STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
DAVID R. ANTHONY D/B/A DELEVAN MOTORS	:	DETERMINATION DTA NO. 810987
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 June 1, 1983 through May 31, 1986.	:	

Petitioner, David R. Anthony d/b/a Delevan Motors, 147 McKinley Avenue, Williamsville, New York 14221, 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 June 1, 1983 through May 31, 1986.

A hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on October 7, 1993 at 1:15 P.M., with all briefs submitted by May 10, 1994. Petitioner appeared by Timothy J. Cooper, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Deborah J. Dwyer, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation's audit methodology, which utilized external indices, was warranted and reasonably reflected the taxes due for the period in issue.

II. Whether the Division of Taxation properly assessed fraud penalty against petitioner for the period in issue pursuant to Tax Law § 1145(a)(2).

III. Whether the Division of Taxation timely issued notices of determination and demands for payment of sales and use taxes due for the period in issue.

FINDINGS OF FACT

At all times pertinent herein, petitioner, David R. Anthony d/b/a Delevan Motors

("Delevan"), was engaged in the business of selling used automobiles at 4491 Broadway, Depew, New York.

For each of the quarters in the audit period, June 1, 1983 through May 31, 1986, Delevan filed sales and use tax returns and remitted tax.

The Division of Taxation ("Division") began a field audit of Delevan in March of 1986. An appointment letter was sent to petitioner on May 2, 1986 to set up a time to review petitioner's records. A subsequent request for documentation was made on May 30, 1989. A review was conducted of sales and use tax returns, Federal income tax returns, bank statements, Delevan's book of registry, sales tax worksheets and available purchase invoices for vehicles.

On May 30, 1986, the Division was informed by the Department of Motor Vehicles that Delevan was not registered with it under the name "Delevan" or "David Anthony". Certain forms "MV-50", certificates of sale, were located at Delevan's place of business but not for the audit period in issue. The certificates of sale for sales made during the audit period were obtained from the Department of Motor Vehicles.

Although not in the record, the auditor's log indicated that a signed consent to extend the period of limitation on assessment of sales and use taxes due, Form AU-2.10, was acquired from Delevan.[1] However, the date to which the period was extended was not disclosed.

On January 28, 1987, the Division terminated contact with petitioner and the case was referred for a fraud investigation and possible criminal implications.

The file was returned to audit in March of 1989 and, after a second request for additional books and records on May 30, 1989, to which petitioner did not respond, a Statement of Proposed Audit Adjustment was mailed to petitioner on June 11, 1990.

At this juncture, petitioner's representative, Timothy Cooper, Esq., asked the Division to issue a letter stating that it would not proceed with the criminal prosecution if petitioner agreed

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[1]The consent was noted twice in the auditor's log, but elsewhere in the audit report it was noted that "waivers" (a term often used synonymously with "consent") were not obtained due to the assessment of fraud.

to the proposed tax. The Division did not issue such a letter.

There were some further discussions between the parties in October of 1990 with regard to the audit methodology, but no further substantiation of sales was provided.

The Division issued to David R. Anthony d/b/a Delevan Motors a Notice of Determination and Demand for Payment of Sales and Use Taxes Due, dated November 13, 1990, setting forth additional tax due of $31,908.44, plus fraud penalty of $15,954.24 and interest of $35,498.37, for a total amount due of $83,361.05. The Division issued a second notice to petitioner, dated November 13, 1990, which set forth additional penalty due of $1,165.10. Both notices covered the period June 1, 1983 through May 31, 1986.

With regard to petitioner's liability for use tax, the Division found the records of purchases to be inadequate. An examination of the expense purchases of such items as snowplowing, sand paper and other automobile supplies indicated that, in many instances, either no tax was paid or no invoice was provided to substantiate what was listed in the check disbursements journal. As a result, the Division examined the purchase invoices for the calendar year 1985 and determined that, for the four quarters of that year, petitioner had additional purchases subject to tax of $26,132.17. The Division compared this figure with total sales for the year of $123,178.00 and arrived at a ratio or "error rate" of .21214. It applied this ratio to gross sales reported in each quarter in the audit period to arrive at additional taxable expense purchases of $71,428.00. The additional tax on these purchases was determined to be $5,348.34.

The Division assessed "omnibus" penalty pursuant to Tax Law § 1145(a)(1)(vi) for the quarters ended August 31, 1985, November 30, 1985, February 28, 1986 and May 31, 1986 because the tax determined to have been omitted by petitioner was greater than 25% of the audited tax due for those quarters.

During the audit, the Division examined the period January 1, 1984 through December 31, 1985 and found that Department of Motor Vehicles records indicated that

petitioner had made 161 vehicle sales while the sales tax returns listed only 80 vehicle sales. The Division concluded that during this period Delevan omitted 50.3% of all vehicle sales from its sales tax returns. In fact, petitioner had not reported $332,001.00 of the $656,964.00 in total taxable sales.

When the Division then requested all the forms MV-50 from the Department of Motor Vehicles for the entire audit period, it found 150 vehicle sales which had been omitted from petitioner's returns. The MV-50's discovered by the Division were all signed by "David R. Anthony" below a certification that he had collected all State and local taxes due on the sales listed on the MV-50.

As a result of this discovery, the Division did a detailed audit of petitioner's books and records, accepting as correct the sales figures reported on the sales and use tax returns, and estimated the sales tax due on those sales not reported by using the values for used cars published monthly by the National Automobile Dealers Association ("NADA") as a basis for the sales prices for those transfers revealed by the forms MV-50 obtained from the Department of Motor Vehicles. The Division took the value for each vehicle described by the MV-50 listed in the NADA publication for the month and year of the transfer and reduced the value listed by 20% to account for the condition of each car, which could not be determined.

This methodology yielded additional taxable sales of $360,390.00 and additional sales tax due of $26,560.10.

Based upon these omissions, the Division asserted fraud penalty against Delevan for all quarters within the period June 1, 1983 through May 31, 1986.

Immediately prior to the hearing in this matter on October 7, 1993, petitioner produced, for the first time, documentation with regard to the 150 omitted sales. Specifically, petitioner provided 50 separate folders with miscellaneous information. Of the 50 folders, 33 contained invoices. The Division adjusted its audit to reflect the sales amounts listed on the invoices and also adjusted the values it had assigned to the 150 sales (80% of NADA value) to 74% of NADA value.

The Division compared the values set forth on the 33 additional invoices provided by Delevan shortly before hearing with the values reported in NADA and arrived at the 74% figure, which it then applied to all the omitted sales. The amount of additional taxable sales was reduced and as a result additional tax due was reduced to $25,738.97.

The 33 invoices presented by petitioner indicated that petitioner had collected sales tax on those sales but had not remitted the tax to the State of New York with his returns.

At hearing, the assessment of taxes due for the quarters ended August 31, 1983 and November 30, 1983 was cancelled by the Division. The Division explained that only use tax was assessed for these periods, not sales tax.

Also at hearing, petitioner submitted a schedule he prepared of sales reported on Delevan's returns filed during the audit period, which set forth the vehicle's year, make, sales price and a NADA value. The NADA value used appears to have been the "average retail" price, or highest value listed by that publication. Petitioner's sales prices were accepted as correct by the Division on audit.

In a post-hearing submission, petitioner submitted the actual NADA pages and invoiced sales prices for each vehicle listed in the hearing exhibit of sales made and reported during the audit period referred to in Finding of Fact "8". Pursuant to this schedule, petitioner prepared a computation summary of sales per invoices versus the NADA values and concluded that petitioner's sales prices were approximately 53% of NADA value, on average, for each of the sales made and reported during the audit period.

SUMMARY OF THE PARTIES' POSITIONS

The Division argues that petitioner's pattern of continuously and substantially understating income during the period in issue, together with his failure to maintain adequate books and records, failure to turn over sales tax collected from purchasers to New York State and failure to explain his absence of records, demonstrated his knowledge of fraud.

The Division further contends that its use of 74% (reduced from 80%) of the NADA values for sales prices in lieu of sales invoices was warranted and reasonable given petitioner's

lack of records, specifically invoices.

Finally, the Division believes that its assessments were timely filed because there is no time limit for issuing notices where a taxpayer has filed willfully false or fraudulent returns with the intent to evade tax.

Petitioner contends that the audit methodology chosen by the Division did not reasonably reflect his tax liability for the audit period given the values for sales made during the audit period, that the Division did not meet its burden of proving that the failure to pay the tax due was due to fraud and that without sustaining its claim of fraud, the assessments were not timely issued.

CONCLUSIONS OF LAW

A. The issues presented will be dealt with as they arose. First, it will be determined whether the audit methodology was reasonable to determine petitioner's actual tax liability for the audit period. Then a determination will be made whether the Division has borne its burden of proving fraud. Finally, it will be determined if the notices were issued in a timely manner.

Soon after the Division received information from the Department of Motor Vehicles that petitioner had transferred 150 vehicles which it did not report as sales on its returns for the quarters in issue, the Division halted contact with petitioner and referred the case for criminal investigation. The case was returned to the Division in March of 1989. Although a second request for documentation was made on May 30, 1989 for the additional unreported sales, nothing was provided until immediately before the hearing. The Division utilized the NADA values for the vehicles sold but not reported, and discounted those values by 20% to account for sales below the highest NADA value (average retail price), despite the fact that the Division was not given one invoice on audit to substantiate a lower value for the 150 unreported sales.

Tax Law former § 1135 states, in pertinent part, as follows:

> "Records to be kept. -- (a) Every person required to collect tax shall keep records of every sale or amusement charge or occupancy and of all amounts paid, charged or due thereon and of the tax payable thereon, in such form as the tax commission may by regulation require. Such records shall include a true copy of each sales slip, invoice, receipt, statement or memorandum upon which subdivision (a) of section eleven hundred thirty-two requires that the tax be stated separately.

* * *

"(d) Such records shall be available for inspection and examination at any time upon demand by the tax commission or its duly authorized agent or employee and shall be preserved for a period of three years, except that the tax commission may consent to their destruction within that period or may require that they be kept longer. Such records may be kept within the meaning of this section when reproduced on any photographic, photostatic, microfilm, micro-card, miniature photographic or other process which actually reproduced the original record."

Further, Tax Law former § 1138(a) states, in pertinent part, as follows:

"Determination of tax. -- (a) If a (1) return required by this article is not filed, or if a return when filed is incorrect or insufficient, the amount of tax due shall be determined by the tax commission from such information as may be available. If necessary, the tax may be estimated on the basis of external indices . . . ."

Before resorting to external indices upon audit, the Division must make an explicit request for the taxpayer's books and records (Matter of Christ Cella v. State Tax Commn., 102 AD2d 352, 477 NYS2d 858), review the records made available (Matter of King Crab Restaurant v. Chu, 134 AD2d 51, 522 NYS2d 978) and find them to be inadequate (Matter of Chartair, Inc. v. State Tax Commn., 65 AD2d 44, 411 NYS2d 41). The use of external indices to estimate the tax due is justified when a taxpayer does not have the source documentation necessary to verify his taxable sales (Matter of Licata v. Chu, 64 NY2d 873, 487 NYS2d 552). It is an auditor's duty to select an audit method which would reasonably reflect the taxes due (Matter of W. T. Grant Co. v. Joseph, 2 NY2d 196, 159 NYS2d 150, cert denied 355 US 869). However, exactness is not required (Markowitz v. State Tax Commn., 54 AD2d 1023, 388 NYS2d 176, affd 44 NY2d 684, 405 NYS2d 454). Once an appropriate audit has been performed, the resulting assessment by the Division is presumed correct (Matter of Cousins Service Station, Tax Appeals Tribunal, August 11, 1988) and the Division does not have the burden of proving the propriety of its assessment (Matter of Blodnick v. State Tax Commn., 124 AD2d 437, 507 NYS2d 536). The taxpayer bears the burden of proving the assessment is erroneous (Matter of Scarpulla v. State Tax Commn., 120 AD2d 842, 502 NYS2d 113) or the audit methodology was unreasonable (Matter of Blodnick v. State Tax Commn., supra; Matter of Cousins Service Station, supra).

Requests for books and records were made in May of 1986 with the appointment letter

and in May of 1989. Petitioner supplied no source documentation with regard to the 150 omitted sales until shortly before hearing. Therefore, the Division was justified in its resort to external indices to determine the additional tax due since there was clearly an inadequacy of records. The method chosen by the Division used the NADA values for average retail price, taken from NADA books issued in the month the sale was made, and allowed a 20% reduction for possible below average retail sales.

Petitioner argues that the values utilized by the Division were erroneous, but when a taxpayer's own failure to maintain records prevents exactness in the determination of sales tax liability, exactness is not required (see, Matter of Meyer v. State Tax Commn., 61 AD2d 223, 228, 402 NYS2d 74, lv denied 44 NY2d 645, 406 NYS2d 1025).

Petitioner suggests that the Division should have looked at his sales tax returns filed for the audit period and compared the values ascribed to the vehicles sold and reported thereon and used a similar discount value, approximately 53% by his estimate, for the 150 vehicle sales omitted from the returns. However, the records submitted by petitioner after the hearing establish an average discount only for those sales reported on the returns, not the omitted sales. There is no factual basis for accepting this value for the unreported sales. Further, petitioner's own submission prior to hearing, the 33 invoices, indicated that the values or sales prices were 74% of NADA average retail price (which was ultimately agreed to by the Division and applied to the unreported sales). Based upon this evidence, it is concluded that petitioner has not met his heavy burden of establishing, by clear and convincing evidence, that the audit methodology or tax assessment was erroneous (see, Matter of Vebol Edibles v. State of New York Tax Appeals Tribunal, 162 AD2d 765, 766, 557 NYS2d 678, lv denied 77 NY2d 803, 567 NYS2d 643; Matter of A & J Gifts Shop v. Chu, 145 AD2d 877, 878, 536 NYS2d 209, lv denied 74 NY2d 603, 542 NYS2d 518).

Therefore, the Division's audit methodology was warranted and reasonably reflected the taxes due on the 150 omitted sales.

B. For each of the quarters in the audit period the Division assessed fraud penalty

pursuant to Tax Law § 1145(a)(2), which provides for the imposition of a civil fraud penalty if the failure to file a return or pay over any tax is due to fraud. The burden of proving fraud by clear and convincing evidence has consistently been interpreted to reside with the Division (see, Matter of Ilter Sener, Tax Appeals Tribunal, May 5, 1988; Matter of Cinelli, Tax Appeals Tribunal, September 14, 1989). Imposition of the fraud penalty requires "clear, definite and unmistakable evidence of every element of fraud, including willful, knowledgeable and intentional wrongful acts or omissions constituting false representations, resulting in deliberate nonpayment or underpayment of taxes due and owing" (Matter of Ilter Sener, supra, quoting Matter of Shutt, State Tax Commn., July 13, 1982; see, Matter of Cousins Service Station, supra). On the record presented here, it is concluded that the Division has proven by clear and convincing evidence that petitioner acted with willful intent to fraudulently deprive the State of the sales and use taxes owed.

Because the sales tax penalty provisions are modeled after Federal penalty provisions, Federal statutes and case law are properly used for guidance in ascertaining whether the requisite intent for fraud has been established (Matter of Uncle Jim's Donut and Dairy Store, Tax Appeals Tribunal, October 5, 1989; Matter of Ilter Sener, supra). Factors found to be significant include consistent and substantial understatement of tax, the amount of the deficiency itself, a pattern of repeated deficiencies, the taxpayer's entire course of conduct and the taxpayer's failure to maintain bank accounts or adequate records (see, Merritt v. Commr., 301 F2d 484; Bradbury v. Commr., 71 TCM 63; Webb v. Commr., 394 F2d 366; see also, Matter of AAA Sign Co., Tax Appeals Tribunal, June 22, 1989). Because direct proof of the taxpayer's intent is rarely available, fraud may be proved by circumstantial evidence, including the taxpayer's entire course of conduct (Intersimone v. Commr., 87 TCM 290; Stone v. Commr., 56 TC 213, 223-224; Korecky v. Commr., 781 F2d 1566). Fraud may not be presumed or imputed, but rather must be established by affirmative evidence (Intersimone v. Commr., supra). Hence, a finding of fraud should not be sustained where the attendant circumstances create at most only a suspicion of fraud (Goldberg v. Commr., 239 F2d 316). The issue of

whether fraud with the intent to evade payment of tax has been established presents a question of fact to be determined upon consideration of the entire record (Jordan v. Commr., 86 TCM 389; see, Matter of AAA Sign Co., supra).

It is well settled that consistent and substantial underreporting of large amounts of taxable income over a period of years is strong evidence of fraud (Merritt v. Commr., supra; Jordan v. Commr., supra). It has also been noted that the mere understatement of income, standing alone, is not sufficient to establish fraud (Intersimone v. Commr., supra). Consequently, in order to establish fraud, it is necessary that other indicia of the taxpayer's specific and willful intent to evade the tax in conjunction with substantial understatement of income must be shown (see, id. [where substantial understatement of income, coupled with the showing that the taxpayer's records were incomplete and inaccurate and that the taxpayer failed to supply the bookkeeper with all relevant data warrants a finding of fraud]). Thus, along with proof of underreporting, the circumstances of the particular case must contain some affirmative indication of the required specific intent to deliberately evade payment of taxes due and owing (see, Korecky v. Commr., supra; Cirillo v. Commr., 314 F2d 478; Matter of Uncle Jim's Donut and Dairy Store, supra).

As noted in the facts, petitioner consistently and substantially underreported sales, approximately 50%, with unreported taxable sales of $332,001.00 of the $656,964.00 total taxable sales. That means for almost every sale reported there was one omitted. Petitioner did not have complete and/or accurate records to substantiate these omitted sales or his expense purchases, save the folders he produced immediately prior to hearing, and even those contained only 33 invoices. These factors strongly infer that petitioner knowingly and willfully underreported taxable sales for the period in issue.

The forms MV-50 filed with the Department of Motor Vehicles were signed by petitioner and certified that he had collected "all New York State and local taxes due" on the sales. Therefore, petitioner knew he should have collected the tax on the 150 omitted sales and, in fact, the 33 invoices supplied by petitioner before hearing indicated that he did charge and collect the tax but did not remit it, even though he collected such taxes as trustee for and on

account of the State of New York (Tax Law § 1132[a]).

The information submitted by petitioner shortly before hearing did not remedy petitioner's inadequate sales records presented during the audit. Nor did it remedy petitioner's failure to account for over 100 MV-50's filed by him with the Department of Motor Vehicles but omitted from petitioner's sales tax returns. Moreover, the invoices indicated that petitioner collected but did not remit the tax collected. Given this knowledge of inconsistencies in reporting, collecting and remitting tax, there is strong evidence that petitioner was aware of but ignored his duty to collect and remit sales tax.

Finally, petitioner failed to appear at the hearing in this matter and has made no attempt since the inception of the audit to explain the discrepancies between the sales information reported and the 150 omitted sales. Although petitioner's counsel argued that the possibility of criminal prosecution prohibited petitioner's full cooperation, ultimately it was his choice not to provide documentation or testimony to explain why he failed to report over 50% of his sales. Clearly, petitioner was in the best position to explain any discrepancies within his own records and has chosen to remain silent. A taxpayer's failure to credibly explain the absence of his tax and business records will be considered additional support for a finding of fraud (Matter of Waples, Tax Appeals Tribunal, January 11, 1990).

Accordingly, petitioner's failure to include 150 sales in his tax returns for the periods in issue (substantial underreporting), buttressed by his signature on each MV-50 certifying that all taxes owing on those vehicles were collected, his subsequent documentation of 33 sales where he did in fact collect sales tax on his sales of vehicles but did not remit it, and his failure to offer any credible explanation for his absence of records provide the basis for finding that petitioner deliberately failed to pay over tax to New York State with the intent to evade the payment of taxes. Therefore, the fraud penalty is sustained.

Additionally, since the tax omitted from the quarters ended August 31, 1985, November 30, 1985, February 28, 1986 and May 31, 1986 was in excess of 25% of the audited tax due, additional penalty (the "omnibus" penalty) was warranted (Tax Law § 1145[a][1][vi]).

C. The last issue is whether the Division timely issued the assessments. Tax Law § 1147(b) limits the time for assessment of additional sales and use taxes to no more than three years from the date of the filing of a return, "except in the case of a willfully false or fraudulent return with intent to evade the tax", when the assessment may be made at any time. Since it is determined that the Division has sustained its burden of proving fraud herein, the notices of determination in this matter were timely issued.

D. The petition of David R. Anthony d/b/a Delevan Motors is denied, and the two notices of determination, dated November 13, 1990, as modified consistent with Findings of Fact "9" and "11", are sustained.

DATED: Troy, New York
October 27, 1994

/s/ Joseph W. Pinto, Jr.
ADMINISTRATIVE LAW JUDGE