STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
ED LIBONATI PRODUCTIONS, 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 March 1, 1983 through February 28, 1989.	:	

Petitioner, Ed Libonati Productions, Inc., 353 West 46th Street, New York, New York 10036, 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, 1983 through February 28, 1989 (File No. 807577).

A hearing was held before Dennis M. Galliher, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on February 27, 1991 at 10:15 A.M., with all briefs to be submitted by June 15, 1991. Petitioner appeared by Mendlowitz and Weitsen, CPA's (Edward Mendlowitz, CPA, and Peter Weitsen, CPA). The Division of Taxation appeared by William F. Collins, Esq. (Robert J. Jarvis, Esq., of counsel).

ISSUE

Whether petitioner has established any basis warranting reduction or abatement of penalties imposed.

FINDINGS OF FACT

On August 18, 1989, the Division of Taxation issued to petitioner, Ed Libonati Productions, Inc., two notices of determination and demands for payment of sales and use taxes due for the aggregate period March 1, 1983 through February 28, 1989. The first of these notices assessed tax due inthe amount of $28,014.79 for the period March 1, 1983 through

August 31, 1986, plus penalty and interest, while the second notice assessed tax due in the amount of $10,866.48 for the period September 1, 1986 through February 28, 1989, plus penalty and interest. On the same August 18, 1989 date, the Division of Taxation also issued to petitioner two additional notices of determination and demands for payment of sales and use taxes due, each assessing omnibus penalty only. The first of such notices assessed omnibus penalty in the amount of $2,086.30 for the period June 1, 1985 through November 30, 1988, while the second notice assessed omnibus penalty in the amount of $28.30 for the period December 1, 1988 through February 28, 1989.[1]

The notices described above were issued as the result of a field audit of petitioner's business operation, which audit commenced on or about January 10, 1986. During the audit period, petitioner was engaged in the business of preparing television commercials for various advertisers.

The audit itself resulted in the imposition of additional tax in three different areas, to wit, sales, fixed asset acquisitions and purchases, as follows:

(a) With respect to taxable sales, the auditor determined that incorrect sales tax jurisdictional rates were applied by petitioner to certain items shipped by petitioner. An error rate of .0026 was calculated, resulting ultimately in additional tax due of $2,128.94;

(b) Petitioner acquired fixed assets in the amount of $16,708.66 in connection with which payment of tax in the amount of $1,378.50 was not substantiated; and

(c) With respect to production expenses, taxable purchases were made by petitioner without payment of tax. Application of an error rate of .11862 on production expenses subject to tax at a tax rate of 4% resulted in expenses of $825,632.00, with unpaid tax due thereon in the amount of $33,025.28. In addition, an error rate of .00409 was applied to those production

---

[1]Validated consents with respect to the period of limitations on assessment had been executed by petitioner such that assessment for the period March 1, 1983 through August 31, 1986 could be made at any time on or before December 20, 1989.

costs assessable at the tax rate of 8.25% resulting in expenses of $28,467.67, with unpaid tax due thereon in the amount of $2,348.58.

The audit results described above were derived via use of test period auditing methodologies to which petitioner agreed. Petitioner specifically conceded that no argument was raised as to the audit method employed or the resulting amount of tax determined to be due. Rather, petitioner contests only the imposition of penalty.

At hearing, petitioner's representative provided schedules further specifying and analyzing the breakdown of items comprising the margins of error found by the auditor. Petitioner's representative noted that approximately 65% of the production cost items whereon no sales tax was paid represented recurring items principally involving the rental of equipment, props and studio time. Petitioner's representative added the dollar amount of items in the auditor's test period assessed at 4% ($112,517.98; a relative error rate of .11862), plus the items assessed at 8.25% ($3,878.16; a relative error rate of .00409), to arrive at $116,396.14 of total non-tax paid production costs assessed during the test period. Petitioner would subtract from such amount $75,686.98, representing rental amounts for equipment, props and studio time (65% of the total non-tax paid production costs) leaving $40,709.16 of production costs out of compliance (i.e., on which tax was not charged or paid), or an error rate of 4.29% (as opposed to the nearly 12% total error rate determined upon audit). Petitioner goes on to note that the $40,709.16 balance consists principally of the cost of production assistants hired on a per diem basis (hairdressers, stylists, make-up persons and scene set-up persons), as well as items such as breakfasts purchased for per diem assistants, prop purchases and flower rentals. Petitioner's representative does not contest the taxability of such items, but rather alleges that because of the nature of the items petitioner was confused as to whether tax was due on all such items. In sum, petitioner's representative argues that the main areas of noncompliance resulted from vendors who did not charge sales tax to petitioner (principally on rented items), arguing further that the onus for tax compliance should be first on the vendor as opposed to the user.

Petitioner's representative alleged, and the auditor agreed, that petitioner maintained

"reasonably good records". Petitioner's representative maintained that petitioner made efforts to comply with the law and accurately pay all sales tax due, noting that the error rates determined upon audit and the amount of tax assessed ($38,881.30) are comparatively low in light of the $11,051,863.00 total gross sales volume for the audit period. While admitting that no tax was self-assessed by petitioner on any of the items in question, it was also noted that where tax was charged to petitioner by the various vendors, petitioner paid such tax. Finally, petitioner points out that some 91 different vendors were included in the test period, thus allegedly indicating a great deal of confusion as to the proper tax treatment of the items in question.

Petitioner's total gross sales volume for the audit period was $11,051,863.00. As the result of audit, additional taxable sales in the amount of $899,543.14 were determined (the amount "out of compliance"). Petitioner reported and paid tax for the audit period in the amount of $17,380.00. Tax assessed as the result of the subject audit was $38,881.30.

CONCLUSIONS OF LAW

A. Tax Law § 1145(a)(1)(i) provides, in pertinent part, as follows:

> "Any person failing to file a return or to pay or pay over any tax to the tax commission within the time required by or pursuant to this article (determined with regard to any extension of time for filing or payment) shall be subject to a penalty of ten percent of the amount of tax due if such failure is for not more than one month with an additional one percent for each additional month or fraction thereof during which such failure continues...."

Additionally, Tax Law § 1145(a)(1)(vi) states, in part, as follows:

> "Any person required by this article to file a return, who omits from the total amount of state and local sales and compensating use taxes required to be shown on a return an amount which is in excess of twenty-five percent of the amount of such taxes required to be shown on the return shall be subject to a penalty equal to ten percent of the amount of such omission."

B. Tax Law § 1145(a)(1)(iii), pertaining to the penalty asserted pursuant to Tax Law § 1145(a)(1)(i) states, in part, as follows:

> "If the tax commission determines that such failure or delay was due to reasonable cause and not due to willful neglect, it shall remit all of such penalty and that portion of such interest that exceeds the interest that would be payable if such interest were computed at the rate set by the tax commission pursuant to section eleven hundred forty-two."

Tax Law § 1145(a)(1)(vi) similarly allows, upon a finding of reasonable cause and lack of

willful neglect, the remission of all or part of the penalty imposed under such section.

C. Regulations of the Commissioner of Taxation and Finance, found at 20 NYCRR 536.5(c) elaborate on what constitutes reasonable cause. Reasonable cause has been found where the taxpayer has clearly established death, destruction of business, inability to obtain information, or pending proceedings with the Division of Taxation (see 20 NYCRR 536.5[c][1] - [4]). This section also contains the following "catch-all" provision:

> "Any other cause for delinquency which would appear to a person of ordinary prudence and intelligence as a reasonable cause for delay and which clearly indicates an absence of willful neglect may be determined to be reasonable cause. Ignorance of the law, however, will not be considered as a basis for reasonable cause" (20 NYCRR 536.5[c][5]).

20 NYCRR 536.5(d)(1) provides, in relevant part, that:

> "reasonable cause, good faith and the absence of willful neglect shall be considered as a basis for cancellation or waiver of all of the assessed or assessable penalty imposed pursuant to section 1145(a)(1)(vi) of the Tax Law only after the understatement or omission of tax has been reduced in accordance with the provisions of such section by that portion of the tax attributable to any item for which there is or was substantial authority for the tax treatment thereof or for which the relevant facts affecting the tax treatment were adequately disclosed with the original return."

This portion of the regulation goes on to state as follows:

> "(2) In determining whether reasonable cause and good faith exist, the most important factor to be considered is the extent of the taxpayer's efforts to ascertain the proper tax liability. In addition to any relevant grounds for reasonable cause as exemplified in subdivision (c) of this section, circumstances that indicate reasonable cause and good faith with respect to the substantial understatement or omission of tax, where clearly established by or on behalf of the taxpayer, may include the following:
>
> (i) an honest misunderstanding of fact or law that is reasonable in light of the experience, knowledge and education of the taxpayer...."

D. After considering petitioner's arguments, it remains that reasonable cause and an absence of willful neglect such as would permit the remittance of the penalties imposed herein has not been clearly established. The main argument advanced is that petitioner was unaware of the taxability of certain materials or services purchased in conducting its business. Petitioner notes, in this vein, that the vendors thereof, rather than petitioner, in failing to charge tax should bear the onus of assuring that proper tax is paid. Whether or not this latter statement is

accurate, ignorance of the law does not constitute reasonable cause (20 NYCRR 536.5[c][5]). In this regard, the language of 20 NYCRR 536.5(d)(2)(i) as to an honest misunderstanding of fact or law must be contrasted with the equally plausible situation that "where no tax was charged, petitioner simply paid none". Petitioner has advanced no evidence as to the knowledge, education or experience of any of its principals vis-a-vis tax obligations. While there was an allegation that petitioner was confused as to the taxability of certain items and that such items represented a large percentage of the items which were "out of compliance", there was no further specification as to the nature of the confusion as to taxability.

Petitioner also argues that its maintenance of relatively good records and its efforts to comply, coupled with the relatively low error rates determined upon audit should militate against imposing penalty. However, petitioner's argument of relatively low error rates is premised upon petitioner's breakdown of the items on audit such that by elimination of certain recurring items, as described, the nearly 12% audit error rate on purchases was reduced to approximately a 4% error rate. However, the fact remains that all of such items were not properly reported as taxable. Finally, petitioner would argue that a comparison of the amount of the assessment herein ($38,881.30) to petitioner's gross sales for the audit period ($11,051,863.00) makes clear that the amount of underreporting was essentially diminimis. However, a more meaningful and telling comparison results when sales are compared to sales, i.e., additional taxable sales determined upon audit ($899,543.14) are compared to petitioner's gross sales of $11,051,863.00. Further, rather than compare the amount of the assessment to the amount of gross sales, a more meaningful comparison is derived from comparing the amount of the assessment ($38,881.30) to the amount of sales tax reported and paid ($17,380.00). In both instances, it cannot be said that either the amount of sales/purchases treated as nontaxable or the underreporting of tax due was diminimis in nature. In sum, petitioner has failed to establish a clear basis warranting reduction or abatement of penalties imposed, and the same, therefore, are sustained.

E. The petition of Ed Libonati Productions, Inc. is hereby denied and the notices of

determination and demands for payment of sales and use taxes due dated August 18, 1989 are sustained.

DATED: Troy, New York

7/11/91

ADMINISTRATIVE LAW JUDGE