STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions	:	
of	:	
OFFICEMAX, INC.	:	DETERMINATION DTA NOS. 818769,
for Revision of Determinations or for Refund of Sales Use Taxes under Articles 28 and 29 of the Tax Law for the period September 1, 1992 through February 28, 1996.	:	818770

Petitioner, OfficeMax, Inc., 3605 Warrensville Road, Cleveland, Ohio 44122, filed petitions for revision of determinations or for refund of sales and use taxes for the period September 1, 1992 through February 28, 1996.

A hearing was commenced before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on June 25, 2002 at 10:45 A.M. and continued to conclusion on June 26, 2002 at 9:30 A.M. with all briefs to be submitted by January 6, 2003, which date commenced the six-month period for issuance of this determination. Petitioner appeared by Morrison & Foerster, LLP (Paul H. Frankel, Esq. and Michael A. Pearl, Esq., of counsel). The Division of Taxation appeared by Barbara G. Billet, Esq. (Cynthia E. McDonough, Esq., of counsel).

ISSUES

I. Whether the notices of determination assessing tax, penalty and interest should be dismissed because they were mailed to an incorrect address.

II. Whether petitioner has shown that the audit method was unreasonable or that the audit results were incorrect.

III. Whether penalties were properly imposed.

FINDINGS OF FACT

1. Petitioner, OfficeMax, Inc. ("OfficeMax"), is a retailer of office supplies, office equipment and office furniture. The company has retail stores and delivery centers throughout the United States. During the period in issue, September 1, 1992 through February 28, 1996, petitioner had approximately 25 stores in New York.

2. In January 1995, the Division of Taxation ("Division") commenced a sales tax field audit of OfficeMax for the period September 1, 1992 through May 31, 1995. With petitioner's consent, the audit period was extended through February 28, 1996.

3. Initially, the Division and petitioner considered the use of a statistical sampling method with the assistance of electronic data processing. This approach was later abandoned because of inadequacy petitioner's retention of computer records such that petitioner could not regenerate reports.

4. During the audit, petitioner executed a series of consents to extend the statute of limitations for assessing tax. The last consent extended the statute of limitations through June 20, 2000 in order to allow petitioner to have time to review the Statement of Proposed Audit Change.

5. The Division made several requests for books and records. One such request was made in a letter dated July 25, 1995 wherein the Division requested that petitioner make available on the appointment date, August 15, 1995, all of its books and records pertaining to its sales and use tax liability for the period under audit.

6. The field audit report shows that petitioner's address is 3605 Warrensville Center Road, Cleveland, Ohio 44122. This is where the auditor made most of her visits. In the course of her

audit, the auditor dealt with Gregg Flaesgarten, Dick Alshaw, Karen Pollard and, starting in September 1999, Nichole Gallagher. There were also a couple of brief meetings with a Mr. Goodman. Ms. Gallagher and Mr. Goodman were cooperative during the audit, petitioner's records were auditable and there were adequate internal controls. However, certain records were missing, not kept in order by state or, in the case of store closing reports, destroyed because they were not reliable.

7. In order to determine the amount of sales and use taxes due, the Division decided to use both detailed and estimated methodologies. Petitioner signed a form authorizing the use of a test period method for sales and recurring expense purchases. The auditor examined the sales and use tax accrual accounts in detail and found that $20,246.51 was due.

8. The capital account was also examined in detail. Petitioner made available three-ring binders with all asset invoices for all of the states. After reviewing all of the invoices, the auditor determined that use tax was due in the amount of $208,401.56. She assessed tax on items where tax had not been paid or accrued. The most significant problem was that petitioner was buying items out of state and not accruing the tax.

9. A test period method using seven months was selected to determine the amount due on expenses. The Division had planned to use each April and October during the audit period since these were not particularly high or low months. However, petitioner was unable to locate certain microfiche records and the test period became October 1992, April 1993, November 1993, April 1994, October 1994, May 1995, and November 1995. Petitioner agreed to the new test period.

10. The auditor reviewed a chart of accounts and selected those accounts she wished to examine. The auditor then examined petitioner's general ledger and microfiche and printed out

the activity for each account number that she had selected for the seven months. The volume was great because petitioner could not regenerate reports.

11. The auditor made a list of vendors so that OfficeMax could select the boxes it needed to get the desired invoices. The auditor explained to petitioner that if she found a vendor who was properly charging tax, she would not need to review invoices from the vendor for the next month. The auditor selected 40 or 50 accounts to examine and then projected the results to the entire audit period. During the audit, petitioner did not object to this methodology.

12. Following a review of invoices, the Division determined that additional tax was due on centralized purchases such as catalogues and grand opening expenses because the Division could not verify that tax had been paid. The centralized purchases were allocated to New York. For printed materials, the allocation was based upon New York stores to total stores. For grand opening expenses, the allocation was based upon total New York stores opened to total stores opened during the audit period. During the audit, petitioner did not explain to the auditor any of the procedures for how it used tax exempt certificates.

13. The additional sales and use taxes due on expenses was $726,876.84. This amount included invoices and cash payouts where there was no backup because the cashiers' closing reports were destroyed.

14. A one-month test of exempt sales was proposed for the month of November 1994. However, data for this month was unavailable. Therefore, the month of November 1995 was agreed upon as the test month. Using the exempt sales report, the Division examined all available certificates and assessed tax on all transactions where a certificate was not obtained or the tax key was overridden by the use of a default key and the customer was not known. The additional sales tax assessed on unsubstantiated exempt sales was $616,187.54.

15. Petitioner appeared to have a casual attitude toward the audit. It had a number of audits in progress and this was regarded as one of many. When Ms. Gallagher started, the auditor started getting more information but Ms. Gallagher encountered resistance from her company.

16. During the audit, the auditor sent petitioner the workpapers and had discussions with petitioner's tax department regarding the progress of the audit.

17. On or about March 13, 2000, the auditor sent petitioner a Statement of Proposed Audit Changes for Sales and Use Tax, with supporting schedules, that stated that tax, penalty and interest were due in the amount of $4,528,111.38. In response, Mr. Mike Tilton, vice-president, corporate tax, sent a letter dated March 20, 2000, which stated that petitioner had been able resolve all of the issues except penalty in the amount of $601,755.17 which he felt should be abated because the liability was the result of reasonable cause and not willful neglect. Mr. Tilton pointed out that the error percentage of tax due on exempt sales was less than 1.6 percent of the total sales during the audit period and that while OfficeMax exercises due care in obtaining exemption certificates and verifying exempt sales, the number of transactions makes complete compliance extremely difficult. In a second undated letter Mr. Tilton explained that OfficeMax was in agreement with the fixed asset and exempt sale portion of the audit. However, OfficeMax disagreed with the method used to allocate the grand opening expenses and the amount of tax assessed on the advertising expenses.

18. In a letter dated April 19, 2000, the auditor told Mr. Tilton that she requested a breakdown of a particular account from Ms. Gallagher before issuing the statement of proposed audit adjustment but Ms. Gallagher was not getting cooperation from OfficeMax's advertising department. The auditor also stated that she felt that penalties were properly imposed because

OfficeMax's business approximately doubled but the liability went up by more than 575 percent. The letter explains that in the interest of resolving this matter, she would be willing to abate the penalties for settlement purposes only. The auditor cautioned OfficeMax that if petitioner continued to disagree with the audit, the penalties would be reimposed.

19. The auditor's team leader, Ms. Sydoriak agreed that penalties were properly imposed because of the difficulties incurred regarding the retrieval of documents. In a conversation, Ms. Pollard, petitioner's employee, explained to Ms. Sydoriak that OfficeMax had problems because of its policy of putting money into opening stores and not in its tax department. As a result, it did not have sufficient staff to deal with records and audits. One reason the audit took a long time to complete is that the auditor had to go through boxes which were sitting in warehouses looking for records which were not there.

20. The auditor addressed the concerns raised by petitioner, and on April 19, 2000, the Division issued a revised Statement of Proposed Audit Change for Sales and Use Tax which stated that tax was due in the amount of $1,722,462.54 plus interest in the amount of $1,045,759.36 for a balance due of $2,768,221.90. Penalty was not imposed on this document.

21. Petitioner disagreed with the revised Statement of Proposed Audit Change. However, it agreed to pay the sales portion of the audit and the minimum interest on the agreed amount of tax. In accordance with this understanding, on May 19, 2000 the auditor sent petitioner by facsimile a new Statement of Proposed Audit Change for that portion of the audit which was accepted by petitioner. This statement assessed tax in the amount of $616,187.54 plus interest in the amount of $368,529.04 for a balance due of $984,716.58. On May 19, 2000, the statement was signed by Mr. Tilton. A notation stating "Agreed Portion Audit Only" was written on the statement directly above a table setting forth the tax and interest which were assessed. Directly

above the line where Mr. Tilton signed there was a paragraph which provided, in part, "I may consider these findings final unless I hear from the Department to the contrary within 60 days after receipt of this signed consent." At the time the auditor agreed to send this statement to petitioner, it was informed that the Division would issue a separate assessment for penalty and interest.

22. Each statement of audit change was sent to 3605 Warrensville Center Road, Cleveland, Ohio 44122.

Preparation and mailing of the notices of determination

23. As a result of petitioner's agreement with the sales tax portion of the audit and disagreement with other portions of the revised audit adjustments, the Division decided to issue three notices of determination. The first notice was for the agreed upon sales tax plus minimum interest and is not in issue in this matter. The second notice assessed additional interest and penalties upon the sales tax portion of the audit. As outlined in the auditor's letter of April 19, 2000, this notice was issued because petitioner did not agree to the entire audit adjustment. The third notice asserted tax, penalties and statutory interest on the use tax portion of the audit.

24. The auditor was not in a position to generate and mail the notices of determination on her own. All notices had to be created by the Division's Case and Resource Tracking System ("CARTS") and mailed from Albany, New York.

25. The auditor needed 30 days prior to the expiration of the statute of limitations in order to prepare the diskette which would then be uploaded into CARTS. By uploading the assessments, it meant that she had to obtain information from the database regarding how she wanted the assessments to be created. These are called sequences and, in this instance, there were three of them. The first sequence was for the agreed tax. The second sequence was for the

excess interest and the penalties and the third was for the balance of the audit. The three sequences generated three assessments. Thereafter, the auditor verified that the correct taxpayer was identified, that she was using the correct taxpayer's identification number and that the audit period was correct. The paperwork was reviewed by the auditor's team leader and, upon approval, the disk was given to clerical personnel whereupon it would be imputted into the system to be uploaded into the CARTS system.

26. An auditor does not tell CARTS where to mail a notice of determination and the computer screen viewed by the auditor does not show the taxpayer's mailing address which would be used to mail a notice of determination. Consequently, at the time she did the uplink, the auditor did not know that the notice would be sent to an Illinois address.

27. Prior to the preparation of the diskette for uploading into the CARTS system, the auditor had printed out petitioner's mailing address which was shown on the Division's Taxpayer's Indicative Data System ("TIDS"). The TIDS's screen listed petitioners' mailing address as P.O. Box 228070, Cleveland, Ohio 44122-8070. This was the same mailing address that petitioner had used on its letterhead in its correspondence with the auditor. The auditor believed that the notices of determination were being sent to this address and that it was a current address.

28. When the auditor was doing the upload, there was a notation which said "nixie 1" which bore the date of January 20, 2000. At the time of the upload, the auditor did not know that nixie 1 meant that an address was not valid. At the time of the hearing, the auditor did not recall if she saw the nixie when she was doing the upload.

29. In the beginning of July, the auditor received a telephone call from Alice Chiappellone, one of petitioner's contact people, stating that she had not received the notices. At

this point, the auditor was not concerned and asked Ms. Chiappellone to check with the tax department in Cleveland or find out if they were "stuck" in the mailroom. The auditor asked Ms. Chiappellone to get back to her if there was a problem. In August, Ms. Chiappellone told the auditor that she had still not received the notices. When the auditor heard this, she became concerned because she was worried that petitioner would lose its right to protest the notices. The auditor wanted to make sure that the taxpayer had the notice numbers so that it would not lose its rights. On August 24, 2000, the auditor sent Ms. Chiappellone, by overnight mail, a post-it with the notice numbers and a request for a conciliation conference so petitioner could file a protest. The auditor also asked the field audit management office to send Ms. Chiappellone copies of the assessment because the auditor could not regenerate them. On August 30, 2000, the notices were mailed to petitioner at its mailing address in Cleveland, Ohio.

30. As a matter of standard practice, the auditor does not receive a copy of the notice of determination.

31. The return address on the envelope used to mail the notices in July 2000 was the Buffalo District Office. Therefore, if the assessments at issue in this matter could not be delivered, they would have been returned to the Buffalo District Office and handed over to the auditor. When Ms. Chiappellone called, the letters had not been returned so the auditor was not concerned. She anticipated that someone in petitioner's mailroom had them.

32. After the notices were mailed a second time, the auditor and another individual on her audit team started examining computer screens and discovered that petitioner had a different address on its highway use tax returns and the computer associated the assessment numbers with that address. The auditors realized that the notices had gone to the address on the highway use

tax returns. After calling a number of people, the auditors learned that since the Ohio address had a nixie, it went to the next address on the system.

33. As part of her inquiry, the auditor requested information from the individual who supervised the mailroom in Albany, New York, James Baisley, as to where the notices were mailed. In response, Mr. Baisley sent the auditor two United States Postal Service form 3811-A's which showed that the notices were delivered to petitioner's highway use tax address in Barrington, Illinois on June 6, 2000 and June 15, 2000, respectively. The forms show that each notice was sent to OfficeMax Inc., c/o Idealease Inc., 28W144 Industrial Ave. #116, Barrington, Illinois 60010-5939. Mr. Baisley also sent the auditor two USPS forms 3849 which indicated that the notices were delivered to the Barrington, Illinois address on June 6, 2000 and June 15, 2000, respectively. The forms contained the signatures of the individuals who received the certified mail.

34. The June 12, 2000 notice was date stamped received by petitioner "September 5, 2000." The notice of June 2, 2000 was date stamped by petitioner "September 21, 2000."

35. Petitioner subsequently requested a conference with the Bureau of Conciliation and Mediation Services. In separate conciliation orders, dated July 20, 2001, the requests were denied and the statutory notices were sustained.

The Relationship between CARTS and TID

36. Notices of determination are generally issued by CARTS. After an auditor uploads the information that becomes part of the CARTS system, CARTS uses the information to generate the notices of determination.

37. In order to obtain the mailing address, the billing system in CARTS calls another system known as TID, taxpayer indicative data, which provides the mailing address for billing.

After the notices are printed, the entire batch of notices is sent to a unit to prepare them for mailing. Copies of the notices of determination are not sent to the auditor at the time that CARTS generates the notices for mailing.

38. CARTS prints notices in batches which range in size from 3,000 to 30,000 notices. There is no manual review of the notices of determination. If a notice of determination is undelivered or returned by the Post Office, it is not returned to CARTS. The undelivered notices go to either the nixie unit, which is on the W.A. Harriman Campus in Albany or the District Office.

39. An individual in a clerical position input information regarding OfficeMax with an Illinois address into the system. No one checked the address because it is an automated process.

40. The TID system sets forth the taxpayer's name, identification number and address. It also includes nonfinancial data that may be present for the specific taxes such as a business creation date, filing frequency and activation date. TID and CARTS are separate systems. CARTS obtains a current address for a particular mailing from TID. There can be different mailing addresses for different taxes for the same taxpayer.

41. The TID system distinguishes between a taxpayer's physical address and mailing address. The two addresses are not necessarily the same.

42. A taxpayer is entered on the TID system through an enrollment process. For sales tax, this involves completing a sales tax registration form and being authorized to do business as a sales tax vendor in New York state. The certificate of registration may have multiple listings such as the physical address, the mailing address and a listing of multiple locations that the taxpayer may have in New York State.

43. The address that TID uses can come from many sources such as the taxpayer, the representative or other agencies such as the Department of State or Department of Labor. It can also come from the Postal Service or vendors.

44. TID handles approximately 20,000 to 30,000 change of addresses annually. At the time of the hearing, TID had 42 million addresses on file.

45. A nixie is an indication that an address is not valid. A nixie 1 indicates that it is the first time that it is entered into the system. Here, the TID system showed that a nixie 1 was entered on January 20, 2000. The TID system also showed that a nixie 2 was entered on August 2, 2000. The nixie 2 refered to the address entered as Tax Department, P.O. Box 228070, Cleveland, Ohio. A nixie 2 will interface with the return processing system. In some instances, it will stop the mailing of returns and notices.

46. During the billing process, TID is called upon with a specific routine that asks for the current address of the taxpayer. When there is a nixie on the address, the computer employs an algorithm which prompts the computer to look for another address that would be considered valid. The Barrington, Illinois address was considered a valid address.

47. Other than the person who is entering the address, there is no one who verifies whether the address is correct.

Prompt Tax

48. Prompt Tax is a processing system which the Division uses for electronic payments and filings. Taxpayers who make large payments are required to participate. The prompt tax system is much smaller than CARTS or TID. It processes transactions for about 15,000 taxpayers annually. Petitioner is a mandatory filer under the Division's Prompt Tax Program.

49. Prompt Tax has a separate enrollment process. In addition to the registration process, it must collect the same information as on the TID system, such as the contact person within the company and the filing and payment option that the person is selecting. Petitioner's enrollment form shows an address of 3605 Warrensville Center Road, Shaker Heights, Ohio 44122.

50. Prompt Tax has a primary contact person because the nature of electronic transactions is so dynamic that whenever there is an error or a need to contact the taxpayer, there is also a sense of urgency because millions of dollars are at stake. On sales tax, the contact person is contacted once a month in order to describe the current transaction, due dates and issues with the taxpayer's account. Prompt Tax handles the payment realm and all of the back office interfaces into the audit maintenance systems. When a taxpayer is selected for an audit, it is passed on to the Audit Division. Prompt Tax makes a practice of sending receipts for the payment of taxes.

51. Each time a payment is made through Prompt Tax, a confirmation is sent to the taxpayer. Prompt Tax does not interface with CARTS. However, it does interface with TID. Nixies are not transferred to the prompt tax system. Consequently, petitioner's Prompt Tax address at 3605 Warrensville Center Road, Shaker Heights, Ohio 44122 continued to be used by Prompt Tax to send out payment confirmations.

52. Once a batch of notices is generated by CARTS, two copies of the certified mail record ("CMR") along with the batch of notices are transferred to personnel under the supervision of Ms. Geraldine Mahon, Principal Clerk. The CMR is a list of the notices that are being mailed by certified mail. The certified numbers run in consecutive order. For each piece of mail, the CMR shows the certified mail number, the notice number, the party the item is addressed to and the mailing address. The date which appears in the corner of the document is

the date the CMR was printed. Ms. Mahon keeps one copy of the CMR until the other CMR comes back from the post office with a postmark date stamped on it.

53. The certified numbers on the CMR correspond with the numbers that appear at the top of the notices. The certified number is visible after it is placed into the envelope so that the Postal Clerk can see it.

54. Ms. Mahon's unit received a seven-page CMR with a printed date of May 23, 2000. Above this date, the date of June 2 is handwritten. The date printed on the upper left hand corner of the CMR is the date that the CMR was printed. The handwritten date is the date that the documents were mailed. The seventh page of the CMR shows that a document with notice number L 017915174 and certified mail number P 911 205 902 was sent to OfficeMax Inc. c/o of Idealease Inc. in Barrington, Illinois. Each page of the CMR bears the stamp of the Colonie Center Post Office.

55. The Notice of Determination which corresponds with this entry in the CMR is dated June 2, 2000 and is addressed to OfficeMax Inc. c/o Idealease in Barrington, Illinois. The notice is dated June 2, 2000 and assesses sales and use tax in the amount of $1,106,275.00 plus interest in the amount of $1,115,353.82 and penalty in the amount of $342,196.04 for a balance due of $2,563,824.86. The notice bears certified mail number P 911 295 902 and assessment number L-017915174-3.

56. Ms. Mahon's unit received a 41-page CMR bearing a printed date of June 2, 2000. This date is crossed off and new date of June 12, 2000 was inserted because that is the date that the notices were mailed.

57. Page 41 of the certified mail record dated June 12, 2000 shows that correspondence with certified mail number P911006657 and notice number L 018009132, was addressed to

OfficeMax Inc. c/o Idealease Inc., 28W144 Industrial Ave. #116, Barrington, Illinois 60010-5939, not to an address in Ohio. The Notice of Determination which corresponds to this entry in the certified mail record is dated June 12, 2000 and bears the same certified mail number as is set forth on page 41 of the CMR. The notice is addressed to OfficeMax Inc. c/o Idealease Inc. in Barrington, Illinois and assesses penalty and interest in the amount of $407,504.38. Each page of the CMR bears the stamp of the Colonie Center Post Office.

58. On June 2, 2000, Ms. Mahon's unit made up a form 8084 which tells the mailroom that there were a certain number of letters which have to be mailed by certified mail on a certain date. The mailroom is also told if the piece of mail needs a return envelope and, if so, what type of return envelope to use. Ms. Mahon's unit needs a lead time of six or seven days between the date that the CMR is printed and the date on the notices in order to get the work completed.

59. The Postal Service stamps the date of mailing on the certified mail record. Thereafter, this record is returned to Ms. Mahon. Initially, Ms. Mahon receives two copies of the certified mail record. She keeps one in her office until she receives the second one back with the date of mailing on it.

60. Ms. Mahon follows the same procedure for all mailings. Someone in the post office affixed the postmark. She does not verify addresses and it is not the responsibility of anyone in her office to verify addressees. Her responsibility is to make sure that they have bills or documents that correspond with the document in the mail log and send them to the mailroom.

61. Mr. LaFar is the principal supervisor of the Division's outgoing mailroom. When Ms. Mahon's unit is finished with its tasks, the mail and CMR are taken to Mr. LaFar's unit.

62. Certified mail is kept in sequential order according to the certified number. The United States Postal Service has approved of the Division's practice of using the CMR in the

place of United States Postal Service Form 3811. The Division checks the first and last numbers against the CMR to determine if they are correct and, when it is a large mailing, the Division will perform a random check to make sure that certain numbers are there and that they are in order.

63. The mail itself has to go through an inserting machine where it is folded and placed in an envelope. The mail is then weighed to make sure it has the right postage on it. Thereafter, the mail is then sealed.

64. The mail and CMR are brought to the post office. After the postal clerk checks the CMR to make sure that it is correct, the postal clerk will stamp each page and circle the total number of pieces received. The clerk is also supposed to initial the page which contains the total number of pieces received. When this process is completed, the certified mail record is returned to Ms. Mahon. Individual offices within the Division decide if they want a return receipt on the envelope.

65. Mr. LaFar's unit does not check addresses or receive verification that notices were delivered.

The Illinois Address

66. OfficeMax had an arrangement with a company called Idealease Inc. ("Idealease") to rent a truck in New York. Under their contract, Idealease provided the equipment and OfficeMax operated the equipment. In 2000, there was a truck operated by one of petitioner's stores which required the filing of a highway use tax return. Under the terms of its full-service lease agreement, it was the responsibility of Idealease to file the return and pay the required amount. Idealease would then issue to petitioner an invoice for the amount due. The only return filed by Idealease for OfficeMax was for highway use tax. The highway use tax returns had the

following address: OfficeMax Inc., 28W144 Industrial Ave. #116/IDE, Barrington, IL 60010-5939.

67. OfficeMax has never given Idealease the authority to act as an agent for OfficeMax to receive tax notices. OfficeMax was not a sister corporation or subsidiary of Idealease. They did not have any common ownership.

Petitioner's Last Sales and Use Tax Returns Prior to the Issuance of the Notices

68. Petitioner filed a New York State and Local Sales and Use Tax Return for Part-Quarterly Filers for the period March 1, 2000 through March 31, 2000. Petitioner's address is listed as 3605 Warrensville Center Road, Shaker Heights, Ohio 44122, and the return is dated April 20, 2000. In a letter dated April 27, 2000 which was addressed to petitioner at the address shown on its sales tax return, the Division acknowledged receipt of the payment which accompanied the return for the month of March.

69. Petitioner filed a New York State and Local Sales and Use Tax Return for Part-Quarterly Filers for the period April 1, 2000 through April 30, 2000. Petitioner's address is listed as 3605 Warrensville Center Road, Shaker Heights, Ohio 44122 and the return is dated May 20, 2000. In a letter dated May 25, 2000, which was addressed to petitioner at the address shown on its sales tax return, the Division acknowledged receipt of the payment which accompanied the return for the month of March. This was the last return filed by petitioner before the notices of determination were issued.

Petitioner's Tax Compliance Efforts

70. A substantial portion of petitioner's sales tax adjustment arose from the use of a "default" key. Under this procedure, the customer, who was exempt from tax, would have gone to the store, entered his or her name and address on a log and signed in a designated location.

The transaction date, dollar amount and transaction number would also be written on the log. The customers would have also completed an exemption certificate at the store. The store was responsible for having the certificate on file. Through the use of a default key by the cashier on the cash register, tax would not be charged on the transaction.

71. At the beginning of the audit period, each store kept a separate file of exemption certificates. However, as time progressed, petitioner started keeping the certificates at its corporate office. Thereafter, if a customer approached the cash register without the proper documentation, a cashier could utilize the default key in order to avoid having the customer make a scene. The customer would be asked to fill out a log. In order to discourage the use of the default key, OfficeMax would impose a charge on the stores for the use of the default key.

72. An internal memorandum of OfficeMax, dated July 11, 2000, stated that in the Fall of 1997 petitioner realized that its method of accepting and tracking customers who were exempt from sales tax was not adequate to satisfy the customer and minimize the risk that OfficeMax was incurring in assessments. It was explained that the current system, which began in 1995, was not sufficiently flexible to allow for the increase in the number of stores, increased catalogue sales and the development of the internet. In order to resolve this difficulty, petitioner proposed to implement a new system, known as Burden of Proof ("BOP") which would serve as a database for tax exempt certificates and screen tax exempt customers in a friendly manner that would satisfy the requirements of New York. In a letter dated August 18, 1999, the Division advised petitioner's accounting firm that it was giving tentative approval for the BOP software. However, as of the date of the hearing, the new system has not been fully approved by New York State and the BOP system was not in place.

SUMMARY OF THE PARTIES POSITIONS

73. At the hearing, the petitioner presented the testimony of Ms. Chiapellone as an expert on auditing. With respect to expenses, Ms. Chiappellone concluded that the deficiency should have been $185,217.97 instead of approximately $726,145.51. She attributed the higher assessment to a double-counting of certain accounts where there was a prepaid item and a corresponding expense such as prepaid maintenance agreements. Ms. Chiappellone calculated an error rate which was applied to total purchases to determine the amount which she felt should have been assessed on expenses.

In regard to capital assets, Ms. Chiappellone reviewed the same documents as the auditor and found that there was a deficiency of approximately $74,000.00. Ms. Chiappellone concluded that a significant amount of the deficiency was attributable to the construction of new stores which are a capital improvement which is not subject to sales tax. Lastly, Ms. Chiappellone found that the auditor's deficiency on catalogue costs overstated the deficiency by more than $120,000.00. In determining the amount due, the taxpayer felt that the auditor used ratios that made no sense.

Ms. Chiappellone questioned the auditor's contention that many documents could not be found and opined that an auditor could not have properly reviewed so many boxes as quickly as the auditor claimed that she did in this instance.

74. Petitioner argues that the notices of determination were invalid because they were mailed to an incorrect address and were not received by petitioner within the periods prescribed by the Tax Law. According to petitioner, the incorrectly addressed notices were not entitled to a presumption of delivery. Therefore, the mailing of the notices to Idealease did not constitute receipt by petitioner. Petitioner next contends that the notice of June 2, 2000, which was mailed

to an incorrect address, should be canceled because it was not received until after the period of limitation had expired. It is further submitted that the notice of June 12, 2000 should be canceled because it was not received by petitioner within the 60-day period provided in the May 19, 2000 Statement of Proposed Audit Change. According to petitioner, the Division's August 30, 2000 mailings of the copies of the notices of determination were invalid because the notices were not remailed in accordance with the Division's procedure and the incorrectly addressed notices were barred by the statute of limitations. According to petitioner, the Division improperly imposed penalties after petitioner complied with the statement of proposed audit change. It is also contends that reasonable cause exists for the waiver of penalty and interest. Lastly, petitioner posits that the use tax adjustment is without a rational basis.

75. In response, the Division argues that the notices of determination were properly mailed because they were timely mailed to a current address of petitioner; that there is no requirement in Tax Law § 1147 that the Division use a particular address for a taxpayer that uses multiple addresses; and, that petitioner was not prejudiced by any purported error in the mailing of the notices. The Division further contends that it properly determined the amount of sales and use taxes due. In this regard, the Division states that petitioner has not established that the Division's audit methodology was irrational or unreasonable. It is further submitted that petitioner's alternative estimates of its tax liability do not invalidate the Division's audit findings. Lastly, the Division maintains that the imposition of penalties was proper.

CONCLUSIONS OF LAW

A. Tax Law § 1138(a)(1) provides that a notice of determination "shall be mailed by certified or registered mail to the person or persons liable for the collection or payment of the tax at his last known address in or out of this state." Section 1147(a)(1) of the Tax Law provides:

> Any notice authorized or required under the provisions of this article may be given by mailing the same to the person for whom it is intended in a postpaid envelope addressed *to such person at the address given in the last return filed by him pursuant to the provisions of this article or in any application made by him or, if no return has been filed or application made, then to such address as may be obtainable.* The notice of determination shall be mailed promptly by registered or certified mail. The mailing of such notice shall be presumptive evidence of the receipt of the same by the person to whom addressed. Any period of time which is determined according to the provisions of this article by the giving of notice shall commence to run from the date of mailing of such notice (emphasis added).

B. The Division's argument that the notices of June 2 and June 12 were timely mailed to a current address overlooks the explicit language of Tax Law § 1147(a)(1). Here, petitioner has consistently used its Warrensville Center Road address on its sales tax returns. In view of the unambiguous language in Tax Law § 1147(a)(1), it is clear that the notices sent to Barrington, Illinois rather than the Warrensville Center Road address in Ohio were not correctly mailed (***see, Matter of Rakuskin***, Tax Appeals Tribunal, July 26, 2001; ***Matter of Combemale***, Tax Appeals Tribunal, March 31, 1994).

C. In regard to the arguments set forth in petitioner's brief, several points are germane. First, the Division's argument that petitioner had multiple addresses which justified the mailing of the notices to Illinois lacks any legal support. Tax Law § 1147(a)(1) calls for the use of the address on the last return filed pursuant to Article 28 of the Tax Law. It is of no consequence that petitioner listed a different mailing address on its correspondence with the Division, that its stores had separate addresses, that it had various office locations in Cleveland or that the address of Idealease was used for its highway use tax returns.

D. Second, the Division has argued that the completed United States Postal Service 3811-A forms establish the delivery by the Postal Service to OfficeMax in Barrington, Illinois. In this vein, the Division refers to Idealease as petitioner's agent for highway use tax filings and

submits that "[p]etitioner through its HUT filing agent received the original Notices . . . ." (Division's brief, p. 30). This argument is also without merit. There is no evidence in the record to support the proposition that Idealease was authorized to act as petitioner's agent to receive notices. To the contrary, the uncontradicted evidence is that Idealease was not authorized to act as the agent for OfficeMax for any purpose.

E. The Division argues that "[p]etitioner was not prejudiced by any purported error in the mailing of the Notices." (Division's brief, p.30). The Division asserts that petitioner included the remailed notices in its petitions and was also able to contest them at the Bureau of Conciliation and Mediation Services. Relying, in part, upon ***Matter of Brager*** (Tax Appeals Tribunal, May 23, 1996) the Division contends that the proper remedy is not to cancel the assessments but to allow for a hearing on the merits. The question is not whether petitioner ever received the notices. Rather, at this juncture the question is where the notices were mailed and when petitioner received the notices. Here, the uncontradicted evidence is that no notices were received by petitioner in June, July or August 2000. This testimony is consistent with the fact that one of petitioner's employees, Ms. Gallagher, made repeated calls to the auditor as to when she could expect to receive the notices.

F. The Division argues that when there are defects in the mailing address, the proper remedy is not to cancel the notices but to allow the petitioner a hearing on the merits. This argument fails to recognize a critical factor - when there is a defect in the mailing address, the question is whether the notices were received in a timely manner. Thus, in ***Agosto v. Tax Commission of the State of New York*** (68 NY2d 891, 508 NYS2d 934) and in ***Matter of Rosen*** (Tax Appeals Tribunal, July 19, 1990) requests for hearing were denied because the taxpayers had actually received the notices within the period of limitations on assessment,

notwithstanding that the notices had errors on the addresses, but had not filed protests within the required 90-day period after actual receipt of such notices.

G. The Division's reliance upon ***Matter of Brager*** (Tax Appeals Tribunal, May 23, 1996) is misplaced. Unlike the situation presented here, in ***Brager*** there was no question that the notices were properly mailed to the address on the last income tax return filed by him.

H. ***Matter of Combemale*** (Tax Appeals Tribunal, March 31, 1994) is instructive on the issues presented in this matter. In this case, it was found that the taxpayers did not receive the notice in issue. The Tribunal then concluded that the error in the address was consequential and that the notice was not sent to the taxpayers' last known address. As a result the notice was not valid. The Tribunal explained the controlling principal as follows:

> The Appellate Division, Third Department, recently ruled on the effect of this provision [Tax Law § 681(a)] in ***Matter of Riehm v. Tax Appeals Tribunal*** (179 AD2d 970, 579 NYS2d 228, ***lv denied*** 79 NY2d 759, 584 NYS2d 447). The taxpayer in ***Riehm*** argued that the mailing of an incorrectly addressed notice of deficiency was ineffective to suspend the period of limitations on assessment and, therefore, if such a notice was received by the taxpayer after the period had run the notice would be untimely. The Court rejected this theory and held that "[a]s long as a notice of deficiency is actually received by the taxpayer in sufficient time to file a petition for redetermination, the notice is valid despite an error in the taxpayer's mailing address" (***Matter of Riehm v. Tax Appeals Tribunal***, ***supra***, 579 NYS2d 228, 229). From this principle, it follows that if the incorrectly addressed notice is not actually received by the petitioner, the notice is invalid (***see***, ***Matter of Karolight, Ltd.***, Tax Appeals Tribunal, February 8, 1990; ***see also***, ***Shelton v. Commissioner***, 63 TC 193).

I. The evidence in the record establishes that petitioner did not receive the incorrectly addressed notice dated June 2, 2000 within the period of limitation for protesting the assessment. Therefore, the June 2, 2000 notice was invalid.

J. Petitioner received the notice dated June 12, 2000 in sufficient time to challenge the assessment. However, petitioner argues that the June 12, 2000 notice should be canceled because it was not received by petitioner withing the 60-day period set forth in the signed May

19, 2000 statement of proposed audit change. The sentence which petitioner relies upon states "I may consider these findings final unless I hear from the Department to the contrary within 60 days after receipt of this signed consent."

K. Petitioner's argument is without merit. The obvious intent of the provision relied upon by petitioner is to insure that a taxpayer receives timely notice whether the findings in a statement of proposed audit change will finally resolve the matter. In her letter of April 19, 2000, the auditor clearly explained that penalties would be imposed unless there was an agreement to the entire audit. Therefore, at the time Mr. Tilton signed the statement he should have known that penalties would be imposed and that he could not consider the findings final. The record also shows that in early July 2000, Ms. Gallagher spoke to the auditor regarding the whereabouts of the notices. The auditor responded that Ms. Gallagher should check with OfficeMax's mailroom. Therefore, it is clear that petitioner "heard" within 60 days that the findings in the Statement of Audit Change were not final.

L. Tax Law § 1145(a)(1) provides that "any person failing to file a return or to pay . . . any tax . . . within the time required by or pursuant to this article . . . shall be subject to a penalty . . . . ." In order to have the penalties remitted, petitioner must establish that "such failure or delay was due to reasonable cause and not due to willful neglect." (Tax Law § 1145[A][1][iii].) The burden is upon petitioner to establish that the penalty was improperly imposed (***Matter of MCI Telecommunications Corp.*** (Tax Appeals Tribunal, January 16, 1992, ***confirmed*** 193 AD2d 978, 598 NYS2d 360).

M. Petitioner has not established that the penalty was improperly imposed. As pointed out by the Division, tax was assessed on four areas: unsubstantiated exempt sales, accruals, fixed

assets and expenses. However, petitioner presented evidence only with respect to its efforts to improve its record keeping of exempt sales.

The steps taken by petitioner with regard to exempt sales do not demonstrate a lack of willful neglect. Petitioner continued to use the "default" key throughout the audit period despite the problems caused by this practice. Although petitioner initiated a new system in 1995, it was not adequate to meet the demands placed upon it. The most recent system, BOP, was not implemented during the period in issue.

Petitioner's record keeping with respect to the other major areas of the audit was also inadequate. The proposed test period for expenses had to be changed because of the unavailability of records. In addition, the auditor found it necessary to allocate centralized purchases, such as for catalogues, to New York. Following a detailed examination of invoices, the Division concluded that there was a significant underpayment of tax on the capital account. This lapse has not been explained. In sum, petitioner has not shown that the failure to pay was due to reasonable cause and not willful neglect.

N. The petitions of OfficeMax, Inc., dated October 12, 2001 are granted to the extent of Conclusion of Law "I" and the Notice of Determination dated June 2, 2000 is canceled. The petitions are otherwise denied and the Notice of Determination, dated July 12, 2000, is sustained together with such penalty and interest as may be lawfully due.

DATED: Troy, New York
July 3, 2003

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE