

STATE OF NEW YORK
STATE TAX COMMISSION

In the Matter of the Petition :
of
Samuel Bernstein :

AFFIDAVIT OF MAILING

for Redetermination of a Deficiency or a Revision :
of a Determination or a Refund of Personal Income
& UBT under Article 22 & 23 of the Tax Law for the:
Years 1969 & 1970.

State of New York
County of Albany

Jay Vredenburg, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 2nd day of October, 1981, he served the within notice of Decision by certified mail upon Sidney Blumenberg the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

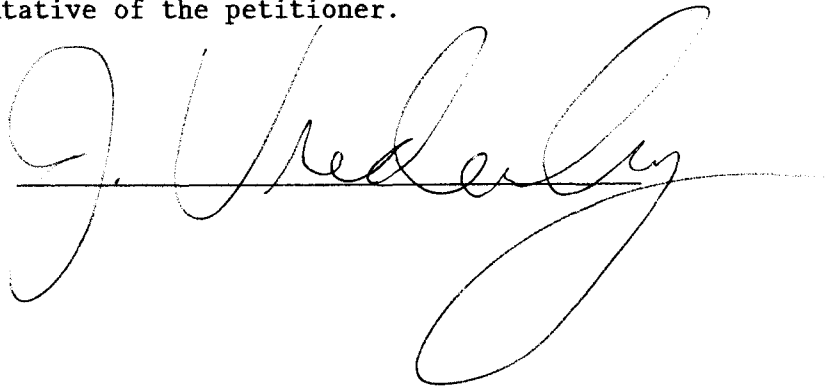
Sidney Blumenberg
276 Fifth Ave.
New York, NY 10001

and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the representative of the petitioner herein and that the address set forth on said wrapper is the last known address of the representative of the petitioner.

Sworn to before me this
2nd day of October, 1981.





STATE OF NEW YORK

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& UBT under Article 22 & 23 of the Tax Law for the :
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State of New York
County of Albany

Jay Vredenburg, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 2nd day of October, 1981, he served the within notice of Decision by certified mail upon Samuel Bernstein, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Samuel Bernstein
5720 Myrtle Ave.
Brooklyn, NY 11227

and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the petitioner herein and that the address set forth on said wrapper is the last known address of the petitioner.

Sworn to before me this
2nd day of October, 1981.

Gennie A. Hackland

J. Vredenburg

STATE OF NEW YORK
STATE TAX COMMISSION
ALBANY, NEW YORK 12227

October 2, 1981

Samuel Bernstein
5720 Myrtle Ave.
Brooklyn, NY 11227

Dear Mr. Bernstein:

Please take notice of the Decision of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 690 & 722 of the Tax Law, any proceeding in court to review an adverse decision by the State Tax Commission can only be instituted under Article 78 of the Civil Practice Laws and Rules, and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 months from the date of this notice.

Inquiries concerning the computation of tax due or refund allowed in accordance with this decision may be addressed to:

NYS Dept. Taxation and Finance
Deputy Commissioner and Counsel
Albany, New York 12227
Phone # (518) 457-6240

Very truly yours,
Kathy Pfaffenbach

STATE TAX COMMISSION

cc: Petitioner's Representative
Sidney Blumenberg
276 Fifth Ave.
New York, NY 10001
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition	:	
of	:	
SAMUEL BERNSTEIN	:	DECISION
for Redetermination of a Deficiency or for	:	
Refund of Personal Income Tax and	:	
Unincorporated Business Tax under Articles	:	
22 and 23 of the Tax Law for the Years 1969	:	
and 1970.	:	

Petitioner, Samuel Bernstein, 5720 Myrtle Avenue, Brooklyn, New York 11227, filed a petition for redetermination of a deficiency or for refund of personal income tax and unincorporated business tax under Articles 22 and 23 of the Tax Law for the years 1969 and 1970 (File No. 29360).

A formal hearing was held before Doris Steinhardt, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on March 9, 1981 at 9:20 A.M. Petitioner appeared by Sidney Blumenberg, P.C. The Audit Division appeared by Ralph J. Vecchio, Esq. (Samuel Freund, Esq., of counsel).

ISSUES

I. Whether the Audit Division properly imposed a fraud penalty upon petitioner, based upon Federal income tax changes and penalties, the amounts of which were settled by stipulation and approved by decision of the Tax Court.

II. Whether the additional income which resulted from Federal changes was properly the subject of unincorporated business tax.

III. Whether the Audit Division's failure to make an evidentiary offering of petitioner's New York State personal income and unincorporated business tax

returns for the years at issue was a flaw requiring that the fraud penalties be cancelled.

FINDINGS OF FACT

1. On June 7, 1979, the Audit Division issued to petitioner, Samuel Bernstein, a Statement of Audit Changes for additional personal income tax and unincorporated business tax for 1969 and 1970, detailed as follows:

(a) Personal income tax:

	<u>1969</u>	<u>1970</u>
Original taxable income	\$ 7,712.00	\$ 9,808.00
Federal adjustment	50,213.70	21,519.75
Corrected taxable income	<u>\$57,925.70</u>	<u>\$31,327.75</u>
Tax after statutory credit	6,657.10	2,932.27
Tax previously stated	290.22	423.50
Additional personal income tax due	<u>\$ 6,366.88</u>	<u>\$ 2,508.77</u>
Payment received 12/21/77	\$9,000.00	
Payment applied	<u>6,366.88</u>	<u>--</u>
	-0-	\$ 2,508.77

(b) Unincorporated business tax:

Business income reported	\$ 9,912.50	\$12,050.97
Federal adjustment	50,213.70	21,519.75
Corrected business income	<u>\$60,126.20</u>	<u>\$33,570.72</u>
Business taxable income after deduction for allowance/exemption	50,126.20	23,570.72
Tax on above	2,756.94	1,296.39
Tax previously stated	122.30	255.24
Additional unincorporated business tax due	<u>\$ 2,634.64</u>	<u>\$ 1,041.15</u>
Payment applied	<u>2,633.12</u>	<u>--</u>
Tax Due	\$ 1.52	\$ 1,041.15

2. On January 30, 1980, the Audit Division issued to petitioner a Notice of Deficiency asserting taxes due of \$3,551.44, plus penalties and interest of \$12,235.76. The penalty, asserted pursuant to subdivision (e) of section 685 of the Tax Law, totalled \$4,500.76 for 1969 and \$1,774.96 for 1970.

3. Petitioner is the sole proprietor of Berns Juvenile Furniture, a discount baby carriage and juvenile furniture business located in Brooklyn, New

York. Petitioner has been engaged in the business since 1938 and has owned the store since 1950.

4. Pursuant to an audit conducted utilizing the bank deposit plus cash expenditures method of income reconstruction, Internal Revenue Service field and special agents computed additional unreported income for petitioner in the amount of \$79,200.33 for 1969 and \$26,034.74 for 1970; such amounts were based upon overdeposits as compared with total gross receipts reported by petitioner on his Federal Schedule C. Petitioner and/or his spouse had seven savings accounts in 1969 and six such accounts in 1970, to which deposits were made and which were analyzed by the agents. The agents also examined three other accounts: a tax account, a checking account in the name of the business and a credit card account. The Internal Revenue Service had conducted an office audit for 1968¹ and had scrutinized all the aforementioned accounts, with the exception of the tax and credit card accounts which were not discovered until the 1969-1970 audit. The tax account was used to deposit and pay withholding taxes, sales taxes and the like. The credit card account was utilized to deposit proceeds of sales charged through bank credit cards; deposits for 1969 and 1970 totalled \$13,636.43 and \$15,578.99, respectively. Petitioner made a number of transfers from this account to the business account, totalling \$9,650.00 in 1969 and \$9,500.00 in 1970.

5. On his Federal returns for 1969 and 1970, petitioner calculated and reported adjusted gross income of \$14,076.07 and \$18,398.29, respectively; included therein was interest income earned on the bank accounts analyzed during the course of the Federal audit.

¹ The 1968 Federal audit disclosed unreported income of \$13,106.00. The resulting tax deficiency and negligence penalty for that year were accepted by the taxpayer.

6. In arriving at the amounts of unreported income, the Internal Revenue agents took under consideration the following: cash living expenses of \$7,200.00 per year; the purchase by petitioner of an automobile and a diamond ring in 1969; and the full amount of business expenses as claimed by petitioner on his Federal returns.

7. In August, 1970, petitioner opened a safe deposit box in a bank near his place of business. The Internal Revenue Service made no discovery as to the contents of the box, but vault records revealed that between August and December, 1970, petitioner, his wife or his daughter entered the safe deposit box on nineteen occasions.

8. A short time after initiation of the Federal audit, petitioner's case was referred to the Intelligence Division of the Internal Revenue Service for investigation. Regional Counsel thereafter recommended the institution of criminal proceedings. On April 15, 1976, the Department of Justice advised that it declined prosecution under section 7201 of the Internal Revenue Code, based upon its observations that the key witness (petitioner's accountant at that time, Mr. Morris Endlich) was incapable of giving consistent testimony and had apparently been negligent in preparing the returns in question.

9. Upon completion of the audit, the Internal Revenue Service field agent and Mr. Blumenberg met on several occasions to discuss the results thereof. The agent advised Mr. Blumenberg that he would consider disposing of the case without the fraud penalty, if it were within his authority to do so. Upon inquiry, the agent was informed that such a decision was not within his jurisdiction.

10. Internal Revenue Service Appellate Division conferences resulted in an agreement between the Service and petitioner, the terms of which were as

follows: taxable income, after settlement adjustments, of \$61,489.70 for 1969 and \$37,042.75 for 1970; for 1969, a deficiency of \$15,373.16, plus a penalty under Internal Revenue Code section 6653(b) of \$7,686.58; and a deficiency and penalty for 1970 of \$7,673.02 and \$3,836.51, respectively.

11. On May 24, 1978, the Honorable C. Moxley Featherston signed a Tax Court decision which approved the above-mentioned agreement, as follows:

"That there are deficiencies in income taxes due from the petitioners [Samuel Bernstein and Esther Bernstein] for the taxable years 1969 and 1970 in the amounts of \$15,373.16 and \$7,673.02, respectively; and That there are additions to the tax due from the petitioner, Samuel Bernstein, for the taxable years 1969 and 1970 under the provisions of I.R.C. §6653(b) in the amounts of \$7,686.58 and \$3,836.51, respectively."

12. Application of an income reconstruction method by the Internal Revenue Service was seemingly necessary because the taxpayer's accountant did not maintain formal books of account. Mr. Endlich informed the Service that the Berns Juvenile Furniture account was the sole business checking account. He prepared petitioner's Federal returns from quarterly sales tax returns filed. On said Federal returns, Mr. Endlich indicated no opening or closing inventory; for 1969 and 1970, he claimed, on petitioner's behalf, the standard deduction although itemized deductions would have exceeded that amount.

13. Petitioner did not testify nor appear at the formal hearing in this matter.

14. Mr. Blumenberg contended that since petitioner was engaged in a business which required him to be present at the store from 9:00 A.M. until 9:00 or 10:00 P.M. each day, six days per week, he (petitioner) had delegated the responsibility for maintaining records and preparing tax returns to Mr. Endlich; that there had been no intention on petitioner's part to conceal the bank accounts examined by the Internal Revenue Service; that the pattern of deposits

could only be explained on the basis of prior accumulations, and not current sales; and, that the assertion by the Audit Division of unincorporated business tax against petitioner was improper because there was no evidence that the income upon which it was imposed was indeed business income. In addition, Mr. Blumenberg testified that petitioner had initially objected to the settlement which included the fraud penalty because of inferences which might be drawn therefrom, but subsequently consented, upon the advice of Mr. Blumenberg.

15. According to the Mass Retailers Merchandising Report of 1971, the median gross profit percentage of a juvenile furniture business (non-discount) was 30.6 percent for that year. Mr. Blumenberg contended that the addition of the allegedly unreported income to business receipts yielded a gross profit percentage of 45, a totally unrealistic figure, especially in light of petitioner's business as a discount operation.

16. Following the agreement reached between petitioner and the Internal Revenue Service, and prior to entry of the Tax Court decision, Mr. Blumenberg wrote to the Audit Division on petitioner's behalf, advising the Division that a settlement with the Federal authorities was pending; he enclosed an estimated computation of the increase in state taxes and a check in the sum \$9,000.00.

17. Counsel for the Audit Division did not offer into evidence petitioner's New York State personal income or unincorporated business tax returns for the years at issue.

CONCLUSIONS OF LAW

A. That where a personal income tax deficiency is attributable to fraud on the part of the taxpayer, subdivision (e) of section 685 of the Tax Law authorizes imposition of a penalty equal to fifty percent of the underpayment. Section 685 is made applicable to Article 23 by section 722.

B. That on the issue of whether petitioner is guilty of fraud with intent to evade tax, the burden of proof is upon the Audit Division (sections 689(e)(1), 722), which must prove the fraud by clear and convincing evidence. A mere preponderance of the evidence is insufficient to meet this burden. Matter of J. David Goldin, State Tax Comm., April 25, 1980.

C. That the Audit Division has failed to show by clear and convincing evidence that petitioner's understatement of income for 1969 and 1970 was due to his fraudulent intent to evade payment of taxes. As the Tax Court stated in its memorandum decision Annie Mary Timmons:

"While there is no question in our minds but that petitioner's taxable income for 1942 and 1943 was grossly understated that fact alone does not prove the existence of fraud. There is not in the evidence of record convincing proof that petitioner willfully concealed income or claimed false deductions with the intent of evading taxes." (Emphasis supplied.) 10 T.C.M. 622, 625 (1951).

The fact that petitioner reported on his Federal returns interest earned on the accounts examined by the Federal agents militates against a finding of actual, intentional wrongdoing, with the specific purpose of tax evasion. See Mitchell v. Commissioner, 118 F.2d 308 (5th Cir. 1941); Richard A. Ench, 21 T.C.M. 894 (1962); Donald B. Semple, 10 T.C.M. 795 (1951).

More importantly, the Audit Division failed to make an evidentiary offering of petitioner's state returns for 1969 and 1970 or to prove the contents thereof by secondary evidence. A showing of the amounts of tax petitioner paid was insufficient; it is impossible to know, for example, whether petitioner filed separate returns or joint returns with his wife. It has been held in numerous instances that the Commissioner's failure to produce the returns in question or evidence as to what information the returns contained

is fatal to a determination that such returns are false or fraudulent. Drieborg v. Commissioner, 225 F.2d 216 (6th Cir. 1955); Martha G. Whitfield, 31 T.C.M. 654 (1972).

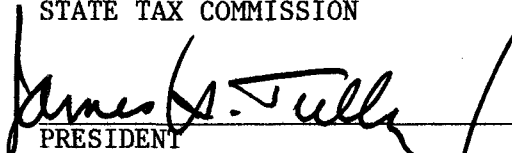
D. That petitioner offered no evidence to establish that the unincorporated business tax deficiencies asserted against him were erroneous or improper; his representative's theory that the deposits could only be explained by prior accumulations was unsupported.

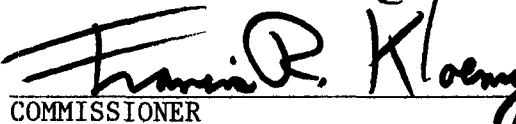
E. That the petition of Samuel Bernstein is granted to the extent indicated in Conclusion of Law "C"; that the Notice of Deficiency issued January 30, 1980 is to be modified accordingly; and that, except as so modified, the deficiency is in all other respects sustained.

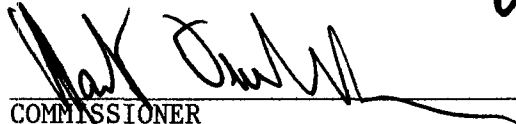
DATED: Albany, New York

OCT 02 1981

STATE TAX COMMISSION


PRESIDENT


COMMISSIONER


COMMISSIONER