STATE OF NEW YORK

DIVISION OF TAX APPEALS

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| In the Matter of the Petition | : | |
| of | : | |
| **RIGHTWAY COURIER, N.Y., INC.** | : | DETERMINATION<br>DTA NO. 815310 |
| for Redetermination of Deficiencies or for Refund of Personal Income Tax under Article 22 of the Tax Law and the New York City Administrative Code for the Years 1990, 1991 and 1992. | : | |

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Petitioner, Rightway Courier, N.Y, Inc., Zeckendorf Towers, 111 East 14th Street, Suite 307, New York, New York 10003, filed a petition for redetermination of deficiencies or for refund of personal income tax under Article 22 of the Tax Law and the New York City Administrative Code for the years 1990, 1991 and 1992.

On May 31, 1997 and June 13, 1997, respectively, petitioner, appearing by Harry B. Wallace, Esq., and the Division of Taxation appearing by Steven U. Teitelbaum, Esq. (Laura J. Witkowski, Esq., of counsel) consented to have the matter determined on submission without a hearing. The Division of Taxation submitted documentary evidence on July 17, 1997 and a brief on September 19, 1997. Petitioner had until October 3, 1997 to submit a reply brief, which date began the six-month period for the issuance of this determination. After review of the entire record, Thomas C. Sacca, Administrative Law Judge, renders the following determination.

## *ISSUES*

I. Whether petitioner failed to properly remit the New York State and New York City taxes shown to have been withheld on the W-2 Wage and Tax Statements of its employees during the years 1990 and 1991.

II. Whether petitioner improperly classified employees as independent contractors, thereby resulting in the failure to properly withhold and remit taxes to New York State and New York City on the wages paid to such individuals during the year 1990.

III. Whether petitioner failed to properly withhold on the "withdrawal" account income paid to two of its shareholders during the years 1990, 1991 and 1992.

IV. Whether petitioner has established reasonable cause to abate the Tax Law § 685(a) late filing and § 685(b) negligence penalties assessed for its failure to timely file and pay withholding taxes for the years 1990, 1991 and 1992.

V. Whether petitioner has established that the Division of Taxation improperly calculated the amount of petitioner's withholding tax deficiencies.

## *FINDINGS OF FACT*

Pursuant to section 3000.15(d)(6) of the Tax Appeals Tribunal's Rules and Regulations and sections 302(1) and 306 of the State Administrative Procedure Act, the Division of Taxation submitted proposed findings of fact in this matter. Those proposed findings have been accepted in their entirety and appear below as Findings of Fact "1" through "31".

1. Petitioner, Rightway Courier, N.Y., Inc., was incorporated in New York State on December 21, 1989 and became a sub-chapter S corporation in December 1990. Petitioner is engaged in the business of providing messenger and delivery services.

2. Petitioner's withholding tax records were selected for audit by the Division of Taxation ("Division") in July 1992. The audit was originally scheduled to cover the years 1989 through 1991. However, the 1989 tax year was subsequently removed from audit consideration after it was determined that petitioner had only incorporated in December 1989 and had not begun doing business in New York State until 1990. In addition, the 1992 tax year was subsequently added to the audit (in order to bring the audit up to date) following the expiration of the due dates for the filing of petitioner's 1992 withholding tax returns.

3. The Division's records indicate that petitioner was registered for corporation franchise and withholding taxes. However, the Division's records also indicate that no withholding taxes were remitted by petitioner for the years 1990 or 1991.

4. Following several postponements by petitioner, a withholding tax field audit was eventually commenced on February 25, 1993 at the office of Mr. James Simermeyer at 853 Broadway, Suite 412, New York, New York. Mr. Simermeyer was the president and 75% shareholder of petitioner during the audit period.

5. During the first field visit, the following books and records were provided by petitioner: wage and tax statements (Form W-2) for 1990 and 1991 tax years, parts of the general ledger for 1990, the check register for 1990 and part of 1991, and the payroll register for part of 1991.

6. The Division's review of the foregoing information indicated that petitioner had several potential withholding tax problems. The potential problems identified by the Division included the following:

(a) During the 1990 and 1991 tax years, petitioner had employees to whom it paid taxable W-2 wages and it withheld tax from those wages, but petitioner failed to remit the tax withheld to New York State and/or New York City.

(b) During the 1990 and 1991 tax years, petitioner's shareholders — Dominick Feliceo (25%) and James Simermeyer (75%) — worked for the business but were not listed on the payroll. Instead, petitioner maintained a "drawing account" from which the shareholders made regular withdrawals in amounts ranging from $250.00 to $7,000.00, with the average withdrawal being approximately $1,000.00. Petitioner claimed that these monies did not constitute income subject to withholding. However, there was no evidence presented to indicate that these withdrawals constituted "loans" to the shareholders and the funds were separate and distinct from the monies paid to the shareholders pursuant to their schedule K-1s, which listed the partners' share of the partnership income.

(c) During the 1990 tax year, petitioner classified its messengers and delivery personnel as nonemployees and issued Form 1099, "Miscellaneous Income" (with no withholding), instead of Form W-2, "Wage and Tax Statements" (with proper withholding). The form 1099s were not available for review at the time of the initial field visit. In addition, it appeared that these individuals should have been classified as employees based, in part, on the fact that petitioner subsequently treated some of these individuals as employees and issued wage and tax statements in the following tax year.

(d) During the 1990 and 1991 tax years, petitioner issued form 1099s to its two shareholders without any apparent basis.

7. Due to the fact that the information provided during the initial field visit was insufficient to conclude the audit, the auditor scheduled a follow-up visit. Following several

postponements by petitioner, the second field visit eventually took place on July 22, 1993 at Mr. Simermeyer's new office at 27 Union Square West, Suite 503, New York, New York.

8. During the second field visit, the following books and records were provided by petitioner: forms 1099 for 1990 and 1991, Federal corporation tax returns for 1990 and 1991, an itemized category report for 1991, employer's annual federal unemployment tax returns (Form 940) and employer's quarterly tax returns (Form 941) for 1990 and 1991, and reconciliations of tax withheld (Form IT-2103) for 1990 and 1991. The information for the year 1992 was still unavailable at this time.

9. Prior to the second field visit, petitioner's representative, Mr. Wallace, informed the Division that the majority of the withholding exemption certificates (Form W-4) that had been filed by petitioner's employees had claimed "single, one exemption," but that he would have to check and see if petitioner had retained these documents. No such documents were ever produced for review by the Division.

10. After the auditor completed her review of the foregoing materials, she prepared an analysis of Federal corporation tax returns for 1990 and 1991. Based upon her review of the additional information and her workpapers, the auditor determined that the potential withholding tax problems that were identified during the first field visit still remained.

11. The 1990 and 1991 forms 940, 941 and IT-2103 confirmed that petitioner had employees to whom it paid taxable wages and withheld tax, but for whom it failed to remit the tax to the Division. The total amounts withheld but not paid over were $10,610.47 in 1990 and $8,462.14 in 1991.

12. The shareholders were issued forms 1099 in 1990 (Feliceo $54,210.00) and 1991 (Feliceo $31,460.00 and Simermeyer $37,775.00). The Division's review of petitioner's records showed that these amounts were comprised of the amounts withdrawn from "drawing accounts" (although not all of the money withdrawn was classified as 1099 income) and some form of commission income. No tax was withheld on the amounts withdrawn.

13. Approximately six recipients of Form 1099 in the 1990 tax year were issued W-2s for the 1991 tax year. These individuals were Helmholz, Trotto, Morrison, Rivera, Perez and Haywood.

14. At least part of the 1099 income paid to petitioner's messengers was classified as "commission" income. No tax was withheld on the commission income even though commissions are considered supplemental wages subject to withholding.

15. After informing petitioner of the apparent withholding tax problems, the auditor explained to petitioner that it could establish that its employees had satisfied their personal income tax liabilities, and thereby avoid any liability for the withholding tax not withheld and remitted, by having the employees complete and submit Form AU-7 to the Division. A Form AU-7 is used by the Division in situations where the employer fails to withhold and remit tax on taxable wages. It allows the employer to obtain credit for the tax that may have been paid by the employee with his or her personal income tax return filed for that year. It is a sworn statement made by the employees that they filed returns and paid whatever personal income tax was due. When the Division receives a completed Form AU-7, the employer is generally given credit for the tax paid (assuming the Division's records confirm that a return was filed), but the employer may still be issued an assessment for penalty and interest for its failure to properly withhold.

16. The auditor next prepared a Statement of Withholding Tax Audit Changes, dated September 23, 1993, for the 1991 and 1992 tax years based upon the information that had been provided to date. The basis for the audit changes was that petitioner had withheld but not remitted tax on taxable wages paid to employees, had improperly classified employees as nonemployees and had failed to withhold on monies paid to two officers/shareholders.

17. Petitioner responded to the Statement of Audit Changes via letter, dated September 27, 1993, wherein it claimed that the assessment was improper because it was an "estimated" assessment. Petitioner also requested a reaudit or hearing to review the Division's numbers.

18. The auditor subsequently explained to petitioner that the numbers set forth in the Statement of Audit Changes were not "estimated" numbers. The auditor further explained that there were several different components to the Division's calculations. First, there were employees who received W-2 wages upon which petitioner withheld but failed to remit tax as required by law. Petitioner was assessed the tax that it collected but failed to remit, plus penalties and interest for failing to comply with the Tax Law.

Second, there were employees who were improperly classified as nonemployees and for whom petitioner failed to withhold and remit tax on the wages and commissions paid. For these people, former personal income tax regulation 20 NYCRR 165.1 (current 176.1) requires that petitioner must prove that the individuals filed their New York State personal income tax returns and satisfied their income tax liabilities, or it will be liable for the tax due on the income set forth on the 1099s. Petitioner was also assessed penalties and interest for failing to properly withhold for these employees.

Finally, petitioner had two officers who received income from the "drawing accounts" and who received forms 1099. The regulation also requires that petitioner show that these

individuals filed their New York State personal income tax returns and satisfied their income tax liabilities, or it will be liable for the tax due on the income received by the officers. Since petitioner failed to establish that either of these individuals had filed their returns, petitioner was determined to be liable for the tax due on this income. Petitioner was assessed penalties and interest for failing to properly withhold for these individuals.

Based upon the actual information contained in petitioner's records regarding the total taxable wages paid to all three of the foregoing categories of individuals, and using the existing withholding tax tables, the Division computed the total amount of tax due for each employee and officer for each year. Since petitioner failed to provide the withholding exemption certificates (Form W-4) for any of its workers, the Division used the single, one-exemption, table and the flat withholding tax rate set forth in the withholding tax tables (Publication IT-2100) to determine their tax liability, in accordance with standard Division procedures. In addition, since there was no evidence as to when the income was received by any of these individuals (except for the officers' "drawing account"), the Division assumed that the wages were paid evenly throughout the year.[1]

The Division then took the total amount of tax due and used that to determine the frequency with which petitioner should have been filing withholding tax returns and remitting tax. In this case, it was determined that petitioner should have been filing on a semi-monthly basis in 1990 and 1991. The Division then divided the total amount of tax due by the number of

[1]Although the officers' drawing account did set forth the dates of the withdrawals, there was no indication as to when the officers received their 1099 income. Thus, because the officers received more than one type of taxable income, and there is only a small difference in the actual calculations when assuming that the income was paid evenly throughout the year (versus using the exact payment dates), it was determined that the tax due on the officers' wages would be calculated in the same manner as the other employees.

filing periods (24) to determine the tax due per filing period. From those amounts, the Division's computer automatically calculated the penalties and interest due on the amounts underwithheld.

19. At the time the auditor prepared and issued the Statement of Withholding Tax Audit Changes in September 1993, petitioner had failed to establish that any of the individual employees had filed their New York State personal income tax returns for 1990 or 1991 (i.e., no AU-7 forms had been submitted).

20. At petitioner's request, a meeting was conducted with the auditor, her team leader and her unit head on November 15, 1993. At this meeting, petitioner provided its 1992 Federal return (Form 1120) and AU-7s for the following individuals: (a) James Haywood for the year 1990 for wages in the amount of $9,933.80, dated November 15, 1993; (b) Dominick Feliceo for the years 1990 and 1991 for wages in the amounts of $54,210.00 and $31,041.07, respectively, both dated November 15, 1993; (c) Robert Stern for the year 1990 for wages in the amount of $13,606.64, dated November 15, 1993; and (d) James Simermeyer for the year 1991 for wages in the amount of $37,775.00, dated November 12, 1993. Petitioner also agreed to furnish additional information for the 1992 tax year and certain determinations of employee work status for purposes of Federal employment taxes and income tax withholding (Form SS-8) in a few weeks. An SS-8 is filed with the Internal Revenue Service ("IRS") to request an opinion as to whether a worker should be classified as an employee or an independent contractor for Federal withholding tax purposes.

21. Following the Division's receipt of the five AU-7 forms, the auditor checked the Division's records to confirm whether the Division had actually received the returns from the individuals in question. This review revealed that only one of the five individuals had actually filed his personal income tax return with New York State (Robert Stern for the year 1990). As a

result, the Division gave petitioner credit for the withholding tax that should have been paid by petitioner for Mr. Stern for the year 1990.

22. The auditor and her team leader next went to Mr. Simermeyer's office in December 1993 to review petitioner's 1992 withholding tax information that was finally made available. At this meeting, petitioner claimed that the 1099 income received by the two shareholders constituted 40% of each transaction that took place during the years in question. Petitioner also claimed that the payment of commissions was industry practice and that the IRS had audited its records for the same tax years and had found no improprieties.

23. Despite the Division's requests, petitioner failed to provide any proof of an IRS audit and the result of such an audit. In addition, petitioner failed to provide any proof regarding industry practices and the treatment of messengers. Moreover, petitioner failed to provide any completed forms SS-8 for its messengers.

24. Petitioner's information for the 1992 tax year revealed that petitioner was no longer classifying its messengers as nonemployees.

25. Although the information provided was still insufficient to conclude the audit, the Division's attempts to set up another meeting to review the additional information needed met with repeated cancellations by petitioner. Accordingly, the auditor prepared a revised Statement of Withholding Tax Audit Changes for the years 1990, 1991 and 1992 based upon the available information.

26. The revised Statement of Withholding Tax Audit Changes indicated that petitioner had underwithheld the following amounts of tax for the 1992 tax year:

| **Jurisdiction** | **1st Quarter** | **2nd Quarter** | **3rd Quarter** | **4th Quarter** |
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| State | $639.00 | $466.00 | $2,718.00 | $4,343.00 |
| City | $328.00 | $237.00 | $1,466.00 | $2,326.00 |

27. For the 1990 tax year, the assessments were broken down into two types. The first assessed tax, penalty and interest for petitioner's failure to withhold tax for those employees for whom the filing of New York State personal income tax returns had not been established by petitioner. The second assessed just penalty and interest for petitioner's failure to withhold for those individuals for whom the filing of New York State personal income tax returns had been established. For 1991 and 1992 there was no need to separate the assessments into two groups because petitioner had failed to establish that any of its employees had filed New York State personal income tax returns for those years. These calculations reflect the credit given for the one taxpayer who submitted a verified form AU-7 (Robert Stern).

28. When petitioner did not respond to the second Statement of Audit Changes, the auditor prepared an Income Tax Report of Audit, closed the file and sent it to Albany for the audit personnel to prepare the notices of deficiency.

29. On July 5, 1994, the Division issued to petitioner 14 notices of deficiency assessing tax due in the aggregate amount of $73,173.00, plus penalty and interest.

30. Following the issuance of the notices of deficiency, an additional adjustment was made to petitioner's assessment. At the Bureau of Conciliation and Mediation Services conference, petitioner established that one of the shareholders, Mr. James Simermeyer, had filed his New York State personal income tax return for the year 1991, wherein he reported the income in question, and petitioner remitted an additional check from Mr. Simermeyer for $424.00 to fully satisfy his liabilities. As a result, petitioner was no longer liable for the tax that it had failed

to withhold on the monies paid to Mr. Simermeyer, only the penalties and interest due for its failure to properly withhold. Petitioner's assessments were therefore adjusted to give petitioner credit for the tax due but not remitted to New York State ($2,905.00) and New York City ($1,480.00) based upon Mr. Simermeyer's having filed a 1991 return. Following the conference, BCMS issued a Conciliation Order dated May 24, 1996 reducing the tax due to $68,787.72, plus penalty and interest.

31. The only explanation offered by petitioner to show why it had classified its messengers as nonemployees was that it was industry practice to do so. However, petitioner failed to provide the Division with any substantiation of its claims regarding industry practice.

32. In its petition, Rightway Courier, N.Y., Inc. made the following allegations as to why the notices of deficiency were in error:

(a) they were based upon erroneous allegations by the auditor that petitioner failed to adequately provide necessary information to complete the audit;

(b) the auditor misclassified all nonemployees as employees for purposes of the withholding tax;

(c) the auditor improperly determined that certain legitimate business expenses should be disallowed;

(d) the notices of deficiency exceed the permissible rate of assessment.

Unfortunately, petitioner submitted no evidence to support any of these contentions.

## *CONCLUSIONS OF LAW*

A. Tax Law § 671(a)(1) requires every employer maintaining an office or transacting business in the State and making payment of any taxable wages to a resident or nonresident, to deduct and withhold from such wages for each payroll period a tax in an amount substantially

equal to the tax reasonably estimated to be due from the employee's New York adjusted gross income or New York source income received during the calendar year (***see also***, Administrative Code of City of NY §§ 11-1771 and 11-1908). The method of determining the amount to be withheld is prescribed by regulations issued by the Commissioner (Tax Law § 674[a][1]).

B. During the years 1990 and 1991, section 674(a)(4) of the Tax Law required employers to file returns (Form IT-2101) and pay withholding tax on a semi-monthly basis where the aggregate amount required to be deducted and withheld by the employer for either of the semi-annual periods could reasonably be expected to be $7,500.00 or more, but less that $35,000.00. Based upon the information provided during petitioner's withholding tax audit, the Division determined that petitioner should have been filing withholding tax returns and remitting withholding tax on a semi-monthly basis pursuant to Tax Law § 674(a)(4).

During the year 1992, section 674(a)(1) of the Tax Law provided that an employer who has been required to deduct and withhold a cumulative aggregate amount of $700.00 or more of tax during a quarter must file a return and pay over the tax. The foregoing return and remittance must be submitted on or before either the third or fifth business day following the date of making the payroll, depending upon the cumulative aggregate amount that the employer was required to pay in the calendar year which precedes the previous calendar year.[2] Tax Law § 674(a)(4) further provides that employers shall file a quarterly combined return, that quarter's wage reporting information, and such other related information as the Commissioner may prescribe no later than the last day of the month following the last day of the quarter, except that the return covering the last quarter of the year shall be filed no later than February 28th of the succeeding year.

[2]If $15,000.00 or more, it is the third business day; if less than $15,000.00, it is the fifth business day.

If supplemental wages (i.e., bonuses, commissions, overtime pay, sales awards) are paid at the same time as regular wages, the taxes to be withheld should be determined as if the total of the supplemental and regular wages were a single wage payment for the regular payroll period. If supplemental wages are paid at a different time, the employer may determine the tax to be withheld by adding the supplemental wages either to the regular wages for the current payroll period or to the regular wages for the last preceding payroll period within the same calendar year. However, if New York State tax and the applicable city tax have been withheld from an employee's regular wages, the employer may withhold from an employee's supplemental wages at rates determined pursuant to regulations issued by the Commissioner of Taxation and Finance, without any allowance for exemptions or deductions (***see***, TSB-M-91-[6]I).

C. Section 675 of the Tax Law provides that every employer required to deduct and withhold tax under Article 22 is liable for such tax (***see also***, Administrative Code §§ 11-1775 and 11-1913). Tax Law § 676 further provides that if 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 for such failure to deduct and withhold (***see also***, Administrative Code §§ 11-1776 and 11-1914). Thus, the employer will not be relieved of its liability for payment of the New York State personal income tax required to be deducted and withheld under sections 671 and 674 unless it can meet its burden of establishing that the tax has been paid.

D. The Tax Appeals Tribunal held in ***Matter of Atlantic & Hudson Ltd. Partnership*** (January 30, 1992) that:

> [a]lthough a determination of tax must have a rational basis in order to be sustained upon review (*see*, *Matter of Grecian Sq. v. New York State Tax Commn*., 119 AD2d 948, 501 NYS2d 219), the presumption of correctness raised by the issuance of the assessment, in itself, provides the rational basis, so long as no evidence is introduced challenging the assessment (*see*, *Matter of Tavolacci v. State Tax Commn*., 77 AD2d 759, 431 NYS2d 174; *Matter of Leogrande*, Tax Appeals Tribunal, July 18, 1991, c*onfirmed Matter of Leogrande v. Tax Appeals Tribunal*, 187 AD2d 768, 589 NYS2d 383, *lv denied* 81 NY2d 704, 595 NYS2d 398).

Where, as here, petitioner has failed to introduce any evidence to rebut the presumption of correctness, the issuance of the assessment provides the rational basis for the assessment. To hold otherwise would be in irreconcilable conflict with the principles that the Division does not have the burden to demonstrate the propriety of its assessment (***see***, ***Matter of A & J Gifts Shop v. Chu***, 145 AD2d 877, 536 NYS2d 209, ***lv denied*** 74 NY2d 603, 542 NYS2d 518; ***Matter of Blodnick v. New York State Tax Commn***., 124 AD2d 437, 507 NYS2d 536, ***appeal dismissed*** 69 NY2d 822, 513 NYS2d 1027; ***Matter of Scarpulla v. State Tax Commn***., 120 AD2d 842, 502 NYS2d 113) and that petitioner has a heavy burden to prove the assessment erroneous (***see, Matter of Executive Land Corp. V. Chu***, 150 AD2d 7, 545 NYS2d 354, ***appeal dismissed*** 75 NY2d 946, 555 NYS2d 692).

In that petitioner did not submit any evidence in support of its petition, petitioner has "surrendered to the statutory presumption of correctness" and the subject assessments must be sustained (***see, Matter of Tavolacci v. State Tax Commn***., 77 AD2d 759, 431 NYS2d 174).

E. The petition of Rightway Courier, N.Y., Inc. is denied and the notices of deficiency dated July 5, 1994, as modified by the Conciliation Order dated May 24, 1996, are sustained.

DATED: Troy, New York
April 2, 1998

/s/ Thomas C. Sacca
ADMINISTRATIVE LAW JUDGE