

STATE OF NEW YORK
DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
P-H FINE ARTS, LIMITED	:	ORDER
for Revision of a Determination or for Refund	:	DTA NO. 807866
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Period September 1, 1984	:	
through August 31, 1987.	:	

Petitioner P-H Fine Arts, Limited, c/o General Media International, 1965 Broadway, New York, New York 10023, brought a motion, dated January 8, 1993, to vacate a determination issued on August 27, 1992 and to reopen the administrative hearing to present additional evidence. Petitioners appeared on the motion by Lefrak, Newman & Myerson (Louis Wollin, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Robert J. Jarvis, Esq., of counsel). Based on petitioners' motion papers, a brief and reply brief filed by petitioner on January 11, 1993 and March 9, 1993, respectively, a letter submitted by Mr. Jarvis in lieu of a formal brief, and upon the entire record of the administrative hearing, Jean Corigliano, Administrative Law Judge, renders the following order.

FINDINGS OF FACT

On December 20, 1988, the Division of Taxation (the "Division") issued to petitioner P-H Fine Arts, Ltd. ("Fine Arts") two notices of determination and demands for payment of sales and use taxes due. Petitioner made a timely request for a conciliation conference to challenge those notices. As a result of a conference held on September 18, 1989, the statutory notices were sustained. Petitioner then made a timely application for a hearing in the Division of Tax Appeals. Following an administrative hearing and the submission of a brief by Fine Arts, a determination was issued, denying the petition and sustaining the notices of determination.

Petitioner now seeks to vacate the determination and reopen the record for additional evidence and a new determination on the ground that the Division "failed to ever notify

Petitioners of the ground ultimately relied upon to sustain the Commissioner's determination of a tax deficiency. Accordingly, Petitioners' fundamental right to reasonable notice of the basis of the tax deficiency and an opportunity to adequately prepare and present a defense has been denied." (Affirmation of Louis Wollin, ¶ 2.)

The facts of the case can be summarized briefly. Fine Arts was incorporated for the purpose of buying and selling fine art. Its president, Robert Guccione, is a well-known public figure, the publisher of Penthouse magazine and president of Penhouse International, Ltd. ("Penthouse"). A sales tax audit disclosed that for the period September 1, 1984 through August 31, 1987 Fine Arts, a registered sales tax vendor, made purchases of artwork in the amount of \$3,671,441.46. Fine Arts filed sales tax returns, but it reported no sales for the audit period. During the course of the audit, the Division's auditors visited a Manhattan townhouse where artwork purchased during the audit period was displayed. The lower floors of the townhouse were used by Guccione as his personal corporate offices and the upper floors served as his residence. Based on the observations of the auditors, the Division made a determination that the purchases of fine art were not made for resale within the meaning of Tax Law § 1101(b)(4)(i) and, therefore, that the purchases were subject to either sales tax (Tax Law §1105[a]) or compensating use tax [Tax Law § 1110). The facts relied on by the Division to support its determination that the purchases were not for resale were detailed in the Field Audit Report. The report ends with this statement: "all purchases of art were taxed as assets subject to use tax." The auditor's handwritten log contains this statement:

"The paintings were all over the house including the bathroom. The paintings had no description or prices attached. My conclusion based on the observation is that the paintings were bought for personal use."

At hearing, Fine Arts presented evidence that it was in the business of buying and selling artwork; that artwork purchased by Fine Arts was displayed on the first two floors of the townhouse which were used as offices by Penthouse and Mr. Guccione; and that, as part of Fine Arts's marketing strategy, the public was falsely led to believe that the artwork was part of Mr. Guccione's private collection and was not for sale. Based on these facts and the personal

observations of the auditors, the administrative law judge found that, although Fine Arts purchased artwork for resale, until the artwork was sold it was put to use by Guccione and Penthouse to furnish and decorate the first two floors of the townhouse. Citing to Matter of Micheli Contracting Corp. v. New York State Tax Commn. (109 AD2d 957, 486 NYS2d 448) and 20 NYCRR 531.3(a)(2), the administrative law judge held that in order to qualify for the resale exclusion tangible personal property must be purchased exclusively for resale and not be diverted to a taxable use by the purchaser; the interim use of the artwork by Guccione and Penthouse to decorate the townhouse was found to be a taxable use.

Neither the Division nor Fine Arts attempted to correlate individual items purchased during the audit period with the paintings hung on the first two floors of the townhouse. The record establishes that some of the more notable pieces acquired by Fine Arts, including paintings by Matisse, Chagall and Picasso, were displayed in the public areas, but many smaller or less important works were never accounted for. The evidence did establish that a fully furnished room on the second floor was used to store a number of small paintings and drawings. Those articles were stacked against a wall and laid on sofas and chairs. It is possible that some of the artwork purchased by Fine Arts during the audit period was stored in this second floor room or elsewhere. Without any facts to distinguish those paintings which were on display from those which were not, the determination treated all purchases made during the audit period as subject to sales or compensating use tax.

In arriving at a determination, the administrative law judge acknowledged that the legal grounds which formed the basis for her determination had not been addressed or cited by either of the parties. Citing primarily to Matter of Chamberlin (Tax Appeals Tribunal, January 30, 1992), the administrative law judge found nonetheless that it was appropriate for her to apply the relevant statutes and regulations to the facts adduced at hearing.

In support of its motion to vacate and reopen the record, Fine Arts submitted the affidavit of Robert Guccione. As pertinent here, the affidavit states:

"Based upon the audit report and the presentation of the Audit Division at the hearing, the issues for trial concerned whether Fine Arts was engaged in a business

and whether it acquired artwork for resale. Apparently, after the hearing, and submission of briefs by Petitioners only, Judge Corigliano considered an issue never raised at the hearing; namely, whether the artwork displayed was acquired for some additional purpose besides resale or was diverted to a taxable use."

The record shows that the legal grounds relied on in the determination were not directly addressed by either of the parties in the administrative proceeding.

(a) In its request for a conciliation conference, Fine Arts set forth its understanding of the grounds for the Division's determination of tax due.

"In the course of their audit, examiners viewed the taxpayer's business premises, the artwork inventoried there and reviewed its business records. Upon conclusion, the auditors arbitrarily concluded and orally advised the taxpayer's representatives that Fine Arts is 'not engaged in a trade or business'. This conclusion was based upon the following erroneous 'facts':

"1. All of the artwork is held in the 'residence' of the taxpayer's primary shareholder and no separate gallery is maintained for the artwork.

"2. 'No' sales, either wholesale or retail, were made by taxpayer during the period under audit.

"We respectfully submit that the auditor's findings misrepresent both the facts and the applicable law."

In its petition, Fine Arts cited to Tax Law § 1101(b)(4)(i) and 20 NYCRR 526.6(c)(1) which states:

"Where a person, in the course of his business operations, purchases tangible personal property or services which he intends to sell, either in the form in which purchased, or as a component part of other property or services, the property or services which he has purchased will be considered as purchased for resale and therefore not subject to tax until he has transferred the property to his customer."

In its answer to the petition, the Division stated: "that the auditor's review of petitioner's business operations showed that petitioner's purchases of fine artwork were made for investment purposes, rather than for resale. Hence, petitioner's purchases were deemed to be acquisitions of business assets" (Division's answer, ¶ 6). The answer does not refer to personal use of the paintings by Guccione or Penthouse.

In his opening statement, the Division's attorney stated, as relevant to petitioner: "I think the only issues involved really for P-H Fine Arts is whether the purchases were made for resale" (Tr., pp. 12-13). The Division's attorney did not state the Division's reasons for finding that the

purchases were not for resale. In his closing statement, the Division's attorney summarized the Division's position as follows:

"[W]e're asked to believe that the corporation was in the normal business of selling things such that they should be entitled to a resale exemption from sales tax on their purchases. You know, that argument can be made for almost anything. I could take my watch and say to the person who I'm buying it from, 'I'm going to resell this watch at some point in time, maybe after 20 years. It'll be an antique and it's going to be worth more than. Therefore, I don't have to pay sales tax.'

"That's the argument here, whether Mr. Guccione bought these artworks as investment or for himself or corporation, possibly personal pleasure, whatever the reason, they certainly don't fit the mold of a normal purchase for resale. They're certainly classified at the very best, in the best light, as investments rather than purchasing for resale and possibly simply purchases for personal use.

"Certainly the artworks were displayed in his personal area of residence. He treated them as personal artworks when he showed them to his cocktail party guests and that sort of thing. I submit that the resale exclusion here certainly is not met by the facts and circumstances which have been presented and, therefore, the entitled-to-sales-tax exemption should be disallowed" (Tr., pp. 283 - 285).

The record of the administrative hearing establishes that personal use of the paintings by Guccione and/or Penthouse was a relevant and material issue, litigated by the parties. In an opening statement, Fine Arts's representative stated:

"As we understand it, this determination [of tax due] is based upon the auditor's conclusion drawn from a brief viewing of the premises where the artwork is displayed, that P-H Fine Arts, Limited acquired the artwork for the personal use of Robert C. Guccione and not for resale as submitted by the taxpayer, P-H Fine Arts. At this hearing, we intend to show that the auditor's conclusion is incorrect because P-H Fine Arts, Limited conducts its business in the manner well suited to dealing with fine art and did offer and does intend to offer its artwork for resale." (Tr., p.90).

In the cross-examination of the auditor by Fine Arts's representative, Thomas Holman, the following exchange occurred.

Mr. Holman: "Now, in your audit report, is it correct that you concluded that it was your observation of the premises that led you to conclude that the P-H Fine Arts paintings were bought for personal use, wasn't that your conclusion?"

Mr. Toorie: "Yes."

Petitioner seeks to reopen the record to introduce evidence that not all of the artwork purchased by Fine Arts during the audit period was placed on display in the townhouse. In addition, Fine Arts seeks to introduce evidence to establish that the artwork was displayed solely for the purpose of attracting potential buyers and no ancillary benefit accrued to Guccione

or Penthouse by having the artwork displayed in the townhouse.

CONCLUSIONS OF LAW

A. The primary ground for Fine Arts's motion to reopen is its contention that the administrative procedure deprived Fine Arts of due process of law. Petitioner argues that the controversy between itself and the Division was finally determined by the administrative law judge on a legal theory not expounded by the Division, and, as a consequence, that it was denied the opportunity to address the legal and factual issues raised in the determination. More importantly, Fine Arts contends that the record is incomplete because Fine Arts could not have anticipated the factors which would be considered material in arriving at a determination and for this reason failed to introduce relevant and material evidence.

In establishing the Division of Tax Appeals, the legislature set forth the following statement:

"This article is enacted to establish an independent division of tax appeals within the department of taxation and finance which shall be responsible for providing the public with a just system of resolving controversies with such department of taxation and finance and to ensure that the elements of due process are present with regard to such resolution of controversies. (Tax Law § 2000; emphasis added.)

An elementary and fundamental requirement of due process in any administrative proceeding is notice sufficient to allow a party to adequately prepare and present a defense to charges that will be the subject of a hearing (Matter of Diamond Terminal Corp. v. Dept. of Taxation and Fin., 158 AD2d 38, 557 NYS2d 962, lv denied 76 NY2d 711, 563 NYS2d 767). As the Division points out, petitioner has the burden of proof to overcome an assessment of tax (see, e.g., Matter of A & J Gifts v. Chu, 145 AD2d 877, 536 NYS2d 209, lv denied 74 NY2d 603, 542 NYS2d 518). Fairness demands that the taxpayer be informed of the Division's reasons for assessing tax in order to enable him to meet this burden of proof (see, Matter of Shoprite, Tax Appeals Tribunal, February 22, 1991; Matter of Basileo, Tax Appeals Tribunal, May 9, 1991).

The Division argues, first, that the record demonstrates that Fine Arts knew exactly what the issues were at the time of the proceeding and that its claim of surprise is disingenuous. In

the alternative, the Division's representative contends that the Division had no duty to inform petitioner of the law, regulations or legal theory which might form the basis for holding the purchases subject to sales or use taxes since petitioner has the burden of proving entitlement to any exemption from tax. He states as follows:

"Here, Fine Arts is undisputedly seeking an exemption from tax. It is well established in New York's Tax Law that one seeking a tax exemption must show entitlement to that exemption. It is equally well settled that, at administrative hearings before the Division of Tax Appeals, the taxpayer has the burden of proving, by clear and convincing evidence produced at hearing, all of the facts required to support the taxpayer's position. Accordingly, even if petitioner and/or its representatives did not at the time of its purchases, investigate the conditions required for these purchases to be nontaxable purchases for resale, such an investigation should have been undertaken at the latest, when preparing for this hearing. Undeniably, New York's law requires that a purchase be made exclusively for resale in order to be qualified as a nontaxable wholesale purchase. Consequently, petitioner should have recognized that, to meet its burden of proof at hearing, it must show that there were no personal use or investment aspects to the purchased artwork, and that its purchases were all for the exclusive purpose of being resold to others. It can therefore be seen that this taxpayer cannot claim to be excusably surprised by the issues involved in determining whether its purchases qualified for the resale exemption (Letter of Robert Jarvis, pp. 4 - 5, emphasis in original).

In a footnote to this paragraph, Mr. Jarvis states: "it must be noted that there is no requirement, statutory or otherwise, for the Division of Taxation to advise a taxpayer of what must be shown at hearing in order for the taxpayer to prove its case."

It cannot seriously be contended that placing the burden of proof on the taxpayer (see, e.g., Matter of A & J Gift Shops v. Chu, supra) relieves the Division of any obligation to inform the taxpayer of the basis for its claim of tax due. Fairness requires that the Division provide the taxpayer with some explanation of the assessment (see, Matter of Diamond Terminal v. Dept. of Taxation and Fin., supra). The question then is not whether the Division has a duty to inform the taxpayer of the basis of its assessment, but whether, in this case, the Division provided enough information to allow petitioner to meet its burden of proof.

To determine whether petitioner had adequate notice of the basis for the tax assessment, it is necessary to review the issues that were raised and addressed by the parties in the course of the administrative proceeding.

The Division commenced an administrative proceeding for collection of sales and use tax

by issuance of a notice of determination (Tax Law § 1138[a][1]). Other than noting that the determination was based on an audit of the taxpayer's records, the notice of determination does not indicate the basis for the Division's determination of tax due. It was sufficient to apprise Fine Arts that the Division determined sales and use tax due in a definite amount for the assessment period. While that may be all that is required from the statutory notice, (see, Matter of Pepsico, Inc. v. Bouchard, 102 AD2d 1000, 477 NYS2d 892), it is apparent that the notices of determination issued did not apprise Fine Arts of the basis for the Division's claim of tax due.

In its request for a conciliation conference, Fine Arts stated the grounds which it believed formed the basis for the Division's determination of tax due, notably that P-H Fine Arts was not engaged in the business of buying and selling fine art during the audit period. In its petition, Fine Arts took the position that it (and not Robert Guccione) purchased the artwork in question in the ordinary course of business with the intention of reselling it. In its answer, the Division asserted that the artwork was purchased for investment rather than resale, hence the purchases "were deemed to be acquisitions of business assets" (Division's answer, ¶ 6). In short, the parties understood that the primary issue was whether the artwork was purchased for resale, but neither the notice of determination nor the pleadings raised the issue of "personal use" or cited to the regulation relied on by the administrative law judge in upholding the tax assessment.

In his reply to the motion, the Division's representative asserts that the record as a whole demonstrates that the Division provided adequate notice to Fine Arts of the grounds ultimately relied on to sustain the assessment. Certainly, the opening statement of the Division's representative offered no guidance to petitioner, since there may be any number of reasons why the purchase of tangible personal property might be deemed not to be for resale. The reasons set forth in the Field Audit Report and the Division's closing statement suggest that the auditors believed that Fine Arts was a front, that it was not in the business of buying and selling artwork but was formed for the purpose of acquiring artwork which was intended to be part of Guccione's private collection. I use the word "suggest" deliberately, since the Division's representative never cited to any statute, regulation or case to clarify or support its position and

never enunciated a coherent legal theory to explain the Division's assessment of tax. Viewing the record as a whole, however, I believe this is a fair interpretation of the Division's position at the time of hearing. Petitioner reasonably believed this to be the Division's position and structured its evidence to prove that it was actually in the business of buying and selling fine art and purchased the artwork in question with the intent of reselling it.

Even after hearing petitioner's proof, the Division did not argue, in the alternative, that compensating use tax must be imposed on the "use" of tangible personal property which is purchased for resale but later diverted to a taxable "use" (20 NYCRR 531.3[a][2]), and it never applied this regulation to the facts adduced at hearing. Now, the Division's representative argues that petitioner should have recognized the applicability of the regulation to the facts of its case and offered evidence or a legal theory or both to establish that its transactions did not come within the purview of the regulation. Essentially, this is the position taken in the determination where it was acknowledged that the determination rested on legal grounds not addressed by either of the parties. It continues to be my position.

The resale issue as it relates to petitioner's factual claims has two intertwining strands. To show that the artwork was purchased for resale, it was necessary for petitioner to prove that it was purchased in the normal course of its business with the intention of reselling it (20 NYCRR 526.6[c]). The determination concluded that petitioner met its burden of proof on this strand. According to the determination of the administrative law judge, it was also necessary for petitioner to prove that Guccione and Penthouse made no personal or business use of the artwork, pending its sale (20 NYCRR 531.3[a][2]) and that petitioner's proof failed on this point. Petitioner claims that it had no notice that it would be called upon to provide proof that no intervening "use" was made of the property pending its sale; however, as noted in the Findings of Fact, personal use of the paintings by Guccione and/or Penthouse was a relevant and material issue litigated by the parties (Finding of Fact "8"). Petitioner was aware of the Division's claim that the artwork "was acquired for the personal use of Robert C. Guccione" (Petitioner's opening statement, Tr., p. 90). Consequently, I conclude that petitioner knew, or

should have known, that it would be required to show that neither Guccione or Penthouse made personal or business use of the artwork after its purchase.

B. Petitioner's motion to vacate the determination issued on August 27, 1992 and to reopen the record is denied.

DATED: Troy, New York
April 1, 1993

/s/ Jean Corigliano
ADMINISTRATIVE LAW JUDGE