STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
ILTER SENER		DECISION
d/b/a JIMMY'S GAS STATION	:	
for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period December 1, 1978 through November 30, 1980.	:	

Petitioner, Ilter Sener, d/b/a/ Jimmy's Gas Station, 237 Terrace Road, Bayport, New York 11705, and the Division of Taxation each filed an exception to the determination of the Administrative Law Judge issued on September 24, 1987 with respect to petitioner's petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 1978 through November 30, 1980 (File No. 800498). Petitioner appeared pro se. The Division of Taxation appeared by William F. Collins, Esq. (Michael Infantino, Esq., of Counsel),

The parties did not request oral argument nor file briefs on this exception.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUES

I. Whether the Audit Division improperly estimated petitioner's gasoline sales on the basis of external indices?

II. Whether the Administrative Law Judge was correct in not imposing a penalty pursuant to former section 1145(a)(1) of the Tax Law against the petitioner for petitioner's failure to

timely pay sales taxes. This penalty is imposable for the failure to timely file sales tax returns or timely pay sales taxes. Since only petitioner's failure to timely pay is at issue in this case, the penalty will hereinafter be referred to as the "late-payment penalty."

FINDINGS OF FACT

We adopt the findings of fact stated by the Administrative Law Judge, except that we find that petitioner ceased doing business on October 8, 1980 rather than on October 8, 1981. These facts may be summarized as follows.

The petitioner, Ilter Sener d/b/a Jimmy's Gas Station, operated a gasoline service station located at 530 Franklin Avenue, Franklin Square, New York from December 1, 1978 through October of 1980. Petitioner did not perform automobile repairs.

On November 19, 1981, the Division of Taxation visited petitioner's business address and discovered that he had discontinued operations on October 8, 1980. A notice of audit was mailed to the petitioner. The Division requested all books and records, including journals, ledgers, sales invoices, purchase invoices, cash register tapes, exemption certificates and all sales tax records pertaining to the tax liability of Jimmy's Gas Station for the period December 1, 1978 through August 31, 1981 (the "audit period"). At no time were any books or records submitted by the petitioner.

The Division of Taxation relied on third party verification from the petitioner's gasoline supplier, Power Test, to estimate the petitioner's actual sales during the audit period. Power Test reported that the amount of gasoline purchased by the petitioner for the months of March through October 1980 was 423,568 gallons. Multiplying total gallons by an estimated selling price of $1.25 per gallon, a figure which the Division derived from numerous gasoline audits,

the auditors arrived at a total taxable sales figure for that period of $529,460. Taxable sales reported by the petitioner during the same period were subtracted from this figure to arrive at additional taxable salesof $355,489. The percentage of error derived from this computation was 204. 338. This percentage was applied to the taxable sales reported by the petitioner for each of the quarters in the audit period. The result was an additional taxable sales total of $1,133,158.97 which, when multiplied by the applicable tax rate, yielded an additional sales tax liability of $79,321.12. A Notice of Assessment Review was mailed on September 13, 1982 to the petitioner for the period of December 1, 1978 through November 30, 1980. In addition to an assessed tax liability of $79,321.12, the Notice indicated a penalty of $39,660.57 and interest amounting to $22,873.81.[1]

We also find, as requested by the Division of Taxation in its exception, that: 1) The Division, in its answer to the taxpayer's petition for a redetermination and at hearing, requested that the late-payment penalty be imposed against the petitioner, if the Administrative Law Judge were to find insufficient grounds for the fraud penalty, and 2) the petitioner did not pay over all sales tax due at the time it was properly due and owing.

Following the hearing on this matter, the Administrative Law Judge held that the petitioner had failed to sustain his burden of proving that the audit method chosen was not reasonably calculated to reflect the taxes owed by the petitioner. The tax deficiency asserted

[1]On March 20, 1982, the petitioner was mailed a Notice of Determination and Demand for Payment of Sales and Use Taxes Due of $131,432.67, a fraud penalty of $65,716.35 and interest of $35,656.04. After the Audit Division received verification from Power Test of sales to the petitioner from March through October 1980, the petitioner was mailed a Notice of Assessment Review indicating the revised figures described in the text.

was thus sustained. The Administrative Law Judge declined to impose the fraud penalty, but did not address the request for imposition, in the alternative, of the late-payment penalty.

Both the Division and the taxpayer have filed exceptions to the findings below. The petitioner continues to assert that the Audit Division improperly estimated his gasoline sales on the basis of external indices. The Division of Taxation objects to the failure of the Administrative Law Judge to impose the late-payment penalty.

OPINION

Issue I. Whether the Division of Taxation improperly estimated the petitioner's gasoline sales based on external indices?

Section 1135(a) of the Tax Law provides that every person required to collect sales taxes shall keep records of every sale and all amounts paid, charged, or due, and the tax payable thereon. These records are to include a true copy of each sales slip, invoice, receipt or statement.

If a taxpayer fails to keep the records required by section 1135(a), the Commissioner may select a method of audit "reasonably calculated to reflect the taxes due." (Matter of Grant Co. v. Joseph, 2 NY2d 196, 206; Matter of Urban Liquors, Inc. v. State Tax Commn., 90 AD2d 576, 576.) In such an event "It is then incumbent upon petitioner to show by clear and convincing evidence that the method of audit or amount of tax assessed was erroneous." (Matter of Clarence R. Oliver Post Memorial, Inc. v. State Tax Commn., 101 AD2d 921, 922; Matter of Carmine Restaurant, Inc. v. State Tax Commn., 99 AD2d 581.) In the case at bar, the petitioner has not met that burden.

Petitioner's primary assertion is that the application of a uniform price of $1.25 was unreasonable because of fluctuations in gas prices during the late seventies and early eighties, the period here in issue. Although the price of gas may have been lower in December of 1978 than in November of 1980, petitioner's own testimony indicates that New York City gas prices exceeded $1.25 a gallon at different times during that same period. Thus, though in some months the $1.25 figure may have exceeded what petitioner was able to receive for his gasoline, in others, the $1.25 estimate was less than the amount per gallon he was actually paid. The key point here is that the petitioner has failed to fulfill his statutory responsibility to maintain accurate sales tax records. (See, Tax Law §1135[a].) In this situation, we will not insist on exactness in arriving at an assessment but only that the Division utilize a reasonable audit method. (See, Matter of Grant Co. v. Joseph, 2 NY2d 196, 206.) External indices are appropriate. (Tax Law §1138.)

To prevail in his challenge to this audit, where petitioner offered no books and records, petitioner must show that the method of audit selected was arbitrary and capricious or otherwise unreasonable. (Matter of Ristorante Puglia, Ltd. v. Chu, 102 AD2d 348.) The record is bare of any indicia that Power Test provided inaccurate records of the gasoline it supplied to the petitioner. Thus, it was not unreasonable for the auditor to use these records to estimate petitioner's actual sales. Again, the method is sufficient so long as it was reasonably calculated to reflect the taxes due. The petitioner has failed to show the audit method at issue here was unreasonable.

Issue II. Whether the Division of Taxation may in its answer to the taxpayer's petition for redetermination assert the late-payment penalty as an alternative to the previously determined fraud penalty?

Under former section 1145(a)(1) of the Tax Law, taxpayers who failed to timely file returns or timely pay New York sales taxes were subject to a penalty of up to twenty-five percent of the tax liability.[2] However, if the taxpayer establishes that the failure or delay in paying the sales tax "was due to reasonable cause and not due to willful neglect," the penalty may be abated (Tax Law §1145[a][1][iii]). The burden of showing such "reasonable cause" has been held to be on the taxpayer resisting the late-payment penalty,

In 1975, the New York Legislature added the so-called "fraud penalty" to the sales tax by adding section 1145(a)(2) to the Tax Law. Section 1145(a)(2) provides in pertinent part:

> If the failure to file a return or to pay over any tax to the tax commission within the time required by this article is due to fraud, there shall be added to the tax a penalty of fiftv percent of the amount of tax due (in lieu of the penalty provided for in subparagraph (i) of paragraph one) plus interest (Emphasis added.)

The Legislature modeled the fraud penalty of section 1145(a)(2) on the penalty provisions already existing with respect to deficiencies of, inter alia, income tax. (See, 1975 N.Y. Legis. Ann., at 350.) The burden of showing fraud under section 1145(a)(2) has been consistently interpreted to reside with the Division. (See, e.g., Matter of Adamides Service Station, Inc., State Tax Commn., March 27, 1986, annulled in part in Matter of Adamides v. Chu, 134 AD2d 776. See also, Tax Law §689[e] [placing the burden of showing fraud in income tax cases on the Division].)

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[2] §1145(a)(1) was amended by L 1985, ch 65, §86 to increase the penalty from 25 percent to 30 percent for taxes required to be paid after September 1, 1985.

Section 1145(a)(7) of the Tax Law provides that the sales tax penalties limay be determined, assessed, collected and enforced in the same manner as the tax imposed by this article." Section 1138(a)(1) of the Tax Law provides the method of assessment, i.e., a notice of determination must be mailed to the taxpayer. The notice of determination irrevocably fixes the tax determined therein unless the taxpayer protests the determination within ninety days. (Tax Law §1138[a][1].)

The Tax Law does not specifically address whether the Division may initially assert the fraud penalty and subsequently in its answer assert the late-payment penalty as an alternative basis of liability. Section 1145(a)(7), in providing that the sales tax penalties may be "determined, assessed, collected and enforced" in the same manner as the sales tax, suggests ab initio that the failure to assert the late-payment penalty in a notice of determination renders the assertion of the penalty invalid. However, the argument against this conclusion is persuasive.

Although unstated, the only reasonable inference from the Legislature's enactment of section 1145(a)(2) of the Tax Law is that the Legislature intended to impose a greater penalty on those taxpayers whose failure to pay was due to fraud. Certainly it was not the Legislature's intention to impose no penalties in those instances where a taxpayer's failure to pay falls just short of fraud, but where such failure was clearly due to willful neglect. Such a strict interpretation of the Tax Law would, in almost all borderline cases, prevent the Division of Taxation from imposing the fraud penalty for fear of not sustaining its burden of proving fraud and of being precluded from alternatively asserting the 25 percent penalty. Such a result could not have been intended by the legislature.

The strength of this argument persuades us that the Division of Taxation may assert the late-payment penalty in the answer in cases in which the fraud penalty was initially asserted in the notice of determination. Our view is not without statutory support. Section 1145(a)(7) of the Tax Law is permissive rather than mandatory when it provides that the sales tax penalties "may" be assessed in the same manner as the underlying tax. In addition to his general powers, the Commissioner of Taxation and Finance is authorized "[t]o assess, determine, revise and readjust the taxes imposed by this article."[3] (Tax Law §1142[6].) The use of the terms "revise and readjust" rather than the term "redetermination" indicates that the statute contemplates situations in which adjustments in the tax and penalty liabilities of taxpayers may be made outside the usual determination procedures. We believe that the assertion in the Division's answer of the late-payment penalty as an alternative to the fraud penalty is just such a situation as the statute contemplated.

Due process considerations do not preclude such an interpretation. The assertion of the late-payment penalty as an alternative to the fraud penalty does not increase the amount of tax deficiency asserted against the taxpayer. Moreover, though the elements justifying the imposition of the two penalties differ, in some cases they overlap and a taxpayer prepared to defend himself against a charge of fraud should be prepared to defend himself against a

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[3] The Tax Tribunal has the "same power and authority as the commissioner of taxation and finance in any instance where such commissioner is authorized to impose, modify or waive interest, additions to tax or civil penalties... (Tax Law §2006[12].) See also Tax Law § 689(d)(1) providing that:

"If a taxpayer files with the Tax Commission a petition for redetermination of a tax deficiency, the tax commission shall have the power to determine a greater deficiency than asserted in the notice of deficiency and to determine if there should be assessed any addition to tax or penalty provided in section six hundred eighty-five, if claim therefor is asserted at or before the hearing under rules of the tax commission."

Cf., Tax Law §689(e)(3) which provides that the burden of proof is on the Division of Taxation in cases involving the issue of "whether the petitioner is liable for any increase in a deficiency where such increase is asserted initially after a notice of deficiency was mailed and a petition under this section filed..."

charge of "willful neglect." Finally, the taxpayer has adequate notice, prior to hearing, of the late-payment penalty asserted in the Division's answer.

Although we feel compelled, for the reasons stated above, to hold that the Division may assert the late-payment penalty outside the usual determination procedure, we feel similarly compelled to place a restraint on the Division's use of this extraordinary procedure. The restraint we find appropriate is that the Division bear the burden of proving that the late-payment penalty is properly payable. This means that where the Division has asserted the late-payment penalty in the answer, the Division must prove that the taxpayer's failure or delay was due to willful neglect and was not due to reasonable cause. Our formulation of this rule is based on support in Federal case law and statutes, basic principles of fairness, our own statutory authority and the absence of statutory mandate to the contrary.

When analyzing state statutes modeled after federal statutes, we may look to federal cases for guidance (Matter of Levin v. Gallman, 42 NY2d 32). The income tax late-payment and fraud penalty provisions were modeled after similar federal statutes (see I.R.C. §§6651, 6653) and were extended to "mark another step in the process of conforming the State's income tax laws to comparable provisions of Federal law..." (See, L 1962, ch 1011; Memorandum of State Department of Taxation and Finance, McKinney's 1962 Session Laws of New York at 3536-37. See also, Tax Law §685.) The sales tax penalty provisions were modeled after those in the income tax laws. (See, e.g., L 1975, ch 287; Memorandum of State Department of Taxation and Finance, McKinney's 1975 Session Laws of New York, at 1625.) Thus, in essence, the sales tax penalty provisions were modeled after the federal statutes and we may turn to the federal cases for guidance.

The federal income tax statutes contain statutory penalty provisions similar to those of section 1145. (See, I.R.C. §§6651, 6653.) In Federal practice, the taxpayer has the burden of showing reasonable cause to overcome the assertion of the late-payment penalty and the Internal Revenue Service (hereinafter Service) has the burden of proving fraud. (See, Marsellus v. Commissioner, 544 F2d 883 [5th Cir 1977]; Heman v. Commissioner, 32 TC 479 [1959]. See also, Rule 142, Tax Court Rules of Practice and Procedure.) The penalties are mutually exclusive, that is, the late-payment penalty may not be imposed on any portion of an underpayment found attributable to fraud. (See, I.R.C. §6653[d].) These penalties are assessed, collected, and paid in the same manner as taxes". i.e., through a Notice of Deficiency. (See, I.R.C. §§6662(a), 6213.)

Nonetheless, it is clear that the Service may wait until its answer to assert the late-payment penalty as an alternative to the fraud penalty. (See, IRC, §6214; Pickett v. Commissioner, 34 TCM [CCH] 213, 224 [1975].) It is equally clear, however, that if the Service waits until such time to assert the late-payment penalty, then the burden of proof is on the Service. (See, Wilcox v. Commissioner, 44 B.T.A. 373 [1941]; Langston v. Commissioner, 36 TCM [CCH] 1703 [1977]. See also, Rule 142 of the Tax Court's Rules of Practice and Procedure which provides that, although the burden of proof generally rests on the taxpayer, the Service has the burden of proof on any "new matter" which is pleaded in its answer.) Thus. the rules we articulate in this decision follow the Federal resolution of this issue.

Fundamental considerations of fairness require this burden of proof restraint because without it the Division would be encouraged to assess fraud in every determination, and raise late-payment in the alternative in every answer. The Division's argument in favor of such an

arbitrary assessment procedure is that the statutory requirement that the fraud penalty be imposed "in lieu of" the late-payment penalty indicates that in cases in which fraud is not proved the late-payment penalty is imposed by operation of law. In our view, the "in lieu of" language was not intended to encourage the indiscriminate assertion of the fraud penalty, but instead merely to indicate that the late-payment and fraud penalties may not be imposed as to the same portions of a deficiency.

While serving as a check on the Division's indiscriminate assessment of fraud, the burden on the Division to prove that there was a lack of reasonable cause for the taxpayer's delay or that the delay was due to willful neglect should not be too onerous where the Division is prepared to proceed to prove fraud.

At the same time, this rule will assure that the taxpayer has a fair hearing by placing him in a defensive posture on both the fraud and late-payment penalties. This consistent defensive posture will guarantee that the taxpayer's response to the Division's fraud case is not prejudiced by his burden to affirmatively prove reasonable cause at the hearing.

In sum, the fairness of this combination which would allow the Division to assert the late-payment penalty in the alternative in its answer, but would then place the burden of proof on the Division on this issue is plain. Accordingly, we think that to create such a rule is consistent with our statutory purpose to provide the public "with a just system of resolving controversies (between taxpayers and the Department of Taxation and Finance] and to insure that the elements of due process are present with regard to such resolution of controversies." (Tax Law §2000.) Because of our statutory authority, we find no conflict with section 306(l) of the State Administrative Procedure Act, which generally places the burden of proof on the party

initiating the proceeding, except as otherwise provided by statute. We also note that this rule is not inconsistent with any provision of the Tax Law, since the Tax Law does not contain a provision allocating the burden of proof on sales tax penalty issues.

The only apparent impediment to the application of this rule in this case is our own regulation which also provides that "The burden of proof shall be upon the petitioner except as otherwise provided by law." (20 NYCRR 3000.10[d][4].) Obviously, the rule that we articulate herein which places the burden of proof on the Division in one instance is a refinement not articulated by this regulation. While we are mindful that as a general rule an agency is bound by its own regulations (Nekoosa Papers, Inc. v. Chu, 115 AD2d 821), we are also aware of the well recognized exception that "[i]t is always within the discretion of a court or an administrative agency to relax or modify its procedural rules adopted for the orderly transaction of business before it when in a given case the ends of justice require it. The action of either in such a case is not reviewable except upon a showing of substantial prejudice to the complaining party." (American Farm Lines v. Black Ball Freight, 397 US 532, 539 [1970] citing NLRB v. Monsanto Chemical Co., 205 F2d 763, 764 [8th Cir 1953].)

This exception has been stated in New York State administrative law as "[r]ulings which do not affect substantial rights of individuals, the waiver of which would not be prejudicial, may be relaxed when the ends of justice require it." (Matter of Lake Placid Club v. Abrams, 6 AD2d 469, 472 affd 6 NY2d 857.)

The refinement of our own regulations that we put forth herein certainly does not prejudice substantial rights of the individual, but instead attempts to safeguard the rights of the individual by checking the Division's ability to assert alternative penalties against him.

A review of the facts of this case indicates that the Division also has not been prejudiced by this refinement. At the hearing below, the Division was prepared to proceed to prove fraud, since fraud had been asserted in the Notice of Determination. The standard of proof necessary to support a finding of fraud requires "clear, definite and unmistakable evidence of every element of fraud, including willful, knowledgeable and intentional wrongful acts or omissions constituting false representation, resulting in deliberate nonpayment or underpayment of taxes due and owing." (See, Matter of Walter Shutt and Gertrude Shutt v. State Tax Commn., State Tax Commn., July 13, 1982.) Although the Division knew it had this burden at the hearing to prove fraud, the Division introduced no evidence at all with respect to the circumstances of the petitioner's underpayment and certainly none indicating the failure was intentional and willful. Given this circumstance, we conclude that the Division would not have handled the case any differently had it known it bore the burden of proof on the late payment penalty. Therefore, we find no indication that the Division has been prejudiced by our refinement of our own regulation.

Since we find no evidence in the record that the petitioner's failure to pay tax due was due to willful neglect and was not due to reasonable cause, we find that the Division failed to sustain its burden on this issue. Therefore, we affirm the Administrative Law Judge's determination not imposing the late payment penalty pursuant to section 1145(a)(1) of the Tax Law.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is in all respects denied, except to the extent that findings of fact "1" and "2" as requested in the Division's exception are so found;

2. The exception of the petitioner, Ilter Sener, is in all respects denied;

3. The determination of the Administrative Law Judge is affirmed; and

4. The petition of Ilter Sener is denied and the Notice of Determination issued on March 20, 1982 is sustained, except to the extent modified by conclusions of law "E" and "F" of the Administrative Law Judge's Determination.

DATED: Albany, New York
MAY 0 6 1988

/s/ John P. Dugan
John P.Dugan
President

/s/ Francis R. Koenig
Francis R. Koenig
Commissioner