

STATE OF NEW YORK
DIVISION OF TAX APPEALS

In the Matter of the Petition :
of :
JAMES WAITE, OFFICER :
OF HARRISON RADIO CORP. :
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 March 1, 1976 :
through May 31, 1980. : DETERMINATION
DTA NOS. 806363
AND 806419

In the Matter of the Petition :
of :
MICHAEL WAITE, :
OFFICER OF HARRISON RADIO CORP. :
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 March 1, 1976 :
through May 31, 1980. :

Petitioner James Waite, officer of Harrison Radio Corp., 37 Spruce Street, Smithtown, New York 11787, 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 March 1, 1976 through May 31, 1980.

Petitioner Michael Waite, officer of Harrison Radio Corp., 5 Hills Park Lane, Smithtown, New York 11787, 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 March 1, 1976 through May 31, 1980.

A consolidated hearing was held before Dennis M. Galliher, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on February 26, 1992 at 1:15 P.M., with the record left open to allow for examination of petitioner Michael Waite by deposition due to said petitioner's inability to attend proceedings as a result of

ill health. The examination of Michael Waite occurred on July 14, 1992 at 11:00 A.M., and the transcript thereof was received on August 10, 1992. Briefs were to be submitted by the parties by April 14, 1993. Petitioner Michael Waite, represented by Stewart Buxbaum & Co. (Stewart Buxbaum, C.P.A.), submitted a brief on October 22, 1992. Petitioner James Waite, represented by Theodore M. Rosenberg, Esq., submitted a brief on November 10, 1992. The Division of Taxation, represented by William F. Collins, Esq. (Herbert Kamrass, Esq., of counsel), submitted a responding brief on February 10, 1993. Neither petitioner submitted a reply brief.

ISSUES

I. Whether alleged responsible officers of a corporation are precluded, by operation of collateral estoppel, from contesting the audit methodology employed in arriving at an assessment against such corporation where resort to such methodology has already been challenged by and upheld as against such corporation.

II. Whether, assuming petitioners are not estopped from challenging such methodology and its results, the Division of Taxation nonetheless properly determined sales and use tax liability against the corporation known as Harrison Radio Corp. and properly assessed the sales tax portion thereof against petitioners as responsible persons.

III. Whether either or both petitioners were persons responsible to collect and remit sales and use taxes on behalf of the corporate entity known as Harrison Radio Corp., and are therefore liable for any such unpaid taxes owed by the corporation.

IV. Whether, assuming petitioners are held liable for such unpaid taxes, the Division of Taxation should nonetheless be estopped from collecting against petitioners based on its alleged failure to pursue collection efforts against the corporation.

FINDINGS OF FACT

On May 12, 1986, the Division of Taxation ("Division") issued to petitioner James Waite, as an officer of Harrison Radio Corp. ("Harrison"), two notices of assessment review covering the respective periods March 1, 1976 through August 31, 1979 and September 1, 1979 through May 31, 1980 and reflecting adjusted tax due in the respective amounts of \$37,513.57

and \$10,577.59, plus interest. These notices indicate on their faces that the revised amounts reflect adjustments "recommended" by the State Tax Commission. By way of explanation, and as will be detailed more fully hereinafter, two notices of determination and demands for payment of sales and use taxes due were issued to petitioner James Waite on May 27, 1981 for the same periods as are covered by the above-notices of assessment review. These notices of determination assessed tax due in the respective amounts of \$221,069.80 and \$35,402.08, plus interest, which amounts represent the amounts of sales tax initially assessed against Harrison as the result of a field audit. Harrison, in turn, challenged such assessments and, following a hearing before the former State Tax Commission, received a decision revising and reducing the amounts of sales tax assessed to the amounts shown on the notices of assessment review.¹

¹The record herein includes a copy of the notice of determination issued to James Waite for the period 9/1/79 through 5/31/80. Such notice is, in turn, referenced on the face of the notice of assessment review covering the same period by way of identical assessment number (S810527112C) and amount assessed (including interest). Such notice of determination is also the notice protested on one of the two petitions filed by James Waite and dated August 19, 1981, as revealed by the information (assessment number, period covered, and amount at issue) set forth in such petition (see Exhibits "A-1", "B" and "C-1"). By contrast, the record herein does not include a copy of the notice of determination issued to James Waite for the period 3/1/76 through 8/31/79. However, such notice is, as above, referenced on the face of the notice of assessment review covering the same period by way of identical amount assessed (including interest), and by its assessment number (S81052711C) which number immediately precedes that pertaining to the assessment against James Waite for the period 9/1/79 through 5/31/80. Also as above, such notice of determination is protested on the second of two petitions filed by James Waite and dated August 19, 1981, as revealed by the information (assessment number, period covered and amount at issue) set forth in such petition (see, Exhibits "A-2" and "C-2"). Notwithstanding that the record does not include a copy of the notice of determination for the period 3/1/76 through 8/31/79 there is, as detailed above, ample ancillary evidence that the same was issued to, received, and protested by James Waite. In fact, there is no dispute raised as to the issuance of both notices of determination to James Waite. Similarly, there is no claim that the notices of assessment review are in any way invalid or do not accurately reflect the dollar amount(s) remaining at issue, in light of reductions to the notices of determination resulting from prehearing conferences and from the former State Tax Commission's decision vis-a-vis Harrison. In view of all of these factors, and noting again that petitioner James Waite has raised no issue in this regard, the lack of a copy of the notice of determination in the record, as described, is of no consequence in this case (cf., NYS Dept. of Taxation & Fin. v. Tax Appeals Tribunal, 151 Misc 2d 326, 573 NYS2d 140).

On the same May 12, 1986 date, two additional identical notices of assessment review were issued to petitioner Michael Waite, as an officer of Harrison (the record includes copies of both notices of determination issued against Michael Waite). These notices of assessment review were issued upon the same basis as were those issued to James Waite and reflect the same adjustments to the notices of determination.

As noted, the subject assessments arise out of an audit of Harrison. Harrison was organized in or about 1942, was acquired by Waite Electronics, Inc. in August 1976 and thereafter emerged again under the name Harrison Radio Corp. While the record does not specify as much, Waite Electronics, Inc. was apparently owned by petitioners Michael Waite and James Waite together with a third individual (see, Finding of Fact "17"). Harrison was engaged in the sale of electronic communication products, on a wholesale and retail basis, with customers including government contractors, the military, commercial businesses and also amateur radio operators. During the period at issue (March 1, 1976 through May 31, 1980), Harrison operated retail locations in the greater New York City metropolitan area, varying in number from two to six. Harrison's principal offices were situated in Farmingdale, New York.

According to the testimony and documentary evidence introduced during the course of these proceedings and during proceedings conducted before the former State Tax Commission in the Matter of Harrison Radio Corp., (January 28, 1986) Harrison was advised of the Division's intent to commence an examination of its books and records. This audit examination, allegedly first scheduled for March 7, 1979, did not actually commence until April 15, 1980. The delay was due to postponements requested by Harrison in order to deal with certain then ongoing financial problems relating to a substantial investment loss suffered by Harrison. In addition, the corporation was then in the process of restructuring itself and was moving its accounting personnel and records to its Farmingdale office.

The Division could not produce, at hearing, an audit appointment letter memorializing

the scheduled appointment date or specifying the nature and extent of records to be made available by Harrison. However, the auditor's Log of Comments and Contacts ("auditor's log") includes entries made by the Division's auditor first assigned to this matter noting his telephone calls to the corporation and the postponements requested by the corporation. The auditor's log also makes reference to an appointment letter allegedly mailed to the corporation on August 9, 1979, a follow-up "flasher" mailed to Harrison's controller, and a responding telephone call scheduling a tentative first appointment date for March 17, 1980. The auditor's log notes a subsequent meeting held with Harrison's controller, one Martin Hills, on such date, and a rescheduled audit commencement appointment for April 15, 1980. The auditor's log also reveals that the case was transferred to another Division auditor at some time between March 17, 1980 and April 15, 1980, and that this latter person conducted the audit of Harrison.

During one of the auditor's initial meetings at Harrison's premises, Michael Waite introduced two individuals, Martin Hills (noted above) and Bill Macy, as Harrison's controller and assistant controller. These individuals were presented to the auditor as the persons who would represent Harrison and work with the auditor during the course of the audit. Martin Hills, the controller, left Harrison's employ shortly after the audit began, and the balance of the auditor's work was conducted with Bill Macy, assistant controller (it is unclear whether Bill Macy was formally promoted to the position of controller). In addition to the log entries, the auditor testified that he requested and reviewed Harrison's general ledger, income and sales tax returns, sales journals, purchase journals, invoices, and exemption certificates. His initial requests for records were made by phone and/or in person to Martin Hills. Later requests were apparently in the form of written lists of specific records needed, as given to Martin Hills and/or Bill Macy. The auditor noted in testimony that due to corporate restructuring it often took months for Harrison's personnel to locate and retrieve records the auditor requested.

Harrison was unable to produce its records for the first two quarterly periods of the audit (spanning March 1, 1976 through August 31, 1976). In fact, the record reveals such records had not been located as of the May 27, 1981 date on which assessments were made against Harrison

and petitioners herein, nor apparently at any time thereafter. For the balance of the audit period, each of the corporation's retail stores maintained cash register tapes which were forwarded to Harrison's Farmingdale central accounting offices on a weekly basis, such that the coded transactions recorded on the register tapes could be deciphered and consolidated for sales tax purposes. The register tapes were part of a National Cash Register ("NCR") system installed by Harrison. While the register tapes apparently did not specifically identify the individual items sold, the tapes were coded to indicate, among other things, sales, charges, payments on account and sales tax collected. The corporation's accounting personnel used these various codes to prepare register reports and register take-off spread sheets ("RTOs"). Sales tax reported by Harrison equalled sales tax collected per the RTOs, and gross sales reported also came from the RTOs. However, Harrison calculated and reported taxable sales by dividing the amounts of sales tax collected per store location, per the RTOs, by the particular jurisdictional tax rates in effect for each store location (a method known as capitalization).

The Corporation Audit

The audit steps undertaken and the results thereof with respect to the corporation are described as follows:

Underreported Sales (Sales Tax)

(a) The auditor reconciled the corporation's sales, per its general ledger, with sales per its Federal corporation income tax returns. Over a three-year period, sales as reflected in the general ledger exceeded sales as reported on the Federal returns by \$30,956.83, a difference of less than one-tenth of one percent. The auditor, however, was unable to reconcile sales per the general ledger with sales as reported for purposes of Articles 28 and 29. More specifically, sales as reflected in the general ledger exceeded sales reported per sales and use tax returns (as taken from the RTOs) by \$7,668,076.00. Of this total discrepancy, \$990,996.00 represented taxable sales. Several days of analysis undertaken by the auditor, by petitioner's controller, and by the two together, failed to reconcile this difference. (Over the period of time between the audit and the former State Tax Commission's decision, this difference was ultimately

reconciled, save for some \$25,264.00.) In addition, the amount of sales tax remitted with Harrison's returns was not in agreement with the amounts shown in the corporation's sales tax payable account. The source of the postings to the sales tax payable account was the RTOs and, as described above, sales per the general ledger exceeded sales per the RTOs. In the auditor's opinion, this differential tended to cast doubt on the accuracy of the RTOs. Based on these factors, the auditor concluded that additional sales tax should be assessed on the \$990,996.00 in underreported taxable sales.

Claimed Nontaxable Sales (Sales Tax)

(b) The corporation's claimed nontaxable sales fell into three categories: industrial sales, international sales and a portion of its retail sales. By random sampling techniques, the auditor verified the nontaxable nature of the industrial and international sales. With regard to retail sales he decided to conduct test period analyses, in consultation with the corporation's controller, under the following reasons as set forth in the audit report:

"Vendor had an inordinate number of retail sales, and since vendor's methods and policies in regard to handling retail sales remained consistent over the years, a reasonable test was selected which would be most expedient, accurate and representative."

The auditor explained to Harrison's controller that he could participate in the selection of the test periods; he did not specifically advise that Harrison could reject the employment of testing procedures and insist on an item-by-item audit. The auditor testified that he discussed and explained the type of tests to be performed with Harrison's controller, and explained to the controller that without testing the auditor would "have to look at every invoice [Harrison] had." He described the response to be ". . . they didn't want that", meaning Harrison didn't want the auditor to do the type of audit analysis which would require the retrieval of all of Harrison's records. The auditor testified to his belief that Harrison's controller fully understood the nature of the testing and agreed thereto. As noted above, all records for March 1, 1976 through August 31, 1976 were missing. Further, while the auditor did not attempt to ascertain the specific availability of register tapes, register reports and RTOs for the remainder of the audit period, he noted that the same did not provide identification of the individual items being sold.

At the time of the tests, the corporation operated four retail stores located in Farmingdale, Carle Place, Valley Stream and New York City. The auditor analyzed the sales of each of the stores for a two-day test period in June 1979 (Farmingdale, Carle Place and New York City, June 11 and June 13; and Valley Stream, June 12 and 13), selecting the dates in consideration of the ready availability of register tapes, invoices and register reports. The auditor transcribed nontaxable sales directly from the register tapes. He was unable, even with the assistance of the corporation's controller, to decipher some of the codes but concluded that this inability would not have a significant impact on the results of the tests. The corporation did not prepare sales invoices for sales totalling less than \$10.00, but instead gave its customers a portion of the cash register tape. According to the audit report, this practice rendered it impossible for the auditor to determine whether such sales were taxable or nontaxable. The reviewed tapes also displayed many claimed nontaxable sales ranging in amount from \$1.00 to \$3.00 for which Harrison was unable to provide additional documents or other evidence to substantiate such sales as nontaxable. Inasmuch as petitioner calculated and reported taxable retail sales by capitalizing the sales tax collected (see, Finding of Fact "7"), the auditor employed the same procedure. He capitalized sales tax collected to obtain taxable sales, then deducted taxable sales from gross sales to arrive at nontaxable sales. As a result of the described testing procedures, the auditor arrived at a disallowance percentage of 39.14 which he applied to claimed nontaxable retail sales. His arithmetical steps are shown below:

Retail sales per general ledger 9/1/76-5/31/80	\$17,855,900.00
Less: sales for resale	(565,000.00)
Less: amount previously assessed	(990,996.00)
Less: reported taxable sales	<u>(10,261,440.00)</u>
Nontaxable retail sales	\$ 6,038,464.00
Disallowance percentage	<u>.3914</u>
Disallowed nontaxable retail sales	\$ 2,363,454.80

Margin of Error

(c) The auditor calculated a .025473571 margin of error for underreported sales (difference in sales per general ledger versus sales per sales tax returns [\$990,996.00] divided by gross sales reported per sales tax returns [\$38,902,909.00]). He also calculated a .0825186 margin of error with respect to disallowed nontaxable sales (disallowed nontaxable retail sales [\$2,363,454.80] divided by reported nontaxable sales [\$28,641,469.00]). These margin of error calculations allowed assessment for the first two quarters for which no records were available. Application of such error rates resulted in underreported sales of \$1,073,089.78 and disallowed nontaxable sales of \$2,542,228.65 for the entire audit period. In sum, the auditor calculated \$76,120.85 in sales tax due on underreported sales and \$180,351.03 in sales tax due on disallowed nontaxable sales.

Expense Purchases (Use Tax)

(d) The auditor examined the corporation's expense purchases to determine which accounts might include items subject to tax, then tested these accounts for one-month periods to ascertain the percentages of purchases therein properly taxable. The result of such procedures is presented as follows:

<u>Account</u>	Percentage of Purchases Subject to Tax
Maintenance and repairs (72020)	9.00
Maintenance and repairs (73020)	15.86
Printed forms	32.28
Stationery	7.85
Dues and subscriptions	21.04
Catalog	100.00

Invoices for catalog purchases throughout the audit period were missing. With respect to the remainder of the above-mentioned purchases categories, invoices for the first two quarterly periods, March 1, 1976 through May 31, 1976 and June 1, 1976 through August 31, 1976, were missing; for the period September 1, 1976 through May 31, 1980, approximately five of one hundred invoices were missing. Prior to June 1, 1978, all expense purchases were contained in one account. According to the audit report, "Vendor did have a computer run on expenses;

however, it would have taken weeks to perform the tasks necessary to arrive at specific account amounts." The auditor therefore compared the expense accounts for 1979 to expenses reported on the corporation's Federal return for such year, ascertained the percentage of total expenses each account represented, and multiplied total expense deductions listed on the 1977 and 1978 Federal returns by the percentages so determined. The appropriate assessment rate for each account (shown in the table above) was applied, resulting in a use tax liability of \$15,201.80 for the period September 1, 1976 through May 31, 1980. For the two initial quarterly periods where records were missing, the auditor projected use tax liability via a margin of error. He determined the proportion which use tax due for the period September 1, 1976 through May 31, 1980 bore to gross sales for the same period, and multiplied gross sales for the quarters ended May 31, 1976 and August 31, 1976 by that percentage, calculating tax due of \$595.46 for such earlier periods. As a result, use tax on expenses for the entire audit period totalled \$15,797.26.

Fixed Assets (Use Tax)

(e) The corporation's fixed asset purchases fell within the following categories:

- Building improvements
- Furniture and fixtures
- Leasehold improvements
- Machinery and equipment
- Delivery equipment

Some invoices were available regarding the leasehold improvements and the furniture and fixtures accounts; with regard to the remaining accounts, invoices were unavailable. The auditor assessed the accounts in the amounts displayed below, by reason of tax being owed or missing documentation:

<u>Account</u>	Amount Subject to Tax
Furniture and fixtures	\$289,686.40
Leasehold improvements	337,300.61
Machinery and equipment	163,636.33
Delivery equipment	<u>31,249.58</u>
Amount subject to tax	\$821,872.92
Use tax due	\$ 57,531.04

Again, due to the unavailability of information respecting the first two quarters under audit, the auditor employed a projection to determine use tax upon fixed asset purchases, as follows:

Use tax 9/1/76-5/31/80: \$ 57,531.04
Gross sales 9/1/76-5/31/80: \$38,902,909.00 .00147883645

Gross sales 3/1/76-8/31/76: \$3,222,704.00 x .00147883645 = \$4,765.74 use tax
3/1/76-8/31/76

(f) The results of the audit examination are summarized below:

Sales tax on additional taxable sales and disallowed nontaxable sales	\$256,471.88
Use tax on expense purchases	15,797.26
Use tax on fixed assets	<u>62,296.78</u>
Total	\$334,565.92

Post Audit Reductions

Harrison challenged the audit results and a prehearing conference was held pursuant to the former State Tax Commission's Rules of Practice and Procedure (20 NYCRR former 601.4[b], [c]). By agreement of the parties, the auditor conducted a second test of claimed nontaxable retail sales, utilizing records of transactions in June 1978. The test revealed a disallowance percentage of 10.9, as contrasted with the percentage of 21.3 for 1979. Given the variance between the two percentages, the auditor and the corporation's controller considered, but decided not to conduct, further testing. The auditor applied the average of the two percentages, 16.23%, against claimed nontaxable sales for the audit period, with the result that this aspect of the assessment, sales tax upon disallowed nontaxable sales, was reduced from \$180,351.03 to \$84,209.64. At the conference, the corporation also presented a properly completed exemption certificate which further served to decrease the sales tax on disallowed nontaxable sales to \$76,757.57.

Certain additional adjustments were made to underreported taxable sales, based on a reconciliation of retail sales per Harrison's general ledger with sales reported on its sales and use tax returns. This portion of the assessment, sales tax on additional taxable sales, was

accordingly reduced to \$41,768.63. The use tax assessed on fixed asset purchases was also reduced from \$11,339.06 to \$8,676.17, reflecting elimination of the tax upon leasehold improvements. The corporation, by its authorized representative, agreed to the use tax on fixed asset purchases as so adjusted. Finally, use tax on catalog purchases was decreased from \$11,326.00 to \$1,732.98. The auditor had originally disallowed and assessed all such purchases, but at conference recalculated this portion of the assessment upon considering that a certain percentage of catalogs were shipped to locations outside New York. Such percentage was determined after the corporation was able to provide one purchase invoice together with a survey listing amateur radio operators throughout the United States according to the state in which they resided.

The corporation maintained at its hearing that certain sales which occurred within the test period should not have been subjected to sales tax and thus should not have entered into the computation of the disallowance percentage. These sales included, as is relevant herein, a June 13, 1979 sale of communication equipment to Ecuatoriana Airlines ("Ecuatoriana"). More specifically, on June 13, 1979, at the

corporation's Madison Avenue, New York City retail store, an air-to-ground communications system was sold to Ecuatoriana for use at its commercial facilities in Quito, Ecuador. The sales invoice, in the amount of \$454.15, listed the airline's address as Robles 840 y Amazonas, Quito. Delivery of the equipment and payment therefor took place at Ecuatoriana's terminal at John F. Kennedy International Airport in New York City. Petitioners continue to assert that this sale was an out-of-country sale improperly subjected to tax. Petitioners argue that the equipment was delivered at John F. Kennedy Airport to Ecuatoriana in its capacity as a common carrier, for transport of such equipment to Ecuador for use by Ecuatoriana in Ecuador. The former State Tax Commission rejected the corporation's claim on this sale in its January 28, 1986 decision.

ADDITIONAL FACTS

The initial audit period, March 1, 1976 through February 28, 1979, was first extended for two additional quarterly periods through August 31, 1979, and was thereafter again extended to include three additional quarterly periods through May 31, 1980. As described by the parties in testimony, there is no apparent dispute that the initial audit period spanned March 1, 1976 through February 28, 1979. However, there are no letters in evidence or other information in the log advising the corporate petitioner of the described audit updates or requesting records in connection therewith. Rather, the auditor testified that the updates were discussed and agreed to in telephone conversations and in direct conversations between himself and Harrison's controllers. The auditor indicated that the updates were necessary due to the delays requested by petitioner and to the resulting passage of time during which the audit was conducted. The updates were calculated by applying the audit test results (percentages) to the general ledger figures for the updated periods.

Petitioners herein, and the corporation at its hearing, challenged the validity of the assessment in general. Petitioners (and Harrison) claim the corporation's records to be adequate, and argue that the auditor's resort to testing was unwarranted. Petitioners (and Harrison) also challenge the alleged oral agreement to test period procedures as made by Harrison's controllers. In this latter regard, two consents (dated 3/26/79 and 3/17/80, respectively) extending the period of limitations on assessment were executed by Martin A. Hills, the corporation's controller. Petitioners herein assert that Mr. Hills was not a corporate officer, nor did he possess a power of attorney authorizing him to so act on behalf of the corporation. Petitioners assert on this basis that the controller acted beyond his scope of authority in orally agreeing to the use of test period auditing methods. Petitioner's also challenge the propriety of updating the audit for the additional quarterly periods as described (see, Finding of Fact "12"). Other than the sale to Ecuatoriana, petitioners raised no specific challenge to any individual sales or purchases analyzed on audit, or to the mathematical calculations made on audit or thereafter in the various reductions to the assessments.

Martin A. Hills signed the corporation's Federal corporation income tax return and New York franchise tax report for the fiscal year ended May 31, 1978 on February 26, 1979, stating his title as "vice president-controller." He also allegedly had check signing authority for a period of time (during 1980 or 1981).

In addition to challenging the propriety of the Division's use of indirect auditing methodologies, petitioners herein also challenge the assertion that they were persons responsible to collect and remit the taxes in question on behalf of the corporation pursuant to Tax Law §§ 1131(1) and 1133(a). Petitioners' evidence and argument with regard to this aspect of the case follows:

Petitioner James Waite's Testimony

Petitioner James Waite served in the Air Force until approximately 1955, after which he became employed by Sperry Gyroscope Company in the electronics marketing field. James Waite thereafter left Sperry and went to work for a franchise agency representing six or seven manufacturers selling specialized electronic components principally to military and industrial customers. In 1972, James Waite became the national sales manager with Diplomat Electric in Long Island. At the same time James Waite's brother, petitioner Michael Waite, terminated his employment with the Ford Motor Company and moved back to the East Coast, specifically to the Long Island area.

In June or July of 1976, petitioners James Waite and Michael Waite, together with a third person, one Albert Roth, purchased Harrison (see, Finding of Fact "3"). Albert Roth became Harrison's president and chairman of its board of directors, and remained in such positions with the company for the period July 1976 through approximately June 1978. Harrison's founder, William F. Harrison, also remained with the corporation for a period of time after petitioners and Mr. Roth acquired Harrison. At the time of the acquisition, Harrison operated two retail outlets, located in Farmingdale, New York and Valley Stream, New York, respectively. James Waite described Harrison as consisting of two separate divisions, to wit, a retail division engaged in the sale of televisions, stereos, hi-fis, antennae, and other consumer

electronic products, and a military industrial division engaged in the sale of specialized electronic components such as transistors, diodes, relays, switches, and capacitors. James Waite described his position and title to be "vice president of the military and industrial component sales and marketing division", explaining that he was principally involved in the area of international sales. He described Michael Waite's title as "vice president of administration and finance of the retail division".

James Waite testified that he exercised no authority in the hiring and firing of retail division employees, did not order retail merchandise inventory, and did not direct the payment of bills or sign checks with respect to the retail side of the corporation's business. He received a salary, but was not paid a bonus and did not receive any dividends. His salary was allegedly not dependent on the performance of the retail side of the business. During the period of time in question, the retail side of the business expanded rapidly such that it ultimately included five or six store outlets. James Waite had no specific

input in this expansion, and had no involvement in hiring sales personnel, in signing or reviewing store leases or locations, or in setting retail employees' salaries.

In or about 1978 William F. Harrison, the corporation's founder, ceased his involvement with the corporation and Albert Roth's ownership interest in the corporation was purchased by petitioners James Waite and Michael Waite. James Waite noted that, at the same time, his title changed from vice president to president of his division (president of component sales and marketing), and that petitioner Michael Waite became chairman of the board and chief executive officer, as well as vice president of administration and finance of Harrison. James Waite's responsibilities did not change at the time of the change in his formal title, he received no salary raise and he continued to exercise no specific involvement with the retail side of the business.

James Waite explained that he was not actively involved in the financial side of the business, but rather spent his time traveling throughout the United States and overseas with

respect to the operation of the military and industrial side of the business. In his last year of involvement with the company, military and industrial division sales exceeded retail sales by more than 50%.

James Waite testified that his salary was \$50,000.00 per annum, and that petitioner Michael Waite received a larger salary, unspecified in amount. He also testified that he left the corporation in March 1983, when he was "effectively forced out", and that he was not permitted back into the corporation's premises after his departure in March of 1983.

James Waite attended no meetings with the auditor at the time of the audit, was not involved in the conduct of the audit, and claimed that he was not notified of the liability assessed against him personally until approximately January 1987. In fact, both petitioners claim they were unaware of the assessments issued against them personally until approximately 1987.

James Waite admitted to signing Harrison's New York State Corporation Franchise Tax Report for the short period January 1, 1976 through May 31, 1976. Petitioner Michael Waite signed a related request for an extension of time to file such report. James Waite admitted to having, as an owner and officer, actual authority at least within the military and industrial division, to hire and fire personnel, sign payroll checks and sign sales tax returns. He testified that he never prepared any tax returns.

James Waite testified that from the outset it was understood he would run the military and industrial sales side of the business, in view of his knowledge, experience and reputation in such field. He explained that he had no specific knowledge or experience in retail (consumer) electronic products. James Waite did attend some board of directors meetings, and directed the payment of bills within the military and industrial division. He testified, however, that he was not "invited" to board of directors meetings unless the same were to involve discussion of "his side" of the business. Though authorized to sign checks for Harrison, James Waite signed checks only with respect to the military and industrial side of the business. He claimed that he did not know, during the relevant time period,

if sales tax returns would involve separate returns for each division or rather if all sales would be reported on one return, notwithstanding that military and industrial sales may not have been taxable.

James Waite described his education to include a high school diploma plus his experience in the Korean War when he was in the Navy. By contrast, petitioner Michael Waite is college educated and worked as a financial analyst for Ford Motor Company. James Waite testified that during his employment period at Harrison, he trusted his brother Michael Waite to take care of all financial matters and that he (James Waite) "would sign whatever his brother Michael Waite gave [him] and told [him] to sign". James Waite noted that he would give documents such as a notice of determination to his brother Michael Waite for advice. He testified that he considered himself to be an owner of Harrison with responsibility during the summer of 1976, when the business was purchased, but thereafter to have responsibility only with respect to the military and industrial side of the business.

When James Waite left the corporation, an agreement was executed whereby he was to receive \$50,000.00 in exchange for his shares of stock. Although the record is not fully clear on this point, it appears that he actually received \$1,000.00 in exchange for his 985 shares of stock, plus \$49,000.00 in repayment of loans he had made to the corporation. He testified that the company grew very rapidly during the initial two to three years after he was involved in its acquisition, specifically on the military and industrial side. He explained that he didn't pay much attention to the retail side of the business, mainly because he was travelling almost constantly. He noted that "his side" of the business was profitable. James Waite testified that his oldest son, Mark, also worked for him in the military and industrial side of the business, and that his son's employment was terminated by petitioner Michael Waite a few days before Michael Waite "made his move against [James Waite]".

James Waite described voluntarily meeting with the auditor and with additional Division personnel in early 1987 to describe assets available to satisfy the liability assessed against the corporation. He described as assets allegedly available in January 1987 certain military and

industrial components, including approximately three-quarters of a million dollars worth of connectors, \$100,000.00 worth of line boards, tooling machines to assemble connectors valued at \$65,000.00 to \$75,000.00, and an inventory of integrated circuits valued at \$150,000.00. In addition, James Waite noted that an IBM mainframe computer, plus terminals, were owned by the corporation, and that the corporation also held an assignable option to buy the real property on which its main office building was located (Smith Street, Route 110, Farmingdale, New York). He also advised the Division that Harrison continued to operate well into the 1980's, that other officers of the corporation received salaries during such time, and that the corporation allegedly had assets sufficient to pay the assessed tax liabilities at least until 1983. In this regard, James Waite argues that the Division's failure to proceed in collection efforts against Harrison with respect to those assets detailed should serve to preclude the Division from collecting on its assessed liability, if any, against him.

Petitioner Michael Waite's Deposition

Petitioner Michael Waite gave testimony by deposition due to serious health problems which left him unable to attend the February 26, 1992 hearing. His testimony confirmed much of the testimony given by James Waite regarding availability of assets which the Division allegedly could have collected against through the mid 1980's. He noted that the corporation's assets were sold to Harrison Electric Corp. in or about May 1984, along with its liabilities and debts. Michael Waite noted his last day-to-day activities with the corporation occurred in or about 1984 or 1985.

As to the corporation's records, Michael Waite claimed that register tapes and sales invoices were available for the entire audit period for all stores and for all sales. He maintained that under the National Cash Register system put in place at the corporation, the inventory of the corporation was controlled and accounted for to the extent that management knew about every piece of inventory and every item that was sold. He also testified that at the outset of the audit he introduced the auditor to two persons, one of whom was Martin Hills, variously called assistant controllers and/or accounts payable managers, telling these persons that they were to

give the auditor whatever records he requested and to be cooperative. He also expressed his opinion that the auditor went to a test period at the outset of the audit, and that while permission to use a test period may have been given by Harrison's controller, the same was never requested of or given by Michael Waite.

Michael Waite claimed, as noted previously, that he first became aware of the tax liability at issue in or about 1987, maintaining that to his knowledge he faced no assessment as of the time he ceased involvement with the corporation. He also noted his "understanding" that the audit period spanned March 1976 through "late 1978", contending he was not aware that the audit had been extended for any additional period of time (see, Finding of Fact "12"). Michael Waite signed the perfected petition in the corporate matter, dated October 4, 1984.

Michael Waite admitted that he was the chief financial officer of the corporation and explained that the company was divided into two segments as described hereinabove. He confirmed that his brother James Waite operated the military and industrial segment of the business, and that "two lower guys" operated the retail side of the business and were accountable in such operation to the board of directors (which board included petitioners Michael Waite and James Waite). He also confirmed that James Waite never exercised direct authority or control over the retail side of the business, and primarily spent his time in the military and industrial division. In this regard, Michael Waite noted that James Waite did discuss the retail side of the business with him, but that James Waite did not order inventory for the retail side of the business or decide which retail supplier bills to pay, did not execute store leases, etc. He explained that most company checks were in fact signed by an accounts payable clerk or clerks. Michael Waite testified to his belief that he signed a tax return or tax returns on behalf of the corporation. At the same time he testified that James Waite did in fact have authority to sign corporation checks, including payroll checks, and that James Waite signed such checks, at least with respect to the military/industrial side of the business. He could not recall if James Waite signed any tax returns for Harrison. He confirmed that James Waite was an officer of the corporation and a member of the board of directors, and that the board of

directors exercised the authority to make major decisions as to the overall operation of the company. Michael Waite testified that James Waite left the business at the time of and due to the fact that James Waite's son, Mark, was allegedly involved in a major theft of parts from the business.

CONCLUSIONS OF LAW

A. The former State Tax Commission issued its decision in Matter of Harrison Radio Corp on January 28, 1986. The Commission held that there were deficiencies in Harrison's record keeping which justified the Division's resort to indirect auditing, and that such deficiencies left the Division under no obligation to seek approval before turning to such method of auditing. In turn, the Commission upheld (with certain specific item modifications [see Finding of Fact "11", fn. "8"]) the audit and its results. Petitioners here challenge the correctness of such holding, as well as their alleged status as responsible officers. The Division, by contrast, claims petitioners are precluded from re-litigating the issue of the Division's resort to indirect auditing and are therefore limited to contesting only the issue of whether they are personally liable. Thus, the first issue is whether petitioners are collaterally estopped from challenging the former State Tax Commission's decision sustaining the Division's resort to indirect auditing and the results thereof (as modified).

B. Collateral estoppel is a doctrine which is a narrower form of res judicata. In essence, it precludes a party from relitigating, in a subsequent action or proceeding, an issue clearly raised in a prior action or proceeding and decided against that party or those in privity, whether or not the tribunals or causes of action are the same (Ryan v. New York Telephone Co., 62 NY2d 494, 478 NYS2d 823; see generally, Siegel, NY Prac § 443, at 673 [2d ed]).

In Capital Telephone Co. v. Pattersonville Telephone Co. (56 NY2d 11, 451 NYS2d 11), the Court of Appeals held that collateral estoppel (or its more modern name "issue preclusion") applies to administrative as well as judicial proceedings. This is true as long as the determination of the administrative agency was rendered pursuant to the adjudicatory authority of the agency to decide cases brought before its tribunal employing procedures substantially

similar to those used in a court of law (Staatsburg Water Co. v. Staatsburg Fire District, 72 NY2d 147, 531 NYS2d 876). In either type of proceeding, required for application of the doctrine are: (1) that the issue as to which preclusion is sought be identical with that in the prior proceeding; (2) that the issue was necessarily decided in the prior proceeding; and (3) that the litigant who will be held precluded in the present matter had a full and fair opportunity to litigate the issue in the prior proceeding (B. R. Dewitt, Inc. v. Hall, 19 NY2d 141, 278 NYS2d 596). The courts have also held that the burden of establishing that the issue was identical and that the issue was necessarily decided in the prior proceeding is on the proponent of preclusion. As to the question of full and fair opportunity to contest the issue, the burden is on the party who opposes preclusion.

It appears clear that the first two parts of the test, to wit, "identical issue" and "issue necessarily decided in the prior litigation", have been satisfied. In this regard, the question of adequate request for and review of records before resort to indirect auditing was presented and decided in the prior proceeding. However, as to the third part of the test, it is equally clear that the parties to the first proceeding, Harrison and the Division, are not the same parties as are at interest herein. In this case, it is the individual petitioners allegedly responsible as officers of Harrison who are challenging the Division's audit actions, and who will be precluded from doing so if collateral estoppel is applied. It could be argued that such parties (officers of a corporation) would be in the best position to know of and vigorously defend the corporate liability in the initial proceeding. However, such is not always the case due to any number of circumstances (e.g., officers who leave a corporation's employ prior to the litigation, potential problems in giving notice and/or scheduling consolidated hearings, etc.). In any event, it remains that neither of the petitioners herein were included as a party in the first action. Hence, it cannot be said that petitioners' interests were necessarily represented or that petitioners had the opportunity to fully and fairly litigate in the prior proceeding. Given these factors, it would be inappropriate to apply the doctrine of collateral estoppel to this matter and limit petitioners to challenging only their status as responsible officers. In reaching this conclusion it is noteworthy

that the Tribunal has held decisions of the former State Tax Commission are entitled to "respectful consideration", but are not "binding precedent" (Matter of the Racal Corporation, Tax Appeals Tribunal, May 13, 1993.)

C. Turning to the audit itself, petitioners have failed to provide such evidence in this proceeding as would compel a conclusion that the Division's resort to indirect auditing methods was unsupported, unauthorized or inappropriate. Review of the record in the prior proceeding, together with the evidence offered herein, does not lead to the result that either the auditor's request for and investigation of records was insufficient to determine the adequacy of Harrison's records, that such records were in fact complete, adequate and available or, of equal importance, that personnel designated to handle the audit on behalf of Harrison did not consent to the exact procedures employed by the auditor (see, Sloan's Supermarkets v. Chu, 140 AD2d 794, 527 NYS2d 889).

As to the issue of request for and review of records, the auditor's log makes reference to the issuance of an audit appointment letter to Harrison. The Division was, however, unable to produce a copy of such a letter, and petitioners offered no admission as to Harrison's receipt of such a letter (which in its standard form includes a request for records necessary to conduct a sales tax audit). However, the auditor's testimony describes in some detail his visits to the corporation's premises, his introduction to the persons specifically authorized to work on the corporation's behalf regarding the audit, and his discussions vis-a-vis records with such personnel. On this score, the auditor testified that he requested and reviewed the corporation's records (see Finding of Fact "6"), at least for the initial period of audit (3/1/76 through 2/28/79).

Perhaps the most persuasive support for the conclusion that the auditor requested and reviewed available records comes from the fact that the auditor was able to offer specific testimony detailing those records not available. More specifically, the auditor explained that there were no records available for the first two quarterly periods, that he was unable to

reconcile sales per the general ledger with sales reported per sales tax returns, and that Harrison's controller was similarly unable to reconcile the two, that the sales tax payable account was not in agreement with sales tax per returns, and that sales per the general ledger exceeded sales per the RTOs (such sales per RTO's were based on register reports based, in turn, on cash register tapes). Cash register tapes did not specify individual items sold (Matter of Licata v. Chu, 64 NY2d 873, 487 NYS2d 552), with identification of particular items sold therefore requiring review of invoices where such were created (i.e., only on sales in excess of \$10.00). There were no invoices created by Harrison for any sales less than \$10.00 in amount, there were many claimed nontaxable sales ranging between \$1.00 and \$3.00 for which no specific proof of nontaxability was available, and catalog purchase invoices were missing as were some fixed asset invoices. Finally, Harrison calculated and reported taxable sales by capitalizing the amount of sales tax collected, itself an estimation method of reporting.

The auditor testified that he requested specific records for the various areas of Harrison's business he was examining, and that apparently

due to the volume of records petitioner maintained it took an extended period of time to retrieve such records. He also testified that when he spoke to Harrison's controllers of reviewing all of Harrison's individual records for the period of audit, it was made clear to him by Harrison's controllers that they did not desire that type of examination and its attendant record retrieval (see Finding of Fact "8-b").

Against this background, viewed in full, petitioners' claim that Harrison had complete, adequate and available records is simply not borne out. While the lack of a written audit appointment/request for records letter gives reason for pause, it remains that there is at least reference to the issuance of such a letter and, more importantly, the auditor's testimony as to records requested and reviewed leaves inescapable the conclusion that he adequately requested and reviewed Harrison's records. On balance, therefore, the noted inadequacies in Harrison's records as described by the auditor on his review thereof, coupled with the questions

surrounding the ability to retrieve and present records in a reasonably timely fashion, leaves the auditor's resort to test and projection audit methodology acceptable.

Given the foregoing, it was not necessary for the auditor to secure Harrison's permission prior to resorting to test and projection auditing. In any event, however, it is apparent that the persons validly acting on Harrison's behalf did consent on behalf of Harrison to test period auditing. The auditor testified several times to discussing the tests as to period and scope with Harrison's controllers. Petitioners in this case claim to have had no active involvement in the audit, and the auditor testified the responsibility for the conduct thereof was specifically delegated to Harrison's controllers (first Martin Hills and thereafter Bill Macy), who agreed to the methods of audit employed. Petitioners now seek, however, to disavow agreements made by the persons to whom Harrison delegated the authority to be in charge of the conduct of the audit. In fact, Michael Waite testified that any question of granting permission for indirect auditing should have been brought to him. This position, seeking involvement in the course of an audit, is curious in juxtaposition to a claim under which petitioners would disavow personal responsibility for any taxes due as found on audit. Finally, on the issues of the auditor's requests for records, the adequacy and availability thereof, and consent to testing, petitioners could have produced either Martin Hills or Bill Macy to testify in rebuttal to the auditor's testimony. Petitioners did not do so, and they have not offered any claim or evidence that either of these individuals was unwilling to testify or was unavailable.

D. While the audit methodology was appropriate for the original audit period, the same cannot be said for the updated period (i.e., 3/1/79 through 5/31/80). In this regard, there is neither a written request to review records for the updated period, nor is there testimony from which it can be concluded that the auditor specifically requested or reviewed Harrison's records for such updated period to determine their adequacy prior to assessing such period based on application of the test period derived margins of error. While the evidence would support the conclusion that Harrison's controllers were made aware that the updated quarterly periods

would be subjected to assessment, per discussions with the auditor, it does not show that any request for records was made for such periods or that Harrison's controllers consented to assessment based on projection (see, Matter of Top Shelf Deli, Tax Appeals Tribunal, February 6, 1992). In fact, the evidence is that the auditor simply extended the audit period, based on the passage of time over which the audit took place, via use of the test derived percentages. Accordingly, tax assessed for the last five quarterly periods at issue herein is cancelled (Matter of Adamides v. Chu, 134 AD2d 776, 521 NYS2d 826, lv denied 71 NY2d 806, 530 NYS2d 109; Matter of Anton's Car Care Center, Ltd., Tax Appeals Tribunal, November 23, 1988).

Finally, petitioners argue that the assessments should be cancelled because they were not notified, in writing on the face of the notices issued to them, that the audit results were based on estimation auditing methodologies. This argument is rejected. On this score, it is sufficient to note that petitioners have neither alleged nor proven that they were misled or suffered any prejudice, or did not enjoy any privilege which a notice specifically providing that the assessments were derivative of estimated assessments would have accorded them (Matter of Negat, Inc., Tax Appeals Tribunal, April 9, 1992).

E. Having concluded that the evidence is insufficient to overcome the Division's resort to test period auditing techniques would normally lead to a discussion as to the reasonableness and accuracy of the results of the auditing techniques employed. However, in this case, the results have been refined over a long period of time, and in fact petitioners raise no specific arguments with respect to the type of testing conducted or the results of the audit as applied, save for challenging the Equatoriana Airlines sale. While petitioners continue to claim this sale to have been improperly subjected to tax it remains that the purchaser, Equatoriana, took delivery of the equipment in question in New York and thus the transaction was properly held subject to sales tax (20 NYCRR 525.2[a][3]; Matter of David Hazan, Inc. v. Tax Appeals Tribunal, 152 AD2d 765, 543 NYS2d 545, affd 75 NY2d 989, 557 NYS2d 306).

F. As to the issue of petitioners' responsibility for the taxes in question, Tax Law §

1131(1) defines "persons required to collect tax" to include:

"any officer, director or employee of a corporation or of a dissolved corporation, any employee of a partnership or any employee of an individual proprietorship who as such officer, director or employee is under a duty to act for such corporation, partnership or individual proprietorship in complying with any requirement of [Article 28]"

Tax Law § 1133(a), in turn, imposes liability as follows:

"every person required to collect any tax imposed by [Article 28] shall be personally liable for the tax imposed, collected or required to be collected under [Article 28]."

G. Matter of Autex (Tax Appeals Tribunal, November 23, 1988) summarizes the factors which are considered relevant in determining whether an individual is responsible for the sales and use taxes due from a corporation, as follows:

"The determination that an individual is a responsible officer depends on the particular facts of each case (Stacy v. State, 82 Misc 2d 181, 183). Factors stated by the Division's regulations are whether the person was authorized to sign the corporate tax return, was responsible for managing or maintaining the corporate books or was permitted to generally manage the corporation (20 NYCRR 526.11[b][2]).

"Other indicia developed by the case law are: the authorization to hire or fire employees, derivation of substantial income from the corporation or stock ownership (citation omitted); the individual possible shared status as an officer, director or stockholder (citation omitted); the individual's day-to-day responsibilities, involvement with, knowledge of and control over the financial affairs and management of the corporation, the duties and functions as outlined in the certificate of incorporation and the bylaws, the preparation and filing of sales tax forms and returns (citation omitted); and the payment, including the authorization to write checks on behalf of the corporation, of other creditors other than the State of New York and the United States (citation omitted)" (Matter of Autex, supra).

As a general proposition, the issue to be resolved is whether petitioners had or could have had the ability, in fact as well as in law, to control the affairs of the corporation so as to be considered persons under a duty to collect and remit the unpaid taxes in question (Matter of Constantino, Tax Appeal Tribunal, September 27, 1990; Matter of Chin, Tax Appeals Tribunal, December 20, 1990).

H. In this case, petitioner Michael Waite has advanced no evidence and little argument which would tend to absolve him of responsibility for the taxes in question. The only apparent argument on his behalf is that the retail side of the business was operated by "two lower guys"

and that he operated the "personality side of the business". However, Michael Waite was a stockholder in the corporation, was in charge of its financial affairs, was a member of the board of directors, possessed all apparent and actual authority to oversee and engage in the operation of the corporation's business and was fully involved in the operation of the business.

Accordingly, petitioner Michael Waite was properly held to be a person responsible to collect and remit sales and use taxes on behalf of Harrison.

With respect to petitioner James Waite, the main claim is that he was involved only in the military and industrial side of the business, the sales of which were not subject to tax, and that given his full involvement with the requirements of operating this side of the business, including extensive travel, he should be absolved of his responsibility to insure that the taxes in question were collected and remitted. However, there is no evidence or argument that petitioner James Waite did not have actual authority or was in any way precluded from exercising such authority during the period at issue in carrying out the responsibility to assure that the taxes in question were in fact remitted. Such being the case, the Division properly concluded that petitioner James Waite was a person responsible to collect and remit the taxes in question (Matter of Pais, Tax Appeals Tribunal, July 18, 1991).

I. Finally, petitioners' claim that the Division's failure to collect against the corporation should serve to estop the Division from collecting against petitioners is rejected. The allegation that Harrison had available assets does not serve to establish that assets were in fact available, nor does the Division's alleged failure to proceed aggressively in collection efforts against Harrison establish or constitute "exceptional facts or circumstance" requiring application of estoppel, a remedy generally not available against governmental entities, particularly in questions of tax collection (see, Matter of Harry's Exxon Service Station, Tax Appeals Tribunal, December 6, 1988; see also, Manhattan Cable Television v. New York State Tax Commn., 137 AD2d 925, 524 NYS2d 889, lv denied 72 NY2d 808, 534 NYS2d 666).

J. The petitions of James Waite and Michael Waite are hereby granted to the extent indicated in Conclusion of Law "D"; the notices of determination dated May 27, 1981, as

reduced to the amounts of tax shown due per the notices of assessment review dated May 12, 1986, are to be further reduced in accordance herewith; and the petitions are otherwise denied.

DATED: Troy, New York
November 24, 1993

/s/ Dennis M. Galliher
ADMINISTRATIVE LAW JUDGE