

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :
of :
SAMUEL BOGOCH : DETERMINATION
 : DTA NO. 818007
for Redetermination of a Deficiency or for Refund of :
Personal Income Tax under Article 22 of the Tax Law :
and the Administrative Code of the City of New York for :
the Year 1994.

Petitioner, Samuel Bogoch, 46 East 91st Street, New York, New York 10028, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law and the Administrative Code of the City of New York for the year 1994.

A hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on May 1, 2001 at 10:30 A.M., with all briefs to be submitted by November 19, 2001, which date commenced the six-month period for issuance of this determination. Petitioner appeared *pro se*. The Division of Taxation appeared by Barbara G. Billett, Esq. (Peter B. Ostwald, Esq., of counsel).

ISSUE

Whether it was proper for the Division of Taxation to disallow certain deductions as unsubstantiated.

FINDINGS OF FACT

1. Petitioner, Samuel Bogoch, received a medical degree and a Ph D in biochemistry from Harvard University. Petitioner and his wife, who is also a medical doctor and co-researcher, earn their living by developing patents concerning the diagnosis and treatment of cancer. At the

time of the hearing, petitioner had been engaged in research and development for 40 to 50 years. A significant period of time may pass from the time when one begins performing research to the time a patent is acquired and one obtains income from the patent.

2. The research conducted by petitioner in 1994 resulted in patents being issued in 1999 and 2000. These patents pertained to new methods of cancer diagnosis and treatment. In order to augment their income, petitioner and his wife purchased and rented houses.

3. Petitioner filed a New York State and New York City Resident Income Tax Return for the year 1994. He also filed a U.S. Individual Income Tax Return for the same year. In each instance, he claimed a filing status of married filing separate return. Petitioner's Federal return included a Schedule C which described his business or profession as research and real estate. On this schedule, petitioner combined his income and expenses from his activities in research and real estate and reported that the combined amounts resulted in a net loss. The items of income and expense were as follows:

<u>Item of Income or Expense</u>	<u>Amount</u>
Gross receipts or sales	\$99,721.88
Advertising	\$64.50
Car, truck expenses and taxi	\$4,615.91
Insurance	\$805.21
Mortgage paid to banks	\$16,528.05
Office or laboratory expense	\$6,212.87
Repairs and maintenance	\$4,654.73
Taxes and licenses	\$19,770.37
Travel - conferences	\$11,100.66
Utilities and telephone	\$7,531.45
Loss carried forward from 1993	\$19,821.16

4. The Division of Taxation (“Division”) mailed a Statement of Proposed Audit Changes to petitioner, dated May 14, 1999, which stated that New York State personal income tax was due in the amount of \$6,173.33 plus interest in the amount of \$2,262.43 and penalty in the amount of \$1,620.45 for a balance due of \$10,056.21. The statement also explained that New York City personal income tax was due in the amount of \$3,442.44 plus interest in the amount of \$1,261.60 and penalty in the amount of \$930.60 for a balance due of \$5,607.64. According to the statement, there were a number of difficulties with the return. Among other things, petitioner’s return for the year 1994 was due by April 15, 1995, but it was not received until April 15, 1998. Further, petitioner incorrectly entered all of his income on a Schedule C rather than reporting the wages he received from New York State on the first line of the return. The statement also noted that the rental income and expenses should have been reported on Schedule E. Additionally, it explained that petitioner’s consultation income and expenses pertaining to a business could be reported on a Schedule C, but that a separate Schedule C was needed for each business. The statement asked petitioner to review his return and the Federal schedules mentioned above and pointed out that he might need to file an amended return. It also stated that a recomputation of his return resulted in a balance due. Further, the Division asserted a penalty for late filing pursuant to Tax Law § 685(a)(1).

5. The Division issued a Notice of Deficiency, Assessment Number L-016296386-5, dated July 8, 1999, which asserted that New York State and New York City personal income tax, penalty and interest were due for the year 1994 as follows:

	Tax	Interest	Penalty	Balance Due
NYS	\$6,173.33	\$2,351.87	\$1,620.45	\$10,145.65
NYC	\$3,442.44	\$1,311.48	\$903.60	\$5,657.52

	Tax	Interest	Penalty	Balance Due
Totals	\$9,613.77	\$3,663.35	\$2,524.05	\$15,803.17

6. Petitioner filed an amended 1994 New York State Resident Income Tax Return, dated May 30, 2000, wherein he attempted to correct many of the asserted errors in the prior return. Among other things, unlike the first return, petitioner's wages were reported on the first line of the return and taxable interest income was reported on the second line. The amended return included two Schedule C's. On their face, one schedule pertained to the research activities and the second schedule concerned the real estate business.

7. The Schedule C concerning the research activities reported the following income and expenses:

Gross Receipts	\$12,025.00
Car, truck and taxi expenses	\$4,115.91
Insurance	\$2,192.56
Interest	\$4,836.05
Legal/Professional	\$4,187.56
Other business property/Laboratory	\$4,700.00
Taxes and Licenses	\$19,770.37
Travel - Conferences	\$11,430.66
Utilities and telephone	\$7,327.87
Net Operating Loss carryforward from 1993	\$19,821.16

8. The Schedule C pertaining to petitioner's real estate activities reported the following income and expenses:

<u>Item of Income or Expense</u>	<u>Amount</u>
Gross Receipts	\$5,293.63
Car, truck and taxi expenses	\$500.00
Advertising	\$64.50
Insurance	\$1,076.28
Interest (mortgage)	\$16,528.05
Other	\$270.66
Legal and professional	\$2,877.15
Repairs and maintenance	\$4,654.73
Utilities and telephone	\$203.58

9. On or about June 21, 2000, petitioner filed a second amended Resident Income Tax Return. A new Schedule C, which pertained to petitioner's research activities, was attached to the return. It reported the following income and expenses:

<u>Item of Income or Expense</u>	<u>Amount</u>
Gross Receipts	\$12,025.00
Car and Truck expenses	\$5,453.19
Insurance	\$2,172.16
Interest	\$5,635.87
Legal/Professional	\$4,352.00
Other business property/Laboratory	\$6,700.00
Supplies (other laboratory expenses)	\$6,223.45
Taxes, Licenses and Patents	\$13,694.37
Travel/Conferences	\$2,831.24
Utilities	\$6,448.24
Net Operating Loss carryforward from 1993	\$19,821.16

10. Petitioner also filed a Schedule E which reported the income and expenses of his real estate business as follows:

Location of Real Estate	Staatsburg, NY	Hyde Park, NY	Brookline, MA	Claimed
Rents Received				\$5,293.63
Advertising			\$64.50	
Auto/Travel			\$500.00	
Insurance			\$801.43	
Legal/Professional				\$2,000.00
Other Interest-Bank				\$270.66
Repairs/Maintenance				\$4,425.81
Taxes		\$2,000.00		\$2,000.00
Utilities	\$1,315.07		\$1,623.14	\$2,938.21

Real Estate Activities

11. In response to the Division's request for substantiation, petitioner submitted packets of documents concerning his real estate business and his research activities. Following a review of the evidence concerning the real estate activities, the Division allowed the deductions set forth below:

Location of Real Estate	Staatsburg, NY	Hyde Park, NY	Brookline, MA	Claimed	Allowed
Rents Received				\$5,293.63	-0-
Advertising				\$64.50	\$64.50
Auto/Travel				\$500.00	-0-
Insurance				\$801.43	\$801.43
Legal/Professional				\$2,000.00	\$2,000.00
Other Interest- Bank				\$270.66	-0-
Repairs/Maintenance				\$4,425.81	\$1,434.00
Taxes				\$2,000.00	\$2,000.00
Utilities				\$2,938.21	\$1,600.00

12. When he prepared his New York State income tax return for 1994, petitioner estimated that his auto and travel expenses for his real estate activities were \$500.00. The estimate was based on his need to rent a car to visit the rental properties in Massachusetts and New York. Petitioner visits the rental properties more than once each year and, in the process, incurs rental expenses and tolls.

13. A review of the evidence presented by petitioner pertaining to his auto and travel expenses shows there was one canceled check, dated January 20, 1994, payable to G.A.P. Auto Repair Inc. in the amount of \$46.00. At the hearing, petitioner offered to provide additional information after the hearing with respect to his auto and travel expenses. However, additional information was not presented.

14. The Division disallowed an item in the amount of \$270.66 referred to as "Other int-Bk." At the hearing, petitioner did not recall how this expense was incurred. However, he offered to provide documentation with respect to the bank interest. Additional documentation was not offered on this expense.

15. On his return, petitioner claimed a deduction for repairs and maintenance in the amount of \$4,425.81. During the audit, petitioner submitted documentation for only \$1,434.00 and this amount was allowed by the Division. Petitioner did not present any additional testimonial or documentary evidence on this point.

16. Petitioner claimed utility expenses with respect to his real estate activities in the amount of \$2,938.21. On the basis of the documentation submitted, the Division allowed utility expenses in the amount of \$1,600.00. Petitioner has not presented any additional evidence or argument on this adjustment.

Research and Development

17. As set forth above, the Division did not allow the deductions which petitioner claimed for research and development. In explaining the decision that no expenses would be allowed, the auditor stated, among other things, that it appeared that petitioner was claiming both personal and business expenses. The Division believed that petitioner could be claiming expenses that should be claimed as itemized deductions. Further, when petitioner was asked to document the expenses, the Division concluded that very little was provided. For example, it was noted that although petitioner claimed \$2,831.24 for travel and conferences, the documentation presented only accounted for \$898.37 without any explanation of the purpose of the payments. With respect to the gross receipts, petitioner indicated that they were paid as consultative earnings. This explanation was considered inadequate because Forms 1099 were not provided as documentation and, therefore, the auditor could not review the source of the income.

18. In regard to the deduction of a net operating loss, the auditor noted that there are specific instructions on how to report this type of loss and it could not be claimed on a Schedule C. He also pointed out that there was a particular way of calculating this type of loss and that the taxpayer would have to show how the amount of the loss was determined.

19. Turning to the specific income and expenses claimed for research and their disallowance, the record shows that in 1994 petitioner was paid \$82,000.00 for consulting with an organization known as the Brain Research Laboratory. According to petitioner, this income was erroneously placed on a Form W-2 and it should have been reported on a Form 1099. Additional evidence has not been presented on this point.

20. Petitioner claimed car and truck expenses in the amount of \$5,453.19. He explained that he incurred the car and truck expenses in research and development because he had to travel

to the employer's site. The documentation presented by petitioner shows that he had receipts for road tolls in the amount of \$737.03, two checks for repairs in the total amount of \$96.00, depreciation on an automobile of \$3,000.00 and taxi expenses of \$282.88. In addition, there were credit card charges from AMEX and Mastercard of \$237.95 and \$1,099.33.

21. Petitioner claimed insurance expenses in the amount of \$2,172.16. In 1994, petitioner had a laboratory in Boston and a second laboratory in London. He rented a laboratory in London because a leading expert who had the greatest knowledge about the subject petitioner was working on was at University College Hospital in London. This expert would not come to the United States, so petitioner went to London. Petitioner maintained insurance on both laboratories. In support of this expense, petitioner submitted three checks. The first check was numbered 3227 and dated May 7, 1994. It was drawn on an account in petitioner's name at Citibank and made payable to the order of Liberty Mutual in the amount of \$966.81. The second check was numbered 3226, drawn on the same account as the first bank, and also dated May 7, 1994. Like the first check, it was drawn on an account in petitioner's name and made payable to the order of Liberty Mutual in the amount of \$399.10. The third check was numbered 3168 and dated March 18, 1994. It was drawn on the same account as the first two checks and made payable to "St. Paul (Insurance)" in the amount of \$806.25.

22. Petitioner reported that he paid interest expense on his charge cards in the amount of \$5,635.87. He incurred the interest expenses on charges which were not immediately paid in full. Although petitioner claimed at the hearing that he could substantiate this expense, documentary evidence was not presented either at or after the hearing.

23. Petitioner claimed a deduction for legal and professional expenses in the amount of \$4,352.00. This expense was incurred for legal advice on business contracts and leases. In

support of this expense, petitioner presented copies of five canceled checks drawn on an account in his name. The checks may be described as follows:

(a) The first check was dated March 8, 1994 and bore number 3164. It was made payable to the order of Landenau Kooner & Kurtz¹ in the amount of \$1,187.56. A notation was inserted in the space for a memo which stated “Client #930079 Re: Billings Wayne N. Outtec Legal.”

(b) The second check was dated July 6, 1994 and was numbered 3273. It was made payable to the order of Scopetta & Seiff in the amount of \$1,000.00. A note in the memo portion of the check said “legal.”

(c) The third check was dated July 14, 1994 and was numbered 3274. It was also made payable to the order of Scopetta & Seiff in the amount of \$1,000.00. The legible portion of a notation in the memo portion of the check said “Bal \$1,000 LEGAL.”

(d) The fourth check was dated August 12, 1994 and was numbered 3289. It was also made payable to Scopetta & Seiff in the amount of \$1,000.00. The memo portion of the check stated, in pertinent part, “LEGAL.”

(e) The last check was dated December 30, 1994 and was numbered 3335. It was made payable to the order of the New York State Education Department in the amount of \$165.00. A notation on the memo section of the check stated “License No. 193305 Registration 01/01/95 - 12/31/95.”

24. Petitioner claimed an expense for “Other business prop.” in the amount of \$6,700.00. The term “other business prop.” was used by petitioner to explain the rent expense for the laboratory in London. The record contains copies of five checks which were made payable to 93

¹ It is difficult to discern from the handwriting the exact spelling of the name.

Harley St., Ltd. The check number, date, amount and, if present, memorandum on the checks are as follows:

Check Number	Date	Amount	Memo
3160	February 15, 1994	\$1,500.00	
3204	April 16, 1994	\$1,100.00	“Lab 93 Harley St.”
3288	August 12, 1994	\$1,100.00	“Rent 93 Harley St. London”
3307	October 28, 1994	\$2,000.00	“Apply to Rent Only (Not services) Lab rent 93 Harley St.”
3152	January 13, 1994	\$1,000.00	

25. Petitioner also offered two letters in support of the rent expense. One letter, dated September 11, 1995, was from F. W. GAAP Management Services Limited in London. In this letter, petitioner was advised, among other things, that he had been offered a new three-year lease on a basement suite at 93 Harley Street. The second letter was from the office of the Chief Executive and Director of Finance of the City of Westminster and was dated December 10, 1998. In this letter, petitioner was advised that he had an outstanding balance due on certain accounts for the period April 1, 1990 through March 31, 1995.

26. Petitioner reported deduction in the amount of \$6,223.45 for supplies and other lab expenses. The documents offered by petitioner include numerous canceled checks and credit card statements regarding transactions with such entities as Thomas Scientific, Staples, Bonomo Tile Co., Federal Express and CPA Inc. It also included two corporate card quarterly management reports for the quarters ending September 30, 1994 and December 31, 1994. The latter documents list a variety of transactions such as dealings at gasoline stations and other automobile related expenses, purchases at retail establishments such as Staples and dealings at

certain restaurants. Very little testimony was offered on the supplies expense and it is not possible to discern from the documents which expenses were included in the amount claimed for supplies. At the hearing, petitioner stated that the supplies expense was for the purchase of chemical supplies. Although this may be true of some of the expenses, it is also clear that many of the expenses documented were unrelated to the purchase of supplies. It is found that the following expenses were incurred for the payment of supplies - payments to Thomas Scientific in the amounts of \$161.70 and \$522.32 and expenses incurred at Staples in the amounts of \$359.12, \$106.03, \$38.22, \$152.97, \$261.05 and \$19.66.

27. Petitioner claimed \$13,694.37 for "Taxes & Licenses & Patents" on his income tax return. The deduction was disallowed because petitioner had not mentioned to the Division that he had not purchased the patents. At the hearing, petitioner explained that this amount was solely for licenses and patents and that no amount was included for taxes. Petitioner submitted a packet of photocopied checks showing the following:

Check Number	Date	Payee	Amount	Memo
3162	2/17/94	Commissioner of Patents and Trademarks	\$481.50	
3203	4/16/94	College of Physicians and Surgeons of BC	\$800.00	Req. No. 04814 1994
3209	4/27/94	Commissioner of Patents and Trademarks	\$65.00	Application # 08/198, 139 To file missing parts

Check Number	Date	Payee	Amount	Memo
3239	5/11/99	Kenyon & Kenyon	\$850.00	illegible:[9426/46776] Fees(Protest) International (illegible) Vaccine
3298	9/18/94	Boult Wade Tennant	\$1,079.59	Renewal Japanese Patent No. 1660592
3299	9/25/94	Dr. Elenore Bogoch	\$2,400.00	Partial Reimbursement for Boult Wade payment
3300	10/2/94	Boult Wade Tennant	\$1,580.00	Restoration UK Patent # 0015755
3252	5/25/94	Boult Wade & Tenant	\$3,600.00	Japanese Patent 1633581 Renewal Fee
3254	5/27/94	College of Physicians & Surgeons Ont.	\$420.65	(Illegible) # 13508 Inv# 9410808
3295	8/30/94	Boult Wade & Tennant	\$1,757.70	Euro German P2967534.1
3321	12/30/94	Commissioner of Patents & Trademarks	\$55.00	08/031,562 Response
3326	12/29/94	Commissioner of Patents and Trademarks	\$605.00	Petition to Revive 08/198,139

28. The evidence offered by petitioner also included correspondence dated August 17, 1994 from Boult Wade Tennant, a firm of patent attorneys in London, England. Among other things, the letter states that petitioner's remittance would be applied to the debt owed to the firm and that he must remit additional funds and instructions for the renewal of a Japanese patent. The letter provided petitioner with a list of patents which were due or overdue for renewal. In addition, the law firm noted that it was awaiting instructions regarding the restoration of another

patent. On September 26, 1994, the law firm again asked for instructions regarding the restoration of a patent. On September 16, 1994 and September 30, 1994, the law firm sent letters to petitioner which thanked him for his remittances.

29. Petitioner claimed a deduction in the amount of \$2,831.24 for the expenses he incurred to attend conferences such as a meeting of the National Cancer Institute on February 9, 1994. Petitioner secures contracts by giving talks and reporting on his research and development. In support of his deduction, petitioner presented copies of canceled checks which show the following:

Check Number	Date	Payee	Amount	Memo
3154	1/14/94	US Air	\$433.20	National Cancer Inst. Mtg. 2/9/94
3163	2/17/94	Kintetsu (Illegible) Express Inc.	\$70.00	Hamanetsu (?) Conference Japan A/C # 20971
3158	2/13/94	Doubletree Hotel	\$395.17	National Cancer Inst. Mtg. 2/9 - 13/94
3207	4/20/94	Elsevier Science Ltd.	\$979.00	Lancet Conf. Louden Brugge
3208	4/21/94	Quest	\$107.00	Lancet Conf. (Illegible)
3310	11/7/94	Port Authority	\$4.00	

30. In 1994, petitioner was invited to attend and speak at a conference of Elsevier Science Ltd. He paid \$979.00 for the registration. This portion of petitioner's papers also include, among other things, an abstract, which was written by petitioner and his wife, for a meeting of the National Cancer Institute in San Diego, California on February 9, 1994 through February 13,

1994. A page from The Lancet advised its readers that an international conference on breast cancer would take place in Brugge, Belgium on April 21 and 22, 1994. Petitioner's papers also include an abstract for the Brugge meeting. The last document offered was a credit card statement for December 1993. On its face, the expenses listed on the credit card statement concerned expenses incurred in November and December 1993.

31. Petitioner claimed utility expenses in the amount of \$6,448.24. He sought to substantiate this expense with the following canceled checks which all pertained to research and development:²

Check Number	Date	Payee	Amount	Memo
3215	4/28/94	Boston Edison	\$1,640.00	Acct # 217703060293 36 Fenway Boston
3217	4/28/94	Boston Edison	\$1,000.00	Acct # 561191001901
3260	6/20/94	Boston Water & Sewer Commission	\$600.00	For 36 Fenway Acct # 134126 Wd. 4 (\$500/mos. to clear acct.)
3290	8/22/94	Boston Water & Sewer Commission	\$858.24	Act 134126000 36 Fenway
3296	9/02/94	Boston Water & Sewer Commission	\$550.00	Payment Plan 36 Fenway Acct # 134126 WARD # 04

² At the hearing, the auditor stated that he believed that one of the checks was for petitioner's residence in New York City. This statement was disregarded since all of the checks were made payable to a Boston utility.

Check Number	Date	Payee	Amount	Memo
3308	10/28/94	Boston Gas	\$1,800.00	36 Fenway Acct # 1141258275010

32. Petitioner claimed a net operating loss carryforward from 1993 in the amount of \$19,821.16. The loss, which arose in 1993, pertained to research and development. At the hearing, petitioner was not sure how the loss was being shown on the amended returns, i.e., whether the loss carryforward was split between the two returns.

SUMMARY OF THE PARTIES' POSITIONS

33. At the hearing, petitioner argued that it is permissible to combine income from different activities on a Schedule C. According to petitioner, he has been subject to three previous audits, and no one has ever objected to combining the different businesses on a Schedule C. Petitioner also contends that he is allowed to deduct the expenses because he developed the patents and did not purchase them.

34. Petitioner submits that all of the research and development expenses claimed are part of his research and development business. He maintains that obtaining the patents is an absolute prerequisite to the licensing and selling of the products. He also argues that the recently issued patents should establish the legitimacy of the deductions in issue.

35. With respect to the specific deductions, petitioner posits that he is entitled to deduct the cost of developing the patents. He also contends that he is entitled to deduct the laboratory rent of \$6,700.00 because he was working in close collaboration with the University College Hospital in London. Further, he only deducted six months rent because he only paid six months rent. Petitioner argues that the research expenses of \$6,223.45 were incurred because his home

is in New York. On his income tax return, petitioner deducted the expenses of making round trips to Boston or London, the lodging expenses and one-half of the meal expenses. He also deducted the laboratory supplies (e.g., Thomas Scientific) and the related office supplies (e.g., Staples). Lastly, petitioner notes that the net operating loss carry-forwards from the years 1991 through 1993 were \$54,250.00, \$52,413.09 and \$19,812.16, respectively.

36. In response to the foregoing, the Division argues that after reviewing the documentation submitted, it determined that petitioner failed to keep accurate records. The Division submits that it is the responsibility of the taxpayer to keep records that will substantiate his expenses by providing proper receipts, diaries and explanations. In regard to the research activities, it is contended that since it appears that some of the expenses may be for personal use, a better explanation was needed for all of the expenses claimed. It is also noted that the rental properties are jointly owned with petitioner's spouse and since petitioner's filing status is married filing separately, petitioner needs to substantiate that the expenses are his alone. The Division also stated that petitioner never substantiated or explained the income or expenses claimed on Schedules C and E. Therefore, the final determination was to adjust petitioner's return by allowing expenses up to the amount of income claimed on Schedule C and Schedule E. The amount of income claimed on Schedule C was \$12,025.00 and the amount of income reported on Schedule E was \$5,293.63. Accordingly, the Division allowed petitioner expenses of \$17,318.63.

37. In accordance with the foregoing, the Division recalculated petitioner's taxable income as follows:

Wages	\$82,403.00
Interest Income	<u>1,050.00</u>
Federal Adjusted Gross Income	\$83,453.00
Tax Law § 414(h) add back	<u>2,576.00</u>
New York Adjusted Gross Income	\$86,029.00
Less: Standard Deduction	4,750.00
New York Taxable Income	\$81,279.00

38. After calculating the amount of tax due from the tax rate schedules, the Division determined the amount due by subtracting the amount of tax withheld and adding a penalty pursuant to Tax Law § 685(a)(1) and interest to August 31, 2001. The computation resulted in a total amount of New York State and New York City personal income tax due of \$6,381.00.

39. In response to the foregoing, petitioner argues that the contention that “the taxpayer failed to keep accurate records” is false. According to petitioner, the leases, bills, checks, and location of banks in which they were cashed show that there were two sites of research and development activities. Petitioner notes that it was necessary to incur expenses in the United Kingdom because the world’s leading experts in antibody synthesis were in the United Kingdom and he needed to work with them on the anti-cancer antibody which he had isolated and which was the subject of his patents. It is further contended that the assertion that some of the expenses may have been for personal use, without citing a specific example, is improper. In regard to the joint ownership of some properties and his wife’s business expense, petitioner states that Dr. Eleanore Bogoch’s expenses were separately deducted on her income tax return. Petitioner submits that each item of research and rental expenses was documented and explained.

Petitioner maintains that he is unable to understand why the Division will not accept the proposition that he made deductible expenditures. It is submitted that the Division is now

“fishing” by means of innuendo to exclude his expenses so that he will have to pay taxes on his losses.

CONCLUSIONS OF LAW

A. The issue presented in this case is whether petitioner has substantiated the deductibility of a series of expenses. In essence, this raises two questions - - whether petitioner is entitled to deduct the expense as a matter of law and the amount of the deduction which is to be allowed. The Tax Law of the State of New York imposes upon petitioner the burden of refuting the Division’s disallowance of the deductions and of establishing that he is entitled to the expenses claimed (Tax Law § 689(e); ***Matter of Macaluso***, Tax Appeals Tribunal, September 22, 1997 ***confirmed***, 259 AD2d 795, 686 NYS2d 193; ***Matter of Schneier***, Tax Appeals Tribunal, November 9, 1989). The starting point for determining New York personal income tax liability is a taxpayer’s Federal adjusted gross income (Tax Law § 612[a]; 20 NYCRR 112.1). Since the New York State personal income tax law is patterned after the Federal income tax laws, the Internal Revenue Code (“IRC”) provides guidance with respect to the deductibility of the various expenses.

B. In reviewing the documents submitted, two difficulties become readily apparent. First, a very confusing situation has been created because petitioner did not follow the instructions which accompany the forms. At the beginning of the instructions to Form 1040, Schedule C, the instructions state that one should use Schedule E and not Schedule C to report rental real estate income or loss that is not subject to self-employment tax. The instructions for line A of Schedule C further state that “[i]f you owned more than one business, you must complete a separate Schedule C for each business.” Here, petitioner not only reported the real estate

activities on the wrong schedule, he combined the real estate business with the research activities. The merging of the two businesses makes it impossible to match income and expenses of each separate business in order to determine the separate activities' income or loss. The Division is entitled to be able to verify each item of income or loss and petitioner's reporting practice frustrates this right. Further, petitioner's practice of reporting a net operating loss carryforward on a Schedule C is also erroneous. Individuals are required to calculate a net operating loss carryforward on a Form 1045 and report the information called for therein.

C. A second difficulty is presented by the lack of organization of the records which were presented for substantiation. The pertinent Treasury Regulation provides that "any person required to file a return of information with respect to income, *shall keep such permanent books of account or records . . . as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown by such person in any return or such tax or information*" (Treas Reg § 1.6001-1[a]; emphasis added). In this case, petitioner presented groups of documents such as canceled checks, invoices and correspondence. However, he did not offer any books or records and, as a result, with respect to certain expenses, it is not clear what invoices or portions of invoices he was claiming as expenses.³ At the hearing, petitioner contended that his original return was simply a composite of the separate schedules pertaining to his research and real estate activities and that mathematically, one would have the same income or loss whether one filed one schedule combining the businesses or separate schedules for each business.

³ This difficulty was particularly troublesome with respect to the supplies expense which was claimed as research.

Petitioner's position is rejected as contrary to the pertinent Federal provisions requiring a separate reporting for each business. Furthermore, there are numerous unexplained discrepancies. The problem is demonstrated by a comparison of the second amended return with the original return. On the original return, petitioner claimed expenses for car, truck and taxis in the amount of \$4,615.91. On the last set of amended returns, he claimed \$5,453.19 for this expense under research and an additional \$500.00 under the real estate business. There is no explanation for the discrepancy. Similarly, on the original return, petitioner claimed an insurance expense in the amount \$805.21. However, on the second amended return, the insurance expense for the research business was reported as \$2,172.16 and the insurance expense for the real estate business was reported to be \$801.43. Again, there is no explanation for the discrepancy. It is obvious that petitioner did not keep precise records of his expenses. Further, no documentation was presented with respect to the amounts listed as income.

D. Before addressing the specific expenses, it should be noted that the Division accepted petitioner's reported Federal income. Of course, if it had chosen to do so, the Division could have used an indirect audit method, such as source and application of funds, to verify the amounts listed as income.

E. The presentation of inadequate records does not necessarily mean that a deduction will not be allowed. "Under certain circumstances, if a taxpayer has no records to prove the amount of a business expense deduction but can establish that some expense was incurred, an allowance may be based on an estimate (*Matter of Coleman*, Tax Appeals Tribunal, May 18, 1989; *cf.*, *Matter of Schneier*, Tax Appeals Tribunal, November 9, 1989). However, the absence of supporting records will "bear heavily' against the taxpayer 'whose inexactitude is of his own

making” (see, *Olken v. Commr.*, 41 TCM 1255, 1257 quoting *Cohan v. Commr.*, 39 F2d 540, 544).

Real estate activities

F. Since a deduction was allowed for certain real estate expenses, only those deductions which were disallowed in whole or in part will be examined.

(1) The first issue in this category concerns the extent to which, if any, petitioner should receive a deduction for business use of his automobile. Presently the statutory requirements for proving entitlement to a business deduction for an automobile used in travel are strict.

Taxpayers are required to keep detailed records substantiating their use of automobiles for business purposes (IRC § 274[d][4] as amended by Pub L 98-369 § 179[b][1]). Specifically, a log reporting total mileage, business mileage, commuting mileage and other personal mileage driven is required (Treas Reg § 1.274-5T). Here, petitioner’s documentation does not include the required log. Accordingly, there is no basis to disturb the Division’s disallowance of the automobile and travel expenses.

(2) The item characterized as “Other int - Bk” was not substantiated in any manner. In situations where the taxpayer has not provided any evidence upon which an estimate could reasonably be based, courts have denied the deduction altogether (*Lerch v. Commissioner*, 877 F2d 624, 89-1 US Tax Cas ¶ 9388). Therefore, no adjustment will be made to the Division’s disallowance of this item.

(3) Petitioner claimed an expense for repairs and maintenance in the amount of \$4,425.81. Prior to the hearing, petitioner presented canceled checks to the Division in the amount of \$1,434.00 in order to substantiate the repair and maintenance expense. This documentation was

accepted by the Division. Additional evidence was not presented on this item, and therefore further consideration of an adjustment is not called for.

(4) Petitioner claimed utility expenses in the amount of \$2,938.21. In order to substantiate this expense, petitioner presented the Division with canceled checks totaling \$1,600.00 and this documentation was accepted. Inasmuch as additional evidence was not presented with respect to the utility expenses, consideration of an additional adjustment is unwarranted.

G. Research Activities

(1) Petitioner claimed car and truck expenses in the amount of \$5,453.19. As before, this expense must be disallowed in its entirety because petitioner did not maintain the required records substantiating the business use of the automobile (*see*, Conclusion of Law “F[1]”).

(2) Petitioner claimed an insurance expense in the amount of \$2,172.16 for the cost of maintaining insurance on laboratories in London and Boston. In view of petitioner’s offering of canceled checks payable to insurance companies in the amount claimed and the credible testimony that petitioner maintained insurance on both laboratories, it is concluded that petitioner is entitled to deduct the insurance expense claimed of \$2,172.16.

(3) The Division disallowed a deduction which petitioner claimed for “Interest - Other charge cards” in the amount of \$5,635.87. At the hearing, petitioner offered to present documentation substantiating this expense. However, no documents have been received. Therefore, there is no basis to disturb the Division’s disallowance of this deduction.

(4) Petitioner claimed legal and professional expenses in the amount of \$4,352.00. The record in this matter contains five checks which on their face pertain to legal and professional

expenses and equal the total amount of the deduction claimed. The Division has not presented any argument as to why this amount should not be allowed as a deduction and, accordingly, it is determined that it was error to not allow this deduction as claimed.

(5) On his return, petitioner claimed a deduction for “Other business prop.” in the amount of \$6,700.00. The credible testimony at the hearing establishes that this expense was for a laboratory which petitioner maintained in London, England. The copies of the canceled checks show that the expense claimed was in fact incurred. Since no argument was advanced that this was not an ordinary and necessary business expense, it is concluded that the Division should have allowed this deduction.

(6) Petitioner claimed a deduction of \$6,223.45 for supplies and other lab expenses.⁴ As set forth in Finding of Fact “26,” it is clear that a number of the expenses set forth on the sheets were unrelated to laboratory supplies. Under the circumstances presented, it is found that the documents show that the following expenses were incurred for the payment of supplies and were deductible - two payments to Thomas Scientific in the amounts of \$161.70 and \$522.32 and a series of payments to Staples in the amounts of \$359.12, \$106.03, \$38.22, \$152.97, \$261.05 and \$19.66.

(7) Under the category of taxes, licenses and patents, petitioner claimed a deduction of \$13,694.37.⁵ At the hearing, petitioner explained that taxes were not included in the amounts claimed. Each of the expenses documented appears to be related to a license or patent and is

⁴ The Treasury Regulations provide that a taxpayer may adopt the current expense method for deducting research or experimental expenditures on the taxpayer’s income tax return (Treas Reg. § 1-174-3[a]). A taxpayer is required to maintain records that permit verification of the amount deducted (Rev Rul 58-356).

⁵ The total amount of the checks listed is \$13,694.44.

regarded as an ordinary and necessary business expense of a business activity related to developing medical patents. Therefore, it is found that petitioner is entitled to a deduction for licenses and patents in the amount of \$13,694.44.

(8) Petitioner claimed a deduction of \$2,831.24 for travel and conferences. As noted earlier, the *Cohan* rule does not apply to this expense, and since petitioner has not maintained the required documentation, he has not substantiated the amount claimed.

(9) Petitioner maintained a laboratory in Boston at 36 Fenway. Petitioner's testimony is consistent with the memos on most of the checks and establishes that petitioner incurred utility expenses for his laboratory in Boston in the amount of \$6,448.24. Accordingly, the Division should have allowed this amount as a deduction.

(10) The Division disallowed a net operating loss carryforward from the year 1993 in the amount of \$19,821.16. As noted earlier, during the year in issue, individuals were required to calculate and report net operating losses on a Form 1045 on the basis of information called for therein. Here, petitioner has not presented information on how the net operating loss was computed. Under these circumstances, the net operating loss may not be allowed.

H. In an attempt to resolve the matter, the Division allowed petitioner expenses up to the amount of income on Schedules C and E totaling \$17,318.63. Therefore, the question presented is whether petitioner is entitled to a greater amount of deductions under the Division's proposal or under the analysis set forth above. Under the analysis set forth herein, petitioner was permitted deductions for his real estate activities of \$7,899.93. As set forth above, this amount should be increased by the deductions permitted pursuant to petitioner's research activities of \$32,815.75 for a total amount of business deductions of \$40,715.68. Since the latter amount is

greater, the notice of deficiency should be adjusted to permit business deductions in the amount of \$40,715.68.

I. The petition of Samuel Bogoch is granted to the extent of Conclusions of Law “G(2),” “G(4),” “G(5),” “G(6),” “G(7),” “G(9),” and “H” and the Division is directed to modify the Notice of Deficiency, dated July 8, 1999, accordingly; except as so granted, the petition is otherwise denied and the notice of deficiency is sustained.

DATED: Troy, New York
May 2, 2002

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE