

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
of	:	
JOSEPH PETITO	:	
for Redetermination of a Deficiency or for	:	
Refund of Personal Income Tax under Article 22	:	
of the Tax Law for the Years 1975 through 1981.	:	

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DETERMINATION

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In the Matter of the Petition	:
of	:
AARDVARK SANITATION, INC.	:
for Redetermination of a Deficiency or for	:
Refund of Corporation Franchise Tax under	:
Article 9-A of the Tax Law for the Years 1975	:
through 1982.	:

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Petitioner Joseph Petito, 39 Cornehlson Drive, Huntington Station, New York 11746, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the years 1975 through 1981 (File No. 804767).

Petitioner Aardvark Sanitation, Inc., 39 Cornehlson Drive, Huntington Station, New York 11746, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the years 1975 through 1982 (File No. 804768).

A consolidated hearing was held before Thomas C. Sacca, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on September 20, 1989 at 1:15 P.M., with all briefs to be submitted by April 6, 1990. Petitioners appeared by MeyerZimmerman & Company (Meyer Zimmerman, CPA). The Division of Taxation appeared by William F. Collins, Esq. (Herbert Kamrass, Esq., of counsel).

ISSUES

I. Whether petitioner Aardvark Sanitation, Inc. timely filed a petition for redetermination

of a deficiency or for refund of corporation franchise tax.

II. Whether petitioner Aardvark Sanitation, Inc. filed franchise tax reports for the years at issue.

III. Whether the Division of Taxation properly determined petitioner Aardvark Sanitation, Inc.'s franchise tax liability for the years at issue.

IV. Whether the additional gross sales of the corporation were properly attributed to petitioner Joseph Petito as constructive dividends.

V. Whether reasonable cause exists for the abatement of the penalties asserted against petitioners.

#### FINDINGS OF FACT

On August 24, 1983, the Division of Taxation issued eight notices of deficiency under Article 9-A of the Tax Law to petitioner Aardvark Sanitation, Inc. ("the corporation"), for the years 1975 through 1982 asserting a corporation franchise tax liability in the aggregate amount of \$125,872.30, plus penalty (Tax Law § 1085 [a], [b]) and interest. On September 1, 1983, the Division of Taxation issued two notices of deficiency under Article 22 of the Tax Law against petitioner Joseph Petito, for the years 1975 through 1981 asserting a personal income tax liability in the aggregate amount of \$81,212.76, plus penalty (Tax Law § 685[b]) and interest. These ten notices were based upon the results of a field audit of the business operations of the corporation as described hereinafter.

The corporation operated a trash removal business servicing department stores, manufacturing plants and other commercial businesses. The business was started in 1973. Joseph Petito contributed \$80,000.00 to finance the start-up of the operation, served as its president and was a 50% shareholder of the stock of the corporation. Nicholas Ugenti was the other 50% shareholder. On February 16, 1979, the business was sold to Detail Carting Company, Inc. for \$542,458.25. The agreement provided that the corporation would receive cash of \$102,458.25 at the time of closing plus 36 monthly payments of \$15,000.00. The monthly payments included interest at 10%.

During August 1979, a sales tax audit of the corporation was conducted by the Division of Taxation ("Division") for the period June 1, 1976 through February 16, 1979. The audit revealed that the gross sales shown on the books of the corporation exceeded the gross sales reported on the corporation's sales and use tax returns by \$101,162.25. The corporation was assessed sales tax on the unreported gross sales and the amount assessed was paid in full.

On April 5, 1982, the Division notified petitioner Joseph Petito by letter that he was to be audited for the years 1976 through 1981. The letter indicated that petitioner should make available for examination copies of Federal and New York State income tax returns, supporting schedules, books, records, worksheets and other documents pertaining to the preparation of the income tax returns. Mr. Petito was also advised to make available savings statements, checking statements and cancelled checks for the period January 1, 1976 through December 31, 1981. On April 12, 1982, the Division notified the corporation by letter that it was to be audited for the years 1976 through 1981 and requested that the corporation make available the same records as were requested of Mr. Petito.

The corporation and Mr. Petito did not provide the Division with any of the records requested. The only document provided to the auditor was the sales agreement between the corporation, as seller, and Detail Carting Company, Inc., as purchaser. In addition, the audit revealed that the corporation had not filed Federal income tax returns or New York State franchise tax reports for the years at issue.

In computing the amount of tax due, the auditor began with the period of the sales tax audit, June 1, 1976 through February 16, 1979. The gross sales per the corporation's cash receipts journal were considered to be the gross receipts of the corporation for franchise tax purposes. As the sales tax audit did not cover the period June 1, 1975 through May 31, 1976, the auditor estimated monthly sales for this period. The auditor arrived at a monthly sales figure by totaling gross sales for the period of the sales tax audit and dividing that figure by the number of months involved to arrive at estimated sales per month of \$19,917.00. This estimated monthly sales figure was used to determine the corporation's gross receipts for the

period June 1, 1975 through May 31, 1976. The auditor then subtracted from the gross receipts the salaries of Joseph Petito and Nicholas Ugenti, estimated truck expenses for fuel, repairs, insurance and rentals, estimated utility expenses, estimated office expenses and estimated miscellaneous expenses to arrive at the corporation's net income for the years 1975 through 1978 and the period January 1, 1979 through February 16, 1979.

The sales price for the business of \$542,458.00 was treated as gain from the sale of business assets and considered receipts to the corporation in 1979. The interest on the monthly payments was also treated as receipts to the corporation in the years 1979 through 1982.

As Mr. Petito was a 50% shareholder of the corporation, one-half of the taxable income of the corporation for the years 1975, 1976, 1977 and 1978 and the period January 1, 1979 through February 16, 1979 was attributed to Mr. Petito as constructive dividends. For the year 1979, the auditor also attributed to Mr. Petito one-half of the cash proceeds received by the corporation on the sale of the business and one-half of the monthly payments received pursuant to the sales agreement. In the years 1980 and 1981, the auditor again treated as constructive dividends to Mr. Petito one-half of the monthly payments.

At the hearing, Joseph Petito testified that the day-to-day management and finances of the corporation were handled by Nicholas Ugenti. During 1975 and 1976, Mr. Petito signed only a few checks on behalf of the corporation. After the sale of the business on February 16, 1979, only Mr. Ugenti signed corporate checks. During the audit period, Mr. Petito was paid a salary of \$250.00 per week as a consultant to the corporation. In addition, he signed the February 16, 1979 sales agreement as president of the corporation.

At the time of the sale of the business, Petito and Ugenti agreed that the monthly proceeds received from the purchaser would be used to make the payments on the loans that had been obtained to acquire the equipment employed in the business. This equipment was included in the sale of the business. Following the payment of the loans, any money remaining would either be divided between the two shareholders or used to purchase two carting companies outside New York State, with each shareholder to operate one of these new companies.

Although the loans had not been paid in full, in late 1979 and early 1980 Mr. Petito went to both Hawaii and Florida to negotiate contracts to purchase the Trashman, Inc. carting company, located in Hawaii, and The Garbologist, Inc. carting company, located in Florida. According to Joseph Petito, a contract was signed to purchase Trashman, Inc. in early 1980. On May 13, 1980, two contracts were signed by Nicholas Ugenti to purchase The Garbologist, Inc.; one contract listed the purchasers as "Aardvark Sanitation, Inc." and "Nicholas Ugenti, secretary/ treasurer" while the other contract listed the purchaser as "Nicholas Ugenti". Eventually, Ugenti transferred the assets of The Garbologist, Inc. to a corporation entitled Tampa Garbologist, Inc., which he later sold. Mr. Petito first became aware of these numerous transactions when the seller of The Garbologist, Inc. sued the corporation and Ugenti for breach of contract. Mr. Petito went to Florida to assist in the lawsuit, which is still pending. In addition, Mr. Petito went to Hawaii to attempt to save Trashman, Inc., which, according to Mr. Petito, had been divested of its assets by Mr. Ugenti.

The corporation did not file franchise tax reports during the years at issue. Mr. Petito testified that he and Mr. Ugenti would go to the accountant's office at the time the reports were due to assist in their preparation. The reports were completed and given to Mr. Ugenti to mail. The Division has no record of receiving any of the reports due for the years at issue. Upon being told during the course of the audit that the reports were not filed, Mr. Petito and his accountant reconstructed the reports from the information available and gave them to the auditor. These reports were signed and were delivered after the notices of deficiency were issued. Such reports were not introduced into the record of this matter.

The Division's notices of deficiency were issued by certified mail on August 24, 1983. The corporation's petition was received by the Division of Tax Appeals on October 22, 1987. Mr. Petito testified that he was unaware of the notices because Mr. Ugenti received all the corporation's mail and at times had the mail forwarded to either Florida or Hawaii.

At the hearing, petitioners introduced into evidence the corporation's monthly checking account statements and cancelled checks for the years 1979, 1980 and 1981. The statements for

1979 included all months except February and September. The statements for 1980 included all months except January, February, March, May and June. The statements for 1981 included all months except January and February. The total amount of expenses according to the statements for each year are as follows:

<u>Year</u>	<u>Total</u>
1979	\$217,426.81
1980	114,991.21
1981	121,694.86

Included in the total for 1979 are two checks written to Mr. Petito totaling \$1,500.00. In addition, the checking account statements show the monthly deposits of the payments made pursuant to the sale of the business on February 16, 1979. Mr. Petito testified that he received these monthly payments from the purchaser.

#### SUMMARY OF PETITIONERS' POSITION

Petitioners allege the following:

- (a) An earlier petition was filed for the corporation but was misplaced by the Division.
- (b) The auditor failed to take into account the loan payments and other costs of the business in determining the amount of the gain from the sale.
- (c) Joseph Petito did not receive any money from the corporation except that which he had previously reported on his income tax returns.
- (d) The penalties assessed against Joseph Petito should be abated as he cooperated fully during the audit.

#### CONCLUSIONS OF LAW

A. Tax Law § 1089(b) provides that a taxpayer must file a petition for redetermination of a deficiency within 90 days after the mailing of the Notice of Deficiency to the taxpayer. The petition in this matter was filed more than four years after the issuance of the notices of deficiency to the corporation. Under these circumstances, the corporation's petition must be considered untimely.

B. Where there is some factual basis for deciding that tax returns, as filed, do not accurately reflect the true income received by a taxpayer, the Division may determine proper income using indirect methods (see, Holland v. United States, 348 US 121, 131-132; Hennekens v. State Tax Commission, 114 AD2d 599). The sales tax audit of the corporation revealed additional sales tax due from the business as a result of unreported sales. Such a determination provided a factual basis for deciding that the income reported by petitioner, as a 50% shareholder of the corporation, on his personal income tax returns was not accurate and, therefore, the Division of Taxation properly used the sales tax audit findings to calculate petitioner Joseph Petito's personal income tax liability for the years 1975, 1976, 1977, 1978 and for the period January 1, 1979 through February 16, 1979. No provision of the Tax Law or regulations promulgated thereunder precludes the Division of Taxation from utilizing the results of an audit conducted under one article of the Tax Law in an audit conducted under another article (see, Matter of Castaldo, State Tax Commission, February 15, 1985).

C. Where controlling stockholders divert corporate income to themselves, such diverted funds should be treated as constructive dividends (Ball v. Commissioner, 44 TCM 863). Petitioner Joseph Petito was an officer and 50% shareholder of the corporation and, absent an explanation as to the disposition of the additional corporate income, is deemed to have received same in proportion to his interest in the corporation.

Petitioner has provided an explanation as to the disposition of a portion of the additional corporate income for the years 1979, 1980 and 1981. The checking account statements and copies of cancelled checks establish the following amounts of corporate expenses which are to be subtracted from the constructive dividends attributed to petitioner:

	<u>1979</u>	<u>1980</u>	<u>1981</u>
Expenses	\$217,426.81	\$114,991.21	\$121,694.86
Less: checks to petitioner	<u>1,500.00</u>		
	215,926.81	98,331.49	121,694.86
Percentage of Interest in Corporation	<u>.50</u>	<u>.50</u>	<u>.50</u>
Amount to be Subtracted	\$107,963.41	\$ 57,495.61	\$60,847.43

D. While petitioner Joseph Petito has asserted that penalty imposed pursuant to Tax Law

§ 685(b) should be abated, he has failed to offer any evidence to establish that his failure to comply with the provisions of Article 22 was not due to negligence or intentional disregard of said article or the rules and regulations thereunder. Said penalty imposed upon the deficiencies for each year at issue is, therefore, sustained in full.

E. The petition of Aardvark Sanitation, Inc. is dismissed.

The petition of Joseph Petito is granted to the extent indicated in Conclusion of Law "C"; the Division of Taxation is directed to modify the notices of deficiency issued September 1, 1983 accordingly; and except as so granted, the petition is in all other respects denied.

DATED: Troy, New York

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ADMINISTRATIVE LAW JUDGE