STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :

of :

UNCLE JIM'S DONUT AND :
DAIRY STORE, INC.
A/K/A DASH'S DONUTS :

for Revision of a Determination or for Refund :
of Sales and Use Taxes under Articles 28 and 29
of the Tax Law for the Period December 1, 1979 :
through November 30, 1986.
:

In the Matter of the Petition :

of :

JAMES A. LAMONICA, OFFICER OF :
UNCLE JIM'S DONUT AND DAIRY STORE, INC. DETERMINATION
:

for Revision of a Determination or for Refund
of Sales and Use Taxes under Articles 28 and 29 :
of the Tax Law for the Period December 1, 1979
through November 30, 1986. :

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In the Matter of the Petition
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of
:
JEANNEANN LAMONICA, OFFICER OF
UNCLE JIM'S DONUT AND DAIRY STORE, INC. :

for Revision of a Determination or for Refund :
of Sales and Use Taxes under Articles 28 and 29
of the Tax Law for the Period December 1, 1979 :
through November 30, 1986.

In the Matter of the Petition

of

CHARLES A. LAMONICA, OFFICER OF
UNCLE JIM'S DONUT AND DAIRY STORE, INC.

for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period December 1, 1979 through November 30, 1986.

Petitioner Uncle Jim's Donut and Dairy Store, Inc., 1204 Jackson Road, Webster, New York 14580 filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 1979 through November 30, 1986 (File No. 805337).

Petitioner James A. LaMonica, 1204 Jackson Road, Webster, New York 14580 filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 1979 through November 30, 1986 (File No. 805332).

Petitioner Jeanneann LaMonica, 1204 Jackson Road, Webster, New York 14580 filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 1979 through November 30, 1986 (File No. 805333).

Petitioner Charles A. LaMonica, 44 Angean Drive, Webster, New York 14580 filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 1979 through November 30, 1986 (File No. 805331).

A consolidated hearing was held before Jean Corigliano, Administrative Law Judge, at the offices of the Division of Tax Appeals, 259 Monroe Avenue, Rochester, New York, on August 31, 1988 at 1:15 P.M., with all briefs to be filed by October 28, 1988. Petitioners appeared by Elliot, Stern and Calabrese (Herbert N. Stern, Esq., of counsel). The Audit Division appeared by William F. Collins, Esq. (James Della Porta, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation accurately determined petitioners' sales tax liability.

II. Whether the Division of Taxation has shown that petitioners willfully attempted to evade tax by willfully failing to file sales tax returns or whether, in the alternative, the Division of Taxation established that petitioners were liable for a penalty under Tax Law § 1145(a)(1) for failure to file a return or pay tax when due.

III. Whether petitioners Jeanneann LaMonica and Charles A. LaMonica were persons required to collect tax under sections 1131(1) and 1133(a) of the Tax Law.

FINDINGS OF FACT

1. On December 8, 1986, the Division of Taxation ("Division") issued identical notices of determination and demands for payment of sales and use taxes due to each of the petitioners: Uncle Jim's Donut and Dairy Store, Inc. a/k/a Dash's Donuts; James LaMonica; Jeanneann LaMonica; and Charles A. LaMonica. The first of the three notices issued to each petitioner assessed sales tax for the period December 1, 1979 through May 31, 1983 of $41,440.07 plus fraud penalty of $20,720.04 and interest of $34,164.67 for a total amount due of $96,324.78. The second notice assessed sales tax for the period June 1, 1983 through November 30, 1986 of $37,259.16 plus fraud penalty of $18,629.58 and interest of $9,843.88 for a total amount due of $65,732.62. The third notice assessed a penalty only of $1,393.38 for the period June 1, 1985 through November 30, 1986, under Tax Law § 1145(a)(1)(vi).

2. The notices issued to James LaMonica, Jeanneann LaMonica and Charles A. LaMonica explained that each, as an officer of Uncle Jim's Donut and Dairy Store, Inc., was deemed to be personally liable for the tax assessed against the corporation.

3. A Notice of Determination and Demand for Payment of Sales and Use Taxes Due was issued to Uncle Jim's on December 8, 1986 assessing tax due for the period September 1, 1986 through November 30, 1986 in the amount of $1,400.00 plus penalty and interest.[1]

4. The notices described were issued as the result of an audit of Uncle Jim's books and records. The audit was begun when the Division received a notification of bulk sale from the purchaser of Uncle Jim's business.

5. Uncle Jim's operated a donut bakery and delivered and sold donuts to wholesale customers. It also operated a combination retail donut and coffee shop and convenience store. Uncle Jim's began doing business in November 1977. Sales tax returns were filed from the business's inception through November 30, 1979. A single return was also filed for the period June 1, 1986 through August 31, 1986.

6. James LaMonica was president of Uncle Jim's and responsible for all aspects of its operations. When he was first contacted by the Division's auditor, he stated that the business had been closed for several years and reopened in June 1986. An audit appointment was then scheduled. At this meeting, Mr. LaMonica confessed that Uncle Jim's was operating without interruption from 1977 until its sale in September 1986. He also admitted that Uncle Jim's collected sales tax but did not file returns or remit tax due. From that point on, Mr. LaMonica cooperated completely with the auditor in providing her with books and records and other information.

7. The auditor requested and received cash register tapes for the years 1985 and 1986. These did not indicate the items sold nor in any way segregate taxable and nontaxable items;

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[1]Apparently, this assessment represents sales tax due on the sale of tangible assets transferred in the bulk sale; if so, the tax was paid by the purchaser and this assessment was cancelled.

therefore, they were not usable for the purpose of verifying taxable sales. No guest checks were available. A sales journal and purchases journal for the audit period were available. The sales journal segregated sales into two categories, gross sales in store and wholesale donut sales. For the audit period, it showed gross sales in the store of $1,734,910.60. The purchases journal showed total monthly purchases only. In some periods, purchases were segregated into purchases for the store and purchases for the wholesale donut business. Purchase invoices were available for the years 1983 through the close of business in 1986, although some invoices were missing.

8. The auditor used the records provided to her and information provided by James LaMonica to estimate sales and use taxes due for the audit period.

(a) The auditor first performed a test period analysis of purchases made for the convenience store, using purchase invoices from June, July and August 1986. Purchases were segregated into taxable and nontaxable items. The auditor then calculated a ratio of 68.4 percent taxable items to 31.06 percent nontaxable items. Selling prices were obtained from the donut shop's new owner. These prices were applied to taxable purchases in the test period in several categories: coffee, beer, soda, candy, cigarettes, sandwiches and miscellany. The auditor then calculated an overall weighted markup on purchases of 58.9823 percent.

(b) The auditor applied the taxable ratio to all purchases for the audit period as shown in Uncle Jim's purchases journal. Taxable purchases were then adjusted to reflect inventory sold to the new owner and items removed from inventory for personal consumption. The weighted markup was applied to audited taxable purchases to obtain audited taxable sales of $836,451.99. This figure did not include taxable sales of prepared foods, such as sandwiches, soups and pizza.

(c) Since petitioners had no sales records, the Division estimated sales of prepared foods sold at the counter, such as donuts, pizza, chili, sandwiches, etc., using donut sales as a basis. Based on information provided by James LaMonica, the auditor estimated that 60 dozen donuts were sold at the convenience store each day. The auditor estimated that one-half of these donut sales were subject to sales tax and applied a selling price of 30 cents apiece to the estimated number of taxable donuts sold to obtain audited taxable sales of prepared foods of $266,868.00.

(d) Audited taxable sales made through the convenience store were added to audited sales of prepared foods to obtain total audited taxable sales for the audit period of $1,103,319.99 with a tax due on that amount of $77,232.38. Mr. LaMonica estimated that during each sales tax quarter, he removed from inventory for his own use taxable items valued at approximately $890.00. Use tax due on these items was determined to be $1,682.10. From total tax due for the audit period ($78,914.48), the auditor subtracted tax paid for the quarter ended August 31, 1986 to calculate additional sales and use taxes due of $77,916.00.

(e) The auditor determined that Uncle Jim's failed to pay tax due on its own purchase of a walk-in cooler for $11,189.00. Therefore, an additional tax of $783.23 was assessed for the period in which the purchase occurred, September 1, 1981 through November 30, 1981.

(f) Total tax due for the audit period was determined to be $78,699.23.

9. James LaMonica began doing business as Dash's Donuts in 1973. He registered as a sales tax vendor at that time but either filed no returns or filed returns showing no taxable sales because he conducted a strictly wholesale business. About one year later, he put in a coffee bar

and began collecting tax. Sales tax returns were timely filed and taxes paid in this period.

10. In 1977, Mr. LaMonica moved his business to a new location and incorporated as Uncle Jim's. At the time of incorporation, he named himself, his wife, Jeanneann LaMonica, and his brother Charles LaMonica as corporate officers. Jeanneann and Charles were not informed that they had been named as corporate officers. James LaMonica understood the naming of corporate officers as merely a legal formality with no consequences. Although no corporate shares were actually issued, the incorporation documents, at James LaMonica's instruction, showed a distribution of 25 percent of the outstanding shares to Charles LaMonica and the remainder to James LaMonica. Again, Charles LaMonica was not informed that he was a shareholder. James hoped that the shares would have some value eventually and that he would be able to present them to his brother as compensation for work he was then performing in the donut shop.

11. At the new location, Uncle Jim's continued selling donuts at wholesale and at retail at a small coffee bar. James later added several tables and began selling prepared foods, such as pizza, soup and chili. Several items were tried in an attempt to increase sales and abandoned when they proved unsuccessful. Uncle Jim's filed sales tax returns and remitted taxes through the period ended November 30, 1979.

12. In or about 1979, Uncle Jim's expanded to include a convenience store, selling milk, bread, beer, soda, cigarettes and candy. James LaMonica sought the advice of his accountant regarding the taxable status of items sold at the store and was told that food items were not taxable. He interpreted this to mean that the prepared foods served at the counter were also nontaxable. By December 1, 1979, James LaMonica stopped filing returns on behalf of Uncle Jim's. His reason for doing so was a combination of his confusion over the taxable status of the items he sold and economic difficulties. Uncle Jim's continued to collect tax on nonfood items and items James LaMonica considered nonessential food items, such as soda. Apparently this reflected Mr. LaMonica's understanding of the Tax Law at this time.

13. Shortly after Uncle Jim's stopped filing returns, the Division stopped sending it pre-addressed sales tax returns. At first, James LaMonica believed this was an indication that the Division considered his business not subject to sales tax. By 1981, he became aware, either through observation or conversations with other vendors, that a great range of items sold by Uncle Jim's was taxable. Uncle Jim's began collecting tax from its customers on most taxable items; however, it filed no sales tax returns and paid no tax until the quarter ended August 31, 1986. When asked why he failed to file returns for such a long period, James LaMonica answered:

> "I know I can't use this as an excuse but after, I would say, several quarters, it got out of hand and I always thought a time would come when I would be able to report to the State that I hadn't paid tax and I would be able to make this up and pay them. But I never was able to. Like I say, things got out of hand, and that's about what happened."

14. James LaMonica filed a final return in 1986 because he believed it was necessary in order to facilitate the sale of his business.

15. Sometime before the business was sold, James LaMonica informed his wife and brother that sales taxes had not been paid. They were not told that they had any responsibilities

as corporate officers.

16. Jeanneann LaMonica occasionally worked in the donut shop as a counterperson. At her husband's direction, she maintained Uncle Jim's books and records. James LaMonica provided her with sales receipts and purchase invoices which she posted to the corporation's ledger. She was a signatory on the corporate bank account and prepared and signed checks when instructed to do so by her husband. She did not decide which creditors to pay or prepare tax returns. Until the business was sold in 1986, Mrs. LaMonica was unaware that sales tax returns were not being filed by Uncle Jim's.

17. Charles LaMonica worked as an employee of Uncle Jim's, delivering donuts to wholesale customers. He was also a signatory on the corporate bank account and signed checks at James LaMonica's instruction when the latter was unavailable to do so himself. Aside from these activities, Charles LaMonica had no involvement in or responsibility for the operation of Uncle Jim's. He was unaware that an ownership interest in the corporation had been distributed to him until informed of this by James LaMonica, late in the audit period. Other than employee wages, Charles LaMonica received no compensation from Uncle Jim's.

18. Petitioners presented no books or records or other documentary evidence. An accountant testifying on their behalf challenged the accuracy of the estimated tax on three grounds:

(a) that the Division used an unrepresentative test period resulting in an erroneous ratio of taxable to nontaxable sales;

(b) that the selling price of donuts (see Finding of Fact "8[c]") failed to take into account the rise in prices over the years in the audit period;

(c) that the markup was overstated because the Division failed to reduce purchases to reflect waste, spoilage, etc.

CONCLUSIONS OF LAW

A. Where a taxpayer fails to file a return required to be filed under article 28 of the Tax Law, the Division of Taxation must determine the amount of tax due from such information as may be available to it (Tax Law § 1138[a][1]). Where the taxpayer's books and records are undeniably inadequate, the Division cannot be asked to compute the tax due with a high degree of accuracy, since it is the taxpayer's lack of recordkeeping which has prevented an accurate accounting (Matter of Meskouris Bros. v. Chu, 139 AD2d 813). It is only necessary that the Division select an audit method reasonably calculated to reflect the taxes due, and the burden is then placed on the petitioner to show that the method of audit or amount of tax assessed was erroneous (Matter of Surface Line Operators Org. v. Tully, 85 AD2d 858, 859).

In the absence of any verifiable sales records, the indirect methods of estimating tax employed by the Division were reasonable. At best, petitioners' evidence demonstrated that alternative factors might have been employed to estimate the tax. They have not shown that the methods used were unreasonable or that the amount of tax assessed is erroneous.

B. Tax Law § 1145(a)(2) provides for the imposition of a civil fraud penalty if the failure to file a return or to pay over any tax is due to fraud (L 1985, ch 65, § 86, eff September 1, 1985; former par. [2] adopted in 1975 contained a similar provision). The burden of showing fraud is upon the Division. To meet its burden, the Division must show clear and convincing evidence of every element of fraud, including willful, knowledgeable and intentional wrongful acts or omissions constituting false representations, resulting in deliberate nonpayment or underpayment of taxes due and owing (Matter of Ilter Sener d/b/a Jimmy's Gas Station, Tax Appeals Tribunal, May 5, 1988). Since the sales tax penalty provisions were modeled after Federal statutes, Federal precedent may be looked to for guidance in determining whether the Division has met its burden (Matter of Ilter Sener, supra).

A civil fraud penalty may be imposed when the taxpayer has willfully attempted to evade tax by a willful failure to file returns, as well as by filing intentionally false returns (Stoltzfus v. United States, 398 F2d 1002; Acker v. Commissioner, 26 TC 107). However, the willful failure to file returns is not in itself sufficient evidence of fraud (Cirillo v. Commissioner, 314 F2d 478, 482; Jones v. Commissioner, 259 F2d 300). The issue of fraud with intent to evade tax presents a factual question to be determined upon a consideration of the entire record; therefore, the taxpayer's failure to file must be considered along with other relevant facts in determining whether the requisite fraudulent intent is present (Powell v. Grandquist, 252 F2d 56; Beaver v. Commissioner, 55 TC 85, 92-93).

C. Admittedly, this is a close case with factors on both sides of the question. James LaMonica admitted that he collected tax throughout the periods in question and knew he was obligated to file returns and remit tax to the Division. He admitted that having begun a pattern of nonfiling he continued in this path over a period of almost six years, primarily because he never had the money to satisfy the past liabilities. Finally, he initially lied to the auditor in stating that Uncle Jim's was out of business for several years before reopening in June of 1986.

However, the record also contains evidence that petitioners, although guilty of a willful failure to file returns, did not have the specific intent to evade tax. Sales and purchase journals were maintained throughout the audit period and freely made available to the auditor. While the records were inadequate for the purpose of verifying taxable sales, there is no indication that they were deliberately false or misrepresentative of gross sales and purchases. Once Mr. LaMonica recanted his initial lie, he was fully cooperative with the auditor. Mr. LaMonica stopped filing returns because he believed that most of his sales were nontaxable. Ignorance of the law is not a defense to nonfiling and this misunderstanding of the law does not explain why Mr. LaMonica continued to collect tax without filing. Still, it is some evidence of his state of mind and tends to show that he did not begin nonfiling with an intent to evade tax. It also weighs in petitioners' favor that a return was filed for the final quarter of the audit period, despite the fact that petitioners must have known that the filing of a return might call them to the attention of the Division. In the same vein, James LaMonica confessed the nonpayment of taxes to his wife and brother shortly before the business was sold. From this, it may be inferred that he was aware that he would ultimately be held liable for his failure to pay sales taxes.

While there is a division among the Federal Courts of Appeal, as to what the Internal Revenue Service must show to prove the requisite fraudulent intent in a Federal tax case (see, Morrell v. Commissioner, 30 TCM 393), there is significant authority for requiring some affirmative act evidencing an intent to evade tax, in addition to the willful failure to file (see___, Cirillo v. Commissioner, supra at 482; Jones v. Commissioner, supra; First Trust & Savings Bank v. United States, 206 F2d 97).

The Division points to James LaMonica's assertion that the business was closed for several years as an affirmative indication of his intent. This, however, is inapposite as evidence of fraudulent intent. Mr. LaMonica scheduled an audit appointment shortly thereafter where he immediately admitted that Uncle Jim's had been in business continually since 1979, and he cooperated fully in all aspects of the audit. Furthermore, I am convinced that Mr. LaMonica's statements at hearing regarding his initial decision not to file were offered as evidence of his state of mind rather than as an excuse or reason for not filing.

"[I]n determining the existence of fraud, it is the state of mind of the taxpayer during the period in question with which we are concerned" (Powell v. Grandquist, supra at 61). After careful consideration of the entire record, it is concluded that the Division failed to show by clear and convincing evidence that petitioners had a fraudulent intent.

D. The Division asserted, as an alternative argument in the course of its summation, that, in the event the fraud penalty was not sustained, the penalty set forth at Tax Law § 1145(a)(1) should be imposed. Thus, although not formally phrased as such, the issue becomes whether the Audit Division may amend its answer just prior to the conclusion of the hearing to assert the section 1145(a)(1) penalty.

Section 6214(a) of the Internal Revenue Code has been interpreted as authorizing a claim for an increased deficiency at any time before decision and judgment have been entered (see, Ferrill v. Commr., 684 F2d 261, 265). However, the authority to permit an amendment is not unfettered. "If there is evidence of surprise or substantial disadvantage to the petitioner, the Commissioner's motion to amend should be denied because the purpose of section 6214(a) is to give the petitioner a fair opportunity to answer and resist the claim before it is considered by the Court" (Law v. Commr., 84 TC 985, 990). Thus, in the absence of surprise or prejudice, the Commissioner of Internal Revenue has been allowed to amend his claim to seek an increased deficiency (Law v. Commr., supra at 990. See generally, Ferrill v. Commr., 684 F2d 261, 265.)

Applying this standard to the instant matter leads to the conclusion that the Tax Law § 1145(a)(1) penalty was properly asserted. Petitioners raised no objection to the assertion of these penalties as an alternative to the fraud penalty, either at hearing or in their post-hearing memorandum of law. There can be no doubt that petitioners were grossly negligent in failing to file returns and pay tax and that the Division sustained its burden of proof of establishing the propriety of the Tax Law § 1145(a)(1) penalty (Matter of Ilter Sener, supra).

E. The Tax Law imposes personal liability for taxes required to be collected under article 28 upon a person required to collect such tax (Tax Law § 1133[a]). A person required to collect such tax is defined in part as "any officer, director or employee of a corporation...who as such officer, director or employee is under a duty to act for such corporation...in complying with any requirement of [article 28]" (Tax Law § 1131[1]). Whether an individual was a person required to collect tax requires a factual inquiry in each case. Pertinent inquiries include, among others, authorization to sign the corporate returns, responsibility for management or maintenance of the corporate books, authorization to hire or fire employees, derivation of substantial income from the corporation and stock ownership (Matter of Blodnick v. New York State Tax Commn., 124 AD2d 437). Neither Jeanneann LaMonica nor Charles A. LaMonica were persons required to collect tax under sections 1131(1) and 1133(a) of the Tax Law. It is apparent that James LaMonica was solely responsible for the operation of Uncle Jim's. He alone had the responsibility and authority to determine which bills would be paid and which would not. Jeanneann LaMonica acted substantially as a bookkeeper, posting receipts and invoices to the ledgers at the direction of her husband. Charles LaMonica was merely an employee with no fiscal responsibilities. Neither was even aware of holding a corporate office, so cannot be found to have disregarded his or her corporate responsibilities.

F. The petitions of Uncle Jim's Donut and Dairy Store, Inc. and James LaMonica are granted to the extent indicated in Conclusion of Law "C"; the Division's request to amend its answer is granted to the extent indicated in Conclusion of Law "D"; the notices of determination and demands for payment of sales and use taxes due issued on December 8, 1986 shall be modified accordingly; and in all other respects, the petitions are denied.

G. The petitions of Jeanneann LaMonica and Charles A. LaMonica are granted, and the notices of determination and demands for payment of sales and use taxes due issued on December 8, 1986 are cancelled.

DATED: Albany, New York
February 2, 1989

/s/ Jean
Corigliano_____________________________________
ADMINISTRATIVE LAW JUDGE