

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

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In the Matter of the Petition	:	
of	:	
<b>SONA APPLIANCES, INC.</b>	:	
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, 1988 through February 28, 1991.	:	DECISION

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	:	DTA NOS. 815394
In the Matter of the Petition	:	AND 815395
of	:	
<b>INDER-MOHAN KATHURIA, OFFICER OF</b>	:	
<b>SONA APPLIANCES, INC.</b>	:	
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, 1988 through February 28, 1991.	:	

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Petitioner Sona Appliances, Inc., 37-42 74<sup>th</sup> Street, Jackson Heights, New York 11372 and petitioner Inder-Mohan Kathuria, officer of Sona Appliances, Inc., 341 Woodbury Road, Woodbury, New York 11797-1201, filed an exception to the determination of the Administrative Law Judge issued on February 18, 1999. Petitioners appeared by Warren M. Burd, Esq. The Division of Taxation appeared by Barbara G. Billet, Esq. (Robert A. Maslyn, Esq., of counsel).

Petitioners filed a letter in lieu of a brief in support of their exception. The Division of Taxation filed a brief in opposition. Oral argument was not requested.

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

### ***ISSUES***

I. Whether petitioners have sustained their burden of proving they are not liable for additional sales tax determined as a result of an audit including third-party verification of purchases.

II. Whether petitioners have established by clear and convincing evidence that the sales tax determined by the Division of Taxation is incorrect.

III. Whether petitioners have sustained their burden of proving that the amount of money paid in restitution as a result of a criminal proceeding represents the full amount of their tax liability including penalties and interest.

IV. Whether the Division of Taxation has sustained its burden of proving that a fraud penalty should be sustained, and if not, whether the penalty pursuant to Tax Law § 1145(a)(1) should be sustained.

### ***FINDINGS OF FACT***

We find the facts as determined by the Administrative Law Judge except for findings of fact “3,” “7,” “8,” “19” and “24” which have been modified. We have also deleted findings of fact “25” and “26” because they constituted legal argument rather than findings of fact. The Administrative Law Judge’s findings of fact and the modified findings of fact are set forth below.

Petitioner Sona Appliances, Inc. (“Sona”) is a corporation which operates a retail establishment at 37- 42 74<sup>th</sup> Street, Jackson Heights, Queens, New York. Sona’s business includes the sale of appliances and other merchandise.

In or about 1978, petitioner Inder-Mohan Kathuria (“Mr. Kathuria”), along with his family, moved to the United States from London. Sona was incorporated on July 18, 1978 by Mr. Kathuria and four other individuals. Since June 1982, Mr. Kathuria has been the president and sole shareholder of Sona.

We modify finding of fact “3” of the Administrative Law Judge’s determination to read as follows:

Acting upon information provided by informants to the New York City Department of Finance that Sona was not reporting all its sales on the sales tax returns that were being filed and that it was not collecting sales tax on sales made in the store, on or about April 4, 1991, the New York State Office of the Attorney General obtained a search warrant for Sona's books and records. In executing the search warrant, police officers were directed to seize, without limitation: “ledgers, journals, registers, logs, invoices, receipts, purchase orders, memoranda, packing slips, and other documents and writings relating to the purchase, sale, shipment and/or delivery of either wholesale or retail merchandise; canceled checks, bank statements, bank deposit and withdrawal slips, bank receipts, and bank memoranda or correspondence reflecting any form of bank related monetary transaction; tax returns and tax forms; corporate minute books; exempt certificates, resale certificates and diplomatic certificates; and the books, records, memoranda and other papers contained in the office desk, steel cupboard, grey safe, grey filing cabinet, and TDK video cassette boxes . . . (Exhibit “G”).<sup>1</sup>

The search warrant was executed on April 5, 1991, and investigators removed several boxes of invoices, numerous books, and other records of the business. The inventory of the seized items is as follows:

Item #

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<sup>1</sup>We modified finding of fact “3” of the Administrative Law Judge’s determination to more clearly state the records that were subject to the search.

- 1 - 7 TDK Boxes containing sales invoices 1986 to March 1991.
- 8 Paid checks, corp. book, green ledger disbursement journal, bank statements, IRS and New York City Tax Records.
- 9 Paid invoices for sales merchandise.
- 10 Paid and unpaid invoices for sales merchandise.
- 11 Unpaid invoices for sales merchandise.
- 12 Paid invoices for sales merchandise.
- 13 Sales invoices, price list from manufacturer, shipment records, sales tax records, price list and business diary manufacturers.
- 14 Sales invoices, checkbook, daily sales ledger, ledger of gross sales, shipping charges and taxable sales.
- 15 Purchase and sales invoices from 1991.
- 16 Inventory and stock books (3), sales invoices (7) notebooks of inventory and sales 1990 jewelry business "under Sona Appliances' control."

On or about April 5, 1991, shortly after the search warrant was executed at his business premises, Mr. Kathuria made an incriminating statement to investigators and an Assistant Attorney General.<sup>2</sup> In this statement, Mr. Kathuria admitted that the 15 sales tax returns which he filed on behalf of Sona covering the period March 1, 1987 through November 30, 1990 were not accurate. He also stated that Sona's sales tax returns accurately reflected sales of products purchased from certain suppliers like Sony or Citizen, but did not include the sales of goods purchased by Sona "from the street."

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<sup>2</sup>Mr. Kathuria's statement was tape recorded. During his statement, Mr. Kathuria was informed that he was not in custody and was free to leave at any time. He acknowledged that he understood that and that he was there voluntarily. This statement made by Mr. Kathuria was evidence which the Attorney General intended to use at any trial of the defendant (Mr. Kathuria). On July 21, 1993, the Attorney General filed a "NOTICE OF INTENTION TO OFFER AT TRIAL EVIDENCE OR STATEMENT MADE BY THE DEFENDANT TO A PUBLIC SERVANT, PURSUANT TO CPL SECTION 710.30(1)(a)."

In a letter dated April 23, 1991, addressed to Mr. Karash, Robert E. Reed, Assistant Attorney General, Criminal Prosecutions Bureau, wrote, in pertinent part:

I have been advised of your letter to the New York City Department of Finance, dated April 11, 1991, in which you (1) state that you now represent Sona Appliances, Inc. ("Sona"), (2) assert that *all* of Sona's books and records were taken from the premises of that corporation by "the Department of Finance", and (3) seek the hasty return of those books and records. I now write to you to prevent any misunderstanding.

Sona's books and records were seized pursuant to a search warrant . . . obtained by the Office of the Attorney General. This seizure was conducted in anticipation of a New York County grand jury investigation into certain business practices of Sona and its president, Mr. Indermohan Kathuria.

Most particularly, Sona, through and at the direction of its president, Mr. Kathuria, is alleged to have substantially underreported its taxable sales in recent years. As you may or may not be aware, Mr. Kathuria has already admitted his guilt in this regard. Your cooperation, then, in bringing this criminal investigation to a swift conclusion will be appreciated.

Since this criminal investigation is being conducted at the direction of the Office of the Attorney General, you should refer any telephone calls or correspondence relating to this matter to me, and not to the Department of Finance. Unfortunately, as this is a criminal, and not a civil matter, we will need to retain within the custody of the Attorney General the originals of all documents seized until the matter is concluded. If you need photocopies of particular documents, please call me, and we can begin making arrangements for such photocopying (at Sona's expense, I'm afraid) at the location at which the documents are being held. (If you want these photocopies quickly, you may need to be prepared to bring a portable photocopying machine.) . . . . (Emphasis in original.)

To ensure that the Criminal Prosecutions Bureau had all of Sona's books and records pertinent to the investigation a grand jury subpoena duces tecum for such items was enclosed with the letter.

We modify finding of fact “7” of the Administrative Law Judge’s determination to read as follows:

Subsequent to the seizure of the business records, on May 1, 1991, Hamdi Fattah, a Special Tax Auditor with the New York City Department of Finance,<sup>3</sup> was assigned to perform an audit of Sona’s records. The auditor reviewed the books and records. The business had no general ledger. However, Mr. Fattah reviewed sales invoices, and noted that they were not numbered. He also found invoices for some months were missing. The auditor then reviewed purchase invoices, check disbursement journals and other Sona records gathered in connection with the search warrant. After review of Sona’s sales invoices, the auditor determined that since the sales invoices were unnumbered, there was no way of tracking transactions. Mr. Fattah found that he was unable to trace the unnumbered sales invoices and determine whether all invoices were recorded each month. Additionally, he was not supplied with any cash register tapes which would tie into the sales invoices made available to him. The auditor also reviewed a composition notebook which contained jewelry sales for 1990 seized from the business premises.<sup>4</sup>

We modify finding of fact “8” of the Administrative Law Judge’s determination to read as follows:

After reviewing all of Sona's business records, Mr. Fattah determined that the sales and purchase invoices were incomplete and source documentation of individual sales was lacking. The auditor then concluded that petitioners’ books and records were inadequate to perform a detailed audit. The auditor explained that as standard procedure he is required to either send out questionnaires to verify inventory or to do confirmations of sales to determine whether goods were shipped out of state. The auditor did not confirm out-of-state sales because Sona’s taxable ratio was so high. Rather, the auditor decided that Sona's appliance suppliers

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<sup>3</sup>Mr. Fattah has been employed as an auditor in the New York City Department of Finance for 12 years and has conducted between 300 and 500 audits of retail businesses.

<sup>4</sup>We modified finding of fact “7” of the Administrative Law Judge’s determination to more concisely set forth the record and to clarify that the reason the general ledger was not reviewed by the auditor was because it did not exist.

should be contacted to try to determine the volume of its purchases. The names of the suppliers were taken from Sona's check disbursements journal, and a questionnaire was sent to 31 major suppliers asking for the volume of purchases made by Sona.<sup>5</sup> Only 20 responses to the questionnaires were received and reviewed by the auditor. Some out of state suppliers did not respond.<sup>6</sup>

The auditor explained that the verification (questionnaire)

specifically asks if the suppliers have sold any merchandise to a particular company, in this case it is Sona Appliances, Inc., and it also gives more or less like a blank schedule where they have to fill in any amount that they have sold to Sona by month and date, if possible. (Tr., pp. 202 - 203.)

According to the auditor, the verification indicated the date on which the transaction took place and the amount, but it did not specifically identify the appliances purchased.

Grand jury subpoenas were issued to the appliance suppliers requiring them to verify for the grand jury the information shown in the questionnaire and to provide the underlying invoices and purchase documents.

The auditor reviewed the grand jury materials and reconciled the suppliers' records to the questionnaire responses. He tabulated the responses for the period June 1, 1988 through December 31, 1990.<sup>7</sup> The responding suppliers verified that Sona's purchases during this period amounted to \$1,409,714.51. Sona's purchase records indicated that appliance purchases from those suppliers for this period were \$283,306.40. The auditor determined unrecorded appliance

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<sup>5</sup>According to the auditor, 18 suppliers' names came from Sona's check disbursements journal and 2 additional names were obtained from other Sona records. Other names were ascertained from the surveillance of Sona's business premises performed by two investigators for a few days.

<sup>6</sup>We modified finding of fact "8" of the Administrative Law Judge's determination to more clearly set forth the record.

<sup>7</sup>The auditor's work papers are part of the record. These work papers include summary schedules of his findings.

purchases to be \$1,126,408.11, the difference between supplier verified appliance purchases and Sona's purchase records (\$1,409,714.51 - \$283,306.40). The auditor added the unrecorded purchases to the purchases per Sona's disbursement journal (\$1,126,408.11 + \$2,141,005.00) and determined total purchases of appliances in the amount of \$3,267,413.11 for the period.

To determine the additional taxable sales for the audit period, the auditor first determined a mark-up on appliance purchases. The auditor calculated the gross profit of \$633,348.00 on appliance sales by subtracting Sona's appliance purchases per Sona's disbursement journal in the amount of \$2,141,005.00 from sales reported by Sona in the amount of \$2,774,353.00. A mark-up of 29.5818% was then determined by dividing the gross profit (\$633,348.00) by the appliance purchases per Sona's disbursements journal (\$2,141,005.00). After multiplying the 29.5818% mark-up to total appliance purchases (\$3,267,413.11) and adding the product of \$966,559.63 to total appliance purchases of \$3,267,413.11, the auditor determined total appliance sales for the period to be \$4,233,972.74.

The auditor reviewed the book of jewelry sales for 1990. He also reviewed a second notebook of gold bullion sales and determined that the transactions recorded in that book should not be taxed. He did not include any gold bullion sales in his computation of jewelry sales. The auditor included the jewelry sales in his calculation of additional tax due from Sona because the books were seized from the sales counter located at Sona's business premises, and the Division's records indicated that during 1990 there was not any other entity existing at the premises. Using this book, the auditor determined that jewelry sales for that year totaled \$1,316,451.00.

The total appliance sales for the period were then added to jewelry sales for 1990 (\$4,233,972.74 + \$1,316,451.00) to determine gross audited sales in the amount of

\$5,550,423.74 for the period. The reported sales of \$2,774,353.00 were then subtracted from gross audited sales of \$5,550,423.74 to arrive at additional taxable sales for the audit period of \$2,776,070.74. Applying the 8.25% tax rate to additional taxable sales of \$2,776,070.74 resulted in a determination of additional tax due for the audit period of \$229,025.84.

On July 13, 1993, a 22-count indictment was filed in Queens County Supreme Court charging Mr. Kathuria with one count of Grand Larceny in the Second Degree (Penal Law § 155.40, a class “C” felony), ten counts of Offering a False Instrument for Filing in the First Degree (Penal Law § 175.35, a class “E” felony), ten counts of violating Tax Law § 1817(b) and one count of violating Title 11, Chapter 40, § 4003 of the New York City Administrative Code, failure to file a General Corporation Tax Return for three consecutive years (a class “E” felony). The period covered in the 22 counts of the indictment was June 1, 1988 through February 13, 1991.

Petitioner was represented by Benjamin Brafman, Esq. in the criminal matter. Petitioner, Mr. Brafman and Vincent O’Reilly, the Assistant Attorney General, assigned to the criminal matter, met on at least two occasions to discuss a plea agreement.

For purposes of determining an appropriate restitution amount for the criminal case against Mr. Kathuria, the Attorney General’s office requested that the auditor also calculate the amount of tax that would be due from Sona if the mark-up percentage was eliminated. The auditor determined the “no mark-up” amount to be \$149,284.67.

The criminal action against Mr. Kathuria was eventually resolved pursuant to a plea bargain with the Attorney General. A copy of the transcript of Mr. Kathuria’s March 2, 1994 plea proceeding, in Queens County Supreme Court, Criminal Term: Part K-8, before the

Honorable Kenneth N. Browne, J.S.C., is part of the record. At the beginning of the plea proceeding, Mr. Brafman, on Mr. Kathuria's behalf, outlined the terms of the agreement reached with the Attorney General's Office, the terms of which included that on the date of sentence Mr. Kathuria would pay "\$150,000 in form of restitution to be applied toward any tax bill that he would owe the State in this case and that, in return, the Attorney General has consented, subject to [Judge Browne's] approval, that there would be no sentence of incarceration imposed." (Division's Exhibit L, p. 3.) On March 2, 1994, Mr. Kathuria pled guilty to one count of grand larceny in the second degree (Penal Law § 155.40)<sup>8</sup> and one count of offering a false instrument for filing in the first degree (Penal Law § 175.35).<sup>9</sup>

Count 1 states that: "[T]he defendant, INDERMOHAN KATHURIA, on or about and between June 1, 1988 and February 13, 1991 in the County of Queens stole property having a value in excess of fifty thousand dollars (\$50,000.00) from the State of New York, said property being sales tax money."

Count 8 states that:

[T]he defendant, INDERMOHAN KATHURIA, on or about June 15, 1990, in the County of Queens, with intent to defraud the State or any political subdivision thereof and knowing that a written instrument, namely a New York State and Local Sales and Use Tax Return (Form ST-102) for the period March 1, 1990 to May 31, 1990, contained a false instrument or false information, did offer or present it or cause it to be offered or presented to a public office or public servant, namely, the New York State Department of Taxation and Finance, with the knowledge or belief that it would be filed with, registered in or otherwise become part of the records of such public office or public servant.

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<sup>8</sup>Count 1 of the grand jury indictment.

<sup>9</sup>Count 8 of the grand jury indictment.

Mr. O'Reilly was present on March 2, 1994 when Mr. Kathuria entered his guilty plea to count 1 and count 8. At the hearing in this matter, the Division's representative asked Mr. O'Reilly whether it was apparent to all involved that the restitution amount of \$150,000.00 did not limit any civil liability. Mr. O'Reilly responded, as follows:

It was apparent to Mr. Brafman. It was apparent to me. It was apparent to the court who took the case, and it was apparent to the defendant that the agreement to pay \$150,000 in restitution was the amount of sales tax money that was stolen during the period of time mentioned in Count 1 of the indictment and it did not include penalties, interest or any other sales tax that may be due and owing to the State of New York. (Tr., p. 38.)

Mr. O'Reilly stated that Mr. Kathuria's plea of guilty to count 1 and count 8 was in full satisfaction of the entire indictment.

We modify finding of fact "19" of the Administrative Law Judge's determination to read as follows:

In his allocution in criminal court, Mr. Kathuria stated in part:

I was the owner of this store [Sona Appliances] between June 1<sup>st</sup>, 1988 and through February 13, 1991. During this time I sold merchandise at Sona to the general public. This merchandise included electronic items and gold jewelry. In selling this merchandise I collected sales tax. During the course of this ownership, I filed tax returns and underreported taxable sales on these tax returns. In doing this I underreported the tax I owed to the State of New York. I *knew* these taxes returns [sic] were false (Exhibit "L," emphasis added).

Mr. Kathuria also acknowledged that by doing these acts he stole money owed to the State of New York in the amount of approximately \$150,000.00.<sup>10</sup>

On June 6, 1994, Judge Browne sentenced Mr. Kathuria to five years probation for each count and restitution of \$150,000.00. Mr. O'Reilly was present on the day that Mr. Kathuria was sentenced. At the hearing, Mr. O'Reilly stated that, on the day of sentencing, he made it clear to both Mr. Brafman and Mr. Kathuria that the restitution amount did not limit any civil liability. Mr. Kathuria paid the restitution amount, and subsequently this sum was credited against the amount assessed against him and Sona.

On November 15, 1994, Mr. Kathuria acknowledged receipt<sup>11</sup> of 14 boxes of records and 2 ledger books from Investigator Dinesh Parikh at the Tax Enforcement Division of the New York City Department of Finance, 345 Adams Street, Brooklyn, New York.

On November 28, 1994, the Division issued to Sona, a Notice of Determination (Notice Number L-009863575-8) for sales and use taxes in the amount of \$229,025.84, plus penalty of \$223,447.09 and interest of \$173,420.75, less assessment payment of \$150,000.00, for a total amount due of \$475,893.68 for the period June 1, 1988 through February 28, 1991. The computation section contained the following statement:

In addition, fraud penalties of 50 percent of the amount of the tax due plus statutory interest have been added pursuant to section 1145(A)(2) of the New York State Sales and Use Tax Law.

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<sup>10</sup>We modified finding of fact "19" of the Administrative Law Judge's determination to more clearly set forth the record.

<sup>11</sup>Mr. Kathuria's acknowledgment was witnessed by Mr. Karash and his accountant, Ramesh Sarva.

The taxes shown have been determined to be due in accordance with section 1138 of the New York State Sales and Use Tax Law and are based on an audit of your records.

In accordance with the provisions of section 1145 of the New York State Sales and Use Tax Law, the penalty and/or interest shown is determined to be due.

On March 30, 1995, the Division issued to Mr. Kathuria, as an officer or responsible person of Sona, a Notice of Determination (Notice Number L-010191304-8) for sales and use taxes due in the amount of \$229,025.84, plus penalty of \$229,258.03 and interest of \$185,480.02, less assessment payment of \$150,000.00, for a total amount due of \$493,763.89 for the period June 1, 1988 through February 28, 1991. The explanation and instruction section of the notice explained that the “notice is issued because you are liable as an Officer/Responsible Person for taxes determined to be due in accordance with sections 1138(a), 1131(1) and 1133 of the New York State Tax Law.” The section also included the following statement: “THE ESTIMATION OF TAX DUE MAY INCLUDE CONSIDERATION OF ANY RECORDS SUBMITTED FOR AUDIT.”

Petitioners filed timely requests for conciliation conference with respect to the two notices in issue in this matter. After Sona’s February 13, 1996 conciliation conference, the conferee issued a Conciliation Order (CMS No. 144636), dated July 12, 1996, sustaining the Notice of Determination (Notice Number L-009863575-8). The following starred notation appeared at the bottom of Sona’s Conciliation Order: “A direct payment of \$150,000.00 and a derivative payment of \$5,000.00 have been applied to this Notice.”

After Mr. Kathuria’s March 21, 1996 conciliation conference, the conferee issued a Conciliation Order (CMS No. 147647), dated July 19, 1996, sustaining the Notice of

Determination (Notice Number L-010191304-8). The following starred notation appeared at the bottom of Mr. Kathuria's Conciliation Order: "A derivative payment of \$150,000.00 and a direct payment of \$5,000.00 have been applied to the above Notice."

We modify finding of fact "24" of the Administrative Law Judge's determination to read as follows:

Sona filed a petition challenging the entire amount assessed in the Notice of Determination issued to it.<sup>12</sup>

Ramesh Sarva, a certified public accountant, prepared Sona's Federal corporate tax returns, as well as Mr. Kathuria's personal income tax returns. Mr. Sarva did not maintain Sona's books nor did he prepare the sales tax returns. Mr. Kathuria supplied all information which Mr. Sarva used in the preparation of the corporate and personal tax returns.

According to Mr. Sarva, he did not advise Mr. Kathuria on the type of books and records which he should maintain to be in compliance with the sales and use tax law because Mr. Kathuria "was quite aware of them, having worked in a store before he went into business for himself" (tr., pp. 232-233). He also did not advise Sona to institute any internal controls in its accounting system because most of the internal control is done by the principal officer who is present at the store while it is open and all sales are conducted under his supervision.

Sona did not maintain a general ledger. It did maintain what Mr. Sarva described as a "one-write system." According to Mr. Sarva, the one-write system has the checks in a numerical sequence and as a check is written, a carbon copy is made of the writing. Bank deposits are also recorded as part of the one-write system. The one-write system check disbursements journal is

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<sup>12</sup>We modified finding of fact "24" of the Administrative Law Judge's determination to delete portions that contained legal argument rather than findings of fact.

not part of the record. According to Mr. Sarva, Sona did not maintain a journal which just tracked cash receipts nor did it maintain a purchase journal.

Petitioners offered the testimony of Mr. Kathuria. Mr. Kathuria acknowledged that, in 1988, 1989 and 1990, he conducted an appliance business at 37-42 74<sup>th</sup> Street in Jackson Heights known as Sona. However, he denied that Sona, in 1990, conducted a gold and jewelry business in the premises. According to Mr. Kathuria, Joseph Thomas, a Sona employee at that time, was allowed to conduct a gold and jewelry business within the store. Mr. Kathuria explained that there was no formal lease agreement or any other written agreement concerning Mr. Joseph's rental of space within Sona's premises. Rather, he had an informal agreement with Mr. Joseph, the terms of which were that Mr. Joseph would pay \$1,500.00 a month as rent for a counter near the front of the store. While somewhat vague, Mr. Kathuria thought that Mr. Joseph had in fact paid him \$1,500.00 in cash each month. He further testified that the books seized at the front counter were Mr. Joseph's books relating to his gold and jewelry business. Mr. Kathuria also denied writing anything in the books.

Mr. Sarva did not indicate any rental income from a jewelry business within Sona's premises for the year 1990 on Sona's corporate tax return. He stated that because it was a sublease and a very insignificant sum of money, it was treated as sales revenue. However, according to Mr. Sarva, Sona's one-write system did not have any specific indication of deposits of rental moneys.

Sona, closed on Tuesdays, is open for business six days a week. Sona's sales invoices are not numbered. According to Mr. Kathuria, each customer is given a copy of the sales invoice for warranty purposes.

Mr. Kathuria explained that Sona did not maintain a general ledger only the check disbursements journal. Although Sona did not maintain a cash receipts journal, Mr. Kathuria did maintain what he described as “a small book” in which total daily sales were written.<sup>13</sup> Sona did not keep cash register receipts of its daily sales. When asked how daily sales are actually recorded, he explained that all sales invoices are totaled on a calculator and the calculated tape is attached to the bundle of sales slips. The total from the tape is recorded in the small book. Deposits of the total day's receipts are not made on a daily basis, Rather, bank deposits are made every couple of days.

Relying on Sona's books, the sales invoices and the bank statements, Mr. Kathuria prepared Sona's sales tax returns for the period in issue. He testified that to the best of his knowledge the sales tax returns which he filed on behalf of Sona were correct. He also testified that he never made any substantial purchase of merchandise that was not reflected in the books of Sona. The record does not include any of the books, sales invoices or bank statements used by Mr. Kathuria in the preparation of the sales tax returns. Nor are any of Sona's appliance purchase invoices or receipts part of the record.

Mr. Kathuria's daughter, Amarpreet, was present during the April 5, 1991 search of Sona's premises. She explained that the search took about three hours, during which time her father was told what to do. However, while the search was being conducted, she was able to make some telephone calls. Ms. Kathuria testified that, after the search was concluded, her father was forced to accompany the investigators.

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<sup>13</sup>The “small book” is not part of the record.

As their first exhibit, petitioners submitted one of the notebooks seized in April 1991 which they contend relate to bullion sales not jewelry sales.<sup>14</sup> The handwriting in this notebook is somewhat illegible. Although the cover of this spiral notebook contains the captions “1988” and “Total Sales, Collections & Expences [sic] Book 1988,” there are only two brief notations concerning the year 1988 on the inside back cover. The front of the book has telephone numbers of individuals and jewelry stores. A page at the back of the book contains the foreign addresses of two individuals who purchased items in April 1989. Another back page contains miscellaneous entries concerning amounts of money given by someone named Deepak in September and October 1990. Eighteen pages of this book contain daily entries for the year 1990 and two pages contain entries for the first few days of 1991. Entries appear on the front and back of each page in a two-column format. The left column contains numbers with corresponding dates, these numbers appear to be dollar amounts, although occasionally a series of numbers and letters appear.<sup>15</sup> The right-hand column contains notations of amounts paid to various individuals for items purchased including gold bars, various types of gold coins, 22 KT. gold jewelry (including chains, rings and bracelets), and jewelry boxes. There are also references to refunds paid to named individuals. Entries appear for nine days in 1991, commencing with January 2, 1991 and ending with January 10, 1991. Page 19 contains the following entry: “80000.00 to Mr. Mohan.”<sup>16</sup> The following entry appears in the right-hand column of page 20 about halfway down the page: “[p]aid \$30000.00 to Mr. Mohan 1/9/91, Balance Due 50000.00.” Review of the

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<sup>14</sup>This notebook is marked Grand Jury Exhibit “8.”

<sup>15</sup>The series of numbers and letters appear to represent some sort of transaction known only to the writer.

<sup>16</sup>Mr. Mohan is Inder-Mohan Kathuria.

pages shows that on Tuesdays the writer was “off.” The pages also contain other notations of additional days “off” and vacation days.

The continued hearing in this matter took place on December 2, 1997. At that time, petitioners presented Mr. Thomas K. Joseph (“Mr. Thomas”) as a witness.<sup>17</sup> Mr. Thomas explained that in 1990 he was employed by Sona to sell things and supervise sales. He testified that in 1990 he sold gold bullion and possibly jewelry from the Sona premises. He also testified that he did not think Sona had any relation to his own business of selling gold bullion in 1990. Mr. Thomas stated that he did not have a written rent or lease agreement to pay Sona for the jewelry counter space but he thought he paid \$500.00 or \$600.00 in cash each month to Mr. Kathuria. Mr. Thomas identified Petitioners' Exhibit “1” as the book which he used for his business purposes. He also identified the handwriting in the book as his own. Mr. Thomas did not explain the contents of the book. The Division’s representative asked Mr. Thomas whether he had ever told anyone that he ran a jewelry business as an employee of Sona in 1990. Mr. Thomas stated he thought so, but then claimed he could not remember. He recalled testifying before a Grand Jury concerning Sona, but denied that in his testimony before the grand jury he had stated that in 1990 he had run the jewelry business as an employee of Sona.

In 1991, Mr. Thomas began selling gold bullion and jewelry under the trade name “J & J Jewelers.” According to Mr. Thomas, he obtained a separate telephone number for J & J Jewelers in February 1991. He also obtained a “sales tax number.” Petitioners submitted copies of two sales tax returns under the trade name of J & J Jewelers which Mr. Thomas stated he filed

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<sup>17</sup>It appears that the person alleged to have owned the jewelry business at Sona in 1990 was referred to as “Joseph Thomas” by Mr. Kathuria, but it appears he uses the name “Thomas K. Joseph.” Other evidence in the record indicates that this same person is known as “Kallatu J. Thomas.”

in the first part of 1991. The record also includes copies of some invoices bearing the name J-J Jewelers, as well as checks from the Chemical Bank checking account which J-J Jewelers issued for business purposes. None of the checks or the J-J Jewelers invoices were for any period prior to 1991.

The Division offered the testimony of the auditor to rebut certain claims made by Mr. Thomas in his testimony. The auditor stated that he reviewed the Division's computer records and found that J & J Jewelers never filed sales tax returns in either 1990 or 1991. The auditor explained that he checked the filing record under the identification number shown on the J & J returns submitted into the record and found that no filing under such a number was shown in the Division's records. At this time, the auditor also identified Petitioners' Exhibit "1" as the record which he used as the source to assess jewelry sales for the year 1990.

The record includes the Certificate of Registration which Mr. Thomas filed on September 16, 1991 to obtain a sales tax authorization number from New York State. Review of this certificate reveals that Mr. Thomas signed the certificate on August 30, 1991 and the certificate affidavit on August 31, 1991.

The hearing in this matter concluded on December 2, 1997. However, at the request of both parties, the record remained open for the submission of the following documents: petitioners were allowed to submit J-J Jewelers' canceled checks showing payment of sales tax and the affidavit from the preparers of the sales tax returns and a copy of Mr. Thomas's 1990 Federal Schedule C or an affidavit from the accountant who prepared the personal income tax return for Mr. Thomas, and the Division was allowed additional time to try to obtain the transcript of Mr. Thomas's grand jury testimony. If the Division submitted the transcript of the testimony into

the record, petitioners were afforded the opportunity to submit documentary evidence, as well as a written comment in rebuttal. Prior to closing the hearing, the Administrative Law Judge asked petitioners' representative if he wished additional time to submit a request for release of any Grand Jury testimony or documentary evidence; he gave a negative response.

On December 12, 1997, petitioners submitted the originals and a photo copy of the two checks (Petitioners' Exhibit "10") indicating payment of the tax shown on the two sales tax returns filed by J-J Jewelers for the first two quarters of 1991. By transmittal letter dated February 24, 1998, petitioners' representative submitted a Department of Taxation and Finance form letter concerning J-J Jewelers' 1991 sales tax returns. By letter dated March 9, 1998, the Administrative Law Judge informed Mr. Karash that the form letter could not be submitted into the record and was being returned to him because it was not one of the four items which he had identified that he wished to submit post-hearing. At that time, Mr. Karash was also advised that if the Division submitted the transcript of Mr. Thomas's grand jury testimony into evidence, the form letter could be submitted as part of his rebuttal documentary evidence if it was relevant.

Post-hearing the Division submitted a transcript of the June 10, 1993 grand jury testimony of Mr. Thomas which contradicted much of Mr. Thomas's testimony at the hearing. In his grand jury testimony, Mr. Thomas stated under oath that before he began J & J Jewelers he worked for Mr. Kathuria doing a gold and jewelry business. He testified that the business involved the sale of gold bullion and jewelry, including chains and that he thought Mr. Kathuria was the owner of this business. Mr. Thomas also testified that he began working for Mr. Kathuria at the jewelry counter in 1987. He went on to testify that during the period 1988 through 1990 he sold gold chains from the Sona counter and that there was a safe in Mr. Kathuria's office where jewelry

was kept. According to Mr. Thomas, during the period 1988 through 1990, he wrote up sales of jewelry on Sona invoices. He went on to tell the grand jury that the sales invoices were destroyed shortly after the transactions by Mr. Kathuria and him and that this destruction was done at Mr. Kathuria's instruction. Mr. Thomas also identified Grand Jury Exhibit "8" as the book which he maintained as an employee of Sona in 1990 showing jewelry sales. He also identified Grand Jury Exhibit "44" as the book which contained customer orders and purchases of gold from suppliers for the year 1990. Mr. Thomas also told the grand jury that he began his own business of J & J Jewelers in 1991, and that prior to that time he remained an employee of Mr. Kathuria. According to his grand jury testimony, in order to start his business in 1991, Mr. Thomas paid Mr. Kathuria \$30,000.00 in cash and agreed to pay \$50,000.00 to the gold and jewelry suppliers who were owed for jewelry sold to Mr. Kathuria.

In response to the Division's submission of the transcript of Mr. Joseph's Grand Jury testimony, petitioners submitted Grand Jury Exhibit "44," a spiral notebook (Petitioners' Exhibit "11"). This notebook contains handwritten entries on both sides of the front and back covers, as well as on numerous pages.<sup>18</sup> The book contains pages of names and corresponding telephone numbers. There are pages of entries relating to jewelry orders from June 1990 through April 4, 1991. In addition, some pages contain notations of addresses to which items were to be sent. The record in this matter closed on April 29, 1998.

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<sup>18</sup>The handwriting in this notebook is somewhat illegible.

***THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE***

As noted earlier, petitioners attempted to submit additional documentary evidence after the hearing record was closed. These documents were rejected as untimely by the Administrative Law Judge relying on our decision in ***Matter of Schoonover*** (Tax Appeals Tribunal, August 15, 1991). Therefore, the three documents submitted after the close of the record were not considered in making her determination.

Petitioners contended that the statutory notices provided insufficient information concerning the reasons for the assessment and, therefore, should be canceled. They argued that the notices of determination issued by the Division did not correctly state the basis for the assessments of additional tax. Further, petitioners asserted that while the computation section of the notices stated that the taxes shown were determined to be due based on an audit of their records, the Division did not use the records as the basis for the assessments. Petitioners claimed that they were never advised that third-party verifications were used in determining unreported sales and their liability until two days prior to the hearing. Petitioners also claimed that because they did not learn of the actual basis of the assessment until shortly before the hearing it was impossible for them to meet their burden of proof.

The Administrative Law Judge rejected petitioners' arguments and concluded that the notices were sufficient. The Administrative Law Judge pointed out that the notices state in bold-faced type that the tax was estimated in accordance with Tax Law § 1138 and could be challenged through a hearing process within 90 days. The Administrative Law Judge also noted that there is no statutory provision detailing the contents required for a Notice of Determination, and that a notice is sufficient if it informs the taxpayer that sales tax has not been paid and

advises of the need to pursue legal remedies (*Matter of Pepsico, Inc. v. Bouchard*, 102 AD2d 1000, 477 NYS2d 892). The notices in issue met these requirements.

The Administrative Law Judge also rejected, as not supported by the record, petitioners' claim that they could not meet their burden of proof, because of the Division's alleged failure to reveal the actual basis of the assessment until shortly before the hearing. Sona's seized records were returned to Mr. Kathuria prior to the issuance of the statutory notices in issue. The Administrative Law Judge pointed out that even if it were true that petitioners first learned that the Division used third-party verifications as the basis of the additional tax only two days prior to the commencement of the hearing in September 1997, this matter was continued on December 2, 1997. A three-month continuance is ample time to gather any information which was not available for presentation during the earlier days of the hearing. Furthermore, the Administrative Law Judge noted, petitioners' representative turned down her offer of allowing him additional time post-hearing in order for him to request the grand jury testimony of the suppliers and documentary evidence concerning Sona's purchases.

Next, the Administrative Law Judge discussed a taxpayer's record-keeping requirements. Every person required to collect tax must maintain and make available for audit upon request records sufficient to verify all transactions in a manner suitable to determine the correct amount of tax due (Tax Law § 1135[a]; 20 NYCRR 533.2[a]). Failure to maintain and make available such records, or the maintenance of inadequate records, will result in the Division's estimating tax due (Tax Law § 1138[a]). To determine the adequacy of a taxpayer's records, the Division must first request and thoroughly examine the taxpayer's books and records for the entire period of the proposed assessment (*Matter of Adamides v. Chu*, 134 AD2d 776, 521 NYS2d 826, *lv*

*denied* 71 NY2d 806, 530 NYS2d 109; *Matter of King Crab Rest. v. Chu*, 134 AD2d 51, 522 NYS2d 978). The purpose of such an examination is to determine whether the records are so insufficient as to make it virtually impossible to verify taxable sales receipts and conduct a complete audit. When estimating sales tax due, the Division must adopt an audit method that will reasonably calculate the amount of taxes due (*citing, Matter of W.T. Grant Co. v. Joseph*, 2 NY2d 196, 159 NYS2d 150, *cert denied* 355 US 869, 2 L Ed 2d 75). The burden rests with the taxpayer to show by clear and convincing evidence that the methodology was unreasonable or that the amount assessed was erroneous (*Matter of Meskouris Bros. v. Chu*, 139 AD2d 813, 526 NYS2d 679; *Matter of Surface Line Operators Fraternal Org. v. Tully*, 85 AD2d 858, 446 NYS2d 451).

The assessments at issue here were based upon additional taxable sales of appliances and unreported sales of jewelry by petitioners. The Administrative Law Judge noted that only after determining that Sona's books and records were inadequate, did the auditor resort to third-party verification of suppliers' sales of merchandise to Sona to determine the additional taxable sales of appliances. The auditor used a book of jewelry sales seized from Sona's premises to determine the amount of unreported jewelry sales for 1990. Petitioners challenged the auditor's determination that Sona had additional taxable sales of appliances and unreported jewelry sales for 1990.

Petitioners contended that their books and records were adequate and there was no need for the auditor to resort to third-party verification of sales. The Administrative Law Judge disagreed, and pointed out that the evidence in this matter shows that Sona's books and records were inadequate. The Administrative Law Judge noted that on the same day that Sona's books

and records were seized, Mr. Kathuria admitted to authorities that he did not record “street” purchases and sales, and that Sona's sales tax returns were inaccurate. In addition, the Administrative Law Judge pointed out, Sona failed to number its sales invoices, failed to maintain a cash receipts journal or general ledger and did not maintain cash register tapes. Furthermore, while petitioners assert that Sona's books and records are accurate, they failed to submit them into evidence. The only evidence of Sona’s “adequate records” was the unsubstantiated testimony of Mr. Kathuria. The Administrative Law Judge did not find his testimony to be credible in light of his prior statement to the authorities and his plea allocution in the criminal matter. Sona's source documentation was unreliable, deficient and often, nonexistent. Therefore, the Administrative Law Judge concluded that the Division was justified in resorting to third-party verifications to determine petitioners’ sales tax liability (*citing, Matter of Anton's Car Care Ctr.*, Tax Appeals Tribunal, November 23, 1988; *Matter of Sener*, Tax Appeals Tribunal, May 5, 1988).

Petitioners also argued that the auditor's determination of additional purchases was flawed because he failed to verify the responses he received to the suppliers' questionnaires. They contended that the auditor did not review testimony and documentation provided by the suppliers to the grand jury. Petitioners further argued that the evidence in the record, the summary schedules of purchases prepared by the auditor, was insufficient to support the Division's allegation of additional tax due. The Administrative Law Judge rejected petitioners' arguments as without merit. First, contrary to petitioners’ claim, the auditor did verify the suppliers' responses by reviewing the grand jury materials and reconciling the suppliers' records to the questionnaire responses. Further, the auditor testified that the summary schedules of purchases

per suppliers' records reflected that reconciliation. Second, the Administrative Law Judge pointed out that petitioners, not the Division, bore the burden of proving that the audit method was unreasonable or the amount assessed was erroneous (*Matter of Surface Line Operators Fraternal Org. v. Tully, supra*). Petitioners asserted that Sona's records accurately reflect all purchases made. In support of this assertion, however, they offered only the unsubstantiated testimony of Mr. Kathuria. Given the unreliability of Mr. Kathuria's testimony and the absence of any documentary evidence contradicting the supplier information, the Administrative Law Judge concluded that the auditor's computation of additional purchases and sales of appliances was not shown to be erroneous.

With respect to that portion of the assessment related to jewelry sales, petitioners argued that the auditor erroneously determined that Sona had unreported jewelry sales in 1990. Petitioners claimed that Sona allowed Mr. Thomas, one of its employees, to run an independent business at the front counter in its premises. They also claimed that the business conducted at the front counter in 1990 consisted of sales of gold bullion and gold coins which sales are not subject to tax. Petitioners relied mainly on the testimony of Mr. Thomas at the administrative hearing and two notebooks written by Mr. Thomas in support of their claims.

The Administrative Law Judge also rejected petitioners' claims here. The Administrative Law Judge determined that the record showed that Mr. Thomas, on behalf of Sona, conducted a jewelry business in 1990, and that in 1991, Mr. Thomas left Sona's employ, purchased the jewelry business from Sona and began his own business, J & J Jewelers. The Administrative Law Judge did not find Mr. Thomas' testimony at hearing to be reliable. His testimony was vague and evasive. Further, evidence in the record such as J & J Jewelers' invoices and canceled

checks did not support Mr. Thomas' testimony that he conducted his own business in 1990, because they are all dated in 1991. In addition, Mr. Thomas did not obtain a sales tax registration number until 1991. Furthermore, Mr. Thomas' testimony at the administrative hearing was contradicted by his earlier testimony before the grand jury. In his grand jury testimony, Mr. Thomas stated that he worked for Sona selling gold and jewelry in 1990. He also stated to the grand jury that he did not begin his own jewelry business until 1991 and that he had to pay a total of \$80,000.00 in 1991 for Sona's jewelry business, consisting of a \$30,000.00 payment to Mr. Kathuria and a \$50,000.00 payment to the gold and jewelry suppliers for items sold to Sona for which they had not yet been paid. The documentary evidence confirms Mr. Thomas' grand jury testimony about his 1991 purchase of Sona's gold and jewelry business. In addition, the Administrative Law Judge noted that Mr. Kathuria, in his sentencing allocution, confirmed that he made sales of jewelry during the three-year audit period and did not accurately report his sales tax liability. Furthermore, the notebooks contain notations of jewelry purchases and sales in 1990. Therefore, the Administrative Law Judge concluded that petitioners have failed to prove by clear and convincing evidence that Sona did not conduct a jewelry business in 1990.

Mr. Kathuria pleaded guilty to grand larceny in the second degree and offering a false instrument for filing in the first degree in full settlement of a 22-count indictment based on the fact that he collected and did not remit sales tax. He agreed as part of the plea bargain to pay restitution in the amount of \$150,000.00 and did, in fact, make such payment. The Administrative Law Judge concluded that Mr. Kathuria's plea agreement and the restitution ordered by the court as a condition of the plea collaterally estops him from contesting \$150,000.00 of the \$229,025.84 assessed as tax in this matter (*see, Kuriansky v. Professional*

*Care*, 158 AD2d 897, 551 NYS2d 695). However, the Administrative Law Judge stated, he is not estopped from contesting whether taxable sales of appliances and jewelry took place (*see, Kuriansky v. Professional Care, supra*). Petitioners argued that they have, in fact, overpaid the amount of tax which would be due if the Division's determination that Sona had additional unrecorded appliance purchases in the amount of \$1,126,408.00 is sustained. In support of this contention, they included a computation which uses a 15.24% mark-up and an 89% taxable ratio for additional appliance sales to compute the additional sales tax due. The Administrative Law Judge rejected petitioners' argument. The auditor in making his computations used the mark-up taken directly from Sona's records, i.e., 29.5818%. Inasmuch as petitioners did not submit any of Sona's books and records into evidence, the Administrative Law Judge concluded that they have failed to produce clear and convincing evidence that their mark-up is less than the amount determined by the auditor and that only 89% of the additional appliance sales were taxable. Furthermore, the Administrative Law Judge noted, petitioners' computation assumes that Sona did not make any jewelry sales. However, petitioners failed to prove by clear and convincing evidence that Sona did not have jewelry sales in 1990.

The Administrative Law Judge found that since petitioners' books and records were inadequate, the Division was required to select an audit methodology reasonably calculated to reflect the taxes due and upon their challenge to the assessments petitioners bore the burden to establish by clear and convincing evidence that the method of audit or the amount of tax assessed was erroneous (*Matter of Surface Line Operators Fraternal Org. v. Tully, supra*). The Administrative Law Judge concluded that petitioners have failed to sustain their burden of proving that either the audit methodology or the amount of tax assessed was erroneous.

Mr. Kathuria asserted that the amount of the restitution agreed to as part of his plea agreement in the criminal case was in full satisfaction of any civil liability.

As part of his plea agreement, Mr. Kathuria paid restitution in the amount of \$150,000.00. The period covered by the order is June 1, 1988 through February 13, 1991 and covers the period, June 1, 1988 through February 28, 1991, at issue in this matter.

The Administrative Law Judge noted that the Division is not restricted as a matter of law from issuing a Notice of Determination for the total amount of taxes it determined was due, where that amount is greater than an amount agreed to as restitution in a criminal case based on the same facts for the same time period (*see*, Penal Law § 60.27[6]; *Farber v. Stockton*, 131 Misc 2d 470, 502 NYS2d 901; *Matter of N.T.J. Liquors*, Tax Appeals Tribunal, May 7, 1992). Since the notice was properly issued by the Division, it is petitioners' burden of proof to show that, based on the plea agreement, the amount set forth in the notice is erroneous because of some promise made by the prosecutor that Mr. Kathuria relied upon to his detriment (*see, Matter of Miras*, Tax Appeals Tribunal, October 22, 1992; *Matter of N.T.J. Liquors, supra*). While the Division might not legally be bound to the terms of a plea agreement arrived at between a defendant and a prosecutor,

an earlier promise made by a prosecutor, an agent of the State, must be treated as a highly significant factor when the State agency with the power to enforce the promise is called upon to do so. The mere fact that an agent of the State made a representation to a criminal defendant and the defendant then pleaded guilty, assertedly in reliance on the representation, is entitled to weight (*Chaipis v. State Liq. Auth.*, 44 NY2d 57, 404 NYS2d 76, 80).

The Administrative Law Judge found that Mr. Kathuria had failed to prove that any promises were made to him as part of the plea agreement to the effect that no further civil

liabilities would be assessed. Indeed, the Administrative Law Judge noted, the record of the plea proceedings indicates that the amount of the restitution would be applied toward any final liability of Mr. Kathuria.

Mr. Kathuria's attorney in the criminal matter specifically stated that the agreed amount of restitution was to be *applied toward* any tax bill.

Mr. Kathuria made no specific allegations that there were promises other than those on the record and, indeed, offered no evidence to prove any type of agreement. The Administrative Law Judge found, based on the record provided, that Mr. Kathuria made an informed plea with clear knowledge that civil action was a possibility. Therefore, the Administrative Law Judge concluded that the Division was not limited to the amount of restitution set forth in the plea proceedings (*see, Matter of Miras, supra; Matter of N.T.J. Liquors, supra; Matter of Dallacqua*, Tax Appeals Tribunal, March 2, 1989).

Next, the Administrative Law Judge addressed the fraud issue. Tax Law § 1145(a)(2) provides in pertinent part:

If the failure to pay or pay over any tax to the commissioner of taxation and finance within the time required by this article is due to fraud, in lieu of the penalties and interest provided for in subparagraphs (i) and (ii) of paragraph one of this subdivision, there shall be added to the tax (i) a penalty of fifty percent of the amount of the tax due, plus (ii) interest on such unpaid tax . . . .

The Division bears the burden of showing fraud under Tax Law § 1145(a)(2) (*Matter of Sener, supra; Matter of Kuchеров*, State Tax Commn., April 15, 1987, *confirmed Matter of Kuchеров v. Chu*, 147 AD2d 877, 538 NYS2d 339). 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 Sener, supra, citing, Matter of Shutt*, State Tax Commn., July 13, 1982).

Mr. Kathuria pled guilty to grand larceny covering the period June 1, 1988 through February 13, 1991. In his plea proceeding, Mr. Kathuria admitted that *during that time period* he, as owner of Sona, collected sales tax from customers and, while knowing that such taxes were legally due and owing to the State of New York, failed to pay them to the State. Larceny is defined as the wrongful taking, obtaining or withholding of the property of another, committed with the intent to deprive another of property or appropriate the same (Penal Law § 155.05[1]; *see also, People v. Valenza*, 108 Misc 2d 86, 436 NYS2d 937, *affd* 90 AD2d 466, 454 NYS2d 1018, *revd on other grounds* 60 NY2d 363, 469 NYS2d 642). The Administrative Law Judge concluded that Mr. Kathuria's actions were fraudulent and that his admissions alone meet the *Sener* requirements. Thus, petitioners are estopped from arguing that the fraud penalty in this matter was improperly asserted (*see, Plunkett v. Commissioner*, 465 F2d 299, 72-2 USTC ¶ 9541; *Matter of N.T.J. Liquors, supra; Matter of Cinelli*, Tax Appeals Tribunal, September 14, 1989).

Next, Mr. Kathuria argued that under Article 28 of the Tax Law he, as a responsible person, cannot be held liable for the penalty and interest owed by Sona, but rather only the tax. The Administrative Law Judge concluded that contrary to Mr. Kathuria's claims, a responsible officer under Article 28 is personally liable for the penalty and interest owed by the corporation (*Lorenz v. Division of Taxation of Dept. of Taxation & Fin.*, 212 AD2d 992, 623 NYS2d 455,

*affd* 87 NY2d 1004, 642 NYS2d 621; *Matter of Waite v. Tax Appeals Tribunal*, 225 AD2d 962, 639 NYS2d 584).

***ARGUMENTS ON EXCEPTION***

On exception, petitioners argue that the sales invoices that were missing were not detailed by the auditor, and that the auditor failed to review all of the invoices that were available to him. Accordingly, petitioners urge, the sales records were adequate, and any indirect method employed by the Division was done without petitioners' written permission and was improper. Petitioners also argue that the records of petitioners' purchases obtained by the Division from Sona's suppliers should not be considered, and the assessment should be canceled.

Petitioners continue to argue that the auditor's markup was excessive. Petitioners claim that they submitted information to support the markup of 15.24% as opposed to 29.5818%. Petitioners also continue to deny that they are responsible for tax on jewelry sales.

In addition, petitioners urge that the Division did not properly apply all of their payments to the tax due, and that the form letter submitted by Mr. Karash after the record was closed should have been admitted in evidence. Petitioners argue that out-of-state sales should have been accepted as filed, since the auditor did not question the validity of these sales.

Finally, petitioners argue that their plea of guilty to filing a false instrument related only to March 1, 1990 through May 31, 1990. Therefore, petitioners urge, the Division has failed to prove fraud for periods other than that quarter and that the statute of limitations has expired for all periods except the period ending May 31, 1990.

***OPINION***

We deal summarily with two of petitioners' claims. We first address petitioners' argument that out-of-state sales should have been accepted as filed, since the auditor did not question the validity of these sales. It is unclear what petitioners are challenging here, since this was never an issue in dispute, and, in petitioners' own words, "the auditor did not question the validity of these sales."<sup>19</sup> Since the out-of-state sales *were* accepted by the auditor as filed, there is nothing for us to decide with regard to this issue.

Petitioners next complain in their exception that the Division did not properly apply its tax payments to the tax due. Since this claim is not supported by any credible evidence in the record, petitioners' argument on this issue is rejected without further comment.

Petitioners' claim that the auditor did not review all of the records available to him is also rejected as not supported by the record. We note that petitioners failed to offer any documentary evidence or credible testimony to establish the adequacy of their records. On the contrary, the record in this proceeding establishes that petitioners' records were deficient and unverifiable and inadequate to enable the auditor to conduct a detailed audit. Sona failed to number its sales invoices, failed to maintain a cash receipts journal or general ledger and failed to maintain cash register tapes. Petitioners asserted that Sona's records accurately reflect all purchases made, but failed to offer these records in evidence. Instead, they offered the unsubstantiated testimony of Mr. Kathuria. We agree with the Administrative Law Judge that Mr. Kathuria's testimony was not credible. Given the unreliability of Mr. Kathuria's testimony and the absence of any documentary evidence contradicting the supplier information, the Division could select an

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<sup>19</sup>See petitioners' exception; also see finding of fact "8" of the Administrative Law Judge.

indirect audit method reasonably calculated to reflect the taxes due (*see, Matter of W.T. Grant Co. v. Joseph, supra; Matter of A & J Gifts Shop v. Chu*, 145 AD2d 877, 536 NYS2d 209, *lv denied* 74 NY2d 603, 542 NYS2d 518). The burden rests with the taxpayer to show by clear and convincing evidence that the methodology was unreasonable or that the amount assessed was erroneous (*Matter of Meskouris Bros. v. Chu, supra; Matter of Surface Line Operators Fraternal Org. v. Tully, supra*).

Petitioners argue that the auditor's markup of 29.58% was excessive.

The markup used by the auditor was derived from petitioners' own books and records, and petitioners have failed to offer any credible evidence that the markup used by the auditor was erroneous. We conclude from all of the above that petitioners have failed to meet their burden of proving by clear and convincing evidence that the methodology was unreasonable or that the amount assessed was erroneous (*Matter of Meskouris Bros. v. Chu, supra; Matter of Surface Line Operators Fraternal Org. v. Tully, supra*).

We now address the fraud issue. The Division assessed fraud penalty pursuant to Tax Law § 1145(a)(2), which provides for the imposition of a civil fraud penalty if the failure to file a return or pay over any tax is due to fraud. The burden of proving fraud by clear and convincing evidence has consistently been interpreted to reside with the Division (*see, Matter of Drebin*, Tax Appeals Tribunal, March 27, 1997, *confirmed Matter of Drebin v. Tax Appeals Tribunal*, 249 AD2d 716, 671 NYS2d 565; *Matter of Sener, supra; Matter of Cinelli, supra*). Imposition of the fraud penalty 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 Sener, supra*, quoting *Matter of Shutt, supra*). Petitioners’ claim that their plea of guilty to fraud by filing a false instrument related only to the quarter ending May 31, 1990, and that the Division had failed to prove fraud for any other period.

Since the sales tax penalty provisions are modeled after Federal penalty provisions, Federal statutes and case law are properly used for guidance in ascertaining whether the requisite intent for fraud has been established (*Matter of Uncle Jim’s Donut & Dairy Store*, Tax Appeals Tribunal, October 5, 1989; *Matter of Sener, supra*). Factors found to be significant include consistent and substantial understatement of tax, the amount of the deficiency itself, a pattern of repeated deficiencies, the taxpayer’s entire course of conduct and the taxpayer’s failure to maintain bank accounts or adequate records (*see, Merritt v. Commissioner*, 301 F2d 484, 62-1 USTC ¶ 9408; *Bradbury v. Commissioner*, T.C. Memo 1996-182, 71 TCM 2775; *Webb v. Commissioner*, 394 F2d 366, 68-1 USTC ¶ 9341; *see also, Matter of AAA Sign Co.*, Tax Appeals Tribunal, June 22, 1989). Because direct proof of the taxpayer’s intent is rarely available, fraud may be proved by circumstantial evidence, including the taxpayer’s course of conduct (*Intersimone v. Commissioner*, T.C. Memo 1987-290, 53 TCM 1073; *Korecky v. Commissioner*, 781 F2d 1566, 86-1 USTC ¶ 9232). Fraud may not be presumed or imputed, but rather must be established by affirmative evidence (*Intersimone v. Commissioner, supra*). The issue of whether fraud with the intent to evade payment of tax has been established presents a question of fact to be determined upon consideration of the entire record (*Jordan v. Commissioner*, T.C. Memo 1986-389, 52 TCM 234; *see, Matter of AAA Sign Co., supra; see also, Matter of Drebin, supra*).

Here, in addition to the other evidence, we have a statement by Mr. Kathuria to investigators that he filed 15 sales tax returns and that he knew that each of them were inaccurate. We also have Mr. Kathuria's words taken from his plea allocution, wherein he stated to the Court:

I was the owner of this store [Sona Appliances] *between June 1<sup>st</sup>, 1988 and through February 13, 1991. During this time I sold merchandise at Sona to the general public. This merchandise included electronic items and gold jewelry. In selling this merchandise I collected sales tax. During the course of this ownership, I filed tax returns and underreported taxable sales on these tax returns. In doing this I underreported the tax I owed to the State of New York. I knew these taxes returns [sic] were false* (Exhibit "L," emphasis added).

On the record presented here, it is concluded that the Division has proven by clear and convincing evidence that petitioners acted with willful intent to fraudulently deprive the State of the sales and use taxes owed. We know from Mr. Kathuria's own words, and using nothing more than the \$150,000.00 in tax that petitioners admit to (i.e., the court ordered restitution amount), that petitioners were engaged in consistent and substantial underreporting of taxable sales on their sales tax returns and that this was done knowingly. We view Mr. Kathuria's admittedly consistent and substantial underreporting of tax due for the audit period along with his words that "I knew these taxes returns [sic] were false" as more than sufficient, alone or combined with the other evidence in this record, to establish the necessary specific intent to deliberately evade payment of taxes due and owing the State of New York for the audit period (*see, Korecky v. Commissioner, supra; Cirillo v. Commissioner*, 314 F2d 478, 63-1 USTC ¶ 9311; *Matter of Uncle Jim's Donut & Dairy Store, supra*). Inasmuch as the fraud has been determined and fraud penalties assessed, the statutory notices are not barred by the statute of limitations (Tax Law § 1147[b]).

Finally, petitioners argue that they are not responsible for tax on jewelry sales. However, petitioners offered no credible evidence below or compelling argument here with respect to this issue. Therefore, we affirm the determination of the Administrative Law Judge on the issue of additional tax on jewelry sales for the reasons stated therein.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Sona Appliances, Inc. and Inder-Mohan Kathuria, officer of Sona Appliances, Inc. is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petitions of Sona Appliances, Inc. and Inder-Mohan Kathuria, officer of Sona Appliances, Inc. are denied; and
4. The notices of determination, dated November 28, 1994 and March 30, 1995, respectively, are sustained.

DATED: Troy, New York  
March 16, 2000

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/s/Donald C. DeWitt  
Donald C. DeWitt  
President

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/s/Carroll R. Jenkins  
Carroll R. Jenkins  
Commissioner

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/s/Joseph W. Pinto, Jr.  
Joseph W. Pinto, Jr.  
Commissioner