

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition :

of :

UNCLE JIM'S DONUT AND :
DAIRY STORE, INC. :
A/K/A DASH'S DONUTS :

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, 1979 :
through November 30, 1986. :

In the Matter of the Petition :

of :

JAMES A. LAMONICA, OFFICER OF :
UNCLE JIM'S DONUT AND DAIRY STORE, INC. :

DECISION

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, 1979 :
through November 30, 1986. :

In the Matter of the Petition :

of :

JEANNEANN LAMONICA, OFFICER OF :
UNCLE JIM'S DONUT AND DAIRY STORE, INC. :

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, 1979 :
through November 30, 1986. :

In the Matter of the Petition	:
of	:
CHARLES A. LAMONICA, OFFICER OF	:
UNCLE JIM'S DONUT AND DAIRY STORE, INC.	:
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, 1979	:
through November 30, 1986.	:

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on February 2, 1989 with respect to individual petitions by Uncle Jim's Donut and Dairy Store, Inc. a/k/a Dash's Donuts, James LaMonica and Jeanneann LaMonica, 1204 Jackson Road, Webster, New York 14580 and Charles LaMonica, 44 Angean Drive, Webster, New York 14580 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, 1979 through November 30, 1986 (File Nos. 805337, 805332, 805333, 805331). The Division of Taxation appeared by William F. Collins, Esq. (James Della Porta, Esq., of counsel). Petitioners appeared by Elliot, Stern and Calabrese (Herbert N. Stern, Esq., of counsel).

The Division and the petitioner each filed a memorandum of law. Oral argument was heard on May 23, 1989 at the Division's request.

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

ISSUES

I. Whether the Division of Taxation has shown that petitioners willfully attempted to evade tax by willfully failing to file sales tax returns or, in the alternative, whether the Division of Taxation established that petitioners were liable for a penalty under Tax Law section 1145(a)(1) for failure to file a return or pay tax when due.

II. Whether Charles A. LaMonica was a person required to collect tax under sections 1131(1) and 1133(a) of the Tax Law.

III. Whether the omnibus penalty imposed pursuant to section 1145(a)(1)(vi) should be sustained.

FACTS

We find the facts as determined by the Administrative Law Judge and such facts are stated below.

On December 8, 1986, the Division of Taxation ("Division") issued identical notices of determination and demands for payment of sales and use taxes due to each of the petitioners: Uncle Jim's Donut and Dairy Store, Inc. a/k/a Dash's Donuts; James LaMonica; Jeanneann LaMonica; and Charles A. LaMonica. The first of the three notices issued to each petitioner assessed sales tax for the period December 1, 1979 through May 31, 1983 of \$41,440.07 plus fraud penalty of \$20,720.04 and interest of \$34,164.67 for a total amount due of \$96,324.78. The second notice assessed sales tax for the period June 1, 1983 through November 30, 1986 of \$37,259.16 plus fraud penalty of \$18,629.58 and interest of \$9,843.88 for a total amount due of \$65,732.62. The third notice assessed a penalty only of \$1,393.38 for the period June 1, 1985 through November 30, 1986, under Tax Law § 1145(a)(1)(vi).

The notices issued to James LaMonica, Jeanneann LaMonica and Charles A. LaMonica explained that each, as an officer of Uncle Jim's Donut and Dairy Store, Inc., was deemed to be personally liable for the tax assessed against the corporation.

A Notice of Determination and Demand for Payment of Sales and Use Taxes Due was issued to Uncle Jim's on December 8, 1986 assessing tax due for the period September 1, 1986 through November 30, 1986 in the amount of \$1,400.00 plus penalty and interest.¹

¹Apparently, this assessment represents sales tax due on the sale of tangible assets transferred in the bulk sale; if so, the tax was paid by the purchaser and this assessment was cancelled.

The notices described were issued as the result of an audit of Uncle Jim's books and records. The audit was begun when the Division received a notification of bulk sale from the purchaser of Uncle Jim's business.

Uncle Jim's operated a donut bakery and delivered and sold donuts to wholesale customers. It also operated a combination retail donut and coffee shop and convenience store. Uncle Jim's began doing business in November 1977. Sales tax returns were filed from the business's inception through November 30, 1979. A single return was also filed for the period June 1, 1986 through August 31, 1986.

James LaMonica was president of Uncle Jim's and responsible for all aspects of its operations. When he was first contacted by the Division's auditor, he stated that the business had been closed for several years and reopened in June 1986. An audit appointment was then scheduled. At this meeting, Mr. LaMonica confessed that Uncle Jim's was operating without interruption from 1977 until its sale in September 1986. He also admitted that Uncle Jim's collected sales tax but did not file returns or remit tax due. From that point on, Mr. LaMonica cooperated completely with the auditor in providing her with books and records and other information.

The auditor requested and received cash register tapes for the years 1985 and 1986. These did not indicate the items sold nor in any way segregate taxable and nontaxable items; therefore, they were not usable for the purpose of verifying taxable sales. No guest checks were available. A sales journal and purchases journal for the audit period were available. The sales journal segregated sales into two categories, gross sales in store and wholesale donut sales. For the audit period, it showed gross sales in the store of \$1,734,910.60. The purchases journal showed total monthly purchases only. In some periods, purchases were segregated into purchases for the store and purchases for the wholesale donut business. Purchase invoices were available for the years 1983 through the close of business in 1986, although some invoices were missing.

The auditor used the records provided to her and information provided by James LaMonica to estimate sales and use taxes due for the audit period.

The auditor first performed a test period analysis of purchases made for the convenience store, using purchase invoices from June, July and August 1986. Purchases were segregated into taxable and nontaxable items. The auditor then calculated a ratio of 68.4 percent taxable items to 31.06 percent nontaxable items. Selling prices were obtained from the donut shop's new owner. These prices were applied to taxable purchases in the test period in several categories: coffee, beer, soda, candy, cigarettes, sandwiches and miscellany. The auditor then calculated an overall weighted markup on purchases of 58.9823 percent.

The auditor applied the taxable ratio to all purchases for the audit period as shown in Uncle Jim's purchases journal. Taxable purchases were then adjusted to reflect inventory sold to the new owner and items removed from inventory for personal consumption. The weighted markup was applied to audited taxable purchases to obtain audited taxable sales of \$836,451.99. This figure did not include taxable sales of prepared foods, such as sandwiches, soups and pizza.

Since petitioners had no sales records, the Division estimated sales of prepared foods sold at the counter, such as donuts, pizza, chili, sandwiches, etc., using donut sales as a basis. Based on information provided by James LaMonica, the auditor estimated that 60 dozen donuts were sold at the convenience store each day. The auditor estimated that one-half of these donut sales were subject to sales tax and applied a selling price of 30 cents apiece to the estimated number of taxable donuts sold to obtain audited taxable sales of prepared foods of \$266,868.00.

Audited taxable sales made through the convenience store were added to audited sales of prepared foods to obtain total audited taxable sales for the audit period of \$1,103,319.99 with a tax due on that amount of \$77,232.38. Mr. LaMonica estimated that during each sales tax quarter, he removed from inventory for his own use taxable items valued at approximately \$890.00. Use tax due on these items was determined to be \$1,682.10. From total tax due for the

audit period (\$78,914.48), the auditor subtracted tax paid for the quarter ended August 31, 1986 to calculate additional sales and use taxes due of \$77,916.00.

The auditor determined that Uncle Jim's failed to pay tax due on its own purchase of a walk-in cooler for \$11,189.00. Therefore, an additional tax of \$783.23 was assessed for the period in which the purchase occurred, September 1, 1981 through November 30, 1981.

Total tax due for the audit period was determined to be \$78,699.23.

James LaMonica began doing business as Dash's Donuts in 1973. He registered as a sales tax vendor at that time but either filed no returns or filed returns showing no taxable sales because he conducted a strictly wholesale business. About one year later, he put in a coffee bar and began collecting tax. Sales tax returns were timely filed and taxes paid in this period.

In 1977, Mr. LaMonica moved his business to a new location and incorporated as Uncle Jim's. At the time of incorporation, he named himself, his wife, Jeanneann LaMonica, and his brother Charles LaMonica as corporate officers. Jeanneann and Charles were not informed that they had been named as corporate officers. James LaMonica understood the naming of corporate officers as merely a legal formality with no consequences. Although no corporate shares were actually issued, the incorporation documents, at James LaMonica's instruction, showed a distribution of 25 percent of the outstanding shares to Charles LaMonica and the remainder to James LaMonica. Again, Charles LaMonica was not informed that he was a shareholder. James hoped that the shares would have some value eventually and that he would be able to present them to his brother as compensation for work he was then performing in the donut shop.

At the new location, Uncle Jim's continued selling donuts at wholesale and at retail at a small coffee bar. James later added several tables and began selling prepared foods, such as pizza, soup and chili. Several items were tried in an attempt to increase sales and abandoned when they proved unsuccessful. Uncle Jim's filed sales tax returns and remitted taxes through the period ended November 30, 1979.

In or about 1979, Uncle Jim's expanded to include a convenience store, selling milk, bread, beer, soda, cigarettes and candy. James LaMonica sought the advice of his accountant regarding the taxable status of items sold at the store and was told that food items were not taxable. He interpreted this to mean that the prepared foods served at the counter were also nontaxable. By December 1, 1979, James LaMonica stopped filing returns on behalf of Uncle Jim's. His reason for doing so was a combination of his confusion over the taxable status of the items he sold and economic difficulties. Uncle Jim's continued to collect tax on nonfood items and items James LaMonica considered nonessential food items, such as soda. Apparently this reflected Mr. LaMonica's understanding of the Tax Law at this time.

Shortly after Uncle Jim's stopped filing returns, the Division stopped sending it pre-addressed sales tax returns. At first, James LaMonica believed this was an indication that the Division considered his business not subject to sales tax. By 1981, he became aware, either through observation or conversations with other vendors, that a great range of items sold by Uncle Jim's was taxable. Uncle Jim's began collecting tax from its customers on most taxable items; however, it filed no sales tax returns and paid no tax until the quarter ended August 31, 1986. When asked why he failed to file returns for such a long period, James LaMonica answered:

"I know I can't use this as an excuse but after, I would say, several quarters, it got out of hand and I always thought a time would come when I would be able to report to the State that I hadn't paid tax and I would be able to make this up and pay them. But I never was able to. Like I say, things got out of hand, and that's about what happened."

James LaMonica filed a final return in 1986 because he believed it was necessary in order to facilitate the sale of his business.

Sometime before the business was sold, James LaMonica informed his wife and brother that sales taxes had not been paid. They were not told that they had any responsibilities as corporate officers.

Jeanneann LaMonica occasionally worked in the donut shop as a counterperson. At her husband's direction, she maintained Uncle Jim's books and records. James LaMonica provided her with sales receipts and purchase invoices which she posted to the corporation's ledger. She was a signatory on the corporate bank account and prepared and signed checks when instructed to do so by her husband. She did not decide which creditors to pay or prepare tax returns. Until the business was sold in 1986, Mrs. LaMonica was unaware that sales tax returns were not being filed by Uncle Jim's.

Charles LaMonica worked as an employee of Uncle Jim's, delivering donuts to wholesale customers. He was also a signatory on the corporate bank account and signed checks at James LaMonica's instruction when the latter was unavailable to do so himself. Aside from these activities, Charles LaMonica had no involvement in or responsibility for the operation of Uncle Jim's. He was unaware that an ownership interest in the corporation had been distributed to him until informed of this by James LaMonica, late in the audit period. Other than employee wages, Charles LaMonica received no compensation from Uncle Jim's.

Petitioners presented no books or records or other documentary evidence. An accountant testifying on their behalf challenged the accuracy of the estimated tax on three grounds:

- (a) that the Division used an unrepresentative test period resulting in an erroneous ratio of taxable to nontaxable sales;
- (b) that the selling price of donuts (see Finding of Fact "8[c]") failed to take into account the rise in prices over the years in the audit period;
- (c) that the markup was overstated because the Division failed to reduce purchases to reflect waste, spoilage, etc.

OPINION

The Administrative Law Judge determined that the Division selected an audit method reasonably calculated to reflect the taxes due, and that petitioners did not sustain their burden of proving that the method of audit or amount of tax assessed was erroneous. In addition, the Administrative Law Judge determined that the Division did not sustain its burden of proving

fraud. However, in lieu of the fraud penalty, the Administrative Law Judge determined that the Division sustained its burden of proof to impose the Tax Law section 1145(a)(1) penalty, holding that petitioners were not surprised or prejudiced by the Division's amendment of its answer to include the penalty just prior to the conclusion of the hearing. The Administrative Law Judge also found that neither Jeanneann LaMonica nor Charles A. LaMonica were persons required to collect tax under sections 1131(1) and 1133(a) of the Tax Law. The Administrative Law Judge failed to explicitly address the penalty imposed by section 1145(a)(1)(vi) of the Tax Law.

On exception, the Division contends that the Administrative Law Judge erred in not sustaining the fraud penalty, in that it was an error to hold that petitioners did not have the specific intent to evade the tax. In addition, the Division takes exception to the Administrative Law Judge's determination that Charles LaMonica was not a person required to collect tax under sections 1131(1) and 1133(a) of the Tax Law. The Division also suggests that the Administrative Law Judge did not address the omnibus penalty imposed under Tax Law section 1145(a)(1)(vi). Therefore, the Division assumes the penalty was sustained. However, if in fact the penalty was not sustained, the Division takes exception.

We reverse in part, and sustain in part, the determination of the Administrative Law Judge.

Section 1145(a)(2) of the Tax Law provides for the imposition of a civil penalty if the failure to file a return or pay over any tax is due to fraud (L 1985, ch 65, § 86, eff September 1, 1985 [former para 2 adopted in 1975 contained a similar provision]). The burden of showing fraud is upon the Division, and it must provide clear and convincing evidence of fraud, including willful, knowledgeable, and intentional wrongful acts or omissions constituting false representations, resulting in deliberate nonpayment or underpayment of taxes due and owing (Matter of Ilter Sener d/b/a Jimmy's Gas Station, Tax Appeals Tribunal, May 5, 1988; Matter of Walter Shutt and Gertrude Shutt, State Tax Commn., July 13, 1982). We conclude that the Division has met its burden of showing a willful intent on the part of Uncle Jim's and James LaMonica to fraudulently deprive the State of sales and use taxes owed.

As the sales tax penalty provisions are modeled after Federal statutes, we look to Federal case precedent for guidance in considering the requisite intent for a showing of fraud (Matter of Ilter Sener d/b/a Jimmy's Gas Station, supra). A willful failure to file returns is not in itself sufficient evidence of fraud (see, Cirillo v. Commr., 314 F2d 478). The taxpayer's failure to file must be considered along with other relevant facts in determining whether the requisite fraudulent intent is present (Powell v. Grandquist, 252 F2d 56; Beaver v. Commr., 55 TC 85, 92-93).

Petitioner James LaMonica's willful failure to file was revealed at hearing. When petitioner James LaMonica was asked to explain why, although he collected sales tax, he did not file the sales tax returns for the period at issue, he stated:

"I know I can't use this as an excuse but after, I would say, several quarters, it got out of hand and I always thought a time would come when I would be able to report to the State that I hadn't paid tax and I would be able to make this up and pay them. But I never was able to. Like I say, things got out of hand, and that's about what happened." (Tr. p. 67.)

Further on in the course of the hearing, when asked again why he failed to file returns for the quarters between 1979 and 1986, or at least obtain returns in order to file for the earlier quarters, petitioner replied, "Because I wouldn't have had the money to pay any of those taxes." (Tr. p. 83.) Such testimony clearly indicates that James LaMonica made a conscious and willful decision not to file said returns and that the decision not to file was made in spite of the knowledge that taxes were due (compare, Cirillo v. Commr., supra). Petitioner's recounting of his intention to resume filing does not serve to vitiate his original willful intention not to file.

The relevant facts surrounding the failure to file are that James LaMonica caused Uncle Jim's to completely stop filing returns and paying tax, although James LaMonica continued to collect tax on certain items. By 1981, James LaMonica became aware that sales tax was due on a greater number of items than he had thought. Thereafter, James LaMonica expanded the range of items on which he collected tax, but still remitted no tax to the Division. Further, James LaMonica lied to the auditor in charge of the investigation. While admitting at hearing that he

was aware of his obligations to file sales tax returns and to remit any collected sales tax, the record shows that petitioner told the auditor that the business had been defunct for several years before reopening in June of 1986. Considering all of these factors together, we conclude that James LaMonica acted willfully, knowingly and intentionally in a manner that resulted in the deliberate nonpayment of taxes due and owing (see, Matter of Ilter Sener, supra). Therefore, we conclude that the Division sustained its burden of showing by clear and convincing evidence that petitioner possessed the intent necessary to support imposition of the fraud penalty.

We sustain the Administrative Law Judge's determination that Charles LaMonica was not a person required to collect tax pursuant to sections 1131(1) and 1133(a) of the Tax Law. Such a determination was based upon a factual inquiry in which the Administrative Law Judge considered such elements as authorization to sign the corporate returns, authorization to hire and fire employees, and derivation of substantial income from the corporation (see, Matter of Blodnick v. State Tax Commn., 124 AD2d 437, 507 NYS2d 536). The record clearly indicates that Charles was an employee and was not responsible in any fiscal or managerial sense for the maintenance of the business.

The Division of Taxation contends that Charles LaMonica was not a credible witness and that the Administrative Law Judge erred in believing his testimony. We find nothing in the record which would cause us not to defer to the Administrative Law Judge's evaluation of the credibility of a witness. We therefore sustain the Administrative Law Judge's finding that petitioner Charles LaMonica was not responsible for the operation of the business.

Finally, we find that by sustaining the notices of determination issued to Uncle Jim's and James LaMonica, with certain modifications, the Administrative Law Judge sustained imposition of the penalty imposed pursuant to section 1145(a)(1)(vi) of the Tax Law. This penalty, added by Chapter 65 of the Laws of 1985, is imposable where the taxpayer has omitted an amount from his return in excess of 25 percent of the amount required to be shown. The penalty is 10% of the amount omitted. The penalty may be abated if the taxpayer shows the omission was due to

reasonable cause. Since there is no basis to find reasonable cause on the record before us, we conclude the penalty was properly imposed.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division is granted to the extent that the penalties imposed pursuant to section 1145(a)(2) and 1145(a)(1)(vi) are sustained with respect to Uncle Jim's Donut and Dairy Store, Inc. and James LaMonica, but is otherwise denied;
2. The determination of the Administrative Law Judge is reversed to the extent indicated in paragraph "1" above, but is in all other respects affirmed;
3. The petitions of Uncle Jim's Donut & Dairy Store, Inc. and James LaMonica are in all respects denied;
4. The notices of determination issued on December 8, 1986 to Uncle Jim's Donut and Dairy Store, Inc. and James LaMonica are in all respects sustained;
5. The petitions of Jeanneann LaMonica and Charles A. LaMonica are granted; and
6. The notices of determination issued on December 8, 1986 to Jeanneann LaMonica and Charles A. LaMonica are cancelled.

DATED: Troy, New York
October 5, 1989

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

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

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