

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :

of :

GREAT BAY MARINE, INC. :

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 June 1, 2004 through
November 30, 2007. :

DETERMINATION
DTA NOS. 823771,
823772 AND 823773

In the Matter of the Petitions :

of :

TIMOTHY KELLY AND FRANK RAPCZYK :

for Revision of Determinations or for Refund of
Sales and Use Taxes under Articles 28 and 29 of the
Tax Law for the Period March 1, 2005 through
November 30, 2007. :

Petitioner Great Bay Marine, Inc., 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 June 1, 2004 through November 30, 2007.

Petitioners Timothy Kelly and Frank Rapczyk filed petitions for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 2005 through November 30, 2007.

A hearing was held before Herbert M. Friedman, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals, One Penn Plaza, New York, New York, on December 13

and 14, 2011, with all briefs to be submitted by May 29, 2012, which date commenced the six-month period for the issuance of this determination. Petitioners appeared by Stephen P. Silberling, Esq. The Division of Taxation appeared by Mark F. Volk, Esq. (Michael Hall, of counsel).

ISSUES

I. Whether the audit method employed by the Division of Taxation was reasonable or whether petitioner Great Bay Marine, Inc., has shown error in either the audit method or result.

II. Whether petitioners have established any facts or circumstances warranting the reduction or abatement of penalties imposed.

FINDINGS OF FACT

1. Petitioner Great Bay Marine, Inc. (Great Bay Marine) at all relevant times was a business involved in the sales and servicing of marine equipment, including boats, motors and trailers. During the audit period, its main facility was in West Islip, New York. Great Bay Marine also had a small sales office in Lindenhurst, New York, and a repair facility in Babylon, New York.

2. Petitioners Timothy Kelly and Frank Rapczyk¹ were the president and vice-president of Great Bay Marine, respectively. Messrs. Kelly and Rapczyk have stipulated on the record that they were responsible officers of Great Bay Marine and persons required to collect tax within the meaning of Tax Law § 1131(1) for the period March 1, 2005 through November 30, 2007.

3. On May 3, 2007, the Division of Taxation (Division) sent a letter to Great Bay Marine scheduling an appointment to commence a sales and use tax field audit of its business for the

¹ "Petitioners" refers to Great Bay Marine, Kelly and Rapczyk collectively.

period June 1, 2004 through February 28, 2007. The Division's letter requested that all of Great Bay Marine's books and records pertaining to its sales and use tax liability for the audit period be available for review. Among the records specifically requested were the general ledger, cash receipts journal, federal income tax returns, purchase invoices, sales invoices, fixed asset purchase invoices, cash disbursements journal, bank statements, canceled checks and deposit slips for all accounts, financial statements and exemption documents.

4. The Division's auditor met with Great Bay Marine's accountant, John Van Derlofske, at his office on July 31, 2007. A few days before the appointment, the auditor was informed by Mr. Van Derlofske that all of Great Bay Marine's requested records had recently been stolen, along with the truck owned by Mr. Kelly in which they had been housed. Mr. Van Derlofske also informed the auditor that neither paper nor electronic copies of the stolen records had been retained. As a result of the lack of records, the auditor decided to reconstruct Great Bay Marine's sales activity for the audit period by examining its bank deposits. A request for these records was made by the auditor at this meeting.

5. In late August 2007, the auditor was informed by Mr. Kelly that the stolen vehicle had been recovered, but that all of the records remained missing. A copy of the August 2, 2007 Suffolk County Police Department incident report prepared for the theft of Mr. Kelly's truck was introduced into evidence by the Division. There is no mention of any documents in the section of the report identifying the property stolen.

6. The auditor met again with Mr. Van Derlofske on October 24, 2007 to obtain the requested bank records. The auditor, however, was only provided with bank statements for March of each year from 2004 through 2007. In response, the Division issued a subpoena duces tecum to Great Bay Marine and Mr. Van Derlofske for all of the previously requested bank

statements, and in December 2007, the statements were provided to the auditor after having been obtained from the bank, along with a general ledger. Neither copies of checks deposited into Great Bay Marine's bank account nor deposit slips were provided to the auditor at the time.

7. In her review of the bank statements, the auditor discovered a very large discrepancy between total deposits and gross sales reported by Great Bay Marine on its sales tax returns. After deducting sales tax paid, reported taxable sales, and reported nontaxable sales, Great Bay Marine's bank deposits exceeded its reported gross sales by more than \$5 million for the period of June 1, 2004 through February 28, 2007.

8. On December 26, 2007, the Division sent an additional audit appointment letter to Great Bay Marine extending the audit period through November 30, 2007. According to the auditor, the audit period was extended, consistent with Department policy, because the audit was becoming stale due to the lack of records available for review. This second appointment letter requested the same type of records as were requested in the earlier letter. In response, a portion of the requested records for the period March 1, 2007 through November 30, 2007 were made available and reviewed by the auditor.

9. After her review of the records provided, the auditor made several adjustments. The first area of adjustment was for unpaid taxes on capital assets. In reviewing Great Bay Marine's tax returns, the auditor found that in 2005, there was a reported increase in leasehold improvements of \$31,520.00. In addition, the auditor discovered a reported increase of \$39,890.00 in equipment for 2004 and 2005. Great Bay Marine failed to provide the auditor with invoices or other documentation identifying these acquisitions as nontaxable or proving that taxes had been paid on them. Consequently, it was concluded that in total, there was \$71,410.00

in additional taxable capital asset purchases, resulting in \$6,248.38 in additional tax owed by Great Bay Marine for the period at issue.

10. The second area covered by the audit was verification of claimed nontaxable sales. Due to the lack of available records for the original audit period, the auditor was able to review only those records produced for the added period of March 1, 2007 through November 30, 2007. For that nine-month period, Great Bay Marine reported nontaxable sales of \$2,404,491.00. At audit, though, it only provided invoices for nontaxable sales totaling \$551,919.05, and several of these invoices (totaling \$112,116.34) predated March 1, 2007. Nevertheless, the auditor used the entire \$551,919.05 of provided invoices in an attempt to establish an error rate of disallowed nontaxable sales. After her review, the auditor found an error rate of 0.000414 for nontaxable sales for the nine-month period. This error rate was then applied to the total amount of nontaxable sales claimed by Great Bay Marine for the entire audit period, or \$7,183,864.00, resulting in additional tax due of \$2,974.12. The auditor determined that based on the aforementioned large difference between reported and substantiated nontaxable sales, though, the records were inadequate for a direct audit of this later period.

11. The third and largest area covered by the audit was a bank deposits reconciliation of the entire period in order to determine gross and taxable sales. Upon review of the bank records provided, the auditor determined that there were total bank deposits of \$25,229,704.40 between June 1, 2004 and November 30, 2007. She then subtracted the reported sales tax for the audit period of \$1,029,961.08, resulting in a total amount of audited gross sales of \$24,199,743.32. Great Bay Marine reported \$19,103,734.00 in gross sales for the audit period; thus, the auditor concluded that the difference, or \$5,096,009.32, constituted unreported gross sales.

In order to determine the taxable sales, the auditor subtracted \$7,183,864.00, or the entire amount of nontaxable sales reported by Great Bay Marine, from the aforementioned audited gross sales, resulting in audited taxable sales of \$17,015,879.32. Great Bay Marine reported taxable sales of \$11,919,830.00, which when subtracted from the audited taxable sales, resulted in unreported additional taxable sales of \$5,096,049.32. The entire amount of reported taxable sales was allowed by the auditor because, as she testified, "[she] needed to be as fair as [she] possibly could." She added that she felt sufficiently comfortable to do so based on the low error rate arising from her examination of the reported nontaxable sales in the period March 1, 2007 through November 30, 2007.

12. After her examination, the auditor sent a letter to Mr. Van Derlofske on March 27, 2008 providing her preliminary findings and again requesting documentation for any non-sales that may have been included in Great Bay Marine's bank deposits and could explain the discrepancy, as well as evidence of taxes paid on the capital assets.² Mr. Van Derlofske did not provide the auditor with substantiating materials at that time.

13. The parties never agreed on a test period method of ascertaining the tax. Mr. Van Derlofske testified that he was of the belief that there was a test period audit using the last three quarters of the audit period. He also acknowledged, however, that neither he nor his client received or prepared a written confirmation of the existence of a test period audit. The auditor strongly denied that there ever was a test period audit performed in this matter.

14. On August 21, 2009, following the audit, the Division issued to Great Bay Marine, a Notice of Determination, which asserted \$451,352.85 in additional sales and use taxes due, plus

² Because of the large discrepancy, the auditor also referred Great Bay Marine to the Special Investigations Unit of the New York State Department of Taxation and Finance for potential criminal prosecution. That investigation was eventually closed without prosecution for lack of evidence of criminal activity.

penalty of \$177,472.25 and interest, for the period June 1, 2004 through November 30, 2007.

The penalties included were pursuant to Tax Law § 1145(a)(1)(i), for failure to pay any tax imposed under Articles 28 and 29, and Tax Law § 1145(a)(1)(vi), for omission of greater than 25 percent of the tax due.

15. On September 8, 2009, the Division issued to Mr. Kelly, as a responsible officer of Great Bay Marine, a Notice of Determination, which asserted \$348,799.34 in additional sales and use taxes due, plus penalty of \$136,477.07 and interest, for the period March 1, 2005 through November 30, 2007.

16. Likewise, on September 8, 2009, the Division issued to Mr. Rapczyk, as a responsible officer of Great Bay Marine, a Notice of Determination, which asserted \$348,799.34 in additional sales and use taxes due, plus penalty of \$136,477.07 and interest, for the period March 1, 2005 through November 30, 2007.³

17. Subsequently, on January 27, 2011, petitioners provided the auditor with a set of documents in an attempt to explain the discrepancy between the total bank deposits discovered at audit and the reported gross sales.⁴ Included were schedules listing specific transactions, as well as some of the records previously requested during the audit. The auditor, however, testified that she was not provided with sufficient documentation to ascertain whether a transaction listed on the schedules was a nontaxable sale or just a non-sale. Consequently, she assumed that both categories were claimed on Great Bay Marine's returns as nontaxable sales. Nevertheless, the auditor testified that even after giving Great Bay Marine full credit for all of the transactions

³ The record does not explain why the responsible officer notices issued to Kelly and Rapczyk did not cover Great Bay Marine's entire audit period.

⁴ The referenced documents were submitted on petitioners' behalf by their newly-appointed representative, Stephen Silberling, Esq.

claimed on the recently provided schedules, its total nontaxable sales were still less than the amount allowed at audit.

18. At hearing, the Division acknowledged an error in the calculation of the tax for the period March 1, 2006 through May 31, 2006 in the statutory notice issued to Great Bay Marine. Originally, the assessed tax for this period was \$99,930.94, but as a result of a computer error, all reported nontaxable sales for this period were excluded from the auditor's original computation. Once the omitted nontaxable sales were included in the calculation, the tax for the period was reduced to \$82,176.76, with corresponding reductions in penalties and interest. Consequently, the Division's revised notice asserted \$433,598.67 in additional sales and use tax due, plus penalty of \$70,370.62 and interest, for the period June 1, 2004 through November 30, 2007. These revised amounts are what are at issue in this proceeding.

19. The responsible officer notices for Messrs. Kelly and Rapczyk were similarly revised by the reduction of tax for the period March 1, 2006 through May 31, 2006. The amount of tax at issue for each responsible officer is \$331,045.16, plus penalty of \$129,375.44 and interest.

20. Mr. Van Derlofske testified about his method for preparation of Great Bay Marine's sales tax returns. He stated that Mr. Kelly provided him with copies of the company's bank statements, from which were identified total deposits, and a schedule of non-sales deposits and nontaxable sales deposits for the period. Mr. Van Derlofske then subtracted from total deposits the non-sales and nontaxable sales deposits to determine taxable sales and the tax. He also added together the nontaxable sales and taxable sales to determine total gross sales. He stated that in preparation of the returns, he did not see source documentation, but solely used the bank statements and schedules from Mr. Kelly. Mr. Van Derlofske did not create workpapers in the course of preparation of the returns.

21. At hearing, Mr. Kelly attempted to explain the difference between the audited bank deposits and gross sales reported by Great Bay Marine on its sales tax returns (*see* Finding of Fact 11). He testified at length about the various types of deposits made during the audit period that came from what Great Bay Marine considered non-sales. For each month at issue, Mr. Kelly introduced into evidence a schedule of deposits he alleged were from non-sales with attached bank statements and checks as support. The claimed non-sales fell into several categories:

a) deposits in the amount of \$126,100.00 from Great Bay Marine's line of credit into its checking account. At various times throughout the audit period, Mr. Kelly drew from Great Bay Marine's line of credit and deposited the funds into Great Bay Marine's checking account. These claimed non-sales deposits were substantiated by checks entitled "Elite Credit Account" that Mr. Kelly identified as Great Bay Marine's line of credit;⁵

b) deposits of motor vehicle fees charged by Great Bay Marine to its customers that purchased boats. Great Bay Marine charged a fee of \$350.00 per boat, although the actual registration fee never reached that amount (typically, the true motor vehicle fee was between \$96.00 and \$110.00). This charge was identified on Great Bay Marine's sample invoice as "M.V. FEES/FUEL," but not broken down any further. Mr. Kelly testified that the portion not turned over to the Department of Motor Vehicles went for "fuel and stuff;"

c) deposits from Bank of America, M&T Bank, and Honda Financial for "reserves" paid on loans generated by Great Bay Marine. Mr. Kelly explained that when Great Bay Marine

⁵ Also included on some of Mr. Kelly's schedules, but not included in the claimed \$126,100.00, were other deposits possibly from an unidentified additional line of credit. The supporting documentation for these entries consisted of checks from an entity entitled "CT CASH CLEARING" of West Islip. Despite their inclusion on his schedules, however, Mr. Kelly could not convincingly identify the source or meaning of "CT CASH CLEARING" at hearing. Thus, the nature of these deposits is unclear.

arranged for financing for its customers from these lenders on one of its sales, it received compensation in the form of a "reserve" payment from the lender. The reserve payments from M&T Bank were clearly identified as such on the bank statements provided and totaled \$110,754.71. As for payments from Bank of America, though, the bank statements only referenced general deposits of \$1,092,033.52, without any breakdown or designation for reserves. Petitioners attempted to substantiate the percentage of these deposits that they claimed constituted the reserve payment by submitting sample breakdowns for several deposits made after the audit period. Last, Mr. Kelly's schedules claimed payments from Honda Financial were also reserves and, thus, non-sales deposits. There were other identical entries involving Honda Financial on the bank statements that were not listed as reserve payments on Mr. Kelly's schedules, however. Petitioners failed to explain the disparate treatment of the identical entries;

d) deposits from various entities named Peak Automotive, First Choice Marine, DAM Cycles, and Fred Chall Marine. These entities, all operated by an individual named "Vic,"⁶ arranged for loans for Great Bay Marine customers that otherwise could not obtain conventional financing. Procedurally, Great Bay Marine would sell the boat to Vic's entity, and the latter would arrange for alternative financing and sell the boat to the customer. Mr. Kelly admitted on cross-examination that these transactions were sales, "but that's not the way we put it into our books." Thus, Mr. Kelly classified these types of transactions as non-sales rather than nontaxable sales and claimed they were treated as such for tax purposes. He failed, however, to have any proof of their exclusion from nontaxable sales reported on Great Bay Marine's sales tax returns. He also failed to produce any exemption certificates for the transactions;

⁶ Vic's last name was never identified in the testimony.

e) deposits comprised of purported loans that were made to Great Bay Marine by officers during the audit period. Mr. Van Derlofske testified, however, that he never saw any supporting loan documentation or knew the rate of interest charged on the loans. Mr. Kelly confirmed the lack of loan documentation and was also unable to demonstrate any repayment. Moreover, Mr. Kelly acknowledged that other checks he thought were loans came from entities that were not officers of Great Bay Marine;

f) deposits from out-of-state transactions described by Mr. Kelly as non-sales. As with the transactions described in Finding of Fact 21(d), petitioners failed to have any proof of their exclusion from nontaxable sales reported on Great Bay Marine's sales tax returns or produce any exemption certificates for the transactions;

g) deposits from Bruce V. Schneider Associates, who was identified as Great Bay Marine's insurance agent. Mr. Kelly's testimony was unclear, however, as to the reason for the payments from this entity. Further, one of the checks from Bruce V. Schneider Associates that was deposited in Great Bay Marine's account and claimed as a nonsale actually referenced "service" on its face;

h) deposits of tax refunds from the Internal Revenue Service (IRS) and New York State in the amount of \$7,338.10 and an insurance refund of \$1,449.00 from James F. Sutton Agency, Ltd.

22. In total, Great Bay Marine claimed \$2,304,482.05 in nonsales deposits during the audit period based on the transactions described in Finding of Fact 21.

23. In addition, Great Bay Marine claimed an additional \$1,318,805.90 in nonsales deposits for the audit period as evidenced by a review of checks written from its account. Petitioners' theory behind this assertion was that these disbursements were funded by

corresponding non-sales deposits. Petitioners did not make a direct evidentiary correlation, though, between these disbursements and funds deposited in Great Bay Marine's account.

24. Mr. Rapczyk did not appear at the hearing or offer his affidavit in support of the petitions.

SUMMARY OF THE PARTIES' POSITIONS

25. Petitioners argue that the Division extended the audit period to allow the last three quarters to constitute a test period, and the deficiency should be reduced to reflect the low error rate determined from that period. Alternatively, petitioners assert that they have proved that most of the unexplained bank deposits were in fact non-sales and not taxable sales. Finally, petitioners believe they have established reasonable cause for the abatement of all penalties.

26. The Division states that petitioners failed to produce adequate books and records on audit and, as a result, an alternative audit method was required. It adds that the estimation of the sales tax due by means of its bank deposits analysis was reasonable and that petitioners have not shown to the contrary. Finally, the Division argues that petitioners have not demonstrated reasonable cause justifying the abatement of the assessed penalties.

CONCLUSIONS OF LAW

A. 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]).

B. The Division may estimate tax liability pursuant to Tax Law § 1138(a)(1) only where a taxpayer's records are inadequate (*see Matter of Your Own Choice, Inc.*, Tax Appeals Tribunal, February 20, 2003). Tax Law § 1135(a)(1) compels persons required to collect sales tax to

maintain records sufficient to verify all transactions, in a manner suitable to determine the correct amount of tax due. Records are insufficient where it is "virtually impossible [for the Division of Taxation] to verify taxable sales receipts and conduct a complete audit" (*see Matter of Chartair, Inc. v. State Tax Commn.*, 65 AD2d 44, 411 NYS2d 41, 46 [1978]).

C. To determine the adequacy of a taxpayer's records, the Division must first request and thoroughly examine the taxpayer's books and records for the entire period of the proposed assessment (*see Matter of Adamides v. Chu*, 134 AD2d 776, 521 NYS2d 826 [1987], *lv denied* 71 NY2d 806, 530 NYS2d 109 [1988]).

D. Here, the Division made several requests to Mr. Van Derlofske, who was acting on behalf of Great Bay Marine, for the company's books and records for the period June 1, 2004 through November 30, 2007. Initially, the records were unavailable because, according to Mr. Van Derlofske, they were stolen and copies were not retained. A subsequent attempt by the auditor to obtain the records resulted in the production of incomplete bank records and no source documents. Only after subpoenas were issued was a full set of bank statements provided to the auditor, although the remaining requested supporting documentation, including invoices, was not. Finally, when the audit period was extended, records for only approximately 20 percent of the reported nontaxable sales were provided. Under such circumstances, it is clear that petitioners failed to maintain and produce adequate records, as required by Tax Law § 1135(a)(1), to substantiate Great Bay Marine's sales. The Division therefore properly resorted to an estimate of Great Bay Marine's sales for the period at issue.

E. In so estimating Great Bay Marine's sales tax liability, the Division was required to select a method reasonably calculated to reflect the tax due (*see e.g. Matter of ADGN, Inc.*, Tax Appeals Tribunal, February 6, 1997). It is well established that exactness in the audit result is

not required, for any imprecision arises from the taxpayer's failure to maintain adequate books and records as required under the Tax Law and thus is properly borne by the taxpayer (*see Matter of Cronos Enterprises*, Tax Appeals Tribunal, December 13, 2007).

F. The use of bank deposits as the basis of estimating sales and use tax liability has been affirmed by the Tax Appeals Tribunal as a reasonable methodology (*see Matter of D & V Liquor*, Tax Appeals Tribunal, March 10, 2005). In the present matter, the fact that Mr. Van Derlofske actually used a bank deposits method to originally prepare Great Bay Marine's sales tax returns further affirms the reasonableness of the Division's use of that same method to estimate Great Bay Marine's sales for the periods at issue.

G. Since the audit method was reasonable, petitioners have the burden of proof to show, by clear and convincing evidence, that the result of the audit was unreasonably inaccurate or that the amount of tax assessed was erroneous (*see Matter of Your Own Choice, Inc.*).

H. Petitioners have failed to meet this burden with regard to the issue of capital assets. Petitioners simply failed to present any evidence whatsoever that tax was either paid or not owed on the capital asset acquisitions identified at audit. There were no invoices, checks or exemption certificates placed in the record on this point. As a result, the audit adjustment adding additional tax of \$6,248.38 for the capital assets was proper.

I. Similarly, petitioner offered no reliable evidence or argument to refute the additional tax of \$2,974.14 on disallowed nontaxable sales. Given the opportunity to provide complete books and records for the extended audit period, petitioners provided substantiation for only approximately 20 percent of the claimed nontaxable sales during that time. The auditor examined these sales and reasonably concluded that she would disallow only a small portion of the total non-sales as taxable. As the Division correctly points out, by doing so the auditor

actually provided petitioners with the benefit of the doubt, considering the paucity of records provided.

J. The central question in this case is whether petitioners can explain the large discrepancy between Great Bay Marine's audited bank deposits during the period at issue and its gross sales as reported on its sales tax returns. By reviewing the same bank statements used by Mr. Van Derlofske in his preparation of the returns, the auditor ascertained that Great Bay Marine had \$25,229,704.40 in bank deposits during the audit period. After subtracting sales tax paid, there remained \$24,199,743.32 in deposits. Using the same bank statements, Great Bay Marine amazingly only claimed \$19,103,734.00 in gross sales on its returns. As a result, the source of the difference of \$5,096,009.32 must be explained by petitioners. It could not consist of nontaxable sales, as the Division already allowed all reported nontaxable sales. The crux of petitioners' task, therefore, was to substantiate non-sales in that amount. Petitioners predominantly failed to meet their burden of proof on this issue as well.

As their primary evidence, petitioners offered monthly summaries, prepared by Mr. Kelly, of deposits and expenditures from Great Bay Marine's account that they deemed to be non-sales. Attached to the summaries were bank statements and copies of received and disbursed checks for each respective month. Petitioners argue that this evidence demonstrates they are entitled to credit for over \$3.6 million in non-sales bank deposits. On the contrary, for a variety of reasons, these summaries fail to prove that most of the unexplained bank deposits found at audit were non-sales.

First, many of the claimed non-sales appear to be, in fact, sales. For instance, petitioners listed as non-sales numerous deposits from Peak Automotive Inc., D.A.M. Cycles, Fred Chall Marine, and First Choice Marine, the entities operated by the person named "Vic" (*see* Finding

of Fact 21[d]). Mr. Kelly himself admitted on cross-examination that these transactions were sales, "but that's not the way we put it into our books." In addition, petitioners similarly listed out-of-state transactions as non-sales. The record shows that these transactions were at best nontaxable sales and the Division previously allowed all nontaxable sales claimed by Great Bay Marine on its returns. As a result, they do not affect the audit results.

Additionally, petitioners are not entitled to apply the deposits they claim came from loans from officers during the audit period. The record is devoid of any evidence of supporting loan documentation, rate of interest charged (if any), or any repayment. In sum, it is unclear that these deposits actually came from legitimate loans. Moreover, several of these claimed loans from officers were supported by checks from people or entities that, admittedly, were not officers of Great Bay Marine. Hence, this series of deposits also does not warrant adjustment of the audit findings nor the underlying assessment.

Another series of summarized deposits that do not meet the required burden of proof are those from Bruce V. Schneider Associates. Mr. Kelly's testimony was unclear as to the reason for the payments from this entity. In addition, one of the checks from Bruce V. Schneider Associates that was deposited in Great Bay Marine's account and claimed as a non-sale actually referenced "service" on its face. Therefore, deposits of this kind cannot be considered non-sales.

Petitioners also offered over \$1.3 million in checks written by Great Bay Marine during the audit period that they claim came from corresponding non-sales bank deposits. A large portion of these checks from Great Bay Marine were for Department of Motor Vehicle (DMV) fees paid on boats and trailers sold. The evidence shows that Great Bay Marine collected \$350.00 per sale for DMV fees. The fees paid by Great Bay Marine to DMV, however, do not match the amounts collected; indeed, Mr. Kelly acknowledged that the true fee paid to DMV was only

approximately \$90.00 to \$110.00 per sale. He added that the remainder of the collected fee went for "fuel and stuff," without any actual breakdown on an invoice. As the Division correctly points out, Great Bay Marine's failure to adequately particularize each component of the fee renders it taxable in its entirety (*see* 20 NYCRR 527.1[b]). Petitioners have not met their burden of demonstrating what portion, if any, of the collected DMV fees was a non-sale item.

The remainder of the checks written by Great Bay Marine and placed in evidence are similarly insufficient to demonstrate non-sales deposits. Based on the record here, it is unclear as to when, if ever, funds from non-sales were deposited into Great Bay Marine's account based on payments out of that account. Contrary to petitioners' assertion, these disbursements from Great Bay Marine do not directly prove the corresponding deposits of non-sales transactions.

K. As described in Finding of Fact 18, at hearing, the Division discovered an error in the calculation of the tax for the period March 1, 2006 through May 31, 2006 in the statutory notice issued to Great Bay Marine. Therefore, the Division's revised notice asserted \$433,598.67 in additional sales and use tax due, plus penalty of \$70,370.62 and interest, for the period June 1, 2004 through November 30, 2007. These are the amounts subject to the adjustments described below in Conclusion of Law L.

Similarly, the responsible officer notices for Messrs. Kelly and Rapczyk must be adjusted for the Division's oversight. The amount of tax in the revised notices for each responsible officer is \$331,045.16, plus penalty of \$129,375.44 and interest, before the adjustments described below in Conclusion of Law L.

L. Petitioners do show, however, that certain deposits determined by the Division to be taxable sales are clearly not sales made by Great Bay Marine and, therefore, should not be included in its audited taxable sales for the period at issue. Such deposits are described in

Findings of Fact 21(a), (c) and (h). The basis for these adjustments is further explained as follows:

a) as discussed in Finding of Fact 21(a), petitioners were able to substantiate non-sales deposits in the amount of \$126,100.00 from Great Bay Marine's line of credit into its checking account. Petitioners produced copies of deposited checks entitled "Elite Credit Account" that Mr. Kelly credibly identified as coming from Great Bay Marine's line of credit. Petitioners were unable, though, to convincingly demonstrate any other claimed deposits from additional lines of credit (*see* Footnote 5). Thus, Great Bay Marine's taxable sales for the audit period should be reduced by \$126,100.00. Messrs. Kelly and Rapczyk's notices should be similarly adjusted to give credit for all Elite Credit Account deposits made within the period March 1, 2005 through November 30, 2007.

b) as discussed in Finding of Fact 21(c), petitioners were able to substantiate non-sales deposits from M&T Bank for reserves paid on loans generated by Great Bay Marine. The reserve payments from M&T Bank, which totaled \$110,754.71 for the audit period, were clearly identified as such on the bank statements provided and were, thus, non-sales. As for payments from Bank of America, though, the bank statements only referenced general deposits. There was insufficient evidence to prove what portion of these deposits was attributable to reserves paid for the audit period. Likewise, the Honda Financial payments contain comparable ambiguity. Mr. Kelly's schedules included as non-sales some, but not all deposits from Honda Financial without explanation for the disparate treatment of the identical entries. Petitioners simply did not meet their burden of clear and convincing proof on the Bank of America and Honda Financial deposits. Consequently, Great Bay Marine's taxable sales for the audit period should be reduced by an additional \$110,754.71 for the M&T Bank reserve payments. Messrs. Kelly and Rapczyk's

notices should again be similarly adjusted to give credit for all M&T Bank reserve payments made within the period March 1, 2005 through November 30, 2007 (*see* Appendix).

c) as discussed in Finding of Fact 21(h), petitioners were able to substantiate as non-sales deposits several tax refund checks from the IRS and NYS, as well as the insurance refund from James F. Sutton Agency, Ltd. The tax refund deposits total \$7,338.10 and the insurance refund totals \$1,449.00, or \$8,787.10 in aggregate. Therefore, Great Bay Marine's taxable sales should be reduced accordingly. Messrs. Kelly and Rapczyk's notices should be similarly adjusted to give credit for these deposits.

M. Petitioners' assertion that the last three quarters of the audit period should be considered a test period is rejected. The record plainly shows that the parties did not agree on a test period audit. The auditor convincingly testified to that effect, pointing out that the Division did not elect to use a test period method. Further, Mr. Van Derlofske acknowledged that there was nothing in writing confirming the existence of a test period audit, such as an audit method election form (*see e.g. Matter of Wallach v. Tax Appeals Tribunal*, 206 AD2d 696, 614 NYS2d 647 [1994], *lv denied* 85 NY2d 805, 626 NYS2d 756 [1995]). Lastly, petitioners have not demonstrated that the bank deposits audit method chosen by the Division was erroneous, thereby warranting use of a different method.

N. Penalties were imposed pursuant to Tax Law § 1145(a)(1)(i) for failure to pay any tax imposed under Articles 28 and 29 of the Tax Law, and Tax Law § 1145(a)(1)(vi) for omission of greater than 25 percent of the tax due. Tax Law § 1145(a)(1)(iii) provides that if the failure or delay was due to reasonable cause and not due to willful neglect, penalty and additional interest shall be remitted. Reasonable cause includes any cause for delinquency which would appear to a person of ordinary prudence and intelligence as reasonable cause for the delay in filing a sales tax

return and paying the tax imposed under Articles 28 and 29 of the Tax Law (20 NYCRR 2392.1[d][5]).

In this case, penalties were properly imposed because of the substantial discrepancy between the amount of reported taxable sales and the amount of tax determined on audit (*see Matter of S.H.B. Super Markets v. Chu*, 135 AD2d 1048, 522 NYS2d 985 [1987]; *Matter of Himed Deli Corp.*, Tax Appeals Tribunal, March 20, 2000). Mr. Van Derlofske used a bank deposits method in order to ascertain gross sales and prepare Great Bay Marine's sales tax returns yet, remarkably, the Division found over \$5 million in unreported gross sales when examining the same bank statements. Such a significant and questionable inconsistency hardly gives rise to reasonable cause for abatement of penalties. Moreover, there has no been showing that Great Bay Marine maintained adequate records of its sales and, clearly, it did not produce records as required. As the Tribunal has held in other cases, the failure to maintain and provide records is reason to sustain the imposition of penalties (*see Matter of Rosemellia*, Tax Appeals Tribunal, March 12, 1992; *see also Matter of Shukry v. Tax Appeals Tribunal*, 184 AD2d 874 [1992]). Thus, the penalties are sustained.

O. The petitions of Great Bay Marine, Inc., Timothy Kelly, and Frank Rapczyk are granted to the extent indicated in Conclusion of Law L,⁷ but are in all other respects denied. The

⁷ The schedule of allowed M&T Bank reserves, along with the tax and insurance refund deposits discussed in Conclusion of Law L, is attached in the Appendix.

Division of Taxation is directed to modify the notices of determination dated August 21, 2009 and September 8, 2009 in accordance with Conclusions of Law K and L, and as modified, the notices are sustained.

DATED: Albany, New York

NOV 15 2012


ADMINISTRATIVE LAW JUDGE

APPENDIX

Schedule of Reserves and Refunds

| Date | Reserves (in \$) ⁸ | Refunds (in \$) | Source of Refunds |
|--------------------|-------------------------------|-----------------|-------------------|
| June 3, 2004 | 4,436.00 | | |
| July 2, 2004 | 5,922.24 | | |
| August 3, 2004 | 1,098.00 | | |
| September 2, 2004 | 4,157.84 | | |
| October 4, 2004 | 1,665.00 | | |
| November 2, 2004 | 495.00 | | |
| December 2, 2004 | 2,152.50 | | |
| February 2, 2005 | 849.37 | | |
| April 1, 2005 | 2,355.00 | | |
| June 2, 2005 | 1,391.22 | | |
| July 5, 2005 | 2,117.69 | | |
| August 8, 2005 | 1,369.86 | | |
| September 23, 2005 | | 1,416.53 | IRS |
| October 4, 2005 | 736.51 | | |
| March 2, 2006 | 1,587.00 | | |
| April 4, 2006 | 1,879.28 | | |
| May 2, 2006 | 189.00 | | |
| June 2, 2006 | 4,822.66 | | |

⁸ The source of all reserves herein is M&T Bank (*see* Finding of Fact 21[c].)

| | | | |
|---------------------|----------------------------|--------------------------|------------------------|
| July 5, 2006 | 2,754.19 | | |
| August 2, 2006 | | 4,376.00 | IRS |
| August 2, 2006 | 2,735.79 | | |
| September 5, 2006 | 2,759.81 | | |
| October 3, 2006 | 4,284.98 | | |
| November 2, 2006 | 1,735.26 | | |
| January 19, 2007 | | 137.94 | NYSDTF ⁹ |
| February 2, 2007 | 3,840.87 | | |
| February 20, 2007 | | 506.66 | NYSDTF |
| March 2, 2007 | 12,815.74 | | |
| April 3, 2007 | 4,616.22 | | |
| May 2, 2007 | 5,737.45 | | |
| June 4, 2007 | 7,370.71 | | |
| July 3, 2007 | 12,361.16 | | |
| August 2, 2007 | 4,488.88 | | |
| September 5, 2007 | 2,508.15 | | |
| September 8, 2007 | | 54.00 | NYSDTF |
| September 15, 2007 | | 846.97 | IRS |
| October 2, 2007 | 3,231.28 | | |
| October 16, 2007 | | 1,449.00 | James F. Sutton Agency |
| November 2, 2007 | 2,230.05 | | |
| | | | |
| <u>TOTAL</u> | <u>\$110,754.71</u> | <u>\$8,787.10</u> | |
| | | | |
| | | | |

⁹ "NYSDTF" denotes a refund from New York State Department of Taxation and Finance.