions be allowed, or in the alternative that an in-person audit be ordered. Petitioner’s argument is rejected. As noted above, petitioner has the burden of proof in this matter (*see* Tax Law § 689 [e]) and has failed to meet that burden. Contrary to petitioner’s argument, the Division is under no requirement to conduct an in-person audit (*see Matter of Mayo*, Tax Appeals Tribunal, March

9, 2017). Rather, petitioner is required to maintain adequate books and records and to provide such books and records upon request by the Division (*see* Tax Law § 658 [a]; 20 NYCRR 158.1 [a], 158.5). Petitioner failed to provide adequate records to the Division in response to the audit inquiry. Petitioner further failed to present any records during the hearing to support his claimed business expenses deductions, despite the administrative law judge's clear instructions that the determination could only be based upon the evidence presented into the hearing record. As such, petitioner has failed to meet his burden of proof in this matter.

G. The petition of Darren J. Farlow is denied, and the notice of disallowance, dated November 3, 2017, is sustained.

DATED: Albany, New York
July 29, 2021

/s/ Barbara J. Russo
ADMINISTRATIVE LAW JUDGE