STATE OF NEW YORK

TAX APPEALS TRIBUNAL

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| In the Matter of the Petition | : | |
| of | : | |
| **DAVID R. ANTHONY D/B/A DELEVAN MOTORS** | : | DECISION DTA No. 810987 |
| 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, 1983 through May 31, 1986. | : | |

Petitioner David R. Anthony d/b/a Delevan Motors, 602 Hopkins Road, Williamsville, New York 14221, filed an exception to the determination of the Administrative Law Judge issued on October 27, 1994. Petitioner appeared by Berkowitz, Pace & Cooper (Timothy J. Cooper, Esq., of counsel). The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Robert J. Jarvis, Esq., of counsel).

Petitioner filed a brief in support of his exception and the Division of Taxation filed a brief in response. Petitioner did not file a reply brief, but such brief was due on June 7, 1995, which date began the six-month period for the issuance of this decision. Petitioner's request for oral argument was denied.

The Tax Appeals Tribunal renders the following decision per curiam.

## *ISSUES*

I. Whether the Division of Taxation's utilization of external indices on audit was warranted and reasonably reflected the taxes due for the period in issue.

II. Whether the Division of Taxation properly assessed fraud penalty against petitioner for the period in issue pursuant to Tax Law § 1145(a)(2).

## *FINDINGS OF FACT*

We find the facts as determined by the Administrative Law Judge except for findings of fact "3" and "4" which have been modified. The Administrative Law Judge's findings of fact and the modified findings of fact are set forth below.

At all times pertinent herein, petitioner, David R. Anthony d/b/a Delevan Motors ("Delevan"), was engaged in the business of selling used automobiles at 4491 Broadway, Depew, New York.

For each of the quarters in the audit period, June 1, 1983 through May 31, 1986, Delevan filed sales and use tax returns and remitted tax.

We modify finding of fact "3" of the Administrative Law Judge's determination to read as follows:

> The Division of Taxation ("Division") began a field audit of Delevan in March of 1986. An appointment letter was sent to petitioner on May 2, 1986 to set up a time to review petitioner's records. A subsequent request for documentation was made on May 30, 1989. A review was conducted of sales and use tax returns, Federal income tax returns, bank statements, Delevan's book of registry, sales tax worksheets and available purchase invoices for vehicles.
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> On May 30, 1986, the Division was informed by the Department of Motor Vehicles that Delevan was not registered with it under the name "Delevan" or "David Anthony". Certain forms "MV-50", certificates of sale, were located at Delevan's place of business but not for the audit period in issue. The MV-50s reflect the name and address of the dealer and the purchaser, a description of the vehicle and a date of sale. The auditor testified that original MV-50s distinguish between retail and nontaxable wholesale transactions in that a corner of each wholesale form is "clipped." The auditor further testified that in order for a vehicle to change ownership, an MV-50 must be filed with the Department of Motor Vehicles. The certificates of sale for sales made during the audit period were obtained from the Department of Motor Vehicles.
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> Although not in the record, the auditor's log indicated that a signed consent to extend the period of limitation on assessment of

sales and use taxes due, Form AU-2.10, was acquired from Delevan.[1] However, the date to which the period was extended was not disclosed.

On January 28, 1987, the Division terminated contact with petitioner and the case was referred for a fraud investigation and possible criminal implications. As part of the Criminal Division's investigation, it attempted to contact former customers of petitioner.

Petitioner's former customers, however, were generally uncooperative.[2]

We modify finding of fact "4" of the Administrative Law Judge's determination to read as follows:

The file was returned to audit in March of 1989. A second request for books and records was made on May 30, 1989. With regard to this request, the auditor's notes state that "[t]he audit was returned to the Audit Division for civil fraud follow-up. The vendor (through his attorney) was requested at that time to produce all books and records of all vehicle sales made by Delevan Motors for the audit period. This request was made after it was stated to the vendor that the department did not intend to pursue criminal prosecution if the vendor cooperated and supplied any and all records not previously presented. No other records were provided from that request." A Statement of Proposed Audit Adjustment was mailed to petitioner on June 11, 1990.

At this juncture, petitioner's representative, Timothy Cooper, Esq., asked the Division to issue a letter stating that it would not proceed with the criminal prosecution if petitioner agreed to the proposed tax. The Division did not issue such a letter.

There were some further discussions between the parties in October of 1990 with regard to the audit methodology, but no further substantiation of sales was provided.[3]

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[1] The consent was noted twice in the auditor's log, but elsewhere in the audit report it was noted that "waivers" (a term often used synonymously with "consent") were not obtained due to the assessment of fraud.

[2] We modified the Administrative Law Judge's finding of fact "3" by inserting the third, fourth and fifth sentences in the second paragraph and by inserting the last two sentences in the last paragraph in order to reflect additional details in the record.

[3] The first paragraph of finding of fact "4" previously read:

> The file was returned to audit in March of 1989 and, after a second request for additional books and records on May 30, 1989, to which petitioner did not respond, a Statement of Proposed Audit Adjustment was mailed to petitioner on June 11,

The Division issued to David R. Anthony d/b/a Delevan Motors a Notice of Determination and Demand for Payment of Sales and Use Taxes Due, dated November 13, 1990, setting forth additional tax due of $31,908.44, plus fraud penalty of $15,954.24 and interest of $35,498.37, for a total amount due of $83,361.05. The Division issued a second notice to petitioner, dated November 13, 1990, which set forth additional penalty due of $1,165.10. Both notices covered the period June 1, 1983 through May 31, 1986.

With regard to petitioner's liability for use tax, the Division found the records of purchases to be inadequate. An examination of the expense purchases of such items as snowplowing, sand paper and other automobile supplies indicated that, in many instances, either no tax was paid or no invoice was provided to substantiate what was listed in the check disbursements journal. As a result, the Division examined the purchase invoices for the calendar year 1985 and determined that, for the four quarters of that year, petitioner had additional purchases subject to tax of $26,132.17. The Division compared this figure with total sales for the year of $123,178.00 and arrived at a ratio or "error rate" of .21214. It applied this ratio to gross sales reported in each quarter in the audit period to arrive at additional taxable expense purchases of $71,428.00. The additional tax on these purchases was determined to be $5,348.34.

The Division assessed "omnibus" penalty pursuant to Tax Law § 1145(a)(1)(vi) for the quarters ended August 31, 1985, November 30, 1985, February 28, 1986 and May 31, 1986 because the tax determined to have been omitted by petitioner was greater than 25% of the audited tax due for those quarters.

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1990.

We modified the first paragraph of finding of fact "4" to more fully reflect the record.

During the audit, the Division examined the period January 1, 1984 through December 31, 1985 and found that Department of Motor Vehicles records indicated that petitioner had made 161 vehicle sales while the sales tax returns listed only 80 vehicle sales. The Division concluded that during this period Delevan omitted 50.3% of all vehicle sales from its sales tax returns. In fact, petitioner had not reported $332,001.00 of the $656,964.00 in total taxable sales.

When the Division then requested all the forms MV-50 from the Department of Motor Vehicles for the entire audit period, it found 150 vehicle sales which had been omitted from petitioner's returns. The MV-50s discovered by the Division were all signed by "David R. Anthony" below a certification that he had collected all State and local taxes due on the sales listed on the MV-50.

As a result of this discovery, the Division did a detailed audit of petitioner's books and records, accepting as correct the sales figures reported on the sales and use tax returns, and estimated the sales tax due on those sales not reported by using the values for used cars published monthly by the National Automobile Dealers Association ("NADA") as a basis for the sales prices for those transfers revealed by the forms MV-50 obtained from the Department of Motor Vehicles. The Division took the value for each vehicle described by the MV-50 listed in the NADA publication for the month and year of the transfer and reduced the value listed by 20% to account for the condition of each car, which could not be determined.

This methodology yielded additional taxable sales of $360,390.00 and additional sales tax due of $26,560.10.

Based upon these omissions, the Division asserted fraud penalty against Delevan for all quarters within the period June 1, 1983 through May 31, 1986.

Immediately prior to the hearing in this matter on October 7, 1993, petitioner produced, for the first time, documentation with regard to the 150 omitted sales. Specifically, petitioner provided 50 separate folders with miscellaneous information. Of the 50 folders, 33 contained

invoices. The Division adjusted its audit to reflect the sales amounts listed on the invoices and also adjusted the values it had assigned to the 150 sales (80% of NADA value) to 74% of NADA value.

The Division compared the values set forth on the 33 additional invoices provided by Delevan shortly before hearing with the values reported in NADA and arrived at the 74% figure, which it then applied to all the omitted sales. The amount of additional taxable sales was reduced and as a result additional tax due was reduced to $25,738.97.

The 33 invoices presented by petitioner indicated that petitioner had collected sales tax on those sales but had not remitted the tax to the State of New York with his returns.

At hearing, the assessment of taxes due for the quarters ended August 31, 1983 and November 30, 1983 was cancelled by the Division. The Division explained that only use tax was assessed for these periods, not sales tax.

Also at hearing, petitioner submitted a schedule he prepared of sales reported on Delevan's returns filed during the audit period, which set forth the vehicle's year, make, sales price and a NADA value. The NADA value used appears to have been the "average retail" price, or highest value listed by that publication. Petitioner's sales prices were accepted as correct by the Division on audit.

In a post-hearing submission, petitioner submitted the actual NADA pages and invoiced sales prices for each vehicle listed in the hearing exhibit of sales made and reported during the audit period referred to in Finding of Fact "8". Pursuant to this schedule, petitioner prepared a computation summary of sales per invoices versus the NADA values and concluded that petitioner's sales prices were approximately 53% of NADA value, on average, for each of the sales made and reported during the audit period.

## *OPINION*

We first address whether the Division's utilization of external indices was warranted and reasonably reflected taxes due for the period.

The Administrative Law Judge held that the Division was justified in resorting to external indices because petitioner supplied no source documentation with regard to the 150 omitted sales until shortly before hearing. The Administrative Law Judge further rejected petitioner's assertion that the auditor should have looked at the prices listed on petitioner's returns and ascribed a similar average value to the 150 unreported sales. The Administrative Law Judge also stated that the 33 invoices petitioner submitted before the hearing indicated that the sales prices for the unreported vehicles were 74% of the NADA values, not the 53% which the returns appear to reflect for the reported vehicles.

Petitioner argues that there is insufficient evidence in the record to establish that the audit had a rational basis. More specifically, petitioner asserts that there was no testimony to the effect that NADA-based values were reasonably related to sales values at petitioner's place of business. Petitioner contends that: the values employed by the Division grossly overstate the sales prices; the Division failed to contact customers to determine sales price; and the Division's methodology assumes all sales were taxable.

Petitioner also argues that the amount assessed is erroneous. Given that there is a record of sales specific to the period at issue that are only 53% of NADA values, petitioner argues the amount assessed at 74% was erroneous.

Petitioner asserts that the Division's request for records was tainted by the Division's referral of the case to the Criminal Division. Petitioner argues that it is "fundamentally unfair to require a taxpayer to choose between the assertion of their constitutional rights and permitting a Governmental Agency to use whatever arbitrary sources are available to it in determining its' tax liability" (Petitioner's brief on exception, p. 7).

We affirm the determination of the Administrative Law Judge on this issue.

In order to resort to external indices in computing a taxpayer's liability, it must first be determined that the taxpayer's records are insufficient, making it impossible to verify sales receipts and conduct an audit (Matter of Chartair, Inc. v. State Tax Commn., 65 AD2d 44, 411

NYS2d 41). The Division must first make an explicit request for petitioner's books and records (Matter of Christ Cella v. State Tax Commn., 102 AD2d 352, 477 NYS2d 858), for the entire assessment period (Matter of Adamides v. Chu, 134 AD2d 776, 521 NYS2d 826, lv denied 71 NY2d 806, 530 NYS2d 109). A thorough examination of the books and records must be made before resorting to external indices (Matter of King Crab Rest. v. Chu, 134 AD2d 51, 522 NYS2d 978). If the records are found to be incomplete or inaccurate, external indices may then be used to estimate tax (Matter of Urban Liqs. v. State Tax Commn., 90 AD2d 576, 456 NYS2d 138). While exactness is not required, the audit methodology utilized must be reasonably calculated to reflect taxes due (Matter of W.T. Grant Co. v. Joseph, 2 NY2d 196, 159 NYS2d 150, cert denied 355 US 869).

As a preliminary matter, we find no merit to petitioner's assertion that the Division's second document request was tainted by the referral of this case to the Criminal Division for investigation. We note that the Division did not issue a subpoena, but rather a document request in the form of a letter. Unlike investigations where a subpoena has been issued, petitioner's failure to comply with the document request in this matter was at his own discretion. Petitioner now seeks protection from his election not to produce complete books and records, but has directed us to no authority for such protection and we have found none.

Even if a subpoena had been issued, we are aware of no authority which would have protected petitioner's noncompliance. Federal Courts have addressed a similar issue with respect to the issuance by the Internal Revenue Service of an administrative summons (United States v. Hallee, Inc., 83-1 USTC ¶ 9130). In Hallee, while investigating the tax liability of the petitioner, the Internal Revenue Service issued a summons requesting relevant and material documents. Because of an ongoing criminal investigation by the Internal Revenue Service, the taxpayer sought to avoid compliance by claiming constitutional protection. The Court ordered the taxpayer to comply because the summons was issued in good faith. The court noted that the matter had not yet been referred for criminal prosecution and that the Internal Revenue Service

was genuinely pursuing a civil tax determination or collection (United States v. Hallee, Inc., supra, at 86,117). The Court went on to state that "since 'criminal and civil fraud penalties are coterminous, the Service rarely will be found to have acted in bad faith by pursuing the former' [citation omitted]. In short, interrelated civil and criminal purposes are almost inevitable, [and] perfectly appropriate . . ." (United States v. Hallee, supra, at 86,117; see also, Wright v. United States, 620 F Supp 904, 85-2 USTC ¶ 9707 [in a civil matter, the Court held that an administrative summons issued by the IRS was permissible where there were ongoing civil and criminal investigations]).

We also reject petitioner's argument that the Division erroneously relied on MV-50s to determine the number of unreported taxable sales. We find the use of MV-50s to be a reasonable means in the present circumstances to determine additional taxable sales (see, Matter of Pasquarella, Tax Appeals Tribunal, July 18, 1991 [auditor relied on MV-50s to conclude underreporting of taxable sales]). Further, the auditor testified at length about the use of the MV-50s in this audit. The auditor testified that wholesale dealer to dealer transactions were distinguished on MV-50s from retail sales (Tr., p. 65). He further stated that additional tax was computed solely on dealer to non-dealer transactions that were reflected on the MV-50s (Tr., p. 64). Nevertheless, if there was any imprecision in the audit, it was the result of petitioner's failure to maintain adequate books and records (Matter of Meskouris Bros. v. Chu, 139 AD2d 813, 526 NYS2d 679).

We also agree with the Administrative Law Judge that utilizing the NADA book values was not unreasonable. What petitioner made available to the Division were two sets of figures. The first group was the sales prices of the vehicles petitioner reported on his sales tax returns. After the hearing, petitioner submitted a comparison list of his prices for these vehicles and what he asserts to be the NADA values for same. Petitioner asserts the figures indicate that his sales prices were 53% of the NADA values (Petitioner's Exhibit "1"). The second set of values were invoices presented before hearing by petitioner. These invoices reflected prices for 33 of

the 150 sales the Division asserts petitioner failed to report on his quarterly returns. The sales prices of the unreported vehicles as indicated on the invoices were 74% of the NADA average retail price. The figure the Division ultimately used to assess additional tax was the average of the unreported invoices. We find no basis to determine the Division's decision was unreasonable, particularly in light of the large discrepancy in average value between petitioner's reported (53% of NADA values) and unreported sales (74% of NADA values).

Petitioner's argument that the MV-50s' listing of customer names and addresses made it incumbent on the Division to contact these individuals to determine selling prices is without merit. The Division's audit methodology must be designed to reasonably reflect tax due (Matter of W.T. Grant Co. v. Joseph, supra) which the Division accomplished by relying on the invoices petitioner submitted for 33 unreported sales. The Division was under no compulsion to try to contact every individual petitioner sold to in order to calculate additional tax due when it was petitioner's lack of adequate records that prompted the need to use external indices.[4] We find petitioner has failed to prove that the audit methodology was unreasonable or that the amount assessed was erroneous.

We next address the imposition of the fraud penalty.

The Administrative Law Judge found the following facts conclusive to establish petitioner's liability for the fraud penalty: petitioner consistently and substantially underreported sales; petitioner did not have accurate records; the MV-50s signed by petitioner indicated that he knew tax was due on the sales; the 33 invoices supplied by petitioner indicated that tax was collected, but not turned over; and petitioner's failure to appear and credibly explain the discrepancy between the tax reported and the sales revealed by the MV-50s.

[4]Petitioner's assertion is particularly unreasonable given the unsuccessful efforts of the Criminal Division to contact his customers.

The Administrative Law Judge concluded by noting that the assessments were timely issued because the returns were fraudulently filed. Therefore, assessment of additional sales and use tax was not limited to three years (Tax Law § 1147[b]).

Petitioner argues that, assuming arguendo that there was substantial underreporting, there is no evidence in the record of any willful conduct or specific intent to evade tax.

The burden of establishing fraud has consistently been interpreted to reside with the Division (Matter of Cinelli, Tax Appeals Tribunal, September 14, 1989; Matter of AAA Sign Co., Tax Appeals Tribunal, June 22, 1989). The standard of proof necessary to support a finding of fraud requires "clear, definite and unmistakable evidence of every element of fraud, including willful, knowledgeable and intentional wrongful acts or omissions constituting false representation, resulting in deliberate nonpayment or underpayment of taxes due and owing" (Matter of Ilter Sener,
Tax Appeals Tribunal, May 5, 1988, citing Matter of Shutt, State Tax Commn., July 13, 1982). The issue of fraud with intent to evade tax presents a question of fact to be determined upon a consideration of the entire record (Matter of AAA Sign Co., supra, citing Powell v. Granquist, 252 F2d 56, 58-1 USTC ¶ 9223; Beaver v. Commissioner, 55 TC 85; Stratton v. Commissioner, 54 TC 255).

The understatement of income alone is insufficient to establish fraud, however, "[c]onsistent and substantial understatements of income is by itself strong evidence of fraud" (Matter of Lefkowitz, Tax Appeals Tribunal, May 3, 1990, quoting Merritt v. Commissioner, 301 F2d 484, 62-1 USTC ¶ 9408, at 84,167). In the matter before us, the record reflects that petitioner substantially understated Delevan Motor's taxable income during the period at issue by approximately 50%, with unreported taxable sales constituting $332,001.00 of total taxable sales. Equally significant, is the consistency with which petitioner underreported taxable sales. Of the ten quarters at issue, all were underreported by at least 30% and five by 50% or more.

The failure of a taxpayer to maintain a complete and accurate set of records is evidence of fraud (Matter of Lefkowitz, supra, citing Korecky v. Commissioner, 781 F2d 1566, 86-1 USTC ¶ 9232, at 83,380; Merritt v. Commissioner, supra, 62-1 USTC ¶ 9408, at 84,167; Bryan v. Commissioner, 209 F2d 822, 54-1 USTC ¶ 9189, at 45,355, cert denied 348 US 912). As correctly pointed out by the Administrative Law Judge, the 150 omitted sales and petitioner's expense purchases were not accounted for in petitioner's records. Further, "[t]he information submitted by petitioner shortly before hearing did not remedy petitioner's inadequate sales records presented during the audit" (Determination, conclusion of law "B").

We find, as did the Administrative Law Judge, clear and convincing evidence of petitioner's willful, knowledgeable and intentional wrongful behavior in that every MV-50 to which petitioner's signature is affixed states, above the place where the seller is to sign his name, that "All New York State and Local Taxes due as a result of this sale have been collected from the purchaser." Petitioner also signed every tax return for the period at issue. Further, the 33 invoices submitted before hearing indicate that tax was collected, but not remitted. The evidence clearly indicates that petitioner was aware of his responsibility to collect tax, that he did collect tax, but that he failed to remit tax on nearly one out of every two sales made.

Further, as noted by the Administrative Law Judge, petitioner's failure to appear at hearing and address the absence of tax and business records provides further support for a finding of fraud (Matter of Waples, Tax Appeals Tribunal, January 11, 1990). In addition, we also consider that petitioner has at no time during his protest of the assessments at issue presented a plausible explanation for why approximately half of his taxable sales were not reported on his returns.

We reject petitioner's assertion that this matter is controlled by our decision in Matter of AAA Sign Co. (supra). In AAA Sign, we found relevant that the taxpayer's accountant credibly testified that AAA Sign's office manager was continually overwhelmed with the volume of bookkeeping the business generated which went to refute the Division's argument that the

underreporting was intentional by the owner of the business. We noted that seven of the sales tax returns were signed by AAA Sign's office manager. We concluded that the office manager's responsibility for bookkeeping and preparing the returns lent doubt to the Division's assertion that AAA Sign's underreporting was a reflection of the petitioner's intent. Here, petitioner's only explanation regarding the substantial and consistent underreporting is his assertion that all of the MV-50s may not have signified taxable transactions. As noted above, the auditor's explanation regarding the MV-50s disposes of petitioner's argument.

Therefore, petitioner's substantial and consistent underreporting, his signature on each MV-50 and tax return, the 33 invoices which show that sales tax was collected on unreported sales but not remitted and his failure to appear and explain the underreporting clearly and convincingly establish that petitioner knowingly, willfully and intentionally failed to remit tax to the State of New York. The fraud penalty is sustained. Given the proper imposition of the fraud penalty, the notices of determination are timely issued pursuant to Tax Law § 1147(b).

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of David R. Anthony d/b/a Delevan Motors is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petition of David R. Anthony d/b/a Delevan Motors is denied; and

4. The two notices of determination dated November 13, 1990, as modified consistent with the Administrative Law Judge's findings of fact "9" and "11," are sustained.

DATED: Troy, New York
November 30, 1995

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

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

/s/Donald C. DeWitt
Donald C. DeWitt
Commissioner