STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :

of :

KRYSTALLOS, INC. D/B/A DESIGN SOLUTIONS :

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 December 1, 1998 through February 29, 2004. :

DETERMINATION
DTA NOS. 821739 AND 821748

In the Matter of the Petition :

of :

STEPHEN STEFANOU :

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 December 1, 1998 through February 29, 2004. :

Petitioner Krystallos, Inc. d/b/a Design Solutions 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 December 1, 1998 through February 29, 2004.

Petitioner Stephen Stefanou 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 December 1, 1998 through February 29, 2004.

A consolidated hearing was held before Brian L. Friedman, Administrative Law Judge, at the offices of the Division of Tax Appeals, One Centre Street, New York, New York, on

August 20, 2008 at 10:30 A.M., with all briefs and additional documents submitted by December 19, 2008, which date began the six-month period for the issuance of this determination. Petitioners appeared by Cahill & Beehm, Esqs. (James N. Cahill, Esq., of counsel). The Division of Taxation appeared by Daniel Smirlock, Esq. (Osborne K. Jack, Esq., of counsel).

ISSUES

I. Whether the activities conducted in New York State by Krystallos, Inc. d/b/a Design Solutions (Design Solutions) caused it to come within the definition of "vendor" in Tax Law § 1101(b)(8)(i), thereby requiring it to collect and remit sales and use taxes to the State of New York.

II. Whether the services provided to its customers by Design Solutions were taxable.

III. Whether petitioners have sustained their burden of proving that the audit method employed by the Division of Taxation (Division) was unreasonable or that the amounts assessed against petitioners were erroneous.

IV. Whether petitioner Stephen Stefanou was personally liable for the sales and use taxes due on behalf of Design Solutions, as a person required to collect and pay such taxes under Tax Law § 1131(1) and § 1133(a).

V. Whether penalties assessed against petitioners should be abated.

FINDINGS OF FACT

1. Design Solutions, based in Dallas, Texas, is a designer and installer of displays (most notably holiday displays) for real property. In 2004, while auditing another unrelated business (a large building corporation in New York City), the Division's auditor came across an invoice in the name of Design Solutions which had done the holiday decorations for the New York City

corporation. Since the invoice to the New York City corporation did not charge sales tax, the auditor did some research on the internet website of Design Solutions in an effort to determine to what extent Design Solutions was doing business in the State of New York. Thereafter, the auditor submitted the invoice along with the website information to his supervisors and an audit of Design Solutions was commenced.

2. By letter dated November 10, 2004, the auditor scheduled an audit of Design Solutions for January 17, 2005 at its office in Dallas, Texas. Pursuant to the letter, the audit period at issue was December 1, 1998 through November 30, 2004. Attached to the letter was a Records Requested List which requested the following: sales tax returns, worksheets and canceled checks; federal income tax returns; New York State corporation tax returns; general ledger; general journal and closing entries; sales invoices; exemption documents; chart of accounts; fixed asset purchase or sales invoices; expense purchase invoices; merchandise purchase invoices; bank statements, canceled checks and deposit slips for all accounts; cash receipts journal; cash disbursements journal; the corporate book; and depreciation schedules.

As a result of the letter, the auditor was put in touch with an accounting firm who represented Design Solutions. Another letter (along with a Records Requested List), dated May 18, 2005, was sent to the accounting firm which scheduled a field audit for September 19, 2005 in Dallas, Texas. When the auditor visited Design Solutions' accountant in Dallas, he did not receive any records.

3. On November 14, 2006, the auditor sent a letter to Attorney James Cahill of Endicott, New York, petitioners' representative for the hearing held herein, which requested New York State sales figures for the audit period. The letter indicated that the auditor had been provided with federal income tax returns, but not with the New York State sales figures and stated that

"[i]n light of the lack of New York sales figures, I will begin to calculate an assessment using the Federal Tax receipts unless the actual NY receipts can be obtained."

4. On November 22, 2006, the auditor sent another letter to Mr. Cahill which stated as follows:

> In response to your November 20th letter, I acknowledge your objection to using the Federal Income Tax numbers to estimate a sales tax due for the above audit. However, as I'm sure you are aware, if a taxpayer does not supply a complete set of records for review, the department may use alternative means to approximate taxable receipts. As of this point, these records have not been supplied. Therefore, I would ask that Design Solutions please forward detailed sales receipts records for New York State for the above period by December 31, 2006.

5. On March 30, 2007, the Division issued a Notice of Determination to Design Solutions assessing additional sales and use taxes of $489,951.92, plus penalty and interest, for a total amount due of $1,204,531.15 for the period December 1, 1998 through February 29, 2004.

6. On April 20, 2007, the Division issued a Notice of Determination to Stephen Stefanou assessing additional sales and use taxes of $489,951.92, plus penalty and interest, for a total amount due of $1,213,001.36 for the period December 1, 1998 through February 29, 2004. The Notice of Determination advised Mr. Stefanou that he was being assessed as an officer or responsible person of Design Solutions.

7. As previously noted, when the auditor visited Design Solutions' accountant in Dallas, he did not receive any records. Subsequently, federal tax returns for the six-year audit period and some financial statements for some of the years at issue (financial statements for 1998 and 1999 were not made available to the auditor) were mailed to him. Based upon the records provided, the auditor determined that such records were insufficient to perform a detailed audit of Design Solutions.

8. No additional tax was assessed on fixed asset purchases since, as far as the auditor could ascertain, Design Solutions had no fixed assets in New York. In addition, no tax was assessed on expense purchases by Design Solutions.

9. Since the auditor never received information as to Design Solutions' New York sales, he attempted to determine the amount of New York sales from the federal tax returns. For the years 1998 and 1999, the auditor had no information from which he could determine the percentage of Design Solutions' sales which took place in New York.

10. For the year 2000 (February 2000 through January 2001), Design Solutions provided the auditor with a profit and loss statement. On the profit and loss statement, the cost of goods sold was broken out by state. Under the cost of goods heading, there was an item entitled "contract labor." Pursuant to the profit and loss statement, "Total Contract Labor - NY" was $122,484.84 and total contract labor (which included New York, Texas and Massachusetts) was $162,590.91. Therefore, the auditor concluded that the percentage of New York contract labor was 75.33% ($122,484.84 / $162,590.91). This percentage was applied to Design Solutions' gross sales for the year per its federal return.

11. For the year 2001, the auditor performed a similar analysis, determining the New York contract labor percentage and applying this percentage to the gross sales for the year per its federal return. However, on the income statement for the 12 months ending January 31, 2002, the auditor acknowledged that he used the incorrect figures, i.e., he utilized the figures from the column entitled "Current Month" rather than from the column "Year to Date." Accordingly, the auditor agreed that the New York percentage of contract labor originally calculated to be 29.11% for the year 2001 should be reduced to 22.82%. By virtue of this adjustment, the total assessment against each petitioner was reduced from $489,951.92 to $467,980.50, plus penalty and interest.

12. For the year 2002, using Design Solutions' cost of goods sold - contract labor in its income statement for the 12 months ending January 31, 2003, the auditor calculated the New York percentage of sales to be 14.15%.

13. For the year 2003, again using Design Solutions' cost of goods sold - contract labor in its income statement for the 12 months ending January 31, 2004, the auditor calculated the New York percentage of sales to be 17.72%.

14. Since the auditor did not have Design Solutions' financial statements for the years 1998 and 1999, he computed the New York percentage of sales by taking the average of the four years where he had financial statements, to wit, 2000, 2001, 2002 and 2003 and applying this percentage to the federal income reported on the 1998 and 1999 federal income tax returns, i.e., the gross receipts or sales reported on line 1 of the returns for each of the two years.

However, the auditor acknowledged that because of the error made for the year 2001 (***see*** Finding of Fact 11), the averages previously computed from years 2000 through 2003 needed to be recomputed. Accordingly, the average percentage for the years 1998 and 1999 was 32.51% rather than 34.08% percent as originally computed by the auditor. By virtue of the revised percentages for 1998 and 1999 (32.51%) and for 2001 (22.82%), the auditor recomputed New York sales for the audit period to be $5,672,490.00 rather than $5,894,009.00 as originally computed. It must be noted that this recomputation is accounted for in the reduction made by the auditor in Finding of Fact 11.

As a result of these recomputations, additional tax due is as follows:

Year	Taxable Amount	Tax Rate	Additional Tax Due
1998	$503, 031.00	.0825	$41,500.06
1999	$1,046,083.00	.0825	$86,301.85

2000	$1,998,059.00	.0825	$164,839.86
2001	$532,681.00	.0825	$43,946.18
2002	$606,991.00	.0825	$50,076.76
2003	$985,645.00	.08625	$85,011.88
TOTAL	$5,672,490.00		$471,676.59

As indicated in Finding of Fact 11, the auditor stated at the hearing that the total tax due was reduced to $467,980.50. From an examination of the above recomputation, it appears that the auditor applied a tax rate of 8.25 percent throughout all of the years at issue when, in fact, a rate of 8.625 percent should have been applied to the 2003 tax year. Since the auditor stated that the tax was reduced to $467,980.50, plus penalty and interest, that is the amount that shall be at issue herein.

15. The auditor determined that Design Solutions was a New York vendor required to collect and remit sales and use taxes on the basis of the invoice which he had seen during a previous audit which indicated that the company was performing work in New York, as well as the company's website which described how Design Solutions would go to the customer's location, observe the property and come up with ideas for a display. On the website, some of the customers for whom Design Solutions performed work were listed and these customers included New York City properties. The website stated that: "[a]fter a discussion of the ideas, objectives, and budgets, Design Solutions visits the proposed site to photograph and evaluate the parameters of the project." The website further stated that Design Solutions provides "turnkey service," which includes installation of the holiday displays.

In addition, from documents received from Design Solutions, there contained references to a New York warehouse and a New York apartment which had been rented by the company during several of the years at issue herein.

16. The Division introduced into evidence an invoice dated October 21, 2002 from Design Solutions to Shorenstein Management (Shorenstein) of New York City in the amount of $25,000.00. On cross-examination, the auditor admitted that this was the customer of Design Solutions that was being audited during 2004, which initially called into question whether Design Solutions was doing business in New York and which led to the audit at issue (***see*** Finding of Fact 1). The auditor stated that since, during the audit of Shorenstein, there was no evidence that Shorenstein had paid sales tax to Design Solutions (no sales tax was charged on the invoice), an assessment by the Division against Shorenstein included tax due on this invoice from Design Solutions which assessment has been paid. Accordingly, the auditor admitted that the tax paid on this invoice ($2,062.50) should be credited against the assessment at issue in this proceeding. Accordingly, in addition to the revision in total tax due made as result of the use of an incorrect figure for the year 2001 (***see*** Finding of Fact 11), the total tax due must be further reduced to account for the $2,062.50 paid by Shorenstein. Total tax due at issue is, therefore, $465,918.00, plus penalty and interest.

17. On cross-examination, the auditor stated that he was aware that Design Solutions did not bill its customers for sales or use tax but, instead, on its invoices to its customers, instructed them to pay the tax directly to the proper taxing authorities. The auditor did not attempt to determine who the New York customers of Design Solutions were and whether such customers had, in fact, complied with the directives on the invoices by paying the sales and use taxes directly.

18. The auditor stated that, with the exception of the year 2000, the format of the profit and loss statements furnished by Design Solutions to the Division was consistent. For the year 2000, the auditor determined the New York contract labor percentage to be 75.33% of total contract labor (***see*** Finding of Fact 10), while for the remaining years for which profit and loss statements were provided to the Division (2001, 2002 and 2003), the New York percentage ranged from a low of 14.15% to a high of 22.82%.

On cross-examination, the auditor stated that, for the 2000 year, he used the figures under the heading "Contract Labor" rather than "Total Labor." Had "Total Labor" been used in the computation, the New York percentage would have been 31.77%. The auditor used "Contract Labor" because " I knew on contract labor how much was New York versus how much was the other states." The auditor indicated that total labor includes the labor of the taxpayer's employees. The auditor indicated that when he sees abbreviations after a general ledger account such as contract labor, that would indicate to him that the work was done in the state designated.

At the hearing, the auditor, at the request of petitioners' counsel, recomputed the average New York percentage of sales for use in the 1998 and 1999 years (***see*** Finding of Fact 14) using the 31.77% (total labor) as opposed to the 75.33% which he used in computing the assessment at issue. Using 31.77%, the average for 1998 and 1999 would be 21.62% instead of 32.51%. The auditor then computed New York sales for the years at issue using the total labor figure for 2000 (31.77%) which would reduce Design Solutions' New York sales for the audit period from $5,672,491.00 to $3,998,189.00.

19. Pursuant to a Responsible Person Questionnaire completed by the auditor, based upon information received from petitioners' representative, petitioner Stephen Stefanou is the president of Design Solutions, devotes 100% of his time to the business, manages the business,

owns corporate stock, derives substantial income from the business and has the authority to sign checks, prepare sales tax returns, hire and fire employees and negotiate loans and borrow money for the business. No evidence was offered by petitioners to dispute the Division's determination that Mr. Stefanou is a person responsible for the collection and payment of sales and use taxes on behalf of Design Solutions.

20. Design Solutions introduced into evidence various invoices and proposals relating to services which the company performed for its customers. Invoice No. 6285, dated July 14, 2003, to Insignia ESG of New York City indicates that the invoice included rigging of all cables for hanging holiday decor. A proposal to Oxford Bath Products of New York City provides that Design Solutions will trim two windows and provide signage. A five-year holiday proposal for 200 Park Avenue, New York, New York, presented by Design Solutions to Met Life on July 16, 2002 stated that the price includes design, production, shipping, installation, dismantling, removal to storage, and storage of all items for five holiday seasons beginning in 2002 and continuing through the 2006 holiday season.

The invoices and proposals state that the price does not include sales tax and that all applicable sales tax is to be paid by the customer to the state and local taxing authorities.

21. By letter dated August 25, 2008, five days after the conclusion of the hearing held in these matters (at the hearing, petitioners did not ask for additional time to submit evidence), petitioners' representative, James N. Cahill, Esq., sent a letter to this Administrative Law Judge which stated that he had received certain correspondence from the Rockefeller Group on August 22, 2008, which, had it been received earlier, would have been submitted into evidence at the hearing. The letter stated that by a copy of the letter, Mr. Cahill was requesting that the Division's representative communicate his consent to the receipt into evidence of the

correspondence and attachments. No such consent was ever received by the Division of Tax Appeals.

The attachments concerned an audit of 1251 Americas Associates II, LP, for the period September 1, 2001 through May 31, 2004 and stated that no additional tax was due from that taxpayer. Included was a letter from petitioners' representative to 1251 Avenue of the Americas which stated, among other things, that petitioners were being assessed "for all of the taxes that Rockefeller Group has failed to pay, together with very substantial penalties and interest." The letter insisted that the Rockefeller Group "promptly advance to Design Solutions all funds necessary to fully respond to the assessment . . . related to the goods and services provided by Design Solutions during the years 1998 through 2004." The letter also insisted that the Rockefeller Group file sales tax returns for goods and services provided for subsequent years (2005 through 2007), pay the indicated sales tax with penalties and interest and provide Design Solutions with proof of filing and payment. Attached to Mr. Cahill's letter was "a schedule calculating the approximate amount due for the period 1998 through 2004 and for the years 2005, 2006, 2007 and part of 2008." According to this schedule, sales tax due on transactions for the period 1998 through 2003 totaled $64,183.14, plus penalty and interest. There is no indication how this amount was computed.

In response to Mr. Cahill's letter, a letter from The Rockefeller Group dated August 22, 2008 stated that 1251 Americas Associates II, LP, remitted tax directly to the State since Design Solutions did not include tax on its invoices. Tax amounts were reported on 1251 America Associates II, LP's quarterly returns for the periods at issue and, accordingly, 1251 has met its sales tax obligations on all of Design Solutions invoices.

22. While the contents of Mr. Cahill's letter and the attachments thereto have been summarized in Finding of Fact 21, no part thereof has been considered for purposes of this determination.

SUMMARY OF THE PARTIES' POSITIONS

23. Petitioners assert the following:

a. Design Solutions is a Texas business with no office in New York and had limited contacts in New York. It did not receive and was not paid sales tax by its customers and, therefore, could not and did not pay tax to the State.

b. The audit method used by the auditor and the amount of tax assessed as a result of the use of such method was erroneous. Because Design Solutions directed its customers to pay the sales and use taxes directly to the taxing authorities, assessing tax on the New York sales of Design Solutions results in double taxation, i.e., tax is being collected both from the vendor and the purchaser.

c. Petitioners contend that the auditor never made a request to Design Solutions for the names and addresses of its customers, but instead requested the amounts of New York sales which Design Solutions could not produce because its dollar sales were not sorted by state. Had the auditor asked for the names of the New York customers, the Division could have confirmed the fact that such customers had, in fact, paid the tax due to the State.

d. In performing his audit, the auditor made a number of errors. These errors included the following: (1) The auditor had no basis to assume that the letters "NY" next to labor expenses in the income statements provided to him by Design Solutions represented labor performed in New York; (2) His calculation of the New York percentage of labor for the year 2000 to be 75.33% was grossly overstated when, in fact, the actual percentage was 31.77%. By virtue of

that error, the average used for the years 1998 and 1999 was also overstated, i.e., the correct average should be 21.62% rather than 32.51%.

e. All proposals for design and installation, submitted to its New York customers, specifically provided that the customer was to be responsible for the payment of sales tax. Such customers have the primary obligation to the pay the sales tax, pursuant to Tax Law § 1133(b), and, upon information and belief, have done so with the result being that no sales tax is owed to the State of New York as a result of these transactions. Accordingly, the Division is obligated to determine whether the customer, in each transaction at issue, has paid the tax and, if not, to assess and collect the tax, with appropriate penalties and interest, from the customer.

f. Penalties should be abated since much or all of the sales tax due on Design Solutions's sales was paid by its customers.

24. The position of the Division may be summarized as follows:

a. Design Solutions is a vendor, as defined in Tax Law § 1101(b)(8)(i) and is, therefore, responsible for the collection and remittance of sales tax to the State of New York.

b. The services provided by Design Solutions were not capital improvements as alleged, but were taxable services.

c. Since petitioners failed to produce complete books and records, despite numerous requests therefor by the Division, which were sufficient to verify its New York sales, the Division was authorized to utilize an indirect audit method, which, in the matter at issue, was reasonable. While petitioners bear the burden of proving, by clear and convincing evidence, that the audit method was unreasonable or that the resulting assessment was erroneous, they have failed to sustain such burden.

d. Petitioner Stephen Stefanou is personally liable for the sales and use taxes due on behalf of Design Solutions, as a person required to collect and pay such taxes under Tax Law § 1131(1) and § 1133(a).

e. Petitioners have failed to show reasonable cause for the abatement of penalties assessed herein.

CONCLUSIONS OF LAW

A. In ***Matter of The Ohio Table Pad Co., Inc.*** (Tax Appeals Tribunal, April 22, 1999), the Tribunal addressed the issue of whether there was sufficient nexus between that petitioner and the State of New York such that New York could impose the obligation to register as vendor and collect sales and use taxes from its New York customers. Citing the Court of Appeals decision in ***Matter of Orvis Co. v. Tax Appeals Tribunal*** (86 NY2d 165, 630 NYS2d 680 [1995], ***cert denied*** 516 US 989, 133 L Ed 2d 426 [1995]), the Tribunal found that the petitioner was a vendor as the term is defined in Tax Law § 1101(b)(8)(i). The Tribunal stated:

> From the facts presented, we believe petitioner's activities in New York constituted more than the "slightest presence." The Court of Appeals was clear in its rationale in ***Orvis***:
>
> We think the foregoing survey of the decisional law discloses the true import of the physical presence requirement within the substantial nexus prong of the ***Complete Auto*** [***Complete Auto Transit v. Brady***, 430 US 274, 51 L Ed 2d 326] test under contemporary Commerce Clause analysis. While a physical presence of the vendor is required, it need not be substantial. Rather, it must be demonstrably more than a "slightest presence" (***see, National Geographic Socy. v. California Bd. of Equalization,*** 430 US 551, 51 L Ed 2d 631). And it may be manifested by the presence in the taxing State of the vendor's property or the conduct of economic activities in the taxing State performed by the vendor's personnel or on its behalf (***Matter of Orvis Co. v Tax Appeals Tribunal***, ***supra,*** 630 NYS2d, at 686-687).

In the present matter, while Design Solutions is a Texas-based company, the fact that it visits the corporate site of its New York customers, installs the holiday displays and maintained

New York property (a warehouse and an apartment) during several of the years at issue, provides evidence that a sufficient nexus with the State of New York existed to require it to collect and remit New York sales and use taxes.

B. Having found sufficient nexus to require Design Solutions to collect and remit New York sales and use taxes, it is clear that the company is a vendor as that term is defined in the Tax Law.

Tax Law § 1101(b)(8)(i) defines the term "vendor," in relevant part, as follows:

> (A) A person making sales of tangible personal property or services, the receipts from which are taxed by this article;
>
> * * *
>
> (D) A person who makes sales of tangible personal property or services, the use of which is taxed by this article, and who regularly or systematically delivers such property or services in this state by means other than the United States mail or common carrier.

Pursuant to Tax Law § 1101(a), the term "person" includes an individual, partnership, limited liability company or corporation.

C. Petitioners do not dispute that Design Solutions made sales of its holiday display services to customers in New York. In addition, its website described how the company's representatives go the customers' location, observe the property, come up with ideas for a display and then perform installation services. Clearly, therefore, as a vendor of tangible personal property or services pursuant to Tax Law § 1101(b)(8)(i), Design Solutions is a person required to collect tax (***see*** Tax Law § 1131[1]).

Since Design Solutions is a person required to collect tax, it must collect the tax from the customer when collecting the price charged and, "[i]f the customer is given any sales slip, invoice or receipt or other statement or other memorandum of the price, amusement charge or

rent paid or payable, the tax shall be stated, charged and shown separately on the first of such documents given to him." (Tax Law § 1132[a][1].)

D. As to whether the services provided by Design Solutions to its customers are taxable, Design Solutions, in its amended petition, has alleged that the services provided to its customers constituted capital improvements. However, no evidence was introduced to substantiate that allegation. Accordingly, it cannot be found that the services and installations of Design Solutions were capital improvements.

Moreover, as correctly noted by the Division in its brief, the invoices and proposals of Design Solutions evidence the fact that the company either installed or serviced tangible personal property (***see*** Tax Law § 1105[c][3]; 20 NYCRR 527.5), serviced or repaired real property (see Tax Law § 1105[c][5]; 20 NYCRR 527.7) or provided decorating or designing services (***see*** Tax Law 1105[c]), all of which are taxable.

E. Tax Law § 1105(a) imposes a sales tax on the receipts from every "retail sale" of tangible personal property except as otherwise provided in Article 28 of the Tax Law. A "retail sale" is "[a] sale of tangible personal property to any person for any purpose, other than . . . for resale as such . . ." (Tax Law § 1101[b][4][i]). Tax Law § 1138(a)(1) provides, in relevant part, that if a sales tax return was not filed, "or if a return when filed is incorrect or insufficient, the amount of tax due shall be determined [by the Division of Taxation] from such information as may be available. If necessary, the tax may be estimated on the basis of external indices . . ." (Tax Law § 1138[a][1].) When acting pursuant to section 1138(a)(1), the Division is required to select a method of audit reasonably calculated to reflect the tax due. The burden then rests upon the taxpayer to demonstrate that the method of audit or the amount of the assessment was erroneous (***see Matter of Your Own Choice, Inc.,*** Tax Appeals Tribunal, February 20, 2003).

F. The standard for reviewing a sales tax audit where external indices were employed was set forth in ***Matter of Your Own Choice, Inc***., 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]) 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).
>
> 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. Tax Commn.***, 119 AD2d 948, 501 NYS2d 219, 221).

G. By letters dated November 10, 2004 and May 18, 2005, the auditor made written requests for the books and records of Design Solutions. On his initial visit to Design Solutions's

accountant's office in Dallas, Texas, the auditor received no records. Later, federal tax returns for the six-year audit period and financial records for some of the years were sent to him. Accordingly, the auditor properly determined that the records presented were insufficient to perform a detailed audit of Design Solutions.

Later, on November 14, 2006, additional letters were sent to Design Solutions' representative, Attorney James Cahill, seeking the New York State sales figures for Design Solutions for the audit period. When Mr. Cahill objected to the use of the federal income tax figures to estimate sales tax due, the auditor, on November 22, 2006, sent another letter asking for detailed sales receipts records for Designs Solutions' New York sales for the audit period, but such records were never provided.

Design Solutions, in its brief and again in its reply brief, asserts that the Division should have contacted petitioners and requested a list of New York customers in order to ascertain whether the customers had paid tax to the State of New York, thereby eliminating the possibility of double taxation.

As noted herein, the Division made numerous written requests for Design Solutions' books and records. While such requests did not specifically seek a list of New York customers, petitioners never provided such a list to the auditor at any time. Petitioners assert that the amounts of New York sales could not be provided to the Division because dollar sales were not sorted by state. While this assertion may or may not be accurate, clearly, a complete list of Design Solutions' customers and invoices and proposals relating to sales to all of its customers, regardless of location, could have been furnished in response to the auditor's request. By reviewing all of these invoices and proposals and the addresses of the customers thereon, the auditor could have determined the percentage of Design Solutions' New York sales. In addition,

the auditor could have contacted the New York customers to ascertain if sales and use taxes had been paid by the customers.

Instead, petitioners maintain that the Division should have audited each and every one of Design Solutions' customers to determine if tax was paid on their purchases from Design Solutions. While arguing that the auditor never requested a list of the New York customers, at no time during the audit or during the hearing held in this matter, did petitioners offer to produce or, in fact, produce a list of all of their New York customers during the audit period. Rather, petitioners now seek to shift the burden to the Division to somehow determine the names of these New York customers, the amounts of their purchases from Design Solutions and, finally, whether the customers paid the tax to the State of New York.

As noted in Conclusions of Law A, B and C, Design Solutions was, during the period at issue, a vendor as that term is defined in the Tax Law and, as such, was required to collect tax from its New York customers. It cannot, therefore, transfer the obligation to its customers to pay the tax directly to the State and cannot shift the burden to the Division to ascertain the names of the customers, the amount of tax due on Design Solutions' sales to these customers and then determine whether the customers paid the tax to the State. The entire argument of petitioners is seemingly a smokescreen to require others, i.e., the customers and the Division, to perform acts which statutes and case law require petitioners to perform (collect and remit tax, maintain complete books and records and supply the same to the Division upon audit).

H. As set forth in Conclusion of Law E, once it has been demonstrated that the records provided to the Division are incomplete or inaccurate (as was clearly the case herein), petitioners bear the burden of proving, by clear and convincing evidence, that the audit methodology selected was unreasonable or that the assessment was erroneous. Again, if a list of New York

customers was available, petitioners could have provided such list during the audit. Moreover, assuming that this list was in the possession of petitioners, the New York customers could have been contacted by petitioners and if, in fact, the customers had paid the tax directly to the State, credits against petitioners' assessments (such as the credit provided in the Shorenstein matter [***see*** Finding of Fact 16]) could have been made.

I. As set forth in Finding of Fact 18, the auditor, at the request of petitioners' counsel, recomputed the average New York percentage of sales for 1998 and 1999 using total labor (31.77%) rather than using contract labor (75.33%) which resulted in a New York average for 1998 and 1999 of 21.62% instead of 32.51% as computed by the auditor. It is the figure of 21.62% which petitioners, in their brief, assert is the correct percentage. Petitioners' assertion is without merit.

The auditor had a valid reason for using the amounts set forth in "Contract Labor" rather than "Total Labor" in the profit and loss statements supplied to him by Design Solutions. He indicated that "Contract Labor" was used because the auditor was able to determine how much work was performed in New York versus other states and that "Total Labor" includes the labor of Design Solutions' employees. If petitioners maintain that these assumptions by the auditor were incorrect, it was incumbent upon them to introduce evidence to support their position, evidence such as actual New York sales figures or actual labor costs related to New York sales. In their brief, petitioners state that the Division's audit is replete with unsupported assumptions and patent errors which confirm that the method of audit used and the amount of tax assessed is erroneous.

As to the errors, these have been corrected and the additional tax due has been reduced from $489,951.92 to $465,918.00, plus penalty and interest. If, however, the auditor made

assumptions which are unsupported, it is the result of petitioners' failure to provide adequate books and records which mandated these assumptions. Petitioners could have produced, at any time during the audit or at this hearing, records which would have controverted the auditor's assumptions, but no such records were forthcoming. Accordingly, absent adequate books and records, it must be found that the audit methodology employed by the Division was reasonably calculated to reflect tax due, and petitioners have wholly failed to sustain their burden of proving, by clear and convincing evidence, that the assessment (after the recomputations) was erroneous or that the audit methodology was unreasonable.

J. Since no evidence was produced by petitioners relating to petitioner Stephen Stefanou's role in Design Solutions or to controvert the Responsible Person Questionnaire (***see*** Finding of Fact 19), the Division has properly determined that Mr. Stefanou is personally liable for the sales and use taxes due on behalf of Design Solutions as a person required to collect and pay such taxes pursuant to Tax Law § 1131(1) and § 1133(a).

K. While the issue of submission of additional evidence by petitioners (***see*** Findings of Fact 21 and 22) after the record was closed in the hearing held in these matters, was not addressed by either party in their briefs, it must be addressed herein. First, it must be noted that the Division never consented to the submission of the evidence.

Second, the Tax Appeals Tribunal has established a firm policy of not allowing the submission of evidence after the record is closed. In ***Matter of Saddlemire*** (Tax Appeals Tribunal, June 14, 2001), the Tribunal stated:

> [w]e have held that in order to maintain a fair and efficient hearing system, it is essential that the hearing process be both defined and final. If the parties are able to submit additional evidence after the record is closed, there is neither definition nor finality to the hearing. Further, the

> submission of evidence after the closing of the record denies the adversary the right to question the evidence on the record (***Matter of Emerson***, Tax Appeals Tribunal, May 10, 2001; ***Matter of Schoonover***, Tax Appeals Tribunal, August 15, 1991).

As previously noted, petitioners did not ask for nor were they granted additional time for the submission of evidence after the conclusion of the hearing and the closing of the record. Moreover, even had such permission been sought and granted, the letters and attachments would not in any way result in an adjustment to the assessments herein.

Other than Mr. Cahill's self-serving schedule of alleged tax due on sales of product and services from Design Solutions to 1251 Americas Associates II, LP, there is nothing in the record which could substantiate the amount of sales made by Design Solutions to this customer during the audit period. Interestingly, while this schedule purports to set forth detailed amounts of tax due, no sales records pertaining to any New York customers were ever offered to the Division during the audit, nor were they introduced at the hearing. It must be concluded, therefore, that petitioners did have in their possession some records of sales to New York customers but chose not to submit them. In addition, it can be inferred that the evidence was not submitted because it would not have been beneficial to the interests of petitioners (***see Matter of Drebin***, Tax Appeals Tribunal, March 27, 1997).

L. Finally, petitioners contend that penalties assessed herein should be abated. In establishing reasonable cause for penalty abatement, the taxpayer faces an onerous task (***Matter of Philip Morris, Inc.***, Tax Appeals Tribunal, April 29, 1993). Referring to the mandatory language of Tax Law § 1145(a)(1)(i), the Tribunal said that "the Legislature evidenced its intent that filing returns and paying tax according to a particular timetable be treated as a largely unavoidable obligation" (***Matter of MCI Telecommunications Corp.***, Tax Appeals Tribunal,

January 16, 1992). In the instant matter, Design Solutions, despite doing business and maintaining property in New York, chose not to comply with the statutory requirements of the Tax Law by charging, collecting and remitting sales tax on sales to its New York customers. Moreover, there has no been showing that Design Solutions maintained adequate records of its New York sales and, clearly, it did not produce records as required. As the Tax Appeals Tribunal has noted, on numerous occasions, the failure to maintain and provide records is a reason to sustain the imposition of penalties ***(Matter of Rosemellia***, Tax Appeals Tribunal, March 12, 1992; ***see also Matter of Shukry v. Tax Appeals Tribunal***, 184 AD2d 874, 585 NYS2d 531 [1992]). Penalties are, therefore, sustained.

M. The petitions of Krystallos, Inc. d/b/a Design Solutions and Stephen Stefanou are granted to the extent indicated in Findings of Fact 14 and 16; the Division of Taxation is hereby directed to modify the notices of determination issued to petitioner Krystallos, Inc. d/b/a Design Solutions on March 30, 2007 and to petitioner Stephen Stefanou on April 20, 2007 accordingly; and, except as so granted, the petitions are in all other respects denied.

DATED: Troy, New York
June 11, 2009

/s/ Brian L. Friedman
ADMINISTRATIVE LAW JUDGE