STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition of **MCI TELECOMMUNICATIONS CORP.** 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, 1984 through December 31, 1985.	:	
In the Matter of the Petition of **MCI EQUIPMENT CORP.** 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 September 1, 1981 through November 30, 1984.	:	DECISION DTA Nos. 806323, 806324, 806325
In the Matter of the Petition of **MCI LEASING, 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 June 1, 1981 through November 30, 1984.	:	

Petitioner MCI Telecommunications Corp., 1133 19th Street, N.W., Washington, D.C. 20036 and the Division of Taxation filed exceptions to the determination of the Administrative Law Judge issued on September 27, 1990 with respect to the petitions of MCI Telecommunications Corp., MCI Equipment Corp. and MCI Leasing, Inc. (hereinafter "petitioners") for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the respective periods December 1, 1984 through December 31, 1985, September 1, 1981 through November 30, 1984 and June 1, 1981 through November 30, 1984.

Petitioners appeared by Shea & Gould (Roger Cukras, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (James Della Porta, Esq., of counsel).

Petitioners filed a brief in support of the exception of petitioner MCI Telecommunications Corp. and in opposition to the Division of Taxation's exception. The Division of Taxation filed a brief and a reply brief in support of its exception and in opposition to the exception filed by petitioner MCI Telecommunications Corp. Oral argument, at the request of petitioners and the Division of Taxation, was heard on April 25, 199l. At the request of the Tax Appeals Tribunal, supplemental memoranda were submitted by petitioners and the Division of Taxation.

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

ISSUE

Whether petitioners have established reasonable cause and the absence of willful neglect warranting abatement of the penalties imposed for their failure to file and pay sales and use taxes during the audit period.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for findings of fact "1", "2", "3", "4", "5", "6", "7", "8" and "11" which have been modified. We have also made an additional finding of fact. The Administrative Law Judge's findings of fact, the modified findings of fact and the additional finding of fact are set forth below.[1]

Petitioners were affiliated corporations engaged in the telecommunications business. MCI Telecommunications Corp. ("MCI Telecom") was an operating company which provided both interstate and intrastate long distance telephone service. MCI Equipment Corp. ("MCI Equipment") and MCI Leasing, Inc. ("MCI Leasing") purchased equipment and leased it back to

[1]This matter was decided by the Administrative Law Judge on documents submitted by petitioners and the Division of Taxation.

MCI Telecom. MCI Equipment and MCI Leasing had no employees. All the employees worked for MCI Telecom.[2]

The Division of Taxation (hereinafter the "Division") performed separate audits of MCI Telecom, for the period September 1, 1977 through August 31, 1981, MCI Leasing, for the period June 1, 1977 through May 31, 1981, and MCI Equipment, for the period June 1, 1977 through May 31, 1981 (hereinafter "the first audit period"). As a result of these audits, petitioners were assessed additional tax due in the respective amounts of $1,115,322.56 plus penalty and interest (MCI Telecom Notices S811130002R and S811130001R, dated November 30, 1981), $465,740.79 plus penalty and interest (MCI Leasing Notice S811214001R, dated December 14, 1981), and $227,508.97 plus penalty and interest (MCI Equipment Notice S811214000R, dated December 14, 1981) (hereinafter "the 1981 notices").[3]

During the first audit period, MCI Telecom filed returns showing no gross sales, taxable sales, purchases subject to use tax, or tax paid. The tax assessment was based on unreported sales concerning intrastate telephone calls and access charges on these calls, installation charges and subscription fees. In addition, use tax was assessed on unreported taxable assets which were purchased or leased. With regard to MCI Leasing and MCI Equipment, the Division found sales tax due based on their failure to file sales tax returns (ST-100s) concerning the leasing of tangible personal property to MCI Telecom. At meetings with the Division at the conclusion of the audit, petitioners' representatives were advised of the basis for the Division's legal position with regard to the taxability of the items at issue. Petitioners were represented at these meetings by, among others, Patrick Nugent, who was the Director of Taxes for MCI Telecom for the period 1978 through 1985.[4]

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[2]The Administrative Law Judge's finding of fact "1" has been modified to include facts concerning petitioners' employees.

[3]The Administrative Law Judge's finding of fact "2" has been modified to add terms used later in the findings and opinion to refer to the audit periods and the notices.

[4]The Administrative Law Judge's finding of fact "3" has been modified by the addition of the first and last two sentences of the finding to provide additional facts on the first audit.

On March 1, 1982, the former Tax Appeals Bureau received petitions filed by each of the petitioners challenging the tax assessment in the 1981 notices. The petitions, which were identical except for the petitioner's name, audit period and assessment numbers, protested the imposition of tax on the purchased or leased assets, because "[t]he Company's property constitutes telephone central office equipment which is not comprehended within the SUTL [Sales and Compensating Use Tax Law] or is in any event exempt from it under SUTL § 1115(a)(12)."[5]

In December of 1984, petitioners and the Division reached a settlement whereby the tax deficiencies in the 1981 notices were reduced by $330,322.50. This reduction recognized a cancellation of the tax related to installation fees and an adjustment to the taxes due on purchased and leased assets. The reduction in the assessment for taxes due on purchased and leased assets was for the "corporation's capitalization of overhead and self-labor included in its fixed assets accounts and for acquisition of assets which, after installation by the seller, resulted in capital improvements" (Exhibit "J", Letter of December 3, 1984, from James Della Porta, Law Bureau, Division of Taxation to Roger Cukras, Esq., Shea & Gould, petitioners' representative). In addition, the Division agreed to cancel the penalty on the tax assessments and reduce the interest to minimum interest. Petitioners paid the tax and the minimum interest in full on all other items in the assessment. On December 26, 1984, petitioners withdrew their petitions challenging the Division's tax assessments for the first audit period.[6]

The Division conducted a second audit of the three petitioners (hereinafter "the second audit period"). The audit of MCI Telecom began in December 1981 and was for the period September 1, 1981, the end of the previous audit period, to December 31, 1985. The audit report indicates that the ending date of the audit period was selected at MCI Telecom's request because as of January 1, 1986 it was instituting a new system for accruing use tax. MCI Equipment was

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[5]The Administrative Law Judge's finding of fact "4" has been modified to indicate that each petitioner filed its own petition and to add the second sentence of the finding.

[6]The Administrative Law Judge's finding of fact "5" has been modified to add the third sentence explaining the reduction in the assessment for the purchased and leased assets and the fifth sentence to indicate the items on which petitioners paid.

audited for the period September 1, 1981 to November 30, 1984; and MCI Leasing for the period June 1, 1981 to November 30, 1984.[7]

The auditor found that MCI Telecom had not made the appropriate corrections after the first audit. MCI Telecom did not accrue or pay use tax on any items during this period.[8] MCI Telecom paid sales taxes to a few suppliers when requested by the supplier; however, it continued to issue exemption certificates for nearly everything it purchased. The Division assessed a tax due based on unreported taxable items such as intrastate calls and purchases of tangible personal property used in New York State, and, for a portion of the audit period, additional local tax. Among the items of property purchased were furniture and fixtures, motor vehicles and data processing equipment that totalled $7,426,497.00[9] for the audit period September 1, 1981 to December 31, 1985. The auditor also found that MCI Leasing and MCI Equipment had unreported taxable sales again based on tangible personal property that was leased to MCI Telecom. MCI Telecom apparently did not supply MCI Leasing and MCI Equipment with exemption certificates for these transactions as no exemption certificates were made available on audit by MCI Leasing and MCI Equipment.[10]

Initial audit results were presented to petitioners so that they could take advantage of the Tax Amnesty Program (see, L 1985, ch 66, § 1[a]). In January 1986, MCI Telecom applied for and obtained tax amnesty for the penalties resulting from its sales and use tax liabilities for the period of the second audit up to December 31, 1984. MCI Leasing and MCI Equipment also

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[7]On November 30, 1984, MCI Equipment and MCI Leasing were merged into MCI Telecom.

The Administrative Law Judge's finding of fact "6" has been modified to add terminology used later in the findings and opinion and to add the third sentence on the selection of the dates for the audit period.

[8]According to the audit report, MCI Telecom did not begin to report any use tax until August 31, 1986.

[9]In their reply brief, dated July 2, 1990, petitioners state that the total dollar amount of purchases with regard to motor vehicles, furniture and fixtures was approximately $1.8 million and not $7,426,497.00 as stated in an affidavit submitted by the Division's auditor (Exhibit "BB"). Petitioners have not submitted any other proof to support this allegation.

[10]The Administrative Law Judge's finding of fact "7" has been modified by the addition of the second sentence and accompanying footnote, and by the third and last sentences to provide additional details of the second audit, and by the addition of the reference to MCI Telecom's failure to pay local tax during a portion of the audit period.

applied for and obtained tax amnesty for penalties with regard to portions of the auditor's results for their second audit periods.[11]

In December of 1986, petitioners were each issued a Statement of Proposed Audit Adjustment (SPAA) for the additional tax due plus penalty and interest remaining after payment under the amnesty program. The items covered by MCI Telecom's SPAA included purchases of microwave towers, repeater sites for microwave transmissions, shelters for equipment, generators, batteries, test equipment and telecommunication services that were not resold. The SPAA also included New York City sales tax on telephone equipment exempt from State sales tax pursuant to Tax Law § 1115(a)(12) and nontelecommunication equipment such as furniture and fixtures for the post amnesty component of the 1981-1985 audit period. The SPAAs of MCI Leasing and MCI Equipment included unreported sales concerning lease arrangements with MCI Telecom of tangible personal property. Petitioners paid the respective tax assessments plus simple interest but declined to pay the penalties and statutory interest assessed on the taxes due.

The Division issued to petitioners three notices of determination and demands for payment of sales and use taxes due dated February 27, 1987: Notice S870227000R to Telecom ($204,180.07 plus interest for the period December 1, 1984 through December 31, 1985), Notice S870227006R to Equipment ($10,125.75 plus interest for the period September 1, 1981 through November 30, 1984) and Notice S870227007R to Leasing ($122,448.94 plus interest for the period June 1, 1981 through November 30, 1984). The notices assessed only penalties plus statutory interest against the respective petitioners based on the tax assessments contained in the SPAAs that had already been paid.

The three petitioners timely filed separate petitions, dated November 22, 1988, challenging their respective notices of determination. The petitions, which were identical except for petitioner's name, audit period and assessment numbers, alleged that the Commissioner had

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[11]The Administrative Law Judge's finding of fact "8" has been modified to clarify that petitioners obtained amnesty only for penalties and not for the amounts of tax due since tax liabilities were not eligible for amnesty (see, L 1985, ch 66 § 1[b]).

erroneously decided that petitioners' failure to pay was not due to reasonable cause, and further asserted that:

> "Between 1980-85, MCI purchased approximately $3 billion of equipment in expanding its telecommunications system country-wide.
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> "Tracking individual purchases for particular states was very difficult.
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> "MCI's New York warehouse facility in Elmsford served 5 states.
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> "On January 30, 1986, MCI paid over $6,000,000 sales and use taxes (inclusive of interest) to the State Tax Department during tax amnesty. The amount not paid was for equipment that arguably was not subject to the state sales taxes, either central office equipment or as equipment temporarily stored for delivery outside New York.
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> "The application of the exemption to MCI's purchase of central office equipment was not clear. Reg. §528.13(f) which contains that exemption was directed to the earliest generation of telephone equipment when switchboards were in use. Switchboards are no longer in use and there were significant purchases to which the exemption arguably applied.
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> "Based on the foregoing, the petitioner submits that there was reasonable cause and that no penalty should be imposed for failure to pay sales and use taxes."[12]

We make the following additional finding of fact:

> An affidavit of Patrick Nugent, submitted to the Administrative Law Judge, reiterates the facts stated in the petition referred to above. In addition, the affidavit states that purchases made by MCI Telecom were used immediately or sent to one of 15 regional warehouses including one in Elmsford, New York and that most of the equipment stored at the Elmsford facility was eventually shipped to other states. Further, the affidavit states:
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> > "During the initial phase of this expansion, MCI's problems of addressing sales taxes were extensive. MCI would have to manually trace each purchase, determine its taxability under each state's laws, determine whether the vendor had charged the proper amount of tax and determine whether the

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[12]The Administrative Law Judge's original finding of fact "11" read as follows:

> "On November 18, 1988, the three petitioners filed separate petitions challenging their respective notices of determination."

The Administrative Law Judge's finding has been modified to more fully reflect the record.

> purchased equipment would be stored in the state of purchase temporarily at a warehouse. In some states, the purchases were completely exempt from tax. In the case of New York State, there was the issue of whether the equipment would fall within the definition of central office equipment and not be subject to the State portion of the tax or would be exempt from tax as a sale for resale and as a lease of real property."

In May 1989, MCI Telecom filed a request for an advisory opinion seeking the Department of Taxation and Finance to exempt certain equipment from sales and use taxes as telephone central office equipment pursuant to section 1115(a)(12) of the Tax Law.

OPINION

Tax Law § 1145(a)(1)(i) states that any person failing to file or pay over any tax to the Commissioner of Taxation and Finance (hereinafter "the Commissioner") "shall" be subject to a penalty. This penalty may be cancelled if the Commissioner determines that the failure was "due to reasonable cause and not due to willful neglect" (Tax Law § 1145[a][1][iii]). As required by Tax Law § 1145(a)(1)(iii), the Commissioner has promulgated regulations as to what constitutes reasonable cause. The regulation which was in effect during the audit period (hereinafter the "prior regulation") was adopted in 1979 and read as follows:

> "(b) Reasonable Cause. . . . Grounds for reasonable cause, where clearly established, may include the following:
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> * * *
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> "(5) pending petition to Tax Commission or formal hearing proceedings involving a question or issue affecting the computation of tax for the year, quarter, month or other period of delinquency" (20 NYCRR § 536.1[b][5]).

This regulation was amended in 1987 (hereinafter the "current regulation") to read as follows:

> "(c) The following exemplify grounds for reasonable cause where clearly established by or on behalf of the taxpayer or other person.
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> * * *
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> "(4) A pending petition to the Commissioner of Taxation and Finance for an advisory opinion or a declaratory ruling, a pending conciliation conference proceeding in the Bureau of Conciliation

> and Mediation Services of the Division of Taxation, a pending petition to the Division of Tax Appeals or a pending action or proceeding for judicial determination may constitute reasonable cause, until the time in which the taxpayer has exhausted its administrative or judicial remedies, as applicable, for a taxable period or periods the return or returns for which are due subsequent to the filing of the petition with the Commissioner of Taxation and Finance, the commencement of the conciliation conference proceeding, the filing of the petition with the Division of Tax Appeals or the commencement of the judicial action or proceeding, provided that:
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> "(i) the petition, action or proceeding involves a question or issue affecting whether or not the individual or entity is required to file a return and collect and remit sales tax or is required to file a return and pay use tax;
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> "(ii) the petition, action or proceeding is not based on a position which is frivolous nor is it intended to delay or impede the administration of articles 28 or 29 of the Tax Law; and
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> "(iii) the facts and circumstances for such taxable period or periods are identical or virtually identical to those of the taxable period or periods covered by the petition, action or proceeding [example omitted].
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> "(5) Any other cause for delinquency which would appear to a person of ordinary prudence and intelligence as a reasonable cause for delay and which clearly indicates an absence of willful neglect may be determined to be reasonable cause. Ignorance of the law, however, will not be considered as a basis for reasonable cause [examples omitted]" (20 NYCRR 536.5[c][4] and 20 NYCRR 536.5[c][5], respectively)."

The Administrative Law Judge found that petitioners MCI Leasing and MCI Equipment had established reasonable cause for their failure to file under the criteria set forth in 20 NYCRR 536.5(c)(4). The Administrative Law Judge found that petitioners' petitions for the first audit period ("the 1981 petitions") and the assessments for the second audit period related to similar equipment and raised substantially similar exemption arguments, and that the positions asserted in the petitions were arguable claims. Since the petitions for the first audit period were not withdrawn until after the second audit period ended, the Administrative Law Judge found that the pendency of the 1981 petitions constituted reasonable cause for petitioners' failure to pay tax during the second audit period. Consequently, the Administrative Law Judge abated penalties for petitioners MCI Leasing and MCI Equipment.

The Administrative Law Judge held that petitioner MCI Telecom had not established reasonable cause under 20 NYCRR 536.5(c)(4) or under 20 NYCRR 536.5(c)(5). The Administrative Law Judge found that since the 1981 petitions were withdrawn prior to the tax period for which MCI Telecom was assessed a penalty, MCI Telecom could not rely on the existence of these petitions as its excuse for not paying tax during this period. In addition, the Administrative Law Judge found that MCI Telecom had not established any other reasonable cause for its delinquency as required by 20 NYCRR 536.5(c)(5), holding that since MCI Telecom was aware of the position of the Division with regard to the taxability of the items assessed, MCI Telecom had an obligation to report and pay tax on these items and, if it wished to contest taxability, to apply for a refund. The Administrative Law Judge also held that MCI Telecom's request for an Advisory Opinion in 1989 did not constitute reasonable cause for its failures to pay tax in 1984-1985. Therefore, the Administrative Law Judge sustained the penalties assessed against petitioner MCI Telecom.

Petitioner MCI Telecom filed an exception to the Administrative Law Judge's determination sustaining the penalties assessed against it. The Division filed an exception to that part of the Administrative Law Judge's determination which cancelled penalties assessed against petitioners MCI Leasing and MCI Equipment. Since the Administrative Law Judge granted the petitions of two of the petitioners and denied the petition of the third, and since each side has filed an exception to that part of the determination which was adverse to it, the issue presented to the Tribunal is the same as presented below, that is, whether each of the petitioners have established reasonable cause and the absence of willful neglect for their failure to pay sales and use tax during the audit period.

Petitioners argue that they have established reasonable cause under 20 NYCRR 536.5(c)(4) and (5). With regard to 20 NYCRR 536.5(c)(4), petitioners assert that the requirements of the regulation have been met by virtue of the 1981 petitions. First, petitioners claim that the facts and circumstances for the second audit period were virtually identical to those for the period covered by the 1981 petitions in that, for both audit periods, the items for which tax was

assessed were substantially the same; the petitions filed in response to both audits made the same exemption arguments with regard to the equipment which was the subject of a large portion of the tax; and the legal arguments for exemption support the conclusion that the law with respect to the equipment in question was (and is) equivocal. Second, the 1981 petitions were withdrawn in December 1984, one month after the end of the second audit period for petitioners MCI Equipment and MCI Leasing. Petitioners do not explain how the facts concerning the timing of the withdrawal of the 1981 petitions applies to MCI Telecom since the 1981 petitions were withdrawn in the first month of the period for which MCI Telecom was assessed a penalty. Rather, petitioners argue generally that, since the equipment which was the subject of MCI Telecom's assessment was the same, and the same exemption arguments with regard to this equipment were made, the existence of the 1981 petitions should serve as reasonable cause for MCI Telecom for this period as well.

Petitioners also assert that their legal arguments in favor of an exemption for equipment which represented a large portion of the tax, and the continuing question of taxability of this equipment as evidenced by MCI Telecom's request for an Advisory Opinion in 1989, establish that their belief that the equipment was exempt was reasonable. In addition, petitioners argue that the rapid expansion of their business during the audit period made it very difficult for them to address their complex sales tax obligations. Petitioners urge that their subsequent substantial investment in developing a computerized sales tax compliance system and other steps they have taken to comply with their tax reporting responsibilities should be considered in determining whether petitioners' failure to file or pay during the audit period was reasonable and not due to willful neglect. For these reasons, petitioners argue that they have established reasonable cause under 20 NYCRR 536.5(c)(5) and that penalties should be abated.

The Division argues that 20 NYCRR 536.5(c)(4) applies when the issue presented by the petition is whether or not a person or entity is required to file a return. The Division asserts that the regulation does not apply when the issue is whether particular items are subject to tax and the Division has indicated that the items are taxable. In the Division's view, applying the regulation

to the facts presented here would erode the basic self-reporting aspects of the tax system. The Division also argues that, even if the regulation applies, petitioners have failed to present evidence establishing that they believed the position being articulated in the petitions. The Division argues that petitioners must show how they came to the conclusion that these purchases were not subject to tax, who made the decision, and what was the basis for the decision. Further, the Division asserts that the regulation applies only when there is a bona fide disagreement with the Division and that petitioners' failure to ever litigate to conclusion the legal positions taken in the petitions, indicates a lack of good faith.

In addition, the Division argues that petitioners' evidence fails to establish the existence of reasonable cause and the absence of willful neglect under the general standards of 20 NYCRR 536.5(c)(5). The Division argues that the record refutes petitioners' claims of good faith, pointing to petitioners' failure to report their tax liabilities on any of their sales or purchases during the two audit periods, and with regard to MCI Telecom, the only petitioner in existence after November 1984, its continued failure to report and pay tax until August of 1986. Further, the Division argues that since some of the same people were handling the tax matters for all petitioners, petitioners' tax compliance record should be viewed as a whole in determining if petitioners' conduct constituted reasonable cause. The Division asserts that the record supports the conclusion that petitioners failed to report and pay tax primarily because they did not have an adequate tax reporting system.

As neither the parties nor the Administrative Law Judge addressed the regulation in effect during the audit period (20 NYCRR § 536.1[b][5]), the Tribunal requested that the parties file supplemental memoranda addressing the issue of reasonable cause in the context of that regulation.

In its supplemental memorandum, the Division asserts that the changes to the regulations in 1987 were merely a clarification of when filing a petition may constitute reasonable cause and, therefore, the terms of the current regulations are applicable to this matter. Further, the Division argues that 20 NYCRR 536.1(b)(5) did not establish an absolute rule that the filing of a petition

will always constitute reasonable cause. Instead, the prior regulation "must be deemed to contain the implicit conditions that the petition be made in good faith, not be frivolous, [be] objectively reasonable, and not intended to delay or impede the administration of Articles 28 and 29 of the Tax Law" (Division's supplemental memorandum of law, p. 2). The Division asserts that these conditions have not been met in this case.

Petitioners argue in their supplemental memorandum that the Division's characterization of the changes to the regulation in 1987 as merely a "clarification" is an oversimplification and assert that the Division's position, that a pending petition only constitutes reasonable cause if the issue presented is vendor status, cannot be found in the wording of the prior regulation. Petitioners argue that under the wording of the prior regulation, the pending petition only has to involve a question or issue affecting the computation of the tax, and that under that regulation, petitioners have met the standard of reasonable cause. Further, petitioners argue that acts taken by petitioners subsequent to the audit period should not be considered in determining whether petitioners acted in good faith.

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

We do not agree that the petitions filed in response to the 1981 notices excuse petitioners' failure to remit tax during the second audit period, or that petitioners have established any other reasonable cause and the absence of willful neglect for their delinquency as required by Tax Law § 1145(a)(1)(iii).

First, we agree with the Administrative Law Judge that 20 NYCRR 536.5(c)(4) clearly cannot apply to petitioner MCI Telecom, as the 1981 petitions were withdrawn in the first month of the tax period for which MCI Telecom was assessed a penalty and prior to the due date for filing the return for that quarter.[13] For the same reason, 20 NYCRR 536.1(b)(5) does not apply.

With regard to the other two petitioners, we find that petitioners have not met their burden of establishing reasonable cause for the abatement of penalties under the requirements of

[13]The notice issued to MCI Telecom was for the period December 1, 1984 through December 31, 1985 only. Penalties for the earlier portion of the audit period had been cancelled under the tax amnesty program.

20 NYCRR 536.5(c)(4)(ii), 20 NYCRR 536.5(c)(5) or 20 NYCRR 536.1(b)(5).[14] As previously noted, Tax Law § 1145(a)(1) first requires that a penalty be assessed for failure to file or pay over any tax within the required time period, and then permits the remission of such penalties under certain circumstances. By first requiring the imposition of penalties (rather than merely allowing them at the Commissioner's discretion), the Legislature evidenced its intent that filing returns and paying tax according to a particular timetable be treated as a largely unavoidable obligation (see, Matter of F & W Oldsmobile v. Tax Commn. of the State of New York, 106 AD2d 792, 484 NYS2d 188). Since there can obviously be circumstances in which it may be appropriate to excuse the failure to file or pay on time, remission of penalties is permitted, but only if the failure or delay in payment was (1) due to reasonable cause, and (2) was not due to willful neglect (Tax Law § 1145[a][1][iii]). While the statute requires the Commissioner to promulgate regulations as to what constitutes "reasonable cause" (Tax Law § 1145[a][1][iii]), given the statutory framework, such regulations obviously could never allow for the remission of penalties under circumstances where the causes of the failures were not reasonable or under circumstances involving willful neglect (see, Matter of Jones v. Berman, 37 NY2d 42, 371 NYS2d 422 [administrative agencies have no authority to create rules which are out of harmony with statutory language]; see also, Matter of Nekoosa Papers v. Chu, 115 AD2d 821, 495 NYS2d 1003, 1006). Because of this statutory framework, we agree with the Division that under either set of regulations, the mere filing of a petition cannot in and of itself constitute reasonable cause.

Petitioners suggest that the correct interpretation of the prior regulation is that any petition involving the computation of tax could serve as a "safe harbor" for a taxpayer's actions during subsequent audit periods. This clearly cannot be correct. Such an interpretation would have

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[14]While it seems clear that the prior regulation (20 NYCRR 536.1 [b][5]) is the regulation applicable to the period here, the parties have made arguments addressed to both the prior and the current regulations. Therefore, both regulations have been discussed below.

In addition, it is unnecessary for us to discuss whether 20 NYCRR 536.5(c)(4) applies only in the limited circumstances argued by the Division, as we have found that petitioners do not, in any case, meet the other requirements of this regulation.

permitted every taxpayer to delay payment or compliance with its tax responsibilities by the filing of a petition. In stating that the petition must involve "a question or issue," the regulation makes it clear that a mere petition of any kind is not sufficient. We cannot agree with petitioners that the failure to include in the prior regulation the specific requirement that the petition not be "frivolous" indicates that the bona fide nature of the question or issue in the petition, or the circumstances surrounding the taxpayer's actions with regard to the petition, cannot be considered. Clearly a petition that was intended to delay or impede the administration of the Tax Law can never be reasonable cause for failure to file or pay under Tax Law § 1145(a)(1), regardless of whether the regulation specifically so stated. By requiring the imposition of penalties for certain failures, Tax Law § 1145(a)(1) makes it clear that its purpose is to prevent delay in the administration of the tax laws and in the collection of tax.

Petitioners have not proven that their petitions were not frivolous or were not intended to delay or impede the administration of the Tax Law, or that their actions show an absence of willful neglect.[15]

Petitioners have relied heavily on the argument that the existence of legal questions as to the taxability of equipment which made up a large portion of the assessments was a sufficient reason for their failure to pay tax during the second audit period. We find that petitioners have not met their burden of establishing their bona fide belief in that position as the reason for their failures to pay tax during the second audit period.[16]

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[15]While petitioners argue in their supplemental memorandum that actions taken subsequent to the audit period should not be considered in determining reasonable cause, in our view, all relevant circumstances should be considered in evaluating whether a taxpayer had reasonable cause for its actions, or failures to act, and whether a taxpayer has established the absence of willful neglect (see, Matter of L T & B Realty Corp. v. New York State Tax Commn., 141 AD2d 185, 535 NYS2d 121, 123). In any case, petitioners' argument is somewhat disingenuous since petitioners have argued in every other phase of this matter that actions taken by them subsequent to the audit period support their claim that penalties should be abated.

[16]We do not agree with petitioners that statements made by the conferee represent the "best evidence" of petitioners' good faith. We cannot consider the letter sent by the conferee in the course of the conciliation proceedings as evidence of the Division's position on this controversy or as support for petitioners' position. The Bureau of Conciliation and Mediation Services was established to provide an opportunity for an informal resolution of a tax controversy before the Division of Tax Appeals process (Tax Law § 170[3-a]). The conciliation order may not be considered a precedent or given any force or effect in any subsequent administrative proceeding (Tax Law § 170[3-a][f]).

Taking the record as a whole, it is clear that petitioners' failures to remit tax occurred not because of the position articulated in the 1981 petitions but because, by petitioners' own admissions, their rapidly expanding business made it very difficult for them to comply with their tax responsibilities. After being advised of the Division's position upon completion of the first audit, petitioners chose complete noncompliance. A review of the circumstances surrounding their noncompliance leads to the conclusion that petitioners' actions were motivated by their inability or unwillingness to achieve compliance and not by their belief in the exempt status of some of their purchases. Throughout the two audit periods petitioners were not even attempting to segregate their purchases into taxable and nontaxable categories, even based on their own evaluation as to what belonged in each category. Nor did they make any attempt to estimate their liability. While claiming their transactions with MCI Telecom were exempt, MCI Leasing and MCI Equipment did not attempt to comply with the tax law by obtaining the proper exemption certificates (Tax Law § 1132[c]; 20 NYCRR 532.4 and 533.2[b][4]).

In addition, we do not agree that a taxpayer's legal dispute with the Division's articulated position on taxability as to some portion of an assessment can excuse payment of any tax during a subsequent tax period while the dispute is being litigated (see, Matter of Auerbach v. State Tax Commn., Sup Ct, Albany County, July 7, 1987, Williams J., affd on other grounds 142 AD2d 390, 536 NYS2d 557; Matter of Benacquista, Polsinelli & Serafini Mgt. Corp., Tax Appeals Tribunal, February 22, 1991). Under these circumstances, neither 20 NYCRR 536.1(b)(5), 20 NYCRR 536.5(c)(4) nor 20 NYCRR 536.5(c)(5) can be used to excuse complete noncompliance.

Petitioners admit that their claim, that the equipment they purchased was exempt from tax pursuant to Tax Law § 1115(a)(12) as "telephone central office equipment . . . for use directly and predominantly in receiving at destination or initiating and switching telephone or telegraph communication" (Tax Law § 1115[a][12]), applied to only a portion (albeit, a large portion) of the assessment. The 1981 petitions and the assessments for the second audit period also included

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In any case, while the letter indicates that the assessment involved issues (unspecified) which the conferee expected would result in civil litigation, as we discuss below, the assessment included tax on items the taxability of which was never in doubt.

items the classification of which as "telephone central office equipment" hardly seems reasonable (for example, the motor vehicles and furniture). Petitioners' argument that items such as motor vehicles and furniture were classified as "telephone central office equipment" for purposes of the sales tax exemption, because such items were considered to be central office equipment for Federal tax purposes, illustrates petitioners' lack of attention to sales tax compliance. In addition, the lack of an exemption in the New York City sales tax law for production equipment of any kind was never in doubt. Petitioners' exemption arguments could never have applied to this aspect of the assessments. Petitioners' argument that their failure to pay this part of the tax should be excused because they could have received a credit for their sales tax payments on their New York City corporate tax return cannot be accepted. The sales tax law requires that payment be made pursuant to a prescribed time table (Tax Law § 1136). It does not provide that payment is excused because of the existence of a credit for a separate tax in a separate taxing jurisdiction (see, Matter of Martin Lithographers and Cosmos Communications, State Tax Commn., December 2, 1985). Petitioners have never presented a legitimate excuse for their failure to pay this aspect of the tax and this lends further support to the conclusion that petitioners' reasons for failing to pay were other than the telephone central office equipment legal dispute.

Two other factors militate against a finding that petitioners' position in the 1981 petitions was based on a bona fide belief as to its exemption from tax. The first is that even after the 1981 petitions were withdrawn in December 1984, the only remaining petitioner, MCI Telecom, did not begin to pay tax until several years later. An acceptable explanation has not been provided for this delay. The lack of an adequate tax compliance system is not an acceptable explanation (see, Matter of Paramount Pictures, Tax Appeals Tribunal, March 14, 1991). This brings us to the second factor, which is, while petitioners continue to assert their belief that the equipment they have purchased is exempt from tax pursuant to Tax Law § 1115(a)(12) as "telephone central office equipment," they have yet to litigate their position, although they have had two opportunities to do so. The request for an Advisory Opinion made in 1989 does not provide an explanation for actions taken more than five years before. While litigation of this dispute may

not have been required in order for petitioners to prove that they acted in good faith, no explanation has been provided for petitioners' failure to litigate, and thus the failure to litigate lends weight to the conclusion that petitioners' actions were not motivated by a bona fide belief in their legal position. We note that on this point we do not have before us any evidence concerning the knowledge or motivations of those who made the decisions for petitioners (see, Matter of L T & B Realty Corp. v. New York State Tax Commn., supra; Matter of Ross-Viking Mdse. Corp., Tax Appeals Tribunal, August 8, 1991).

Petitioners have failed to prove that their actions were not conscious, intentional failures constituting willful neglect (see, United States v. Boyle, 469 US 241). By the end of the first audit period, petitioners were fully aware of the Division's position on the taxability of the items in the assessment. Having been so advised, petitioners consciously chose not to comply. Under the circumstances presented here and under the statutory framework of Tax Law § 1145(a)(1), if petitioners wished to avoid the possibility of penalties, the proper course was to file and pay the tax and thereafter apply for a refund (see, Matter of Auerbach v. State Tax Commn., supra; Matter of L T & B Realty Corp. v. New York State Tax Commn., supra; Matter of Norwest Bank Intl., Tax Appeals Tribunal, May 3, 1990; see also, Church of Scientology of California v. Commissioner, 83 TC 381, affd 823 F2d 1310 [9th Cir], 87-2 USTC ¶ 9446, cert denied 486 US 1015 [petitioner's argument, that it was entitled to continue to file as a tax exempt organization after exempt status had been revoked while it was contesting the revocation, was rejected and penalties were upheld]; compare, Matter of BAP Appliance Corp., Tax Appeals Tribunal, June 22, 1989 [reasonable cause found where Division of Taxation had not made clear its position on the taxable status of the sales in question]).

Petitioners' compliance efforts subsequent to the audit period do not support a finding of reasonable cause or the absence of willful neglect (see, Matter of Rochester Gas & Elec., Tax Appeals Tribunal, January 4, 1991). Rather, they show that compliance was possible but that petitioners did not devote the resources it needed to fulfill its tax compliance responsibilities until after these audit periods (see, Matter of Paramount Pictures, supra).

Nor can the subsequent voluntary payment of the amounts assessed constitute reasonable cause. This argument suggests that it does not matter when a taxpayer complies with its tax responsibilities as long as it does so when asked. This is at variance with the self-reporting character of our tax system. The Tax Law provides for penalties in order to encourage timely filing of returns and prompt payment of tax liability as "taxes are the life-blood of government, and their prompt and certain availability is an imperious need" (Bull v. United States, 295 US 247, 259 [1935]). Petitioners' willingness to pay tax when alerted by the Division does not establish reasonable cause or the absence of willful neglect for failure to pay the tax when originally due (see, Matter of Copley Plaza Co., Tax Appeals Tribunal, June 8, 1989).

Petitioners chose to delay the payment of their taxes for reasons which were important to them. However, having chosen to do so, petitioners must accept the consequential penalties. These penalties are properly imposed here.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of MCI Telecommunications Corp. is denied;

2. The exception of the Division of Taxation is granted;

3. The determination of the Administrative Law Judge is sustained,

except as modified by paragraph 2 above;

4. The petitions of MCI Telecommunications Corp., MCI Equipment Corp. and MCI Leasing, Inc., are denied; and

5. The notices of determination issued to petitioners MCI Telecommunications Corp., MCI Equipment Corp. and MCI Leasing, Inc., are sustained.

DATED: Troy, New York
January 16, 1992

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

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

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