

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

November 10, 1983

Ralph Johnson, Officer
Van Keith Liquors
1438 Boston Rd.
Bronx, NY 10460

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
Bernard W. Zeligson
100 Merrick Rd.
Rockville Centre, NY 11570
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
Ralph Johnson, Officer :
Van Keith Liquors :
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 :
9/1/77 - 5/31/81. :

State of New York *
County of Albany

Connie Hagelund, being duly sworn, deposes and says that she is an employee of the State Tax Commission, over 18 years of age, and that on the 10th day of November, 1983, she served the within notice of Decision by certified mail upon Ralph Johnson, Officer, Van Keith Liquors, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Ralph Johnson, Officer
Van Keith Liquors
1438 Boston Rd.
Bronx, NY 10460

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
10th day of November, 1983.

Martha L. Scunelle

Connie Hagelund

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
Ralph Johnson, Officer :
Van Keith Liquors :
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 9/1/77 - 5/31/81. :

State of New York
County of Albany

Connie Hagelund, being duly sworn, deposes and says that she is an employee of the State Tax Commission, over 18 years of age, and that on the 10th day of November, 1983, she served the within notice of Decision by certified mail upon Bernard W. Zeligson the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Bernard W. Zeligson
100 Merrick Rd.
Rockville Centre, NY 11570

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
10th day of November, 1983.

Maucha L. Dinnelle

Connie A. Hagelund

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :

of :

RALPH JOHNSON :

DECISION

for Revision of a Determination or for Refund :
of Sales and Use Taxes under Articles 28 and 29 :
of the Tax Law for the Period September 1, 1977 :
through May 31, 1981. :

Petitioner, Ralph Johnson, 1438 Boston Road, Bronx, New York, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 1977 through May 31, 1981 (File No. 37500).

A formal hearing was held before Arthur Bray, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York on March 17, 1983 at 9:30 A.M. Petitioner appeared by Bernard W. Zeligson, C.P.A. The Audit Division appeared by Paul B. Coburn, Esq. (Irwin A. Levy, Esq. of counsel).

ISSUES

- I. Whether the Audit Division properly determined the amount of sales and use tax due from petitioner as an officer of Van Keith Liquors, Inc.
- II. Whether the Audit Division properly asserted a penalty based upon fraud.

FINDINGS OF FACT

1. On April 20, 1982, the Audit Division issued two Notices of Determination and Demand for Payment of Sales and Use Taxes Due to petitioner, Ralph Johnson, as officer of Van Keith Liquors, Inc. One Notice assessed a tax due of \$69,756.98

plus a fraud penalty of \$34,878.48, and interest of \$25,952.92 for a total amount due of \$130,588.38 for the period September 1, 1977 through August 31, 1980. The other Notice assessed a tax due of \$17,912.12 plus a penalty for fraud of \$8,956.05 and interest of \$2,584.81 for a total amount due of \$29,452.98 for the period September 1, 1980 through May 31, 1981. The Notices were issued on the ground that petitioner was a person required to collect sales and use tax arising from the sales of Van Keith Liquors, Inc. ("Van Keith").

2. Van Keith operated a retail store which sold wines and liquors.

3. At the commencement of the audit, petitioner was requested to provide the Audit Division with Van Keith's tax returns, purchase and sales records, general ledger, cancelled checks, bank statements, and other books used by Van Keith in the recording of its activities from September 1, 1977 to August 31, 1980. Van Keith complied with this request. However, Van Keith maintained only summary records of its sales rather than a detailed listing of each sale. Thereafter, the Audit Division compared the purchases reflected on Van Keith's books with the invoices of Van Keith's main supplier, Charmer Industries. This comparison disclosed that, with the exception of one month, Van Keith's books failed to fully reflect its purchases from September, 1977 through August, 1980. The total amount of unrecorded purchases during the audit period was \$591,000.00.

4. The Audit Division also computed the markup utilized by Van Keith. The markup was computed by comparing the purchases reflected on Van Keith's books during the months of June, July and August, 1980 with the prices posted on Van Keith's shelves. The months selected were agreed to by Van Keith and the auditor. In addition, Van Keith never raised an objection to the use of a test period. The markup test revealed that Van Keith utilized a markup of 22

percent on liquors and 47 percent on wines. These markups were then weighted to reflect the ratio of wines and liquors to total purchases which resulted in an overall markup on both wines and liquors of 21.16 percent.

5. Following the auditor's examination, the audit was referred to the Special Investigations Bureau of the Department of Taxation and Finance ("SIB"). Subsequently, the case was returned with a recommendation that a fraud penalty be assessed. The SIB also provided workpapers detailing the amount by which Van Keith's purchases were underreported and details of the additional tax due based upon both the adjusted markup and Van Keith's total purchases.

6. Van Keith started selling wine and liquor to the public in September, 1976. Petitioner owned one hundred percent of the outstanding stock and had the title of president. When petitioner started Van Keith, he was active as the president of Lance Investigation Service ("Lance"). As president, petitioner directed the operations of Lance. Lance had approximately four or five hundred employees and its offices were located about two and one-half miles from Van Keith.

7. Petitioner hired a manager and an assistant manager to operate Van Keith. Each morning, petitioner would go to Van Keith, pick up the receipts, and deposit them in a bank. With the exception of the day that Van Keith opened, petitioner did not personally supervise the operations of the store. Petitioner never accepted any merchandise from Van Keith nor did he sign any receipts for merchandise received.

8. It was petitioner's practice that his secretary would prepare checks for purchases for petitioner's signature based upon invoices which the manager would provide to the secretary. Petitioner would then just sign the checks.

9. Petitioner's secretary would record purchases and sales on a daily basis. The accountant for Van Keith would then work from these records.

10. Although Van Keith started operating in September, 1976, the manager was hired in August, 1976. About nine or ten months after he hired the manager, petitioner began to suspect that the manager was not operating in Van Keith's best interests.

11. Petitioner began suspecting that something was awry when he noticed that his manager was in possession of a roll of money containing large denominations. This suspicion was buttressed when the manager purchased a home beyond his apparent financial means.

12. After petitioner began to suspect that his manager was acting on his own behalf, he asked the assistant manager of Van Keith to watch the manager. Subsequently, the assistant manager told petitioner that on various occasions a driver from Charmer Industries would deliver liquor to Van Keith and, upon delivery, the manager would then place the purchase invoice in his pocket. The purchase invoices that the manager placed in his pocket were never given to petitioner's secretary for recording. These additional purchases of liquor, which petitioner was not aware of, would then be sold to "after-hours" clubs. The assistant manager also advised petitioner that the manager would place some cash receipts from sales in his pocket.

13. The manager separated from his employment with Van Keith approximately one and one-half years after he began his employment.

14. Van Keith had to borrow \$200,000.00 to stay in business. A large portion of this money was borrowed from Lance Investigations. As a result of providing these funds, Lance Investigations fell about \$250,000.00 in arrears in federal withholding taxes due. Consequently, the Internal Revenue Service

notified all of Lance Investigations' accounts that all funds to be paid to Lance Investigations were to be paid to the Internal Revenue Service. Lance Investigations almost went out of business because of this action. An apparently related firm, Lance Securities, also fell \$65,000.00 in arrears in federal withholding tax as a consequence of making loans to Van Keith. In addition to the foregoing, petitioner refinanced his home and borrowed on a "key man" life insurance policy in order to finance Van Keith. Prior to the time that money was loaned to Van Keith, neither petitioner nor his businesses were in arrears.

15. Petitioner never tried to have criminal charges initiated against his manager. Other than what he had been told by his assistant manager, petitioner did not have any knowledge that money was being stolen from Van Keith.

16. On the basis of the foregoing, petitioner argued that the manager was, in effect, in business for himself. In addition, the reason the additional purchases found by the Audit Division were never recorded on Van Keith's books was that he was never aware of the purchases.

17. With regard to the computed markup, petitioner maintained that there were three liquor stores in the immediate vicinity of Van Keith and that, as a result of the competition, he would not have been able to markup his inventory more than the industry average. The industry average was purportedly a twelve percent markup on liquor and thirty to thirty-five percent on wine. In conjunction with this argument, petitioner maintained that the posted prices included sales tax. However, no evidence was presented that the posted prices stated that sales tax was included.

CONCLUSIONS OF LAW

A. That resort to the use of a test period to determine the amount of tax due must be based upon an insufficiency of recordkeeping which makes it virtually

impossible to determine such liability and to conduct a complete audit (Matter of Chartair, Inc. v. State Tax Commission, 65 A.D.2d 44). Inasmuch as Van Keith did not maintain original sales invoices or keep accurate records of its purchases, Van Keith did not maintain sufficient records. Accordingly, the use of external indicies was proper (Tax Law §1138(a)).

B. That 20 NYCRR 532.1(c) (formerly, 20 NYCRR 525.6) prohibits a person required to collect tax from holding out to the public that the tax is not separately charged and stated. Since no evidence was presented to show that petitioner held out to the public that the posted prices included sales tax, the markup based upon petitioner's books and the shelf prices was properly determined.

C. That petitioner's explanation that the unrecorded purchases were the result of Van Keith's manager having been in business for himself is found wanting inasmuch as it does not correspond with the fact that the unrecorded purchases continued well beyond the time that Van Keith's manager left Van Keith's employment. Therefore, it is impossible to discern the portion of the unrecorded purchases which was due to the activities of Van Keith's manager, and that portion of the unrecorded purchases due to petitioner's actions. Accordingly, petitioner was a person required to collect sales tax with respect to all of the additional sales determined by the Audit Division (Tax Law §§1131(1); 1133(a)).

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

"If the failure to file a return or to 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."

E. 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 under payment of taxes due and owing." (Matter of Walter Shutt and Gertrude Shutt, State Tax Commission, June 4, 1982). Although the unrecorded purchases constitute some proof of fraud, they alone do not establish clear, definite and unmistakable evidence of every element of fraud. This is particularly true in this instance where an undetermined portion of the underrecording of purchases may be due to the actions of others. Therefore, the penalty based on fraud is cancelled.

F. That the petition of Ralph Johnson is granted only to the extent of Conclusion of Law "E"; that the Audit Division is directed to modify the Notices of Determination and Demand for Payment of Sales and Use Taxes Due issued April 20, 1982 accordingly; and that, except as so granted, the petition is in all other respects denied.

DATED: Albany, New York

STATE TAX COMMISSION

NOV 10 1983

Richard W. Cunn
PRESIDENT

Francis R. Koehn
COMMISSIONER

Mark J. Freed
COMMISSIONER

P 470 315 109

RECEIPT FOR CERTIFIED MAIL

NO INSURANCE COVERAGE PROVIDED—
NOT FOR INTERNATIONAL MAIL

(See Reverse)

Sent to <i>Ralph Johnson</i>	
Street and No. <i>1438 Boston Rd.</i>	
P.O., State and ZIP Code <i>Brana, NY 10460</i>	
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 470 315 110

RECEIPT FOR CERTIFIED MAIL

NO INSURANCE COVERAGE PROVIDED—
NOT FOR INTERNATIONAL MAIL

(See Reverse)

Sent to <i>Edward W. Zeligson</i>	
Street and No. <i>100 Merrick Rd.</i>	
P.O., State and ZIP Code <i>Rockville Centre, NY 11570</i>	
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