STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
MORRIS CHARITON	:	DETERMINATION DTA NOS. 819643
for Revision of a Determination or for Refund of Sales Use Taxes under Articles 28 and 29 of the Tax Law for the Period December 1, 1998 through August 31, 2001.	:	AND 819644

Petitioner, Morris Chariton, 32 Merry Lane, Westbury, New York 11590, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 1998 through May 31, 2001.

A hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York on October 26, 2004 at 10:30 A.M., with all briefs to be submitted by March 25, 2005, which date commenced the six-month period for issuance of this determination. Petitioner appeared by Isaac Sternheim & Co. (Isaac Sternheim, C.P.A. and Jacob Herskovits, P.A.). The Division of Taxation appeared by Christopher C. O'Brien, Esq. (Robert Maslyn, Esq., of counsel).

ISSUES

I. Whether the audit methodology employed by the Division of Taxation was reasonably calculated to reflect the sales and use taxes due.

II. Whether penalties should be canceled.

FINDINGS OF FACT

1. During the period in issue, petitioner, Morris Chariton, was the sole proprietor of a retail jewelry store in Massapequa, New York known as the "Linda Shop." In addition to sales of jewelry and watches, the Linda Shop also performed repair work.

2. On August 3, 2001, the Division of Taxation ("Division") mailed a letter to petitioner which stated that a field audit had been scheduled on August 17, 2001 at 9:30 A.M. The letter requested that petitioner supply all of his books and records pertaining to his sales tax liability for the period September 1, 1998 through May 31, 2001. A checklist accompanying the letter requested that petitioner provide, among other things: sales invoices, merchandise purchase invoices, bank statements, cash receipts journal, cash disbursements journal, general ledger, sales tax returns, Federal income tax returns, and any necessary documentation to prove nontaxable sales.

3. On the morning of October 15, 2001, at 9:30 A.M., an auditor met with petitioner's representative, Mr. Sternheim, in Mr. Sternheim's office. Following the auditor's explanation that he had come to look at the books and records of the Linda Shop, Mr. Steinheim proceeded to look through a series of boxes in order to locate the Linda Shop's records. After half of the day passed, Mr. Sternheim was unable to find the records. Mr. Sternheim told the auditor that the taxpayer would get him the records. The auditor was also told that the taxpayer and his wife were in and out of the hospital and that this was one of the reasons that the taxpayer's representatives did not have the records. After conferring with his supervisor, the auditor returned to his office.

4. The following day, the auditor called Mr. Sternheim and asked if he had received the records from petitioner's accountant. Mr. Sternheim replied that he still did not have any

records. In December 2001, Mr. Sternheim again told the auditor that he did not have any records for the auditor to review. Since the auditor was not presented with any of the Linda Shop's books and records, the auditor's supervisor told the auditor to utilize other information for the audit.

5. The auditor requested and received bank statements for one year from a bank account which petitioner maintained at the Bank of New York. Upon reviewing the bank statements, the auditor noticed that the bank deposits were greater than reported gross sales by approximately $1,500,000.00. The auditor then requested bank statements for the entire audit period and ascertained that the ratio of bank deposits to reported sales was approximately two to one.

6. Documentary evidence of nontaxable sales, such as invoices or shipping records for items shipped out of state, was not produced on audit and petitioner did not report any nontaxable sales on his sales tax returns. Consequently, other than readily evident nonsale credits, such as checks which were returned for insufficient funds and the payment of sales tax, the auditor deemed all of the bank deposits to be taxable sales. Reported taxable sales were subtracted from audited taxable sales to determine additional taxable sales of $2,856,412.41 and additional sales tax due of $242,795.06.

7. The Division issued a Notice of Determination to petitioner and the Linda Shop, dated May 24, 2002 (Assessment L-020837871-8), which assessed sales and use taxes in the amount of $242,795.06 plus interest and penalty for a balance due of $480,733.68. The Division also issued a Notice of Determination to petitioner, dated May 28, 2002 (Assessment L-020849746-9), which assessed sales and use taxes in the amount of $242,795.06 plus interest in the amount of $64,018.73 and penalty in the amount of $177,686.40 for a balance due of $484,500.19. The two notices are the same assessment issued under different identification numbers. The notice

dated May 24, 2002 utilized the business's Federal tax identification number while the notice dated May 28, 2002 was issued under petitioner's social security number.

8. The Division assessed a fraud penalty because it concluded that petitioner's underreporting was consistent and substantial for each quarter of the audit period. The Division also noted that petitioner had been audited on two previous occasions which resulted in the issuance of notices. Since petitioner did not provide any books and records, the Division further determined that he was uncooperative during the audit. Lastly, the Division believed that the civil fraud penalty was warranted by the failure or refusal to explain the difference between the bank deposits and the reported gross sales on the sales tax returns. The Division also assessed an omnibus penalty because the additional tax due was more than 25 percent of the amount of tax reported.

9. Petitioner's wife, Carmelita Chariton, performed bookkeeping services for the Linda Shop and prepared most of the information that was given to the outside accountant. The records were prepared at the store. Petitioner also supplied the accountant with some information. It was petitioner's practice to sit with his accountant when the accountant prepared the income tax returns. Petitioner never prepared his own income tax returns.

10. The sales and use tax returns were primarily prepared by Carmelita Chariton. Mrs. Chariton would use the information, documents and records which she had available to prepare the sales tax returns.

11. According to the Federal Schedule C's which accompanied petitioner's U.S. individual income tax returns, the gross receipts of the Linda Shop were $1,971,548.00 in 1999, $1,977,719.00 in 2000 and $1,910,504.00 in 2001.

12. The Linda Shop reported the following gross sales on its quarterly New York State and Local Sales and Use Tax Returns:

Quarter Ending	Gross Sales
November 30, 1998	$292,915.00
May 31, 1999	$151,430.00
August 31, 1999	$149,794.00
November 30, 1999	$221,061.00
February 29, 2000	$253,890.00
May 31, 2000	$145,824.00
August 31, 2000	$143,321.00
November 30, 2000	$61,591.00
February 28, 2001	$176,650.00
May 31, 2001	$152,721.00

13. Petitioner has been audited by the Division on two previous occasions. One audit, which was for the period December 31, 1994 through August 31, 1997, resulted in an assessment of $110,595.07 plus interest of $69,971.38 and penalty of $42,674.70. The assessment was reduced at a conciliation conference to $25,208.00 plus interest and no penalty. Following an audit for the period March 1, 1987 through November 30, 1991 sales and use tax was assessed in the amount of $152,819.00 plus interest of $89,950.45 and penalty of $49,355.80. After a conciliation conference, the assessment was reduced to $90,702.42 plus interest and no penalty.

14. Petitioner has been in poor health. He had double bypass surgery and has needed repeated trips to the hospital.

SUMMARY OF THE PARTIES' POSITIONS

15. At the hearing, petitioner testified that he made retail and wholesale sales during the period in issue. He also asserted that the Linda Shop had a number of customers from Florida and a few customers from California. Petitioner explained that he used the Postal Service in order to ship merchandise to other states. He further stated that the records of the Linda Shop were not made available to the auditor because he did not know where the records were and that he was hoping that his wife would start to feel better and be able to give the Division all of the information that it needed. In this regard, petitioner noted that his wife has a history of difficulty with her blood pressure and phlebitis. However, her condition kept deteriorating and, on January 7, 2003, she had a stroke. At the hearing, petitioner acknowledged that the records would have been at his home or at the store.

16. Petitioner argues that during the prior audits there were allowances for nontaxable sales and that a similar allowance should have been granted here. Petitioner further submits that the deficiency was a result of poor record keeping and that there was no attempt to defraud anyone. According to petitioner, there should not be any penalty and minimum interest should be charged.

17. The Division maintains that since no records were made available, it was authorized to estimate taxes. The Division notes that this was the third audit and petitioner should have known what was required of him. According to the Division, fraudulent intent may be inferred from the failure to produce records. The Division also notes that the underreporting was consistent for each and every quarter of the sales tax period in issue.

CONCLUSIONS OF LAW

A. The first question presented is whether the Division utilized an audit method that was reasonably calculated to determine Linda Shop's sales tax liability. The standard for reviewing a sales tax audit where external indices were employed was set forth in ***Matter of Your Own Choice, Inc***. (Tax Appeals Tribunal, February 20, 2003), as follows:

> To determine the adequacy of a taxpayer's records, the Division must first request ***(Matter of Christ Cella, Inc. v. State Tax Commn.***, [102 AD2d 352, 477 NYS2d 858] ***supra***) and thoroughly examine (***Matter of King Crab Rest. v. Chu***, 134 AD2d 51, 522 NYS2d 978) the taxpayer's books and records for the entire period of the proposed assessment (***Matter of Adamides v. Chu***, 134 AD2d 776, 521 NYS2d 826, ***lv denied*** 71 NY2d 806, 530 NYS2d 109). The purpose of the examination is to determine, through verification drawn independently from within these records (***Matter of Giordano v. State Tax Commn.***, 145 AD2d 726, 535 NYS2d 255; ***Matter of Urban Liqs. v. State Tax Commn.***, 90 AD2d 576, 456 NYS2d 138; ***Matter of Meyer v. State Tax Commn.***, 61 AD2d 223, 402 NYS2d 74, ***lv denied*** 44 NY2d 645, 406 NYS2d 1025; ***see also***, ***Matter of Hennekens v. State Tax Commn.***, 114 AD2d 599, 494 NYS2d 208), that they are, in fact, so insufficient that it is "virtually impossible [for the Division of Taxation] to verify taxable sales receipts and conduct a complete audit" (***Matter of Chartair, Inc. v. State Tax Commn.***, 65 AD2d 44, 411 NYS2d 41, 43; ***Matter of Christ Cella, Inc. v. State Tax Commn.***, ***supra***), "from which the exact amount of tax due can be determined" (***Matter of Mohawk Airlines v. Tully***, 75 AD2d 249, 429 NYS2d 759, 760).
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> Where the Division follows this procedure, thereby demonstrating that the records are incomplete or inaccurate, the Division may resort to external indices to estimate tax (***Matter of Urban Liqs. v. State Tax Commn.***, ***supra***). The estimate methodology utilized must be reasonably calculated to reflect taxes due (***Matter of W.T. Grant Co. v. Joseph***, 2 NY2d 196, 159 NYS2d 150, ***cert denied*** 355 US 869, 2 L Ed 2d 75), but exactness in the outcome of the audit method is not required (***Matter of Markowitz v. State Tax Commn.***, 54 AD2d 1023, 388 NYS2d 176, ***affd*** 44 NY2d 684, 405 NYS2d 454; ***Matter of Cinelli***, Tax Appeals Tribunal, September 14, 1989). The taxpayer bears the burden of proving with clear and convincing evidence that the assessment is erroneous (***Matter of Scarpulla v. State Tax Commn.***, 120 AD2d 842, 502 NYS2d 113) or that the audit methodology is unreasonable (***Matter of Surface Line Operators Fraternal Org. v. Tully***, 85 AD2d 858, 446 NYS2d 451; ***Matter of Cousins Serv. Station***, Tax Appeals Tribunal, August 11, 1988). In addition, "[c]onsiderable latitude is given an auditor's method of estimating sales under such circumstances as exist in

> [each] case" (***Matter of Grecian Sq. v. New York State Tax Commn.***, 119 AD2d 948, 501 NYS2d 219, 221).

B. In this case, the Division requested an opportunity to examine the Linda Shop's books and records. In response, no records were produced. The failure to make the Linda Shop's books and records available for examination justified the use of an indirect audit methodology (***Matter of Continental Arms Corp. v. State Tax Commn.***, 72 NY2d 976, 534 NYS2d 362). Further, it was reasonable to use bank deposits as a method to estimate the Linda Shop's gross sales and determine the amount of tax due (***see, e.g., Matter of D & V Liquor,*** Tax Appeals Tribunal, March 10, 2005).

C. Petitioner argues that the audit method was flawed because it failed to take into account nontaxable sales. The test of whether the audit methodology was reasonable is based upon the information available to the Division at the time the notice was issued (***Matter of Continental Arms Corp. v. State Tax Commn.***, ***supra***; ***Matter of Northern States Contracting Company***, Tax Appeals Tribunal, February 6, 1992). Here, petitioner did not report any nontaxable sales on his sales tax returns and did not offer any documentary evidence to the Division to support the existence of nontaxable sales. In the absence of any evidence to the contrary, the Division properly presumed that all of the receipts were subject to tax (Tax Law § 1132; ***see***, ***Matter of Petak v. Tax Appeals Tribunal***, 217 AD2d 807, 629 NYS2d 547; ***Matter of Academy Beer Distribs. v. Commr.***, 202 AD2d 815, 609 NYS2d 108, ***lv denied*** 83 NY2d 759, 616 NYS2d 14).

D. Petitioner may not rely on the modifications made at previous conciliation conferences to support adjustments to a notice. The Division has accurately noted that the record does not explain the basis for the adjustments to the prior assessments. Therefore, any adjustment to the

notices at issue because of what happened at prior conferences would be based on speculation. Further, discussions and adjustments made at conciliation conferences are in the nature settlement negotiations and may not be considered as precedent or be given any force or effect in any subsequent administrative proceeding (Tax Law § 170[3-a][f]; ***see, Matter of Petak v. Tax Appeals Tribunal, supra***).

E. Tax Law former § 1145(a)(2) provided in pertinent part:

> If the failure to pay or pay over any tax to the commissioner of taxation and finance within the time required by this article is due to fraud, in lieu of the penalties and interest provided for in subparagraphs (i) and (ii) of paragraph one of this subdivision, there shall be added to the tax (i) a penalty of fifty percent of the amount of the tax due, plus (ii) interest on such unpaid tax. . . .

F. Whether petitioners fraudulently failed to pay sales tax to the Division or filed willfully false or fraudulent returns with the intent to evade payment of tax are questions of fact to be determined upon consideration of the entire record (***Matter of Sona Appliances***, Tax Appeals Tribunal, March 16, 2000). The Division bears the burden of proving fraud by clear and convincing evidence (***Matter of Drebin***, Tax Appeals Tribunal, March 27, 1997, ***confirmed Matter of Drebin v. Tax Appeals Tribunal***, 249 AD2d 716, 671 NYS2d 565**;** ***Matter of Sona Appliances***, ***supra***). A finding of fraud requires the Division to show "clear, definite, and unmistakable evidence of every element of fraud, including willful, knowledgeable and intentional wrongful acts or omissions constituting false representation, resulting in deliberate nonpayment or underpayment of taxes due and owing" (***Matter of Sona Appliances, supra***). In order for the Division to satisfy its burden of proof, there must evidence of a specific intent to deliberately evade payment of taxes which are due and owing in addition to proof of underreporting (***see, Matter of Flanagan***, Tax Appeals Tribunal, June 14, 1990). Significant factors evidencing intent include a consistent and substantial understatement of tax, the amount

of the deficiency, a pattern of repeated deficiencies, the taxpayer's course of conduct and the taxpayer's failure to maintain adequate records (***Matter of Waples d/b/a Jack's Restaurant,*** Tax Appeals Tribunal, January 11, 1990***; see, Matter of AAA Sign Co.***, Tax Appeals Tribunal, June 22, 1989).

G. The Division has sustained its burden of proof of establishing that the imposition of the fraud penalty was appropriate. Throughout the audit period, the amounts deposited in the bank consistently and substantially exceeded the amount of reported sales on the sales tax returns. On the other hand, the bank deposits were consistent with the level of sales reported on the Federal income tax returns. Under the circumstances, it is reasonable to conclude that petitioner was aware that sales and use taxes were underreported on the sales tax returns.

It is recognized that petitioner and his wife were in poor health. However, there is no evidence that petitioner's health or his wife's health was the cause of the underreporting. Furthermore, assuming that books and records existed, petitioner was under an obligation to make those items available for the audit. Petitioner was not permitted to unilaterally decide when the books and records would be produced.

Petitioner's explanation that he could not locate the records is unconvincing. By his own admission, the records would have been in the store or at his home. If records were maintained, they should have been able to be located. As this was petitioner's third audit, he was certainly aware of the need to maintain adequate records. Thus, in addition to the consistent and substantial understatement of sales, the difference in the amounts reported on the sales tax returns versus the income tax returns, the pattern of repeated deficiencies and the failure to produce or maintain adequate records constitute evidence of an intent to deliberately evade payment of taxes due and owing (***see, Matter of Lefkowitz***, Tax Appeals Tribunal, May 3, 1990

[wherein the Tribunal found that consistent and substantial understatements of income is by itself strong evidence of fraud]).

H. Section 1145(a)(1)(vi) of the Tax Law imposes a penalty where the taxpayer has omitted an amount from his return in excess of 25 percent of the amount required to be shown. The penalty may be abated if the taxpayer proves that the failure was due to reasonable cause (Tax Law § 1145[a][1][vi]); ***Matter of Uncle Jim's Donut and Dairy Store, Inc.,*** Tax Appeals Tribunal, October 5, 1989). Here, there is no evidence of reasonable cause. As discussed earlier, there is no evidence that illness played any role in the underreporting of the tax due and owing. Further, the question of why the Federal income tax returns reported far greater sales than the sales tax returns remains unanswered. The lack of evidence of reasonable cause precludes cancelling the penalty imposed pursuant to Tax Law § 1145(a)(1)(vi).

I. Since the Linda Shop was organized as a sole proprietorship, it did not exist independently of its owner. It follows that it was erroneous for the Division to issue a notice of determination to the Linda Shop.

J. The petition of Morris Chariton is denied and the Notice of Determination, dated May 28, 2002, is sustained together with such penalties and interest as are lawfully due. The Notice of Determination dated May 24, 2002 is cancelled.

DATED: Troy, New York
June 30, 2005

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE