

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
ARPER DISCOUNT CENTER, LTD.	:	DECISION
AND KANAT ARBAY, AS OFFICER	:	
for Revision of Determinations or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Period March 1, 1980	:	
through August 31, 1982.	:	

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on July 12, 1990 with respect to the petition of Arper Discount Center, Ltd. and Kanat Arbay, as Officer, c/o Jack M. Portney, 2050 Center Avenue, P.O. Box 346, Fort Lee, New Jersey 07024 for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1980 through August 31, 1982 (File Nos. 801116, 801117, 801607, 801608, 802216 and 802217). Petitioners appeared by Jack M. Portney, C.P.A. The Division of Taxation appeared by William F. Collins, Esq. (Irwin Levy, Esq., of counsel).

Petitioners filed a brief in opposition to the exception. Oral argument, at the request of the Division of Taxation, was heard on January 30, 1991.

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

ISSUES

I. Whether the Division of Taxation properly determined additional sales and use taxes due on the gasoline service station operations of petitioner Arper Discount Center, Ltd.

II. Whether petitioner Kanat Arbay was a person required to collect tax on behalf of the corporate petitioner and is, thus, liable for unpaid sales and use taxes due.

III. Whether the Division of Taxation properly imposed the 50% fraud penalty.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

Petitioner Arper Discount Center, Ltd. operated a Power Test gasoline station located at 2243 Route 112, Medford, New York, from early 1980 to March 31, 1982. The station had 12 gas nozzles and it was determined that no repair work was performed at this station. Petitioner Kanat Arbay was president and owner of Arper Discount Center, Ltd.

Initially this case was assigned to Richard Hinrichs, a former tax auditor with the Suffolk District Office of the New York State Department of Taxation and Finance. A letter dated October 19, 1981 scheduled an appointment with Arper Discount Center, Ltd. for October 26, 1981 for a sales tax field examination for the period December 1, 1978 through August 31, 1981. This appointment letter stated in pertinent part:

"All books and records pertaining to your Sales Tax liability for the period under audit should be available. This would include journals, ledgers, Sales invoices, purchase invoices, cash register tapes, exemption certificates and all Sales Tax records. Additional information may be required during the course of the audit...."

Information obtained pursuant to meetings that apparently took place as a result of the field examination revealed that Arper Discount Center, Ltd. had registered with the Division of Taxation on September 1, 1980. There was evidence that this gas station was in operation as early as January 1980. The audit period was therefore revised to reflect some of this information and the examination was performed for the period April 1, 1980 through August 31, 1981.

On April 1, 1985, Theresa Albrecht, Tax Auditor I, prepared a summary which was intended to be an audit report, summarizing what apparently took place with respect to the original audit and field examination. This report indicates that transcripts of sales per books were not made since there were no records of sales made available upon audit. However, transcripts were made of purchases per books and purchases per Federal income tax returns filed. These amounts were reconciled and subsequently compared to sales tax returns. The

report noted that during the period in audit, the corporation reported approximately \$35,000.00 in taxable sales on its sales tax returns and noted purchases per books and Federal income tax returns of approximately \$988,000.00.

There is no mention in the record as to who made these comparisons nor whether Mr. Arbay or any representative of him or the corporation was contacted. There is nothing in the record to indicate that any other analysis was performed. At some point, a computation was made using purchases per books to compute audited taxable sales. Purchases for the period June 1, 1980 through February 28, 1981 of \$651,449.12 were marked up an estimated 20% to arrive at audited taxable sales of \$781,738.94, as compared to taxable sales reported of \$24,334.00. The additional taxable sales resulted in additional tax due of \$53,018.34, and Assessment Notice Numbers S831220051F and S831220050F were issued against Arper Discount Center, Ltd. and Kanat Arbay, as officer, respectively, on December 20, 1983. Included on the notices was a 50 percent fraud penalty and interest, for a total assessment of \$100,145.64 against each petitioner for the period June 1, 1980 through February 28, 1981.

The Notice of Determination and Demand for Sales and Use Taxes Due indicated that the taxes were due in accordance with Section 1138 of the Tax Law and were based on an audit of the taxpayer's records. It indicated the following:

<u>"Period</u>	<u>Tax Due</u>	<u>Penalty Due</u>	<u>Interest Due</u>
083180 - 181	\$10,729.12	\$ 5,364.56	\$ 4,620.36
113080 - 281	12,922.04	6,461.02	5,163.73
022881 - 381	29,367.18	14,683.59	10,834.04

THE TAX ASSESSED HEREIN HAS BEEN ESTIMATED OR DETERMINED TO BE DUE IN ACCORDANCE WITH THE PROVISIONS OF SECTION 1138 OF THE TAX LAW AND MAY BE CHALLENGED THROUGH THE APPEALS PROCESS BY FILING A PETITION WITHIN 90 DAYS.

In addition to tax, a fraud penalty of 50% of the tax due plus statutory interest have been assessed pursuant to Section 1145(a)(2) of the Tax Law."

Although the notices described above were submitted into evidence for purposes of clarity of the record, it was determined by the parties that a petition was not filed on behalf of Arper Discount Center, Ltd. or Kanat Arbay, as officer, for either Notice Number S831220051F or S831220050F for the tax, penalty and interest as described above.

Executed with respect to the taxable periods March 1, 1980 through November 30, 1981, was a consent extending the period of limitation for assessment of sales and use taxes under Articles 28 and 29 of the Tax Law allowing appropriate amounts of sales and use taxes to be determined for those periods at any time on or before December 20, 1983. The vendor is identified as Arper Discount Center, Ltd. and it contains the signature of Jack Portney, C.P.A., petitioners' representative.

Also as a part of the Suffolk audit computations, additional audited taxable sales were computed for the period March 1, 1981 through August 31, 1981. Purchases of \$821,556.86 were marked up 20% to arrive at audited taxable sales of \$985,868.22. Additional tax due of \$66,325.08 was thereby computed, resulting in the issuance on September 20, 1984 of Assessment Notice Number S840920015F to Arper Discount Center, Ltd. and Notice Number S840920016F,¹ against Kanat Arbay, as officer, for tax due of \$66,325.08 plus a 50% fraud penalty and statutory interest resulting in a total assessment of \$129,161.75.

It is important to note that neither the Suffolk District Office auditor, nor anyone involved in the preparation of these computations, nor the preparer of the audit report, Ms. Albrecht, appeared at the hearing to testify. One of the two witnesses presented by the Division to explain what had taken place with respect to petitioners was Grace Reuter, a sales tax auditor with the Nassau District Office.

Ms. Reuter testified that the file held by the Suffolk District Office with respect to these petitioners was transferred to the Special Investigations Bureau with an implication that further investigation was mandatory in this case due to large discrepancies in reported amounts of sales

¹The record indicates that there is a clerical error with respect to this notice number, and that its correct number may, in fact, end in a 9 rather than a 6.

tax as compared to amounts per books and Federal returns. The witness implied that Special Investigations was to continue review of this file and that Suffolk in no way had completed its audit of petitioners' records.

Mr. Andrew Coughlin formerly of the Special Investigations Bureau, testified that the Arper Discount Center, Ltd. case was assigned to him on February 26, 1982, having been sent to him from the Suffolk District Office. A status report from the Suffolk auditor was attached to the file indicating that he had compared purchases per books to bank deposits for a portion of the time that the gas station was owned by Kanat Arbay. Apparently, the differences between sales as reported on the sales tax return and purchases per the Federal income tax return and per books were not discussed with petitioners' representative at that time, Frank Gulotta, since no power of attorney was on record. Mr. Gulotta had been asked to provide further records to the field auditor and was instructed to contact the auditor when he was in possession of the records.

Mr. Coughlin proceeded by sending out an appointment letter requesting an opportunity to review the corporation's records on March 15, 1982. He visited the premises June 8, 1982, and observed that there were 8 pumps at the station and a new owner had taken occupancy. Mr. Coughlin testified that a new ST-105 certificate of authority had been filed with the Division indicating that as of February 4, 1982, the business was being operated by Kala Discount. Having reviewed the discrepancy between the sales reported per sales tax returns and purchases for the same time period, he testified that it was the procedure of the Division to pursue third-party verification from suppliers of gasoline. Mr. Coughlin subsequently subpoenaed the records of Power Test during January 1983, requesting the lease agreement and a statement of monthly itemized gasoline sold for the period May 1, 1980 through March 31, 1982.

The testimony in this case further disclosed that petitioners did not take issue with the verification of purchases according to the Power Test information supplied to the Special Investigations Bureau, and that in fact, petitioners had reported substantially the same amount of purchases for a similar time period. The primary focus for review was the small amount of sales reported on the sales tax returns.

When Mr. Coughlin pursued an explanation for the discrepancy, he was informed that it was due to gasoline being resold to other parties by petitioners. Both Mr. Gulotta, the former representative of petitioners and Mr. Portney, petitioners' current representative, who appeared at this hearing, provided the Special Investigations Bureau with schedules showing the gasoline purchased as being in agreement with the Power Test information, as well as further information showing the resale of gasoline in gallons and dollars. As the investigation proceeded and Mr. Portney assumed full responsibility for the representation of petitioners, he was requested to provide further information to support the resale claim. The additional information sought by Mr. Coughlin included cash register receipts, daily sheets kept by the gas station showing the measurement of gasoline in the tank, sales invoices and any resale certificates. During the time that Mr. Portney was attempting to gather this information for Mr. Coughlin, the Special Investigations Bureau was terminated. Petitioners' case herein was transferred to the Nassau District Office² at which point this office was instructed to close out the case. The auditor assigned to the case was James Day, and his supervisor or team leader was Grace Reuter. Ms. Reuter testified that a memo was circulated indicating that the case be closed based on information regarding purchases in the file. No one in the Nassau office contacted petitioners nor obtained any further information with regard to the file. It was obvious that Nassau also was unaware that the Suffolk District Office had already issued an assessment for some of the sales tax quarterly periods.

The field audit report prepared by the Nassau office indicated that the corporation did not maintain any records to substantiate book figures with respect to purchases or sales and as a result, the records were deemed inadequate and incomplete. Thus the audit computations performed utilized gas purchases per the Power Test source verification. Taxable gasoline purchases per Power Test distributors for the period June 1980 through February 1982 amounted to \$2,155,293.00. Taxable sales reported by petitioners for the same period were \$111,391.00. The audit report assumes that even if sales were made at cost, additional sales

²The Nassau District Office is also referred to as the Mineola District Office by the parties.

would result in the amount of \$2,043,902.00. Taxable gas purchases were marked up an estimated 10% resulting in total audited taxable sales for the period June 1980 through February 1982 of \$2,370,822.00. Applying the margin of error to the reported taxable sales for the audit period resulted in additional taxable sales of \$2,646,286.00 and additional sales tax due of \$189,727.18. On February 24, 1984, two notices of determination and demands for payment of sales and use taxes due were issued to Arper Discount Center, Ltd. and Kanat Arbay, as officer, in the amount of \$189,727.18, with an assertion of a 50% fraud penalty and maximum interest for a total assessment of \$343,836.50. The periods listed on the notices of determination showed tax, fraud penalty and interest due as follows:

<u>"Period Ended</u>	<u>Tax Due</u>	<u>Fraud Penalty</u>	<u>Interest</u>
08/31/80 - 181	7,113.54	3,556.77	3,286.52
11/30/80 - 281	7,433.02	3,716.51	3,198.42
02/28/81 - 381	20,004.46	10,002.23	7,980.57
05/31/81 - 481	23,233.28	11,616.64	8,523.82
08/31/81 - 182	31,242.75	15,621.37	10,390.08
11/30/81 - 282	44,470.20	22,235.10	13,144.05
02/28/82 - 382	27,132.12	13,566.06	7,034.27
05/31/82 - 482	6,729.38	3,364.69	1,501.99
08/31/82 - 183	22,368.43	11,184.21	4,186.02"

In addition to the tax asserted, the notice of determination issued to Mr. Arbay as officer stated the following:

"You are personally liable as officer of Arper Discount Center Ltd. under Sections 1131(1) and 1133 of the Tax Law for the following taxes determined to be due in accordance with Section 1138(a) of the Tax Law."

On March 27, 1985, an additional Notice of Determination and Demand for Payment of Sales and Use Taxes Due was issued to both Arper Discount Center, Ltd. and Kanat Arbay assessing sales tax due for the quarter ended May 31, 1980 in the amount of \$9,227.08, in addition to a fraud penalty of 50% plus statutory interest, yielding a total assessment of \$20,315.92. There appears to be no discussion on the record as to why this notice was issued at a later date, and whether the basis for this notice is the same as the assessment for \$189,727.18.

Jack Portney, Certified Public Accountant, appeared on behalf of petitioners to represent their positions. Mr. Portney testified that Kanat Arbay obtained gasoline not only for his own retail sale purposes but also for resale. He made reference to the fact that Mr. Arbay would pump gasoline from the station during the night when his business was not in operation with a special pump purchased for that purpose. Evidence submitted by Mr. Portney on behalf of petitioners' resale contention included sales invoices covering the period June 1980 through March 1982, showing sales of various types of gasoline to Sevinc and Ahmet Batur at 2 Saratoga Boulevard, Island Park, New York and Apokan Discount, 189 Sunrise Highway, Amityville, New York, totalling over \$2,300,000.00. He also submitted the original resale certificate executed by Ahmet Batur to Arper Discount Center Ltd. dated May 15, 1980 indicating that there were services for resale.³ Mr. Portney also presented a schedule of purchases of gasoline between June 1980 and March 1982 offset by sales for resale in gallons and dollars as well as retail sales to customers. Lastly, he submitted correspondence which was a verification from the Henrich Petroleum Equipment Co., Inc. dated July 10, 1985 stating that Kanat Arbay purchased a Blackmer explosion-proof pump from this corporation during the year 1978 and that since they were unable to locate the invoice this letter was being submitted as part of the proof of purchase.

OPINION

In the determination below, the Administrative Law Judge found that it appeared that an adequate request for records was made by the Suffolk District Office but that the Suffolk office did not have a sufficient opportunity to completely review or audit petitioners' records before the files were given to the Special Investigations Bureau. The Administrative Law Judge further found that before the Special Investigations Bureau investigation of the taxpayers was completed, the files were closed and transferred to the Nassau District Office. The

³There is testimony in the record reflecting the fact that box A on the resale certificate referring to the resale of tangible personal property may have been a more appropriate indication of the transactions as they existed in this case, in contrast to box C which was checked, indicating that there were services resold. Regardless of the accuracy of the resale certificate, the parties agree that the item in issue is the resale of gasoline only.

Administrative Law Judge also concluded that the Division of Taxation (hereinafter the "Division") grossly and deliberately overlooked the records supporting the resale of gasoline by petitioners. The Administrative Law Judge held that no evidence was presented by the Division to support the fact that the taxpayers' records were insufficient to the extent that it was impossible to verify taxable sales or conduct a complete audit. Although the Administrative Law Judge concluded that the Division did not establish that its resort to an estimate methodology was justified, the Administrative Law Judge determined that petitioners met their burden of proving that the audit performed resulted in erroneous assessments. Finally, the Administrative Law Judge cancelled the notices of determination dated December 20, 1983 and September 20, 1984 on the basis that these notices assessed tax for periods covered by the notices dated February 24, 1984 and March 27, 1985.

On exception, the Division alleges that there still remains unsubstantiated sales of \$234,895.00 with taxes due on such amount and, further, seeks an assessment against Kanat Arbay based on such unsubstantiated sales. The Division has not challenged the Administrative Law Judge's cancellation of the notices of determination dated December 20, 1983 and February 24, 1984.

Petitioners argue that no assessment on any estimated figure can be made against Arper Discount Center, Ltd. as the statutory right to make that assessment does not exist and, therefore, the discussion of a liability against the officer is not valid. Further, petitioners respectfully request that the determination of the Administrative Law Judge be affirmed.

We affirm the determination of the Administrative Law Judge.

The Division has the authority to determine, "from such information as may be available," the amount of tax actually due from a taxpayer for a given period when any one of its sales tax returns is either not filed or states an incorrect or insufficient amount of tax due (Tax Law § 1138[a][1]). However, when the vendor maintains a comprehensive set of books and records, "such information as may be available" (Tax Law § 1138[a][1]) is restricted to his books and records, and not external indicia, because "the honest and conscientious taxpayer who maintains

comprehensive records as required has a right to expect that they will be used in any audit to determine his ultimate tax liability" (Matter of Chartair, Inc. v. State Tax Commn., 65 AD2d 44, 411 NYS2d 41, 43).

To determine the adequacy of a taxpayer's records, the Division must first request (Matter of Christ Cella, Inc. v. State Tax Commn., 102 AD2d 352, 477 NYS2d 858, 859) and thoroughly examine (Matter of King Crab Rest. v. Chu, 134 AD2d 51, 522 NYS2d 978, 979-80) the taxpayer's books and records for the entire period of the proposed assessment (Matter of Adamides v. Chu, 134 AD2d 776, 521 NYS2d 826, 828, lv denied 71 NY2d 806, 530 NYS2d 109).

In the matter at hand, the Division failed to follow this procedure as testimony by Division representatives points out rather vividly that petitioners' books and records (sales invoices and a resale certificate) were never thoroughly examined. An auditor assigned to the Special Investigations Bureau, in testifying, stated that petitioners provided him with a resale certificate before his Bureau was disbanded and that said resale certificate and all his work papers, everything he had, was sent to the Nassau District Office. He further testified that to the best of his knowledge nothing was ever pursued with respect to the resale certificate (Tr., pp. 84-85). When questioned by the Administrative Law Judge, "[s]o, essentially, it appears to me, and please feel free to offer any other information you have, that this information was ignored and an assessment was produced?", the auditor answered, "[b]y the file that is read, that's correct. That's what happened" (Tr., p. 85, lines 3-8).

There was no evidence presented or testimony to support the conclusion that there was a thorough examination of the taxpayers' books and records (Matter of King Crab Rest. v. Chu, supra) to determine through verification drawn independently from within these records (see, Matter of Meyer v. State Tax Commn., 61 AD2d 223, 402 NYS2d 74, 76, lv denied 44 NY2d 645, 406 NYS2d 1025; see also, Matter of Giordano v. State Tax Commn., 145 AD2d 726, 535 NYS2d 255; Matter of Hennekens v. State Tax Commn., 114 AD2d 599, 494 NYS2d 208; Matter of Urban Liqs. v. State Tax Commn., 90 AD2d 576, 456 NYS2d 138), that they are, in

fact, so insufficient that it is "virtually impossible (for the Division) to verify taxable sales receipts and conduct a complete audit" (Matter of Chartair, Inc. v. State Tax Commn., *supra*, 411 NYS2d 41, 43) "from which the exact amount of tax can be determined" (Matter of Mohawk Airlines v. Tully, 75 AD2d 249, 429 NYS2d 759, 760).

Therefore, since the record before us lacks evidence that a thorough examination was made of the taxpayers' records, we conclude that the notices of determination and demands for payment of sales and use taxes due dated February 24, 1984 and March 27, 1985 must be cancelled.

Accordingly, it is ORDERED, ADJUDGED, and DECREED that:

1. The exception of the Division of Taxation is in all respects denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petition of Arper Discount Center, Ltd. and Kanat Arbay, as Officer, is granted;

and

4. The notices of determination dated February 24, 1984 and March 27, 1985 are cancelled.

DATED: Troy, New York
June 27, 1991

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

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

/s/Maria T. Jones
Maria T. Jones
Commissioner

