

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

July 8, 1983

Cardinal Motors Inc.  
and Salvatore Cardinale, as Officer  
1049 Dahill Rd.  
Brooklyn, NY 11204

Gentlemen:

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) 1138 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 Law 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  
Law Bureau - Litigation Unit  
Building #9 State Campus  
Albany, New York 12227  
Phone # (518) 457-2070

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative  
John R. Serpico  
186 Joralemon St., 9th Fl  
Brooklyn, NY 11201  
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petition	:	
of	:	
CARDINAL MOTORS, INC.	:	
and	:	DECISION
SALVATORE CARDINALE, as Officer	:	
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, 1972	:	
through August 31, 1976.	:	

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Petitioners, Cardinal Motors, Inc. and Salvatore Cardinale, as officer of Cardinal Motors, Inc., 1049 Dahill Road, Brooklyn, New York 11204, 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, 1972 through August 31, 1976 (File Nos. 25629 and 25620).

A formal hearing was commenced before Arthur Bray, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York on November 20, 1981, continued at the same offices on March 15, 1982, and concluded at the same offices on May 10, 1982, with all briefs to be submitted by August 4, 1982. Petitioner appeared by John R. Serpico, Esq. The Audit Division appeared by Ralph J. Vecchio, Esq. (Samuel Freund, Esq., of counsel) on November 20, 1981, and by Paul B. Coburn, Esq. (Samuel Freund, Esq., of counsel) on March 15, 1982 and May 10, 1982.

ISSUES

I. Whether the asserted deficiency of sales and use taxes due is barred by the statute of limitations.

II. Whether the Audit Division, in the absence of adequate records, properly determined the corporate petitioner's taxable sales and sales and use tax due.

III. Whether the Audit Division properly asserted a penalty based upon fraud.

#### FINDINGS OF FACT

1. Cardinal Motors, Inc. ("the Corporation") is a retail distributor of Honda motorcycles. In addition to selling motorcycles, the Corporation sells motorcycle parts and performs repairs for its customers. The Corporation has been operating since approximately 1965.

2. Mr. Salvatore Cardinale is the president and sole stockholder of the Corporation. He had control of the Corporation during the periods in issue.

3. On February 26, 1976, Salvatore Cardinale, as the president of the Corporation, executed a Consent Extending the Period of Limitation for Assessment of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the period December 1, 1972 through November 30, 1975 to on or before January 31, 1977. On October 6, 1976, Salvatore Cardinale executed another Consent extending the statute of limitations for the period December 1, 1972 through August 31, 1976 to on or before December 31, 1977. Thereafter, Salvatore Cardinale executed a third Consent extending the statute of limitations for the period December 1, 1972 through August 31, 1976 to on or before December 20, 1978.

4. On December 18, 1978 the Audit Division, as the result of a field audit, issued to the Corporation two notices of determination and demand for payment of sales and use taxes due. One notice was for the period December 1, 1972 through August 31, 1975. This notice assessed a tax due of \$43,666.03, plus penalty of \$8,205.05 and interest of \$23,526.44, for a total amount due of

\$75,397.72. The other notice was for the period September 1, 1975 through August 31, 1976. This notice assessed a tax due of \$36,172.38, plus a penalty imposed for fraud of \$18,086.19 and interest of \$7,578.19, for a total amount due of \$61,836.76.

5. On December 18, 1978 the Audit Division, as a result of a field audit, issued to Salvatore Cardinale a Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period December 1, 1972 through August 31, 1975. This notice asserted a tax due of \$43,666.03, plus penalty of \$8,205.25 and interest of \$23,526.44, for a total amount due of \$75,397.72.

6. On October 5, 1978 the Audit Division commenced a sales tax field audit of the Corporation. At the beginning of the sales tax audit, the auditor requested all of the Corporation's books and records pertaining to sales and purchases. He also requested invoices, sales tax returns, and income tax returns. In response to this request, the auditor was advised that the Corporation's books and records were in a car owned by the Corporation's accountant and that the car had been stolen. When the car was subsequently recovered, the books and records were not returned. Thereafter, the auditor was presented with the Corporation's cash disbursement book, bank deposits, income tax returns and sales tax returns. The cash disbursement book recorded only the purchases of motorcycles and parts.

7. When the audit was begun, petitioners' accountant told the auditor that all receipts were deposited in a bank. The auditor found a significant discrepancy between the amount deposited in the bank and the Corporation's reported sales.

8. The auditor encountered difficulty because of the lack of purchase invoices. Eventually, the auditor was able to obtain six motorcycle purchase

invoices for a period of one month. The auditor then recorded the cost of the motorcycles and compared them to the actual sales price of the motorcycles. A markup percentage on sales was then determined by subtracting the sales price from the cost and then dividing the remainder by the cost. These computations resulted in a markup percentage of 14.9 percent. The auditor concluded that the computed markup percentage was not reliable since it did not correspond to the usual markup found in the type of business the Corporation was engaged in. Therefore, the auditor proceeded with the audit on the theory that the Corporation's bank deposits represented petitioner's taxable sales. The amount of bank deposits were compared with the Corporation's reported sales over the audit period. This revealed that the Corporation's bank deposits exceeded petitioner's reported sales by 165.11 percent. Accordingly, the auditor determined petitioner's adjusted taxable sales by adding the Corporation's reported taxable sales to the amount determined by multiplying 1.6511 times the Corporation's reported taxable sales.

9. At the conclusion of the field audit, the auditor conferred with his supervisors and it was concluded that the audit of the Corporation should be referred to the Special Investigations Bureau of the Department of the Taxation and Finance ("SIB"). This decision was based on finding, among other things: that there was a substantial difference between sales per sales tax returns and sales per cash receipts; that sales per bank deposits did not agree with sales per returns; and that the Corporation did not report its sales of parts, accessories and repairs.

10. On April 22, 1977 an investigator from the SIB served a subpoena duces tecum on the Corporation for the corporate books and records. As a result of the subpoena, the Corporation produced its invoices for 1976. The investigator

then prepared an analysis of the Corporation's sales by comparing the Corporation's sales, as reflected by its invoices, to the sales reported on its returns. To the extent that the analysis corresponds with the periods at issue, the workpapers reveal:

<u>Period</u>	<u>Total Taxable Sales</u>	<u>Reported Taxable Sales</u>	<u>Unreported Taxable Sales</u>	<u>Tax Due</u>
Quarter Ended May 31, 1976	\$197,473.44	\$146,611.00	\$50,862.44	\$4,069.00
Quarter Ended August 31, 1976	112,719.07	88,083.00	24,636.07	1,970.89

Although it is just beyond the period under review, the investigator's workpapers disclose an overreporting of taxable sales and an overpayment of tax due for the quarter ended November 30, 1976.

The SIB investigator's analysis of tax collected as revealed by the invoices compared to the tax reported and paid by the Corporation on its returns reveals:

<u>Period</u>	<u>Total Tax Collected</u>	<u>Tax Reported and Paid on Returns</u>	<u>Tax Collected Which Was Not Reported or Omitted</u>
Quarter Ended May 31, 1976	\$17,005.91	\$11,728.88	\$5,277.03
Quarter Ended August 31, 1976	9,033.93	7,046.66	1,987.27

For the quarter immediately subsequent to the period under review, the SIB investigator found an overreporting of tax collected and paid over.

11. The invoices examined by the SIB investigator were serially numbered. The investigator, however, did not attempt to account for all the invoices because they were voluminous.

12. At the conclusion of the SIB investigator's audit, the investigator recommended that both the Corporation and Salvatore Cardinale be prosecuted for filing false and fraudulent sales tax returns for the quarters ending May 31, 1976 and August 31, 1976. The investigator also recommended that petitioners

be prosecuted for violations of the New York income tax and corporation franchise tax laws. On September 22, 1978 the Corporation pled guilty in New York City Criminal Court to willfully filing a false sales tax return for one quarter of 1976. The judge then imposed a conditional discharge upon the Corporation. The condition imposed was that the Corporation pay all taxes, penalties, and interest as may be finally determined. Additionally, the judge levied a fine of \$250.00 against the Corporation.

13. Generally, the Corporation's sales tax returns were prepared by an accountant and presented to petitioner Salvatore Cardinale for signature. However, the sales tax returns for the periods ending November 30, 1973, November 30, 1975, and August 31, 1975 were signed with Mr. Cardinale's name by his accountant.

14. At the hearing, petitioners' representative presented an analysis of the Corporation's purported nontaxable out-of-state sales based upon an analysis of invoices. Petitioners' representative, however, was unable to verify that he examined all of the Corporation's invoices when this analysis was prepared. Further, no evidence was presented to verify that the sales were in fact exempt out-of-state sales.

15. Petitioner Salvatore Cardinale testified at the hearing that the Corporation's sales were greatest from March to October and, therefore, this was the period during which the Corporation generated most of its income. It was Mr. Cardinale's practice that as the Corporation acquired excess funds in its checking account during the prime season, the money would be redeposited in the business savings account. The funds then accumulated in the savings account would be utilized to finance the Corporation during the winter months. In December, the Corporation would commence purchasing inventory for the new

season. At this time the money which had been saved in the business savings account would be redeposited in the business checking account. Mr. Cardinale stated that when the savings account was exhausted he borrowed the funds needed from friends. Mr. Cardinale also personally loaned money to the corporation. Mr. Cardinale maintained that the loans to the Corporation from himself and his friends neither carried interest nor were represented by a note. Mr. Cardinale averred that during the period in issue he borrowed from forty to forty-five thousand dollars from friends. Mr. Cardinale then stated that during the time when sales resumed he would have checks drawn payable to himself, cash the checks, and they repay his friends in cash.

#### CONCLUSIONS OF LAW

A. That in view of the consents executed by Salvatore Cardinale extending the period for assessment noted in Finding of Fact "3", the assessments are not barred by the statute of limitations (Tax Law §1147[c]).

B. That in determining the amount of a sales tax assessment it is the duty of the Audit Division to select a method "'reasonably calculated to reflect the taxes due' (Matter of Grant Co. v. Joseph, 2 NY2d 196, 206)." (Matter of Meyer v. State Tax Comm., 61 A.D.2d 223, 227 lv. to app. den. 44 NY2d 645). When the Audit Division employs such a method, it becomes incumbent upon the petitioner to establish error (Matter of Meyer v. State Tax Comm., supra).

C. That section 1138(a) of the Tax Law provides, in part, that if a return required to be filed is incorrect or insufficient, the Tax Commission shall determine the amount of tax due on the basis of such information as may be available. This section further provides that, if necessary, the tax may be estimated on the basis of external indices.



D. That resort to the use of a test period to determine the amount of tax due must be based upon an insufficiency of record keeping which makes it virtually impossible to determine such liability and perform a complete audit (Matter of Chartair, Inc. v. State Tax Commission, 65 A.D.2d 44). Petitioner did maintain some books and records which were available to the Audit Division. These records, however, were insufficient for verification of taxable sales as evidenced by the Corporation's books not reflecting the sale of parts or repairs and Mr. Cardinale's inability to present the auditor with a complete set of sales invoices. Therefore, the Audit Division properly utilized an analysis of the Corporation's bank deposits to determine the sales and use taxes due. In addition, petitioners have not presented any evidence which would establish that an analysis of the Corporation's bank deposits resulted in an incorrect determination of sales and use taxes due. The analysis of nontaxable sales relied upon by petitioners' is deficient inasmuch as it is impossible to determine from the record that the sales were in fact exempt out-of-state sales. Similarly, the Audit Division was not required to rely upon the investigator's analysis of the Corporation's invoices to determine sales and use tax due, since it was impossible to verify from the the Corporation's books whether the invoices examined by the investigator were complete. Lastly, in view of the questionable explanation that noninterest bearing loans from third parties in the amount of \$40,000.00 to \$45,000.00 were repaid in cash, as well as the lack of any documentary or testimonial evidence from disinterested individuals to establish that loans were made, Mr. Cardinale's testimony is rejected as lacking credibility.

E. That section 1145(a) of the Tax Law was added by section 2 of chapter 287 of the laws of 1975. During the period in issue, this paragraph provided:

"If the failure to file a return or to pay or pay over any tax to the tax commission within the time required by this article is due to fraud, there shall be added to the tax a penalty of fifty percent of the amount of the tax due (in lieu of the penalty provided for in paragraph (1)), plus interest at the rate of one percent of such tax for each month of delay after such return was required to be filed or such tax became due."

Section 1145(a)(2) of the Tax Law was enacted by the Legislature with the intention of having a penalty provision in the Sales and Use Tax Law which was similar to that which already existed in the Tax Law with respect to deficiencies of, inter alia, personal income tax (N.Y. Legis. Ann., 1975, p. 350). Thus, the burden placed upon the Audit Division to establish fraud at a hearing involving a deficiency of sales and use tax is the same as the burden placed upon the Audit Division in a hearing involving a deficiency of personal income tax. A finding of fraud at such a hearing"... requires clear, definite and unmistakable evidence of every element of fraud, including willful, knowledgeable and intentional wrongful acts or omissions constituting false representations, resulting in deliberate nonpayment or underpayment of taxes due and owing." (Matter of Walter Shutt and Gertrude Shutt, State Tax Commission, June 4, 1982).

F. That a plea of guilty to tax evasion collaterally estops a taxpayer from contesting a civil fraud penalty for the same period (see Plunkett v. Commissioner, 465 F.2d 299 [7th Cir. 1972]). However, the conviction for fraud would only estop the Corporation for the same period (see Tranquilli v. Commissioner, 39 TCM (CCH) 874). Since the period for which the Corporation pled guilty to willfully filing a false sales tax return is not established by the record, the Corporation's plea of guilty may only be viewed as an indication of the Corporation's fraudulent intent. (Wilson v. United States, 5 AFTR2d 1653 (D.C., Minn. 1960)).

G. That, in addition to the Corporation's plea of guilty to willfully filing a false sales tax return, indicia of fraud may be found in: the substantial underreporting of sales over a successive period of years (see Matter of Thomas J. Julia and Carol L. Julia, State Tax Commission, September 5, 1980, which held that a substantial underreporting of income indicated fraud); the failure to furnish records to the sales tax auditor which were apparently available as evidenced by the submission of additional records to the SIB investigator (Granat's Estate v. Commissioner, 298 F.2d 397 [2nd Cir. 1962]); the maintenance of records which did not reflect the Corporation's sales of parts and repairs (see Harvey v. Early, 189 F2d 169 [4th Cir. 1974]); and the failure to pay over to New York the sales tax collected.

H. That, in view of the foregoing, the Audit Division has sustained its burden of proof of establishing that petitioner is liable for the fraud penalty.

I. That the petition of Cardinale Motors, Inc. and Salvatore Cardinale, as officer, is denied and the notices of determination and demand for payment of sales and use taxes due are sustained.


DATED: Albany, New York

JUL 08 1983

STATE TAX COMMISSION

  
PRESIDENT

  
COMMISSIONER

  
COMMISSIONER

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :  
of  
Cardinal Motors Inc.  
and Salvatore Cardinale, as Officer : AFFIDAVIT OF MAILING

for Redetermination of a Deficiency or a Revision :  
of a Determination or a Refund of Sales & Use Tax  
under Article 28 & 29 of the Tax Law for the Period:  
12/1/72 - 8/31/76.

State of New York  
County of Albany

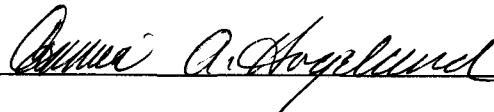
Connie Hagelund, being duly sworn, deposes and says that she is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 8th day of July, 1983, she served the within notice of Decision by certified mail upon Cardinal Motors Inc., and Salvatore Cardinale, as Officer the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Cardinal Motors Inc.  
and Salvatore Cardinale, as Officer  
1049 Dahill Rd.  
Brooklyn, NY 11204

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  
8th day of July, 1983.





AUTHORIZED TO ADMINISTER  
OATHS PURSUANT TO TAX LAW  
SECTION 174

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :  
of :  
Cardinal Motors Inc. :  
and Salvatore Cardinale, as Officer :

AFFIDAVIT OF MAILING

for Redetermination of a Deficiency or a Revision :  
of a Determination or a Refund of Sales & Use Tax :  
under Article 28 & 29 of the Tax Law for the :  
Period 12/1/72 - 8/31/76.

State of New York  
County of Albany

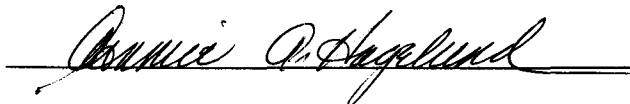
Connie Hagelund, being duly sworn, deposes and says that she is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 8th day of July, 1983, she served the within notice of Decision by certified mail upon John R. Serpico the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

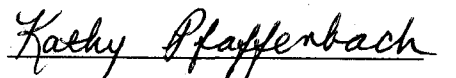
John R. Serpico  
186 Joralemon St., 9th Fl  
Brooklyn, NY 11201

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  
8th day of July, 1983.



  
AUTHORIZED TO ADMINISTER  
OATHS PURSUANT TO TAX LAW  
SECTION 174

P 481 207 683

RECEIPT FOR CERTIFIED MAIL

NO INSURANCE COVERAGE PROVIDED—  
NOT FOR INTERNATIONAL MAIL

(See Reverse)

Sent to <b>John R. Serpico</b>	
Street and No. <b>186 Joralemon St, 9th Fl</b>	
P.O., State and ZIP Code <b>Brooklyn, NY 11201</b>	
Postage	\$
Certified Fee	
Special Delivery Fee	
Restricted Delivery Fee	
Return Receipt Showing to whom and Date Delivered	
Return Receipt Showing to whom, Date, and Address of Delivery	
TOTAL Postage and Fees	\$
Postmark or Date	

PS Form 3800, Feb. 1982

P 481 207 682

RECEIPT FOR CERTIFIED MAIL

NO INSURANCE COVERAGE PROVIDED—  
NOT FOR INTERNATIONAL MAIL

(See Reverse)

Sent to <b>Cardinal Motors Inc.</b> <b>and Salvatore Cardinale, as officer</b>	
Street and No. <b>1049 Dahill Rd.</b>	
P.O., State and ZIP Code <b>Brooklyn, NY 11204</b>	
Postage	\$
Certified Fee	
Special Delivery Fee	
Restricted Delivery Fee	
Return Receipt Showing to whom and Date Delivered	
Return Receipt Showing to whom, Date, and Address of Delivery	
TOTAL Postage and Fees	\$
Postmark or Date	

PS Form 3800, Feb. 1982