

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition :

of :

GENERAL BUILDING APPLIANCE CORP. : DECISION
AND JOSEPH INGRALDI : DTA NOS. 819297 & 819298

:
for Revision of Determinations or for Refund of Sales and
Use Taxes under Articles 28 and 29 of the Tax Law for the :
Period September 1, 1995 through February 28, 1999.

Petitioners General Building Appliance Corp., 750 Stewart Avenue, Garden City, New York 11530-4766 and Joseph Ingraldi, c/o Frank Joseph Ingraldi, Executor, 750 Stewart Avenue, Garden City, New York 11530-4766, filed an exception to the determination of the Administrative Law Judge issued on August 12, 2004. Petitioners appeared by Donald Schwartz, Esq. and Gary S. Weinick, Esq. The Division of Taxation appeared by Christopher C. O'Brien, Esq. (Robert A. Maslyn, Esq., of counsel).

Petitioners filed a brief in support of their exception and the Division of Taxation filed a brief in opposition. Petitioners filed a reply brief. Petitioners' request for oral argument was denied.

Commissioner DeWitt delivered the decision of the Tax Appeals Tribunal. Commissioner Jenkins concurs. Commissioner McDermott took no part in the consideration of this decision.

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

ISSUES

I. Whether Joseph Ingraldi was a person required to collect and remit sales and use taxes on behalf of General Building Appliance Corporation.

II. Whether the Division of Taxation has established that petitioners were properly subject to the imposition of a fraud penalty.

III. Whether the notices of determination were timely issued.

FINDINGS OF FACT

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

On December 31, 2001, the Division of Taxation ("Division") issued to petitioner General Building Appliance Corporation, d/b/a Hampton Sales, a Notice of Determination of sales and use taxes due for the period September 1, 1995 through February 28, 1999 in the amount of \$819,046.66, plus penalty (including fraud penalty) and interest. On the same date, the Division issued to petitioner Joseph Ingraldi a Notice of Determination of sales and use taxes due for the same period and amount, including penalty (fraud) and interest, stating that petitioner was an officer or responsible person of General Building Appliance Corporation. The corporation operated a wholesale and retail appliance business in Garden City, New York.

In August 1998, the Division of Taxation began a sales tax field audit of the corporation. An appointment letter, dated August 19, 1998, was mailed to the corporation advising that a sales tax field audit was being conducted by the Division. The letter requested that all books and records pertaining to the sales tax liability of General Building Appliance Corporation be made available on the appointment date, September 21, 1998, including financial statements, journals,

ledgers, sales invoices, purchase invoices, cash register tapes, sales and use tax returns, Federal income tax returns and exemption certificates for the original period of the audit, September 1, 1995 through May 31, 1998.

The auditor was provided with the corporation's sales tax returns, Federal income tax returns, a general ledger, monthly sales summaries, exemption documents and bank statements. Requested but not provided were worksheets supporting the sales tax returns, a cash receipts journal and purchase invoices. Initially, it appeared to the auditor that the corporation's books and records accurately reflected the corporation's activities, as the sales tax returns, sales recorded in the corporation's books, Federal income tax returns and sales invoices all reconciled. However, after a more careful review of the books and records, the auditor determined that they were not adequate to accurately determine the corporation's business activities for the audit period. Specifically, the auditor determined that the books and records were not in auditable condition, that the books and records did not allow the auditor to trace back to any source documents and that there were inadequate internal control procedures.

A review of the sales tax returns by the auditor revealed that the corporation was claiming approximately 80%¹ of its gross sales as nontaxable, a figure the auditor considered high for a retail appliance business. The auditor also found such a percentage of nontaxable sales unusual in light of the information on the monthly sales summaries which indicated that a majority of claimed nontaxable sales were to the individuals to whom the merchandise had been delivered, rather than as resales or sales to exempt entities.

¹For the initial audit period of September 1, 1995 through May 31, 1998, the business claimed nontaxable sales of \$10,014,173.00 out of total gross sales of \$12,533,294.00.

The questions raised by the sales tax returns and the monthly summary sheets led the auditor to the conclusion that a test period audit was necessary. The auditor had Mr. Ingraldi execute, as secretary of the corporation, a Test Period Audit Method Election on November 4, 1998, in which petitioner General Building Appliance Corporation agreed to the Division's using a test period audit method to conduct its audit. The election states that a test period audit method may not be used to determine a tax liability where a taxpayer's records are adequate unless the taxpayer consents to such a method. The auditor chose the month of May 1998 as the test period because it was without sales fluctuations. In addition, the auditor's examination of the records provided indicated that the month of May 1998 was consistent with the entire audit period in terms of gross sales, nontaxable sales claimed and the taxable ratio of the business.

The auditor requested that the corporation provide all the sales invoices for the month of May 1998 as well as the exemption certificates for the same period. The sales invoices were provided in two folders, one marked "wholesale invoices" and one marked "retail invoices." The vast majority of the claimed nontaxable sales were contained in the wholesale folder. Some exemption certificates were provided; however, the resale certificates and exempt organization certificates were incomplete. The sales invoices contained two sections entitled "delivery to" and "sold to." The delivery destination sections were completed in detail, showing the name, address, telephone number and directions for the delivery destination. In contrast, the sold to sections were generally incomplete, often containing only the name of the purchaser. The auditor discovered many instances where the deliver to sections and the sold to sections appeared to have been completed in either different handwritings or different pens, or both.

The auditor next compiled a transcription of the claimed nontaxable sales. She recorded from each invoice the deliver to section and sold to section information and, where appropriate, matched the sold to information on the invoice to the exemption certificates which petitioner kept on file. In those cases where information was missing on the invoice, the auditor added the information, such as addresses, if available on the exemption certificates. The auditor then prepared a list of missing exemption certificates and provided it to petitioners.

The auditor sent letters to individuals contained on the deliver to sections of the sales invoices, to confirm Mr. Ingraldi's statements that certain deliveries were made on behalf of another appliance dealer, making these sales for resale, as the actual purchaser was not the customer indicated on the invoice but another dealer. The letter sent by the auditor requested of the person receiving delivery information as to whether another dealer was involved or whether the purchase was made directly from the corporation. The auditor did not consult with petitioners before sending the letters to the parties shown on the invoices. All replies indicated that no other dealers were involved and that the purchase was made from the corporation. There were eleven instances where the customer responding provided a copy of the sales invoice which indicated that the customer had paid sales tax to the corporation, but a review of petitioners' copy of the same invoice indicated that no sales tax was collected.

The auditor also sent letters to the businesses or individuals listed in the sold to sections of the invoices. Again, the auditor did not consult with petitioners before sending the letters to the parties shown on the invoices. The responses indicated that the entities had either never done business with petitioners or had not done business during the period at issue.

In those situations where the exemption certificates were insufficient, that is they lacked certain required information, the auditor checked the Division's Business Summary Inquiry System using the business's identification numbers and found that the party listed on the exemption certificates was either unregistered for sales tax purposes during the audit period or had been inactivated prior to the transaction date. The auditor subpoenaed the corporation's bank statements for the month of May 1998, and a review of the checks deposited in the corporation's account revealed they were from the individuals listed on the deliver to sections of the invoices, not the sold to sections. In addition, a review of the canceled checks showed no payments from other appliance dealers to General Building Appliance Corporation.

Following the analysis of the sales invoices, customer responses, bank statements, canceled checks and exempt certificates for the test period of May 1998, the auditor determined that 82% of the corporation's sales were taxable, and 18% were nontaxable. The auditor disallowed 77% of claimed nontaxable sales for one or more of the following reasons: there was no exemption certificate; the person listed in the "deliver to" section of the invoice dealt only with petitioners, and not with a third party; the person or entity listed in the "sold to" section of the invoice had not done business with petitioners; the copy of the canceled check indicated payment to the corporation, not a third party; the "sold to" business was not active for sales tax purposes; or, the exempt certificate was either incomplete or for a business that was unregistered or inactive.

The auditor disallowed nontaxable status to two sales, which the invoices stated had been made to Mercy Hospital, because no exemption certificates were provided. During the audit and

hearing, petitioner did not provide any substantiation, such as an exemption certificate from the hospital, that these sales actually occurred as indicated.

The results of the test period audit performed for the month of May 1998 were applied against total nontaxable sales claimed for the initial audit period of \$10,014,173.00 resulting in disallowed nontaxable sales of \$7,748,666.00 and tax due of \$648,619.95 for the original audit period of September 1, 1995 through May 31, 1998. All documents used by the auditor in her determination to disallow certain nontaxable sales and to compute the amount of tax due were provided to petitioners' representative, Laurence Keiser.

On July 29, 1999, the auditor referred the matter to the Revenue Crimes Bureau of the Department of Taxation and Finance. Following a case review by the Revenue Crimes Bureau, the case was referred and accepted by the Nassau County District Attorney's Office. On June 21, 2000, petitioner Joseph Ingraldi was arrested and charged with grand larceny in the third degree, a Class D Felony (Penal Law § 155.35), falsifying business records in the first degree, a Class D Felony (Penal Law § 175.10), offering false instruments for filing in the first degree, a Class E Felony (Penal Law § 175.35) and filing fraudulent sales tax returns (Tax Law § 1817[b]). On February 21, 2001, in full satisfaction of all the charges, Mr. Ingraldi pled guilty in Nassau County Court to falsifying business records in the first degree and admitted during the taking of his plea that during the period June 1, 1998 through August 31, 1998, he intentionally altered sales invoices of the business records of General Building and knowingly submitted false sales tax returns both with intent to commit the crime of grand larceny by withholding the proper amount of sales tax. He was sentenced to a conditional discharge which included restitution to the Division in the amount of \$537,563.00, which was paid in full on March 14, 2001.

The restitution amount was arrived at using a computation proposed by Mr. Ingraldi's criminal attorney, Jared Scharf, Esq., which was forwarded to the District Attorney's Office. Mr. Scharf stated in correspondence that he had performed a review of sales invoices for the period October 1998 through January 1999 and determined a taxable ratio of 61.54 percent. Although this figure was accepted by the District Attorney's Office, no work papers or documentation were provided to the Division to substantiate this conclusion. The matter was returned to the Division for further action relating to the civil liability.

Upon the return of the case, the auditor determined that during the criminal proceedings and subsequent settlement, the original audit period of September 1, 1995 through May 31, 1998 had been extended to include the period June 1, 1998 through February 28, 1999. During a meeting with petitioners' representative, Mr. Laurence Keiser, it was agreed that the audit be updated to include the additional quarters used in the computation employed to determine the restitution amount that was part of the criminal matter. On September 5, 2001, an updated appointment letter and checklist were provided to petitioners' representative to include the period June 1, 1998 through February 28, 1999. No records were provided by petitioners for this additional audit period.

The auditor's review of the corporation's sales tax returns for the two-year and three-month period immediately following the period at issue revealed that General Building was reporting a taxable ratio of approximately 81%, as compared to the taxable ratio reported during the audit period of 18%. This 81% taxable ratio compares favorably with the 82% taxable ratio determined on audit.

On October 29, 2001, the Division issued to petitioners a Statement of Proposed Audit Adjustment for the period September 1, 1995 through February 28, 1999. The statement indicated that 77.375% of claimed nontaxable sales for the audit period of \$12,453,432.00 were being disallowed, resulting in disallowed nontaxable sales of \$9,635,843.00 and additional sales tax due of \$819,046.33. Petitioners were credited with the restitution payment of \$537,563.00. Civil fraud penalties were imposed based upon the auditor's conclusion that there had been consistent underpayment and a scheme to alter invoices and Mr. Ingraldi's plea to criminal charges.

The auditor concluded that Mr. Ingraldi was a responsible person of General Building. Mr. Ingraldi was the owner of the corporation, an officer of the corporation, managed the day-to-day activities of the business, signed a waiver and sales tax returns as either secretary or president of the corporation, maintained the business's checkbook and made the bank deposits on behalf of the business. Mr. Ingraldi signed a Consent Extending Period of Limitation for Assessment of Sales and Use Taxes which extended the period of assessment for the period September 1, 1995 through February 28, 1996 to March 20, 1999. Subsequently, petitioners' representative executed two additional consents, which provided that the sales and use tax due for the period September 1, 1995 through February 28, 1997 could be determined on or before March 20, 2000.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

In his determination, the Administrative Law Judge noted that when a taxpayer's records are insufficient to verify the amount of the sales and use taxes due for the period under examination, the Division is authorized to estimate such tax liability on the basis of external

indices. The Administrative Law Judge found that while it initially appeared to the auditor that the corporate petitioner's books and records accurately reflected its business activities, a more careful examination of the records obtained by the auditor during the audit and the third-party responses to the auditor's inquiries showed that the corporation's books and records were unreliable, inaccurate and apparently fabricated.

The Administrative Law Judge observed that the case was then referred to the Revenue Crimes Bureau and eventually the Nassau County District Attorney's Office, resulting in the arrest and conviction of Mr. Ingraldi. The Administrative Law Judge held that under these circumstances, it was clearly appropriate for the Division to resort to an indirect audit methodology and estimate sales tax due on the basis of external indices.

The Administrative Law Judge found that petitioners did not show error in either the audit method utilized or the results derived from its application. The Administrative Law Judge rejected petitioners' claim that the audit methodology and results were flawed because the auditor did not follow the Division's Audit Guidelines by obtaining a test period agreement prior to determining the accuracy of the books and records and by failing to advise petitioners that third-party inquiries were being sent to its customers, which precluded petitioners from including a statement of their own in the mailings. The Administrative Law Judge held that the failure to comply with audit manual guidelines does not invalidate an assessment or confer substantive rights upon a taxpayer.

After reviewing the criteria for determining whether an individual corporate officer can be held responsible for the tax, penalty and interest owed by a corporation, the Administrative Law Judge determined that the uncontroverted evidence clearly showed Mr. Ingraldi's involvement in

General Building's operations and established his personal responsibility to collect and remit tax on behalf of such entity. Accordingly, the Administrative Law Judge sustained the Division's assessment of personal liability for the tax, penalty and interest amounts at issue herein against Mr. Ingraldi.

The Administrative Law Judge found that as part of Mr. Ingraldi's criminal plea agreement, he paid restitution in the amount of \$537,563.00, which was computed by petitioner's defense counsel for the period September 1, 1995 through February 28, 1999. 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. The Administrative Law Judge determined that Mr. Ingraldi 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. Therefore, the Division was not limited to the amount of restitution set forth in the plea proceedings.

The Administrative Law Judge noted the provisions of Tax Law § 1145(a)(2) relative to the penalties for fraud and he pointed out the standard of proof which the Division must meet in order to prove fraud. The Administrative Law Judge concluded that the Division met its burden of establishing that the imposition of a penalty for fraud was warranted in this case, based on the enormous level of underreporting of taxable sales and sales tax over a substantial and continuous period of time as well as the plea of Mr. Ingraldi, in which he admitted and agreed that he had underreported sales tax for the period September 1, 1995 through February 28, 1999 in the amount of \$537,563.00. The Administrative Law Judge also found that since the Division's

determination of fraud was sustained, the statutory notices were not barred by the otherwise applicable three-year statute of limitations.

ARGUMENTS ON EXCEPTION

Petitioners, in support of their exception, argue that by relying on the results of the test period audit, the Division failed to establish an underpayment of tax by clear and convincing evidence in each of the taxable periods at issue in order to lift the bar of the three-year statute of limitations as to each of those periods. Petitioners point out that the Division failed to offer in evidence audited invoices for the test period or for any part of the audit period. Petitioners maintain that the Division has improperly attempted to rely on the presumption of correctness accorded to its notices of determination as sufficient to sustain its burden of proof for establishing fraud. This, petitioners assert, was found to be improper by the Tax Appeals Tribunal in *Matter of Cousins Serv. Sta.* (Tax Appeals Tribunal, August 11, 1988) and *Matter of Yel-Bom's Serv. Ctr.* (Tax Appeals Tribunal, May 10, 1990). Petitioners argue that the Administrative Law Judge erroneously first concluded that the audit methodology was appropriate under the circumstances and then found it appropriate that the underpayment determined for the test period could be extrapolated to the remaining months of the audit period. Relying on this, the Administrative Law Judge then found that the Division had proven fraud due to having proved an enormous level of underreported taxable sales and sales tax over a substantial and continuous time. However, petitioners urge that the Administrative Law Judge should have first established an underpayment for each of the quarterly tax periods prior to relying on the presumption of correctness of the notices of determination. Additionally,

petitioners allege that the Division is required to prove what portion of any underpayments are due to fraud, which the Division failed to do.

Petitioners further argue that despite the Administrative Law Judge's conclusion that the corporation had failed to produce all relevant records, such records as were produced were adequate for a complete audit of the 42-month period at issue. Petitioners maintain that the auditor chose to do a test period audit merely for purposes of expediency. Also, petitioners assert that the third party verification letters were defective and not designed to reasonably calculate the taxes due, in that they were not issued in compliance with the Division's audit manual and did not provide a copy of the invoice at issue nor refer to petitioners by its appropriate trade name. However, petitioners urge that the propriety of the audit methodology need not be addressed, as the Division failed to prove substantial underreporting for each of the 14 quarters at issue by clear and convincing evidence. As a result, petitioners believe that the assessments are barred by the statute of limitations.

Petitioners point out that despite the Administrative Law Judge's findings, the criminal conviction of Mr. Ingraldi relates solely to the three month period June 1, 1998 through August 31, 1998. As a result, his conviction and plea statement are limited to that one period of time and are not evidence of fraud for any other period. Petitioners maintain that there is no independent assertion of fraud against Mr. Ingraldi but his assessment for fraud is based on his status as a responsible person in regard to the corporation. Therefore, as with the notice of determination sent to the corporation, the notice addressed to Mr. Ingraldi should also be time-barred.

Finally, petitioners argue that the restitution paid by Mr. Ingraldi was intended as full restitution of any unpaid tax and should have been applied only to tax. As a result, there should have been no assessment of additional tax.

The Division, in opposition, argues that petitioners' books and records were not accurate because the auditor found an unusually high percentage of nontaxable sales for a retail business. Further, the Division asserts that third party information demonstrated that petitioners' records were false and fabricated. The Division maintains that petitioners bear the burden of showing that the audit methodology was flawed and they have failed to do so, notwithstanding that the Division may have failed to follow its own audit guidelines.

The Division argues that there was ample proof in the record to demonstrate fraud by petitioners throughout the audit period. Specifically, Mr. Ingraldi's guilty plea estops him from contesting fraud for the period covered by the plea and it is evidence of fraud for other periods. The Division asserts that for each quarter of the audit period, the auditor only disallowed those nontaxable sales that were fraudulent.

The Division maintains that there was ample evidence in the record that Mr. Ingraldi was a responsible officer of General Building Appliance Corporation and that he participated in the fraudulent activity carried on by that corporation. The Division further disputes petitioners' argument that the restitution by Mr. Ingraldi was intended to be full satisfaction of all civil liability.

OPINION

Every person required to collect tax must maintain and make available for audit records sufficient to verify all transactions in a manner suitable to determine the correct amount of tax

due (*see*, 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 (*see*, Tax Law § 1138[a]; *see also*, *Matter of Ristorante Puglia, Ltd. v. Chu*, 102 AD2d 348, 478 NYS2d 91; *Matter of Surface Line Operators Fraternal Org. v. Tully*, 85 AD2d 858, 446 NYS2d 451).

In this case, although it initially appeared to the auditor that petitioners' records accurately reflected its business activities, the auditor determined that, among other things, there was an unusually large percentage of non-taxable sales reported. The auditor obtained petitioners' written consent to conduct a test period audit. The auditor chose to verify the taxability of sales made during the single month of May 1998. He testified that he was not prevented from verifying the sales from other months and that records were presented to him that would have allowed him to do so. After obtaining third party information on claimed non-taxable sales made during May 1998, the auditor determined that additional tax was due. He then extrapolated the results of the test period to the entire audit period and Notices of Determination were issued to each petitioner.

A presumption of correctness attaches to a notice of determination upon its issuance (*see*, *Matter of Hammerman*, Tax Appeals Tribunal, August 17, 1995). So long as it appears that a rational basis existed for the auditor's calculations, the burden is then placed upon petitioner to show, by clear and convincing evidence, that the audit method employed or the tax assessed was unreasonable (*see*, *Matter of Meskouris Bros. v. Chu*, 139 AD2d 813, 526 NYS2d 679; *Matter of Surface Line Operators Fraternal Org. v. Tully, supra*).

The Division issued Notices of Determination to petitioners asserting not only additional tax and interest but also fraud penalty pursuant to Tax Law § 1145(a)(2). When a taxpayer's failure to file accurate sales tax returns is due to fraud, a penalty of 50% is added to the tax (*see*, Tax Law § 1145[a][2]). At the hearing, petitioners argued that the assessments of additional tax, fraud penalty and interest were time-barred pursuant to Tax Law § 1147(b), in that they were not made within three years of the date of the filing of the sales tax returns for the periods at issue herein. Section 1147(b) contains an exception to the three-year period of limitations for willfully false or fraudulent returns filed with the intent to evade tax.

The issue of whether petitioners filed willfully false or fraudulent returns with the intent to evade payment of tax presents a question of fact to be determined upon consideration of the entire record (*see, Jordan v. Commissioner*, T.C. Memo 1986-389, 52 TCM 234; *see also, Matter of Drebin v. Tax Appeals Tribunal*, 249 AD2d 716, 671 NYS2d 565). The burden of demonstrating this falls upon the Division (*see, Matter of Sona Appliances*, Tax Appeals Tribunal, March 16, 2000). Fraud is not defined in Tax Law § 1145. However, a finding of fraud requires the Division to show “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 Sona Appliances, supra*). In order to establish fraudulent intent, petitioners must have acted deliberately, knowingly and with the specific intent to violate the Tax Law (*see, Matter of Cousins Serv. Sta., supra*).

The sales tax penalty provisions are modeled after Federal penalty provisions and, thus, Federal statutes and case law may properly provide guidance in ascertaining whether the

requisite intent for fraud has been established (*see, Matter of Uncle Jim's Donut & Dairy Store*, Tax Appeals Tribunal, October 5, 1989). Since direct proof of a 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). Relevant factors held to be significant include consistent and substantial understatement of tax, the amount of the deficiency itself, the existence of a pattern of repeated deficiencies and the taxpayer's entire course of conduct (*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).

Unless fraud is established, the Notices of Determination for the quarters September 1, 1995 through November 30, 1998 are barred in their entirety by the statute of limitations (*see*, Tax Law § 1147[b]). For the quarter ending February 28, 1999, the Notices of Determination must be revised to eliminate fraud penalties if the fraud finding is not supported. In determining whether the Division has presented sufficient evidence to establish fraud, there is no presumption of correctness attached to the Notices of Determination issued by the Division. The burden rests with the Division to prove by clear and convincing evidence that petitioners, with willful intent, were in violation of the tax laws (*see, Matter of Cardinal Motors*, State Tax Commn., July 8, 1983). Fraud must be established with affirmative evidence and may not be presumed (*see, Intersimone v. Commissioner, supra*). Therefore, mere suspicion of fraud from the surrounding circumstances is not enough (*see, Goldberg v. Commissioner*, 239 F2d 316, 57-1 USTC ¶ 9261).

The Administrative Law Judge sustained the fraud penalty on the ground that the Division had established an enormous level of underreporting of taxable sales and sales tax over a substantial and continuous period of time. Further, the Administrative Law Judge found that petitioners failed to cooperate on the audit and produced only records that were fabricated and inaccurate. The Administrative Law Judge concluded that in his guilty plea, Mr. Ingraldi admitted and agreed that he had underreported sales tax for the period September 1, 1995 through February 28, 1999 in the amount of \$537,563.00.

The question presented here is whether the Division has demonstrated by clear and convincing evidence that the petitioners consistently and substantially underreported the amount of tax due on their sales tax returns. The Division must show that the calculations giving rise to the assessment do not depend for their validity on the presumption of correctness attached to the Notices of Determination (*see, Matter of Cousins Serv. Sta., supra; Matter of Yel-Bom's Serv. Ctr., supra*). Thus, the Division must affirmatively prove the underreporting and it cannot rely on the Notices of Determination themselves to prove the underreporting. To permit the Division to satisfy its burden of proving fraud by relying on an assessment that was sustained only because the petitioners had failed to overcome it, would be to allow the Division to raise itself up by its own bootstraps (*see, Matter of Yel-Bom's Serv. Ctr., supra*).

Despite the Division's arguments to the contrary, the present situation is analogous to *Cousins*. The auditor, in his testimony, acknowledged that he never reviewed any invoices for periods other than the test period of May 1998. Further, he never inquired of any third parties regarding invoices in periods outside of the test period. The auditor admitted that he was not prevented from doing so but simply chose not to do it. The auditor simply extrapolated his

conclusion that the majority of nontaxable sales were fraudulent to the entire audit period. This was mere conjecture on the part of the auditor and does not constitute proof of fraud. There is no way of determining from the record whether any or all of the claimed non-taxable sales outside of the test period were fraudulent. Despite the conclusion of the Administrative Law Judge to the contrary, the record does not support that, in entering his plea of guilty to a single criminal charge of falsifying business records in the first degree by altering sales invoices with the intent to commit grand larceny for the period June 1, 1998 through August 31, 1998, Mr. Ingraldi admitted and agreed that he had underreported sales tax for the period September 1, 1995 through February 28, 1999 in the amount of \$537,563.00.

For the period May 1998, however, we find that there was ample evidence of fraud on the part of petitioners in the record. Similarly, for the period June 1, 1998 through August 31, 1998, although the auditor did not review claimed non-taxable sales, we find that based on the guilty plea entered by Mr. Ingraldi, petitioners are estopped from contesting fraud for that period. We also find that there is more than sufficient evidence to support the Administrative Law Judge's conclusion that Mr. Ingraldi was a person responsible for the collection and payment of sales tax on behalf of the corporation and that, in entering his guilty plea, he was also admitting that he acted fraudulently on behalf of the corporation as well as individually.

Since we have rejected the imposition of fraud penalty for all periods except for those between May 1, 1998 and August 31, 1998, the three-year statute of limitations, pursuant to Tax Law § 1138, applies to the issuance of the Notices of Determination at issue. As the notices were issued on December 31, 2001, they are untimely except for the aforementioned period of May 1, 1998 through August 31, 1998 and for the period of December 31, 1998 through

February 28, 1999. As to that latter period, we next consider the Division's request asserted in its Answers that, in lieu of fraud, the negligence penalty provided by Tax Law § 1145(a)(1) be imposed.

We held in *Matter of Sener* (Tax Appeals Tribunal, May 5, 1988) that when the Division gives notice in its answer to the taxpayer of its intention to assert a late payment penalty as an alternative to the fraud penalty, doing so shifts the burden to the Division to prove petitioner's willful neglect. "Willful neglect" has been defined under federal law as meaning a "conscious, intentional failure or reckless indifference" (*United States v. Boyle*, 469 US 241, 83 L Ed 2d 622, at 628), a "designed" failure (*Orient Investment & Fin. Co. v. Commissioner*, 166 F2d 601, 48-1 USTC ¶ 9162, at 160), and a "voluntary" failure (*Vaughan v. United States*, 536 F Supp 498, 82-1 USTC ¶ 13,463, at 84,297) to pay the taxes due. Because the Internal Revenue Service has a similar burden as the Division to prove willful neglect (*see, Langston v. Commissioner*, T.C. Memo 1977-421, 36 TCM 1703; *see also, Matter of Sener, supra*), we adopt these definitions as a guide. Proof of a taxpayer's intentions may be shown through the testimony of the taxpayer. In *C. Bundy, Jr., Inc. v. United States* (673 F Supp 318, 87-2 USTC ¶ 9657), the District Court found willful neglect where the taxpayer testified that she intentionally filed federal employment tax forms knowing the tax had not been paid and that she did so based on the inaccurate assumption that she would be penalized less severely than was actually so. Such direct proof of willful neglect may not always be available.

However, relying solely on the presumption of correctness afforded the Notices of Determination and petitioners' failure to rebut that presumption, the Division did not even attempt to obtain any evidence of petitioners' willful neglect for this period. In fact, the period

June 1, 1998 through February 29, 1999 was not included as part of the audit until after the entry of Joseph Ingraldi's guilty plea. As with its failure to clearly and convincingly demonstrate fraud for periods beyond the test period or the period encompassed by Mr. Ingraldi's guilty plea, the Division did not meet its burden to prove petitioners' willful neglect for the period December 1, 1998 through February 28, 1999.

Petitioners have paid restitution of \$537,563.00 in connection with the criminal proceeding, in an amount calculated by petitioners' criminal counsel. It is clear that this amount was not intended to be in full satisfaction of any additional liability of petitioners for tax, penalty or interest. However, as found by the Administrative Law Judge, the Division properly credited the amount of such restitution against the liability determined due pursuant to the Notices of Determination considered herein. Such amount should likewise be credited against the amount determined to be due pursuant to the Notices of Determination as modified by this decision.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of General Building Appliance Corp. and Joseph Ingraldi is granted to the extent that the imposition of the fraud penalty is canceled with respect to the audit periods September 1, 1995 through April 30, 1998 and September 1, 1998 through February 28, 1999, that the Notices of Determination corresponding to the taxable periods September 1, 1995 through April 30, 1998 and September 1, 1998 through November 30, 1998 were untimely issued and the negligence penalty imposed for the period December 1, 1998 through February 28, 1999 is canceled, but is otherwise denied;

2. The determination of the Administrative Law Judge is reversed in accordance with paragraph "1" above, but is otherwise sustained;

3. The petition of General Building Appliance Corp. and Joseph Ingraldi is granted in accordance with paragraph “1” above, but is otherwise denied; and

4. The Notices of Determination are modified in accordance with paragraph “1” above.

DATED: Troy, New York
July 14, 2005

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

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