STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
LYNDSEY HARRISON, INC.	:	DETERMINATION DTA NO. 812671
for Redetermination of a Deficiency or for Refund of New York State and New York City Income Taxes under Article 22 of the Tax Law and the New York City Administrative Code for the Years 1988, 1989 and 1990.	:	

Petitioner, Lyndsey Harrison, Inc., 2000 Broadway, New York, New York 10023, filed a petition for redetermination of a deficiency or for refund of New York State and New York City income taxes under Article 22 of the Tax Law and the New York City Administrative Code for the years 1988, 1989 and 1990.

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 February 21, 1995 at 1:15 P.M., with all briefs to be submitted by August 7, 1995, which date began the six-month period for the issuance of this determination. Petitioner appeared by Stewart R. Fink, Esq. The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Laura J. Witkowski, Esq., of counsel).

ISSUE

I. Whether petitioner has established that it was not required to file withholding tax returns and remit New York State and New York City withholding taxes on monies paid to its two officers, Lyndsey Harrison and Michael Harrison for the years 1988, 1989 and 1990.

II. If petitioner was required to collect the tax and did not, whether it has demonstrated that the failure was due to reasonable cause and not willful neglect, thereby providing a basis for abating the penalties assessed pursuant to Tax Law § 685(a) and (b).

III. Whether the Division's method of computing the penalty base and the resulting penalties assessed was proper.

FINDINGS OF FACT

1. Petitioner, Lyndsey Harrison, Inc. ("Harrison"), was selected for a tax field audit in January of 1991 and the Division of Taxation ("Division") began the audit in March of 1991, when it sent an appointment letter to Harrison dated March 8, 1991, which requested specific books and records for review, including Federal and State withholding tax returns, supporting schedules, all books, records, worksheets and other documents pertinent to the preparation of Harrison's withholding tax returns. The Division also invited Harrison to submit original withholding forms for withholding periods that were past due.

2. In response to the appointment letter, petitioner's representative called the Division and informed it that Harrison was not required to file withholding tax returns or pay the tax because the corporation had only one employee who was also a shareholder who filed estimated taxes and received a bonus at the end of the year. He also told the Division that he was going to submit the following: a letter to explain why Harrison was not required to file withholding tax returns; W-2's and 1120's for the years 1988 and 1989; estimated tax returns; and W-4's. Harrison's representative conceded that it did not have payroll records and cancelled checks for Mr. Harrison's bonuses. Ultimately, Harrison did submit copies of forms IT-2103, Reconciliation of Tax Withheld, for the years 1988, 1989 and 1990.

3. With no further documentation forthcoming, the Division called for a field appointment, and a meeting was set for June 17, 1991. The Division was informed by Harrison's representative that Harrison did not have its cash disbursements journal but did have its cancelled checks and that they would be made available at that time.

At the June 17, 1991 meeting between the Division and Harrison, the Division was provided with Harrison's Federal income tax returns for the fiscal years ended January 31, 1988 and January 31, 1989; Federal W-2 forms (Wage and Tax Statements) issued by Harrison to its employees for 1988 and 1989; Federal and State income tax returns of petitioner's two

officers/employees for 1989; and and various check stubs. No information was provided with regard to 1990 even though requested.

In reviewing the information provided by Harrison, the Division learned that Harrison paid wages to both of its officers/employees in 1988, to wit: $185,000.00 to Michael Harrison and $134,000.00 to Lyndsey Harrison. In 1989, Harrison paid wages to only Michael Harrison in the sum of $50,000.00. Harrison withheld and remitted Federal withholding taxes for Lyndsey Harrison in 1988 and for Michael Harrison in 1989. Harrison's representatives said the difference in handling Federal and State withholding taxes was because Michael Harrison was exempt from New York withholding taxes. No explanation was given for Harrison's failure to file returns or remit withholding taxes to New York on behalf of Lyndsey Harrison while doing so for Federal withholding taxes.

4. Given Harrison's claim that Michael Harrison was exempt from withholding taxes, the Division requested copies of the Federal W-4 forms (Withholding Tax Allowance Certificates) and the New York State IT-2104 forms (Employee's Withholding Allowance Certificate) for both employees, so that the Division could see how many allowances/exemptions the officers were claiming for Federal and State withholding tax purposes.

5. The Division also inquired as to when the wages were paid to the employees during the years in issue, but the representative for Harrison said that no checks had been issued in payment of said wages and that only journal entries had been made. However, when the Division asked to see these entries, it was informed that they were not available. The Division was never shown documentation which proved when the W-2 wages were paid to the employees/officers in 1988 and 1989.

6. In a second meeting with Harrison, the Division received the Federal income tax returns for 1988, 1989 and 1990 for Harrison, copies of W-2's for 1988 and 1989, W-3's for 1988 and 1989; and forms 941 (Employer's Quarterly Federal Tax Return) for 1988 and 1989. Once again, the Division was informed by the representative that the officers/employees were

exempt from withholding taxes for New York State and City. The Division requested W-4's and IT-2104's for the employees but was not provided with any documentation. Further, the auditor's log stated that petitioner's representative told the Division that IT-2104's had never been transmitted to the Division for approval for either of the employees, a fact later contradicted in the affidavit of Lyndsey Harrison.

7. Without the requested documentation, the Division was not able to conclude the audit, even after a second visit to the representative's office.

By letter dated July 25, 1991, the Division requested additional information pertaining to the withholding tax issue, sending copies of the letter to both the representative and the taxpayer. With no response to this request forthcoming by September 1991, the auditor calculated the deficiencies for the years 1988 and 1989 and prepared the statement of withholding tax audit changes. The Division mailed the proposed statements of withholding tax audit changes to the taxpayer and its representative on the same day it received information with regard to the year 1990. The statements of proposed audit adjustment for the years 1988 and 1989 were based upon the materials submitted by petitioner and assessed penalties pursuant to Tax Law § 685(a)(1) and (b) for both the City and State of New York, and were computed using filing status "single, one" exemption and applying the withholding tax tables in the absence of any other information provided by petitioner which would have been apparent from W-4's or IT-2104's for its officers and employees. The status was based on standard audit procedures and the Federal procedures followed when no information concerning withholding is filed by the taxpayer.

8. On September 17, 1991, the Division received Forms 941, for the first, second and third quarters of 1990, two IT-2104's and Forms K-1 for 1988. Petitioner's representative was contacted and advised to send in W-2's, individual returns and the missing Form 941 for the last quarter of 1990.

The two IT-2104's for 1988 were simply marked "exempt" without any calculation of witholding allowances or entry of a number where requested on the form. It was then, in

September of 1991, that the Division first saw any IT-2104's in this matter. Although petitioner's new representative, Mr. Rosenblum in a contradiction of what had previously been told to the Division, said that the forms had been mailed to the Division, he had no proof of said mailing. The Division, after making a search of its records, determined that there was no evidence of receiving the forms.

In an affidavit sworn to September 23, 1993, Lyndsey Harrison, president of Lyndsey Harrison, Inc., stated that she prepared the Employee's Withholding Allowance Certificate, Form IT-2104, for herself and also received one for Michael Harrison, the other employee of the corporation, indicating that the two of them were exempt from New York City and New York State withholding taxes. She stated that "based on the instructions [on the form itself] I concluded that [we] had reasonable basis for filing the exemption certificates, since we expected no New York income tax liability in 1988."

She also stated that the instructions she read on the IT-2104 stated that "you can request that no income taxes be withheld . . . if you expect no tax liability in 1988." In fact, this statement does not appear on the form in this context.

Mrs. Harrison stated in her affidavit that she mailed both certificates by certified mail, return receipt requested, but has since lost all records of the mailing despite a through search of her records and belongings. Mrs. Harrison also stated that she believed no further filing of exemption certificates was necessary for subsequent years in accordance with her interpretation of Tax Department regulations.

9. By letter dated October 11, 1991, the Division requested payroll records, bank statements, canceled checks, W-4's, W-3's and W-2 statements for the year 1990, loan agreement and analysis of the loan agreement and the compensation of officers. The information was provided in December of 1991 and indicated that wages of $7,500.00 were paid to Michael Harrison in the first quarter of 1990 and no extensions were filed for the corporation, only for Michael Harrison. The Division imposed penalty and additional interest because the representative, Harrison, filed late without a properly executed and filed extension.

In a conversation between Mr. Rosenblum, Harrison's second representative, and the auditor on December 5, 1991, the representative informed the Division that petitioner depended on its accountant, Mr. Fink, for instructions on filing withholding tax returns and believed that the exemption was warranted based on his advice.

10. The Division analyzed the information provided for the year 1990, and concluded that, as in the previous years, Mr. Harrison had not satisfied the requirements to be considered exempt from New York State and City withholding taxes. On December 17, 1991, the Division issued to petitioner a Statement of Withholding Tax Audit Changes for the year 1990.

11. Mr. Rosenblum sent the Division a letter dated January 24, 1992, in which he sought an abatement of penalties based upon the Harrisons' reliance upon the advice of their accountant, Stewart Fink, and also their belief that they were exempt from tax based upon the fact that they had a de minimus tax liability for the year 1987 and projected heavy losses for the year 1988. Mr. Rosenblum's letter also asserted that Mr. Fink told the Harrisons that the corporation would not have to withhold taxes from wages if they sent the properly completed IT-2104's to the State, a task Mr. Rosenblum insists was done on January 26, 1988. The letter was never placed in evidence and was only referred to in the auditor's log and in the auditor's testimony at hearing. Mrs. Harrison never mentioned such advice or her reliance on same in her affidavit.

At a conference held with petitioner's representative on February 11, 1992, another basis for reasonable cause was asserted, i.e., that the Harrisons had misinterpreted what their accountant, Mr. Fink, had instructed them to do with regard to the preparation and filing of the withholding tax returns.

12. The Division issued two Notices of Deficiency to petitioner on April 20, 1992 and four Notices of Deficiency on April 27, 1992. Notice numbers L005534205 and L005534206, issued on April 20, 1992, for the tax period ended June 30, 1990, assessed additional tax, interest and penalty of $612.16 and 323.32, respectively.

Notice numbers L005543189, L005543190, L005543191 and L005543192, issued on April 27, 1992, assessed interest and penalty as follows:

Notice No. L005543189

Tax Period Ended	Tax Amount Assessed	(+) Interest Amount Assessed	(+) Penalty Amount Assessed	(-) Assessment Payments/ Credits	(=) Current Balance Due
01-15-88	0.00	411.33	925.64	0.00	1,336.97
01-31-88	0.00	400.78	921.80	0.00	1,322.58
02-15-88	0.00	388.62	917.37	0.00	1,305.99
02-29-88	0.00	377.66	913.37	0.00	1,291.03
03-15-88	0.00	363.32	908.15	0.00	1,271.47
03-31-88	0.00	346.19	901.91	0.00	1,248.10
10-15-88	0.00	116.72	596.32	0.00	713.04
10-31-88	0.00	107.05	592.79	0.00	699.84
11-15-88	0.00	97.40	589.28	0.00	686.68
11-30-88	0.00	86.51	585.32	0.00	671.83
12-15-88	0.00	76.96	489.54	0.00	566.50
12-31-88	0.00	50.36	387.55	0.00	437.91
TOTALS	0.00	2,822.90	8,729.04	0.00	11,551.94

Notice No. L005543190

Tax Period Ended	Tax Amount Assessed	(+) Interest Amount Assessed	(+) Penalty Amount Assessed	(-) Assessment Payments/ Credits	(=) Current Balance Due
01-15-88	0.00	201.53	453.52	0.00	655.05
01-31-88	0.00	196.36	451.63	0.00	647.99
02-15-88	0.00	190.40	449.46	0.00	639.86
02-29-88	0.00	185.04	447.51	0.00	632.55
03-15-88	0.00	178.01	444.95	0.00	622.96
03-31-88	0.00	169.61	441.89	0.00	611.50
10-15-88	0.00	55.33	282.66	0.00	337.99
10-31-88	0.00	50.74	280.99	0.00	331.73
11-15-88	0.00	46.17	279.32	0.00	325.49
11-30-88	0.00	41.01	277.44	0.00	318.45
12-15-88	0.00	36.48	232.04	0.00	268.52
12-31-88	0.00	23.87	183.70	0.00	207.57
TOTALS	0.00	1,374.55	4,225.11	0.00	5,599.66

Notice No. 05543191

Tax Period Ended	Tax Amount Assessed	(+) Interest Amount Assessed	(+) Penalty Amount Assessed	(-) Assessment Payments/ Credits	(=) Current Balance Due
01-31-89	0.00	206.11	464.33	0.00	670.44
02-28-89	0.00	193.12	459.06	0.00	652.18
03-31-89	0.00	177.97	452.91	0.00	630.88

10-31-89	0.00	.35	6.44	0.00	6.79
11-30-89	0.00	.27	6.41	0.00	6.68
12-31-89	0.00	.17	6.37	0.00	6.54
TOTALS	0.00	577.99	1,395.52	0.00	1,973.51

Notice No. 005543192

Tax Period Ended	Tax Amount Assessed	(+) Interest Amount Assessed	(+) Penalty Amount Assessed	(-) Assessment Payments/ Credits	(=) Current Balance Due
01-31-89	0.00	96.31	216.98	0.00	313.29
02-28-89	0.00	90.24	214.52	0.00	304.76
03-31-89	0.00	83.17	211.64	0.00	294.81
10-31-89	0.00	.17	3.22	0.00	3.39
11-30-89	0.00	.14	3.21	0.00	3.35
12-31-89	0.00	.09	3.19	0.00	3.28
TOTALS	0.00	270.12	652.76	0.00	922.88

13. In order to compute the correct penalties owed to the City and State of New York, it was necessary to first calculate the penalty base, or the amount of tax that petitioner should have withheld on the wages paid to its two officers/employees during each filing period. To establish the tax that should have been withheld, the auditor utilized the amounts set forth on petitioners' own 1988, 1989, and 1990 forms 941 (the Federal Employer's Quarterly Tax Return) and the W-2's (Wage and Tax Statement) issued to the employees.

These estimates were then divided in half to determine the amounts to be paid in each of the semi-annual periods ending June 30th and December 31st. The resulting amounts were then used to determine petitioner's filing frequency for purposes of the form IT-2101. From this calculation, it was determined that the withholding tax return filing frequency was semi-monthly, monthly and semi-annually for the years 1988, 1989 and 1990, respectively.

Without any other explanatory documentation provided by petitioner, the Division assumed that the payments stated on the 941's and the W-2's were paid evenly throughout the quarters for which they were reported. The total amount of wages paid in each quarter was divided by the number of filing periods in that quarter yielding the wages paid in the filing period.

Tax was determined by reference to the withholding tax tables in effect for the particular period and utilizing the figure for "single, one exemption" filing status, said to be consistent

with standard audit procedure, Federal precedent and mandated by the lack of documentation provided by petitioner.

The exact amounts of penalties and interest assessed to petitioner were calculated by the Division's computer program for Tax Law § 685(a) and (b) penalties on the penalty base amount.

14. Following the issuance of the notices of deficiency, petitioner filed an application for a conference with the Bureau of Conciliation and Mediation Services. A conference was held on September 15, 1993 and an order was issued on December 3, 1993, which cancelled the tax due for the year 1990 but sustained the penalties for all three years in issue. Therefore, the issues of penalty and interest assessed to petitioner for the years 1988, 1989 and 1990 remain for determination herein.

15. Petitioner, at hearing, submitted the following tax returns of its employees, Michael and Lyndsey Harrison: 1985 and 1986 U.S. individual income tax returns; two amended U.S. individual income tax returns for the year 1990; and a New York Amended Resident Income Tax Return for 1990.

The 1985 return indicated wages of $564,336.00, interest of $70,791.00, taxable dividends of $18,582.00 and other pensions and annuities of $2,784.00, a loss from rents, royalties, partnerships, estates or trusts of $587,742.00, for a total income of $68,751.00. After itemized deductions, the taxable income was $0.00. A refund of $131,954.00 was claimed.

The 1986 return indicated total income of $1,331,418.00 which included a loss from rents, royalties, partnerships, estates or trusts of $717,241.00. After itemized deductions, taxable income was claimed to be $1,237,609.00, tax due was $598,633.00 and the tax owed was stated to be $593,531.00.

An amended United States return for 1990, executed on August 18, 1993, indicated a reduction in the amount of tax due from $126,794.00 to $109,644.00 due to the elimination of recapture on "Super G" pursuant to a settlement agreement with the Internal Revenue Service. The return requested a refund of $17,946.00.

A second 1990 United States amended tax return, undated, indicated changes to the 1990 return due to the elimination of recapture on "Yuletide Associates" pursuant to an IRS settlement agreement. The tax originally due was reduced from $109,644.00 to $671.00. This amended United States return sought a refund of $116,987.00.

The two New York amended returns for 1990 followed the Federal returns and reported the changes as indicated on the Federal returns due to the elimination of the recapture on both "Super G" and "Yuletide Associates" pursuant to settlement agreements with the Internal Revenue Service. The return filed on August 18, 1993 requested a refund of $7,309.00 and the undated return requested a refund of $45,042.00.

16. At hearing, petitioner also submitted worksheets, allegedly from the second page of form IT-2104, which calculated the Harrisons' withholding allowances for the years 1988, 1989 and 1990. The first pages were not attached and the computation sheets indicated that Lyndsey and Michael Harrison were claiming entitlement to 130 withholdings in 1988, 73 in 1989 and 144 in 1990. Since Mr. and Mrs. Harrison did not testify and Mrs. Harrison's affidavit does not state she calculated withholdings, it is not certain who prepared these forms or if they were prepared in conjunction with the IT-2104's which were allegedly prepared by the Harrisons and filed with the corporation and the State.

17. The 1988 IT-2104's allegedly sent to the New York State Department of Taxation and Finance in Albany, NY, were attached to the Petition. Lyndsey Harrison prepared her own and allegedly signed it on January 26, 1988. It is not known who prepared the form for Michael Harrison because Mrs. Harrison said in her affidavit that she only "received" a form for him, not that she prepared a form for him.

Coincidentally, both forms were completed in the same way. On line "1" of each form, which asks for the number of allowances claimed, both Michael and Lyndsey Harrison stated "Exempt" instead of listing the number of allowances. On line "3" of both forms, which calls for the total number of allowances, both individuals listed "Exempt" instead of a number, even though they allegedly completed the worksheets for the number of withholding allowances on

page two of the form, which specifically tells the reader to list the result of the worksheet computation and enter the number on line "1" of the Form 2104.

18. The 1988 instructions for the form IT-2104 stated the following with regard to "Exemptions":

> "In certain cases, you can request that no income taxes be withheld from your pay by filing Form IT-2104E, Certificate of Exemption From Withholding, with your employer. You can claim this exemption from withholding if you had no New York income tax libility in 1987, you expect none in 1988, and you are over 65 years of age, under 18, or a full-time student under 25. If you are a dependent who is under 18 or a full-time student, you are liable for tax if your income is more than $2,800."

The Harrisons did not prepare IT-2104E's for any of the years in issue, but maintained that after they prepared the defective IT-2104's they were under no further obligation to file any further forms for subsequent years.

STATEMENT OF PETITIONER'S POSITION

19. Petitioner argues that Lyndsey and Michael Harrison were justified in filing their IT-2104's for the year 1988 with only the word "exempt" written on the forms and the corporation was justified in relying on said forms for not withholding any taxes from their wages for the years 1988, 1989 and 1990.

Although in conflict with its theory that the corporation and the Harrisons were distinct entities, petitioner urges that the individual's knowledge and intent was imputed to the corporation because they were its only shareholders, officers and employees.

The Harrisons believed that substantial losses would overcome any tax liability they might incur for the years in issue and therefore wrote "exempt" on the forms, purportedly consistent with the instructions on the form.

Petitioner believes that because the Harrisons had a good faith belief that they were exempt from tax it had reasonable cause for not withholding taxes from their wages, even though the Harrisons conceded that there is no way they could have known what part of the partnership losses would be deductible when they filled out their IT-2104's.

Petitioner contends that because there was no tax deficiency notice issued based upon negligence or intentional disregard, there can be no penalty assessed herein, pursuant to Tax Law § 685(b).

Petitioner argues that the penalty base and the penalty itself were incorrectly calculated by the Division, and that the Division should not have assumed that the Harrisons should have filed "single, 0 withholdings".

Petitioner believes that this is a case of exalting form over substance merely because the employees filled out the IT-2104 incorrectly thus making the forms "defective". Further, petitioner reasons, once the certificate was filed with the employer, the employer was required to withhold based upon the certificate.

Petitioner argues that it was entitled to rely on the IT-2104's filed by the Harrisons because their withholdings were based upon alimony, losses from partnerships and other large deductions.

CONCLUSIONS OF LAW

A. Tax Law § 671(a)(former [1]) provided as follows:

> "General. (1) Every employer maintaining an office or transacting business within this state and making payment of any wages taxable under this article to a resident or nonresident individual shall deduct and withhold from such wages for each payroll period a tax computed in such manner as to result, so far as practicable, in withholding from the employee's wages during each calendar year an amount substantially equivalent to the tax reasonably estimated to be due under this article resulting from the inclusion in the employee's New York adjusted gross income or New York source income of his wages received during such calendar year. The method of determining the amount to be withheld shall be prescribed by regulations of the tax commission, with due regard to the New York withholding exemptions of the employee and the sum of any credits allowable against his tax."

Since this case also involved taxes withheld in the City of New York, the provisions of the Administrative Code of the City of New York, virtually identical to the State statute are also pertinent. (See, Administrative Code §§ 11-1771 - 11-1778.)

Tax Law § 671(a)(3) provides as follows:

> "The tax commission shall provide by regulation for an exemption from withholding for (i) employees under eighteen years of age, (ii) employees under twenty-five years of age who are full-time students and (iii) employees over sixty-

five years of age, provided such employees had no income tax liability in the prior year and can reasonably anticipate none in the current year."

A central issue in the instant matter is whether petitioner, Lyndsey Harrison, Inc., a corporation, complied with Tax Law § 671(a) with respect to its sole employees/shareholders/officers during the years 1988, 1989 and 1990. Pursuant to Tax Law § 675, every employer required to deduct and withhold tax is liable for the tax, including any additions to tax, penalties and/or interest with respect to such tax. (See also, Administrative Code § 11-1775.)

Tax Law § 676 provides that:

> "[i]f an employer fails to deduct and withhold tax as required, and thereafter the tax against which such tax may be credited is paid, the tax so required to be deducted and withheld shall not be collected from the employer, but the employer shall not be relieved from liability for any penalties, interest, or additions to the tax otherwise applicable in respect to such failure to deduct and withhold." (See also, 20 NYCRR former 165.1; Administrative Code § 11-1776.)

Although petitioner argues that the separate identity of the legal entities involved here must be recognized, and the legal fictions created be respected, it did not take the necessary steps to provide an objective observer with the evidence to demonstrate that it was abiding by the legal fictions it created for its own benefit and advantage. Certainly, petitioner received an advantage from the structure of its own business enterprise and must adhere to laws governing that entity in its relationships with others, specifically the New York State Department of Taxation and Finance.

In 107 Delaware Assocs. v. State Tax Commn. (64 NY2d 935, 488 NYS2d 634), the Court of Appeals reversed the Appellate Division and reinstated the determination of the Tax Commission for the reasons stated in the dissenting opinion of Justice Casey of the Appellate Division, to wit:

> "Having elected to conduct their businesses under this format, and having reaped the benefits thereof, the individual petitioners now seek to avoid any disadvantage arising out of the selected format. There is nothing irrational about the Tax Commission's determination which has the effect of binding the taxpayers to the form of business chosen by them (see, e.g., Matter of Ormsby Haulers v. Tully, 72 AD2d 845, 421 NYS2d 701)" (107 Delaware Assoc. v State Tax Commn., 99 AD2d 29, 472 NYS2d 467, revd 64 NYS2d 935, 488 NYS2d 634).

In examining petitioner's actions with regard to its obligation to withhold tax on wages paid to its employees, it is determined that it did not act prudently or in accordance with the provisions of the Tax Law or the regulations promulgated thereunder. Further, it did not observe the law and regulations regarding its relationship with its employees even though it chose to do business in the corporate form. Petitioner cannot now claim that the Division's assessment of penalty is erroneous because the assessment is an exaltation of form over substance.

As a general rule an employer is required to withhold on the basis of statements made on a properly submitted IT-2104 until it receives notice from the Division that said form is defective (20 NYCRR former 160.4[d][4][iv][a]). That regulation also stated that an employer is required to submit a copy of any IT-2104 and a copy of the statement from the employee in support of the statements on the certificate if the total number of withholdings exceeds 14 (20 NYCRR former 160.4[d][4]). Given the IT-2104 worksheets in the record, the Harrisons' withholdings were well in excess of 14, and they should have filed such a statement with the corporation.

There is no evidence in the record that the corporation ever received notice from either of its employees/officers that they were changing their number of withholdings or claiming exemption from tax for the years in issue, i.e., 1988, 1989 and 1990. Although Mrs. Harrison stated in her affidavit that she prepared an IT-2104 for the year 1988 and received one for Michael Harrison, there was no evidence that notice of said forms was given to the corporation, albeit that Mrs. Harrison was the president of the corporation. In fact, it was telling that Mrs. Harrison stated that she prepared the form and received one from Mr. Harrison and mailed them both to the Department of Taxation and Finance, never mentioning filing them with or in petitioner's books and records, which may be why they were not produced on audit when the auditor requested copies of all records pertinent to petitioner's withholding tax obligations. Further, when referring to looking for the mailing records for the return receipt and receipt for certified mail she allegedly retained but misplaced, Mrs. Harrison did not search the

corporation's files, only her own "papers and belongings". Since the obligation for filing with the Division was with the corporation, it is clear that the forms were never filed with the corporation, or that the Harrisons observed or respected the legal fiction they created for their own advantages.

More importantly, having determined that the Harrisons never notified the corporation of their change in withholdings or exempt status, it follows that there was no reason for petitioner to file the forms with the Division. Petitioner's argument that the forms were merely defective is a specious one, indeed. They were never filed with petitioner and since there is no record that the forms were ever mailed to the Division, it is further determined that they were never properly filed with the Division which supports the finding that the Division had no record of the forms being filed. With no basis for petitioner's failing to file returns or withhold and deduct taxes from the Harrisons' wages for the years in issue, the Division properly assessed penalty. Additionally, petitioner has not advanced any valid reason for the abatement of said penalties.

One must be cautious when reviewing the record of this matter. Petitioner's officers did not testify at the formal hearing in this matter; did not sign the petition filed in this matter; did not offer any explanation or elaboration for the documents attached to the petition or the two exhibits entered into evidence by its representative at the hearing, to wit: the the 1985 Federal and State income tax returns for the Harrisons; the 1986 Federal income tax return for the Harrisons; two amended Federal income tax returns for the Harrisons for 1990 and two amended New York income tax returns for the Harrisons (Exhibit 1); and three worksheets for forms IT-2104 for the years 1988, 1989 and 1990 (Exhibit 2).

Although its representative chose to characterize various exhibits presented by both the Division and petitioner, the Tribunal has on many occasions cautioned Administrative Law Judges from accepting such argument as evidence, since accepting the unsworn statements of a representative as evidence effectively denies the other party the right to cross-examine the declarant, a right protected by section 306.2 of the State Administrative Procedure Act and it

may confuse or misdirect the representative in cases where the judge directs factual questions to the representatives (not in issue herein). Such statements, being unsworn and hearsay, may result in their being given little weight. (Matter of Cafe Europa, Tax Appeals Tribunal, July 13, 1989.)

I will deal with each of petitioner's submissions below after discussing the only statement in the record which could be considered a basis for reasonable cause, i.e., the affidavit of Lyndsey Harrison. Mrs. Harrison submitted her affidavit to support her petition to have the penalties abated. In it, she averred that she prepared the IT-2104 and received one for Michael Harrison. She claimed that she concluded Michael Harrison and herself were exempt from withholding tax based upon the instructions on the form itself, citing the following language:

> "you can request that no income taxes be withheld . . . if you expect no tax liability in 1988."

Mrs. Harrison proceeded to explain that she projected her 1988 New York State and City tax liability on a substantial increase in exempt income and a decrease in other taxable income. She admitted that in 1987 she owed $40,000.00 in Federal tax and $7,500.00 in New York State and City tax. It is noteworthy that she did not mention Michael Harrison's substantial losses from partnerships for which forms K-1 were submitted by Petitioner's representative (for "Super G Associates" and "Yuletide Associates") and those losses were not reflected on the 1988 New York State tax return for the Harrisons.

Mrs. Harrison incorrectly wrote the word "Exempt" on the IT-2104 where it called for the number of withholdings calculated on the worksheet. In fact, Mrs. Harrison never mentioned calculating the number of withholdings she or Mr. Harrison were entitled to, only that they believed they would owe no tax in 1988 and so filed "exemption certificates". Mrs. Harrison said she only filed for 1988 because the regulations said no further filings of the exempt certificates were necessary for subsequent years.

Unfortunately, Mrs. Harrison did not read or choose to divulge the entire text of the instructions from Form IT-2104, which states that you can claim exemption from withholding by filing Form IT-2104E with your employer and that to qualify you could not have had a New

York tax liability for 1987, expect none in 1988, and that you had to be over 65 years of age, under 18 years of age, or a full-time student under 25. The Harrisons did not qualify under these criteria. (See also, Tax Law § 671[a][3]; Administrative Code § 11-1771[c][3].)

Even if Mrs. Harrison had properly filed the forms with the corporation, which it has been determined she did not, and had the forms been filed with the Department, which it has been determined they were not, the forms were incorrectly filled out and the Harrisons did not qualify for an exemption from withholding. Mrs. Harrison's misreading of the instructions on the form is not a basis for abating the penalties assessed to the corporation for failing to file withholding tax returns pursuant to Tax Law § 685(a)(1) and (b).

Since this is deemed the only evidence of any weight submitted by petitioner, it is determined that petitioner has not met its burden of proof of showing by clear and convincing evidence that the assessments were erroneous (Tax Law § 689[e]). In Bello v. Tax Appeals Tribunal of the State of New York (213 AD2d 754, 623 NYS2d 363), the court said:

> "It is well settled that as the party challenging the assessment, petitioners bore the burden of establishing, by clear and convincing evidence, that the tax assessed was erroneous [citations omitted]. [P]etitioners failed to tender sufficient evidence to establish that the assessment was erroneous and, therefore, the determination must be confirmed." (Id., 623 NYS2d at 364.)

B. As seen from the record in the instant matter, the Division made numerous requests for all documentation relating to petitioner's withholding tax returns for the the years 1988, 1989 and 1990. There were letters requesting the information, visits to the representative's office and follow up with both of the representatives, Mr. Fink and Mr. Rosenblum. The Division made as thorough an investigation as was possible given the lack of cooperation by petitioner.

The two exhibits submitted at hearing add nothing to petitioner's case. The IT-2104 worksheets for the years 1988, 1989 and 1990 submitted by the representative at hearing were not produced on audit and there is no reason to believe that they were prepared by the Harrisons or that they were prepared contemporaneously with the IT-2104's attached to the petition. In fact, Ms. Harrison never mentioned preparing them in her affidavit and, if she did go through

the trouble of preparing the worksheets, it is curious why she did not utilize the withholdings she computed on the face of the IT-2104. Without more elaboration by Mrs. Harrison, the veracity of the worksheets is questionable and they are determined to be incredible for purposes of this determination.

The Harrison's Federal and New York State income tax returns for 1985, 1986 and 1990 (amended) do not shed any light on the issues before this forum. They do not establish reasonable cause for petitioner's failure to withhold tax from the Harrison's wages for the years in issue.

The undeniable facts remain: petitioner did not receive proper notification from the Harrisons through properly completed IT-2104's nor were they filed with the Division. Petitioner was provided with no evidence that the Harrison's were exempt from tax and without such proof should not have agreed to forego withholding New York State and City taxes from their wages, and in fact would not have done so if the Harrisons did not control the corporation. In fact, the Harrisons did not qualify for exemption and offered no reasonable explanation for their belief that they were qualified.

C. Finding of Fact "13" set forth the method used by the Division to calculate the penalty base and the penalty and interest assessed. Petitioner has posited no valid argument which demonstrated this methodology to be in error.

Petitioner argued that there was no tax deficiency and therefore there could be no added penalties and interest. However, this is contrary to the provisions of Tax Law § 676, which specifically speaks to the situation where the tax is subsequently paid and the employer is no longer liable for the tax but continues to remain liable for any penalties, interest or additions to tax that applied to the failure to deduct and withhold, like the Tax Law § 685(b) negligence penalties. (See also, Administrative Code § 11-1776.)

Petitioner also argued that in computing the penalty base, the Division calculated the tax that should have been withheld based upon the supposition that the Harrisons would have filed under the status "single, one exemption". The basis for this supposition was standard audit

procedure and reliance on the Federal provisions regarding situations where persons do not file W-4's, in which instance Internal Revenue Code § 3401(e) requires that the employer withhold on a "single, zero" basis. In fact, the Division was more generous with the Harrisons.

Contrary to petitioner's arguments, the record demonstrates that the Division was provided with no other information on which to base its computations due entirely to the failure of petitioner to provide the requested information. The record does not contain the information necessary to make the adjustments petitioner seeks and the Division's computation of the penalty base and the penalties and interest thereon is sustained.

D. The Division assessed penalties under Tax Law § 685(a)(1) and (b) for, respectively, failure to file a return and because the deficiency was due to negligence or intentional disregard. Tax Law § 685(a)(1) provides that no penalty will be assessed if it is shown that such failure is due to reasonable cause and not due to willful neglect (see also, 20 NYCRR former 102.7[a]). The provisions of 20 NYCRR former 102.7(a) are applicable to the local taxes imposed under Article 30 (New York City personal income tax) (see, 20 NYCRR former 102.7[h]).

The regulation at 20 NYCRR former 102.7(d)(4) provided that any 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 was explicitly excluded from the definition. Further, the burden is once again on petitioner to establish reasonable cause (Tax Law § 689[e]).

Petitioner has failed to establish reasonable cause herein. Although there were weak attempts to argue that petitioner relied on the advice of its accountant, that the Harrisons reasonably believed that they were exempt and that the IT-2104's were mailed to New York State, it was unable to prove by credible evidence that any of these arguments were valid. The only evidence of what the Harrisons believed or thought at the time they prepared the IT-2104's was the affidavit of Lyndsey Harrison, which did not address reliance on an accountant, did not adequately explain the "good faith" belief that they were exempt from withholding tax and did

not establish the filing of the forms with the corporation or the mailing of the forms to the Division. The fact that petitioner's representative sent a letter to the auditor, memorialized by a note in the auditor's log, dated January 24, 1992, which said the Harrisons relied on an accountant's advice, does not establish such reliance.

> "In making a determination as to whether reasonable cause exists when a taxpayer has relied on the erroneous advice of a professional, it must be shown that the taxpayer relied in good faith on the advice which he received and it must have been 'reasonable' for the taxpayer to rely upon the particular advice he was given (see, Auerbach v. State Tax Commn., 142 AD2d 390, 536 NYS2d 557, 561; LT & B Realty v. State Tax Commn., 141 AD2d 185, 535 NYS2d 121, 123). When determining whether the taxpayer has shown that his reliance was reasonable, the burden is on the taxpayer to demonstrate that he acted with ordinary business care and prudence in attempting to ascertain his liability for taxes (see, United States v. Boyle, 469 US 241, 85-1 USTC ¶ 13,602 at 88,255)." (Matter of Erikson, Tax Appeals Tribunal, March 22, 1990).

Although 20 NYCRR former 102.7(b) requires a written statement which affirmatively sets forth the basis of a claim for reasonable cause, the log entry does not suffice. The Division's assessment of penalties under Tax Law § 685(a)(1) and (b) are sustained, given petitioner's failure to meet its burden and establish reasonable cause.

E. The petition of Lyndsey Harrison, Inc. is denied and the six notices of deficiency, dated April 20, 1992 and April 27, 1992 are sustained.

DATED: Troy, New York
February 1, 1996

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