STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
MEDIABUSS SYSTEMS, INC.	:	DECISION DTA NO. 824207
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, 2000 through February 28, 2009.	:	

Petitioner, MediaBuss Systems, Inc., filed an exception to the determination of the Administrative Law Judge issued on November 29, 2012. Petitioner appeared by Ballon Stoll Bader & Nadler, P.C. (Norman R. Berkowitz, Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (Marvis A. Warren, Esq., of counsel).

The parties did not file briefs on exception, but instead resubmitted and relied upon their respective briefs filed with the Administrative Law Judge. Oral argument was heard on September 18, 2013, in New York, New York.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUES

I. Whether the Division of Taxation was warranted in resorting to an indirect audit methodology in this matter.

II. If the Division of Taxation was correct in utilizing an indirect audit methodology, whether the methodology had a rational basis and was reasonably calculated to reflect the sales

tax due for the period December 1, 2000 through November 30, 2006.

III. Whether the Division of Taxation has established that the imposition of fraud penalty under Tax Law § 1145 (a) (2) was warranted, or, in the alternative, whether negligence penalty under Tax Law § 1145 (a) (1) should be imposed.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge, except for findings of fact 1, 13, 14, 20, 24, 25, 26, 27, 29 and 36, which have been modified to more accurately reflect the record. The Administrative Law Judge's findings of fact and the modified findings of fact are set forth below.

1. Petitioner, MediaBuss Systems, Inc. (MediaBuss), was engaged primarily in the business of installing home entertainment and security systems during the period December 1, 2000 through February 28, 2009 (audit period). At all relevant times, Steven Babel was the president and sole shareholder of petitioner.

2. The Division of Taxation (Division) began an audit of petitioner on or about February 2, 2004 with a written request for books and records for the period December 1, 1997 through November 30, 2003. The request sought all books and records pertaining to sales and use tax liability for the audit period, including federal and state tax returns, general ledger, sales invoices, exemption documentation, fixed purchase and sale invoices, expense purchase invoices, bank statements, canceled checks, cash receipts journal and a cash disbursements journal. A second appointment letter was sent to petitioner's representative on January 26, 2005. A copy of the records request list was sent by facsimile transmission on February 28, 2005. Requests for records continued for a period of over five years.

3. The audit period was updated and modified by a formal request for records, dated May 11, 2005, which informed petitioner that the audit period was being modified and would cover the period December 1, 2000 through February 28, 2005. Petitioner was asked to produce all records previously requested and all records for the extended audit period, as well.

4. Another written request was made on April 13, 2006, requesting the same records set forth in the second request. A request made on August 7, 2006 modified the audit period again, this time requesting all previous records and those for the extended period ended August 31, 2005. By letter dated February 20, 2007, the Division requested all previously sought books and records and those for the extended period ended November 30, 2006. Additional written requests for books and records were made on April 27, 2007, December 20, 2007, August 6, 2008 and April 22, 2009. The last of these requests extended the audit period through February 28, 2009.

5. In addition to the written requests for records, the Division of Taxation made many oral requests for books and records, which were recorded in its audit log. These requests were made on the following days: March 5, 2004; June 15, 2004; March 18, 2005; April 27, 2005; June 9, 2005; June 17, 2005; June 21, 2005; September 29, 2005; April 18, 2006; May 22, 2006; August 25, 2006; November 13, 2006; December 7, 2006; February 13, 2007; and May 22, 2007.

6. Over the course of the audit, from February 2, 2004 through December 7, 2009, four Division auditors spent 529.75 hours attempting to determine the sales and use tax liability of MediaBuss for the audit period. During the same time period, the auditors dealt with four different representatives of petitioner.

7. In response to the requests for records, the Division received limited documentation. The written requests of February 2, 2004 and May 11, 2005 yielded some purchase invoices, an

incomplete set of bank statements, a copy of the 2004 U.S. Income Tax Return for an S Corporation, and approximately half of the sales invoices for 2004. It took petitioner's representative, Mr. Edward Broccolo, 16 months to assemble these documents, all the while assuring the Division that all records were available for audit. Mr. Broccolo told the auditor that all of petitioner's income was derived from capital improvements and thus exempt from sales tax but reported that sales invoices were not available to substantiate this claim. He also informed the Division that 95% of, if not all, sales were made out of state, although no proof of this was offered. Mr. Broccolo was presented with a vendor registration application, form DTF-17, on March 28, 2006.

8. The Division did not receive any further documentation until May 8, 2006, when Mr. Broccolo submitted additional bank statements and purchase invoices for the years 2001 through 2005. Although told on May 8th that a general ledger, federal and state income tax returns for all years under audit and a schedule of fixed asset acquisitions were needed, Mr. Broccolo informed the Division on May 31, 2006 that no other documents were available at that time.

9. Over the course of the next five months, Mr. Broccolo did produce additional records, including purchase invoices from Staples for office supplies, income statements for the years 2004 and 2005, 2002 and 2005 U.S. Income Tax Returns for an S Corporation and the 2002 New York State S Corporation Franchise Tax Return.

10. A conference was held between Division representatives and Mr. Broccolo on November 1, 2006, during which he was reminded that he had not submitted a complete set of bank statements with an explanation of the source of deposits. Again, he was provided a form, the DTF-17, for registering petitioner for sales tax purposes, since records submitted on audit

indicated that petitioner was making New York sales and sometimes collecting tax on those sales.

11. Shortly thereafter, also in November 2006, Mr. Jeff Levine, the comptroller of Concierge Direct, a newly-created and related company owned by Mr. Babel, received a power of attorney from petitioner. He began the task of searching for the additional documentation requested by the Division and reconstructing the books and records of the company. He was also presented with a form DTF-17 for registering petitioner as a sales tax vendor. The form was submitted on November 16, 2006, and petitioner filed its first New York State sales and use tax return on December 20, 2006 for the quarter ended November 30, 2006. It stated gross sales of $73,683.00, of which none were taxable. A second quarterly sales and use tax return was filed on or about March 20, 2007 for the quarter ended February 28, 2007, indicating $41,495.00 in gross sales, of which $8,817.00 were listed as taxable. The return stated a tax due of $738.41, which was paid.

12. In a meeting with Mr. Levine on December 7, 2006, the Division reviewed a reconstructed general ledger for 2001, bank statements and supporting documentation. Mr. Levine offered to reconstruct the general ledger for the entire audit period, a task he wanted six months to complete, but the Division concluded that it still needed petitioner to amend its federal and state tax returns and submit balance sheets, income statements and detailed records for one of petitioner's more substantial customers known as Calloway. In addition, petitioner was asked to submit a formal letter requesting permission to complete its record reconstruction work in six months. Ultimately, petitioner chose not to submit any further documentation in following up on

this meeting, and never requested permission to reconstruct its general ledger for the entire audit period.

13. Petitioner hired a new representative, Mr. Michael Buxbaum, later in December 2006. On April 23, 2007, the Division received from Mr. Buxbaum a box of records that included additional sales invoices for 2001 through 2005, which indicated more New York sales than originally reported. It was noted at that time that the invoices produced were not sequentially numbered or prenumbered and provided no other internal controls for verifying sales. It was also noted that such invoices were the same as those reviewed at a February visit to Mr. Buxbaum's office.

14. At this juncture in the audit, the Division still had not received a complete general ledger or any confirmation on the Calloway sales it had requested. In addition, the bank statements it reviewed, including those provided by Mr. Buxbaum as part of the materials received on April 23, 2007, indicated a substantial number of unsupported bank deposits, leading the Division to conclude that there were substantial sales in addition to untaxed expense purchases.

15. On April 30, 2007, the Division received a letter from Mr. Buxbaum withdrawing as petitioner's representative and, soon thereafter, received notice that petitioner had obtained a new representative, Norman Berkowitz, Esq. Mr. Berkowitz was forwarded a records request, an audit method election form and a responsible person questionnaire. Ultimately, Mr. Berkowitz was able to produce copies of invoices for the period September 2005 through November 2006, bank reconciliation schedules and disbursements and a signed audit method election form. The

Division believed that it had received all bank statements through November 2006 by the time it finished the audit.

16. On or about August 1, 2007, the Division decided to send out third-party confirmation letters to petitioner's customers, whose identities had been mined from checks associated with the bank statements and invoices. The form of the letter was approved by Mr. Berkowitz, and the responses were used to confirm sales by petitioner and to help the Division determine a more accurate projection of New York taxable sales.

17. Although an audit method election agreement was signed by petitioner and returned to the Division, after a thorough review of all the books and records received, specifically those received after the audit method election agreement was drafted, it was determined that the documentation did not support using a test period to determine petitioner's sales tax liability and the agreement was rescinded.

18. The auditors reviewed all the sales records produced by petitioner. Based upon the lack of internal controls over the sales invoices, including sequential numbering or prenumbered invoices and the failure to ever provide summary schedules, a cash receipts journal, a sales journal, trial balances or an original and complete general ledger, the Division determined that it could never be assured that it had received all sales invoices and concluded that the records were inadequate to perform a detailed audit. The Division also concluded that the lack of records made it impossible to trace any transaction to its original source or to a final total.

19. The Division's analysis of petitioner's bank statements revealed that its deposits exceeded total sales invoices for some periods and also sales totals reported on federal income tax returns. Since no sales tax returns were filed by petitioner until December 2006, no

reconciliation could be made with the federal returns, and the federal returns were not in agreement with the sales that could be determined for those periods.

20. From the information available to it, the Division devised a methodology to ascertain total audited net sales by using the highest value of the following records that had been made available to it: check deposits discerned from bank statements; federal income tax returns; and actual sales invoices.

For the years 2001, 2002 and 2004, sales invoices were used to determine total audited net sales of $5,356,771.00; for 2005, the federal income tax return was used to determine total audited net sales of $1,980,064.07; and for 2003 and 2006, the Division determined total audited net sales from bank deposits of $2,976,631.50.[1] Other income and sales tax collected was subtracted from total bank deposits for purposes of computing audited net sales per audit.

Total audited net sales were calculated to be $10,313,466.82, which number includes gross sales from the above sources for the years 2001 through 2006, net of other income and sales tax collected and exclusive of capital improvements. The Division's rationale for the methodology was straightforward: for those years in which the sales invoices equaled or exceeded the deposits to the bank account and the gross sales set forth on the federal returns filed, the sales invoices were accepted as petitioner's gross sales.

All sales per the invoices were considered New York sales unless established as out-of-state sales or exempt sales. For those years that the bank deposits exceeded both sales invoices and the gross sales per the federal tax returns, the deposits were accepted as petitioner's sales.

[1] The Administrative Law Judge's finding that audited net sales for 2006 were premised on petitioner's bank deposits is supported by both testimony and the audit workpapers. The workpapers also indicate that bank deposits were equal to invoices for 2006. It is thus equally true to say that audited net sales for 2006 were based on invoices.

For the years that the federal income tax returns stated gross sales that exceeded both the sales invoices and the bank deposits, the reported gross sales were accepted as petitioner's sales.

Since petitioner's own failure to establish its sales through complete books and records was the reason that the Division could not conduct a detailed audit, and the Division could not ascertain an accurate calculation of tax due, it was incumbent on the Division to use a methodology that would protect the state's interest, and it argued that this methodology accomplished that goal.

21. As mentioned, the invoices analyzed by the Division revealed total sales tax charged and collected by petitioner but not remitted, as follows: $1,179.00 for 2002; $1,526.77 for 2004; and $937.58 for 2005. Petitioner was not a registered vendor during these years and did not file sales tax returns.

22. Some of the invoices uncovered that indicated New York sales tax charged on invoices, which were exemplary of petitioner's practice, were: Mr. Doug Benach, $479.20, July 2002; Michael Boatman, $297.35, June and July 2004; Schiller, $96.53, July to September 2004; Thompson, $96.19, June 2004; Gleysteen, $1,146.15, August 2002; Gleysteen, $337.50, November 2002; Gleysteen, $7,494.37, November 2002; and Murphy Brothers, $288.75, June 2002.

23. While attempting to confirm sales with parties with whom petitioner conducted business, the Division received copies of resale certificates issued by petitioner to its suppliers to enable petitioner to purchase materials free of sales tax. One blanket resale certificate was issued to Key Distribution of New Hyde Park, New York, on February 27, 2003. Another blanket certificate, undated, was issued to Bosch Security Systems of Chicago, Illinois. Both certificates

were signed by petitioner's president, Steven Babel, and each stated that MediaBuss held a valid certificate of authority, number 1596937. A third supplier of materials to petitioner, Power Door Products, Inc., of Brewster, New York, sent a letter to the auditor, dated September 5, 2008, which stated that it had done business with petitioner during the period 2003 through 2007 and that it had a resale certificate from MediaBuss on file during that period, but had lost the document in a flood. During the audit period, petitioner also accepted a resale certificate from a customer, Continental Lighting Corp.

24. In order to calculate audited net sales for the extended period, including the quarters ended February 28, 2007 through February 28, 2009, the Division took total audited sales for the period January 1, 2001 through November 30, 2006, $10,313,466.82, divided by the number of months, 71, and found average audited net sales per month of $145,260.10, or $435,780.29 per quarter. The Division applied this figure to each of the quarters of the extended period to arrive at additional audited net sales for the extended period of $3,922,022.59, or total net sales for the audit period of $14,235,489.41.

25. As with sales records requested, petitioner did not produce complete and adequate expense records for the entire audit period. The Division reviewed purchase invoices for materials provided by petitioner for the period March 2001 through December 2005. The Division sought invoices that clearly showed subcontractors, the work completed and the materials used. The Division believed such invoices to be indicative of purchases of materials used in capital improvements. By isolating these invoices from those with no breakdowns, the Division was able to establish the percentage of sales that were materials purchases.

The audited sales calculated from these invoices was $3,903,253.95, and the materials purchases indicated on those invoices amounted to $1,805,495.51. The ratio of materials purchases to sales was computed to be .46256163. The Division also reviewed invoices to determine the ratio of capital improvement sales to total audited net sales. This ratio was computed to be .1007. The Division then applied the materials purchases to sales ratio to quarterly audited net sales, yielding total audited materials purchases per quarter. Next, the Division applied the capital improvement to net sales ratio (adjusted slightly to account for payment of sales tax on a small amount of purchases) to quarterly audited materials purchases to reach quarterly audited capital improvement materials purchases.

The Division thus determined total audited capital improvement materials purchases of $655,665.66 for the audit period December 1, 2000 through February 28, 2009, which resulted in a tax due thereon of $48,850.73.

26. The Division calculated recurring taxable expenses by using the explanatory schedule attached to petitioner's 2004 and 2005 federal income tax returns for "other deductions," listed on line 19 of page 1. With the exception of accounting expenses, bank charges, commissions, fuel, insurance, legal and professional expenses, which were excluded from its calculation, the Division treated all other listed deductions as taxable recurring expenses. The Division assumed that tax was due on such expense purchases because petitioner's offices were located in New York. The Division made an allowance for office supplies in the sum of $5,000.00 in each year because petitioner was able to produce invoices from Staples that indicated sales tax having been paid.

27. For the year 2004, taxable recurring expenses were determined to be $257,902.00 and for 2005, $1,106,442.00. These figures were added together and divided by the audited net sales total for the same two years of $3,420,733.74, to arrive at the ratio that showed recurring expenses as a percentage of audited net sales, or .398845424. The Division then applied this ratio to total audited net sales of $14,235,489.41 to arrive at total taxable expense purchases of $5,677,759.82 and tax due of $425,072.59.

28. Although the Division broke out the utility tax expense for the extended audit period March 1, 2006 through February 28, 2009 due to petitioner's move to New Rochelle, where school taxes may have affected the jurisdictional rates applied to utility bills, the computation was ultimately mooted by the shortened audit period.

29. The Division determined additional taxable sales for the period December 1, 2000 through November 30, 2006 based upon a review of invoices for that period and upon a determination that the excess of bank deposits over taxable invoices for 2003 and the excess of gross sales as indicated on petitioner's federal income tax return over invoices for 2005 constituted taxable sales. Taxable invoices reviewed totaled $1,438,340.60. The difference between bank deposits and invoices for 2003 was $395,667.10. The difference between gross sales per the tax return and invoices for 2005 was $637,747.32. Additional taxable sales for the December 1, 2000 through November 30, 2006 period thus totaled $2,471,755.02 with the tax due thereon of $200,346.83.

The Division also determined additional tax due on sales for the extended audit period March 1, 2006 through February 28, 2009. Specifically, the Division deemed audited net sales, calculated as noted previously, to be taxable sales for this period. The Division thus determined

additional taxable sales of $3,922,022.61, with additional tax due thereon of $317,859.66 for the extended audit period of March 1, 2006 through February 28, 2009.

The Division ultimately issued to petitioner a form AU-346, Statement of Proposed Audit Change, for the period December 1, 2000 through February 28, 2009, which asserted total additional sales and use tax of $991,427.39, plus penalties of $914,423.14 and interest of $816,932.96. The tax was determined based upon additional taxable sales as noted above. In addition, it included use tax on recurring expense purchases and materials purchases associated with capital improvements as noted previously. The total additional taxable sales and purchases was determined to be $12,727,203.06, which yielded additional tax due of $991,427.39.

30. Fraud penalty was imposed because petitioner was found to have charged and collected but never remitted sales tax on numerous invoices. Petitioner never registered as a New York vendor for sales tax purposes until November 2006, having made sales in New York for almost four years prior. Petitioner filed no sales and use tax returns until it filed its quarterly return for the period ended November 30, 2006, immediately after filing its vendor registration.

31. The Division also imposed fraud penalty because of commingling of funds between the two companies owned by Mr. Steven Babel, MediaBuss and Concierge Direct, and personal transactions on behalf of Mr. and Mrs. Babel. In the first instance, while investigating whether petitioner had ceased operations in 2006 and performing an audit of another company owned by Mr. Babel, Concierge Direct, the Division found that MediaBuss had made unexplained deposits to the bank account of Concierge Direct. In the second instance, the Division discovered invoices that revealed that a provider of services to MediaBuss, Mohawk White Plains, issued two refund checks to Mr. and Mrs. Babel in June and July of 2004. In addition, MediaBuss bank

statements recorded payments for apparent personal expenses made to Bloomingdale's, a gynecology and obstetrics practice, and the Bonnie Briar Country Club. On another occasion, as mentioned above, petitioner issued resale certificates with a registration number, even though it was not a registered vendor.

32. Petitioner initially represented to the Division that it made few or no New York sales, but documentation that was ultimately provided proved otherwise, and demonstrated that materials were being delivered into New York and that services were being performed in the state, as well. Responses to third-party confirmation letters demonstrated that petitioner was charging and collecting tax in numerous instances and not remitting the tax collected.

33. Petitioner reported gross sales of $115,178.00 and taxable sales of $8,817.00, paying tax of $738.41 with its quarterly sales and use tax return for the quarter ended February 28, 2007. Petitioner received credit for this payment when the Division calculated additional sales tax due.

34. Of the $724,591.14 in total penalties asserted by the Division for the audit period that ended November 30, 2006, $714,348.33 was attributed to failure to pay tax due to fraud; $10,000.00 was attributed to operating a business without a certificate of authority; and $242.81 was attributed to fraudulently issuing an exempt resale certificate.

35. The Division of Taxation issued to petitioner a Notice of Determination, notice number L-033085647, dated December 27, 2009, which asserted additional sales and use taxes due of $991,427.39, plus fraud penalty of $914,423.14 and interest of $829,184.46 for the period December 1, 2000 through February 28, 2009.

36. Pursuant to a Bureau of Conciliation and Mediation Services Order, dated January 28, 2011, the Notice of Determination was recomputed, eliminating the quarters ended February

2007 through February 2009. The resulting tax due was $525,605.14, plus penalty of $724,591.14 and interest of $903,091.26.

37. Petitioner's witnesses, Jay Sanders, CPA, an accounting consultant, and Greg Giampa, a self-described "temp" at MediaBuss, each related that Frank Galasso was the father-in-law of Steven Babel and that he made advances or loans to MediaBuss as Galasso Trucking. However, neither gentleman could recall when such loans were made, in what amounts, and they never saw any loan documentation. Both witnesses believed that there were adequate records to perform an audit but only Mr. Sanders said that he had reviewed such records, including a complete general ledger, whereas Mr. Giampa believed that Mr. Jeff Levine, the comptroller of Concierge Direct who was brought in to assist in the audit, had tried to reconstruct the books and records because the company had not retained vendors' bills or its own invoices. Mr. Giampa was aware that MediaBuss had made New York sales and Mr. Sanders said that he was aware of the Tax Law requirement that an entity making New York sales had to be registered as a vendor.

38. Petitioner did not produce any books and records at hearing other than a copy of one confirmation response from Arthur Bell CPAs on behalf of Delaware Investment Properties LLC, which contained seven purchase schedules for the years 2000 through 2006, all of which indicated no New York purchases. None of the sheets were date-stamped "received" by the Westchester District Office, a stamp seen on all other pages of confirmations in evidence, but the cover letter did have such a stamp. The response listed purchases for the years 2002, 2003 and 2006. The totals listed for each year were: 2002, $132,590.00; 2003, $99,438.00; 2006, $41,228.72. The total for all three years was $273,166.72. The Division's totals, based upon the bank statements and checks associated therewith, were: 2003, $232,028.00; 2005, $37,656.12;

and 2006, $106,784.46. All of the Delaware Investment Properties sales were listed on the audit workpapers as New York capital improvements and the Division excluded all such sales from its calculation of net sales.

Also, petitioner submitted purchase information from United House Wrecking, Inc., of Stamford, Connecticut, which indicated that Mr. Babel had purchased items from it and was subsequently issued a refund check. The insinuation was that this sum had been incorrectly included in sales. This item appeared in the Division's analysis of check deposits as a refund and was excluded from sales, the net effect of which was that the $2,987.76 deposit on September 20, 2002 was correctly labeled and excluded as "other income" from sales invoices and bank deposit totals for purposes of calculating sales.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge first noted the relevant legal standards. He found documentary evidence supporting the conclusion that the Division made proper requests and that petitioner failed to produce adequate books and records. The Administrative Law Judge noted that petitioner also did not produce records at the hearing. Further, the Administrative Law Judge found the auditors' testimony to be credible, but found Mr. Sanders to be not credible due to inconsistency and gaps in his testimony. The Administrative Law Judge additionally found that the testimony of Mr. Giampa reinforced the non-existence of adequate books and records for the period at issue. As such, the Administrative Law Judge determined that the Division was entitled to estimate petitioner's tax liability for the period at issue.

Reviewing the audit methodology, the Administrative Law Judge determined that there was a rational basis for the estimations of petitioner's tax liability. The Administrative Law

Judge found that the absence of a general ledger and other documents made it impossible to accurately determine petitioner's actual sales. As such, the Administrative Law Judge found that the Division properly utilized the numbers supported by the documentation because they were the lowest known actual sales figures for the period. The Administrative Law Judge rejected petitioner's challenges to the audit methodology because they were either without merit or contrary to the record.

The Administrative Law Judge also determined that fraud penalty was appropriate on the following grounds: (a) petitioner failed to register as a vendor with New York State, despite making New York sales and repeated requests to register; (b) failure to remit sales tax, at least in the amount of $3,643.35; (c) gross failure to maintain and produce sales records; (d) gross failure to report sales during a five-year period; (e) receiving and issuing sales tax exemption certifications, including fabrication of a certificate of authority number; and (f) commingling of corporate funds and personal expenses, including checks to Bloomingdale's, a gynecology and obstetrics practice, and the Bonnie Briar Country Club. The Administrative Law Judge found no merit in petitioner's arguments that the Division did not carry its burden of demonstrating that petitioner acted deliberately, knowingly, and with specific intent to violate the law.

Accordingly, the Administrative Law Judge sustained the Notice of Determination, as modified by the Conciliation Order.

ARGUMENTS ON EXCEPTION

The parties make the same arguments on exception as made before the Administrative Law Judge. The Administrative Law Judge's summary of these arguments appears below.

Petitioner contends that the Division violated its duty to thoroughly examine the records

that were produced by petitioner pursuant to the requests made. Petitioner claims that the auditor testified that she received sales invoices and bank statements for the entire audit period. Further, the Division entered into a test period agreement with petitioner, which it argues can only be done when the Division is satisfied that the books and records are complete and adequate. Petitioner concludes that the Division did not have the legal basis to resort to external indices and estimate the tax due.

Petitioner argues in the alternative that even if the Division properly determined that its records were inadequate, the methodology it chose to calculate petitioner's tax liability was not reasonably calculated to reflect the proper tax due; rather it was chosen merely to establish the highest possible sales and use tax. Petitioner contends that by utilizing the highest sales established by bank records, federal income tax returns and sales invoices, the Division exposed its intent to extract the highest amount of tax rather than the reasonable and appropriate tax.

Petitioner contends that this forum should place little weight on the testimony of the Division's witnesses since it believes that their answers were vague, confusing and evasive and lacked credibility. Petitioner cites the instances where the auditors could not recall facts or adequately explain their work.

Petitioner also maintains that the Division has not carried its burden of establishing fraud. It does not believe that the Division has shown clear, definite and unmistakable evidence of every element of fraud, including willful, knowledgeable and intentional wrongful acts or omissions constituting false representation that resulted in nonpayment or underpayment of tax.

The Division maintains that it made many proper requests for petitioner's books and records and only received incomplete sales invoices, three years of federal income tax returns,

one New York corporate franchise tax return, bank statements and profit and loss statements for two years. The sales invoices were not sequentially numbered or prenumbered and other internal controls were lacking. No summary schedules, cash receipts journal, general ledger or trial balances were ever received, making a detailed analysis of sales invoices impossible because the Division could never determine if petitioner had presented all sales invoices. Bank records and federal income tax returns were not in agreement with sales invoices. As a result, the Division determined that the records produced were incomplete and inadequate and that a resort to an estimated audit methodology was warranted.

The Division's methodology included confirming the sales it could verify, then taking the highest of three sources of sales that had been made available to it: bank statements, sales invoices and federal income tax returns. The Division argues that using the highest value was warranted because it knew that there were at least that number of sales according to bank statements, federal income tax returns and sales invoices, whereas it had no way of determining whether there were more sales, and, if so, what that amount would have been. Therefore, it concludes that the methodology was reasonable.

As with the sales records produced, the expense purchase records were also deemed inadequate and the Division utilized records produced, primarily the federal income tax returns and sales invoices, to create a ratio of expenses (both recurring and capital improvement) to audited sales, which was applied to sales for each quarter of the audit period to arrive at expense purchases.

The Division contends that its assertion of fraud penalty was warranted, given the fact that petitioner had New York sales on which it collected and failed to remit tax; it conducted

business in New York without a certificate of authority to do so; it issued tax exempt resale certificates while unregistered and provided a false registration number; it commingled personal and corporate expenses; and failed to cooperate with the Division in the conduct of the audit. In the alternative, the Division argues that negligence penalty was warranted and petitioner has not offered any evidence to support a finding of reasonable cause for the nonpayment of tax due.

OPINION

Tax Law § 1105 (a) imposes a sales tax on the receipts from every "retail sale" of tangible personal property except as otherwise provided in Article 28 of the Tax Law. Tax Law § 1110 (a) imposes a compensating use tax on tangible personal property purchased at retail for use within New York, to the extent that such property has not already been subject to sales tax. A "retail sale" is a "sale of tangible personal property to any person for any purpose, other than . . . for resale as such" and specifically includes any sale of tangible personal property to a contractor for use or consumption in improving, repairing, maintaining, or otherwise adding to real property (Tax Law § 1101 [b] [4] [i]).

Tax Law § 1138 (a) (1) provides, in relevant part, that if a sales tax return was not filed, "or if a return when filed is incorrect or insufficient, the amount of tax due shall be determined [by the Division of Taxation] from such information as may be available. If necessary, the tax may be estimated on the basis of external indices . . . ." The standard for the use of external indices is as follows:

> "The Division must first request and thoroughly examine the taxpayer's books and records for the entire period of the proposed assessment. The purpose of the examination is to determine, through verification drawn independently from within these records, whether they are in fact so insufficient that it is virtually impossible for the Division to verify taxable sales receipts and conduct a complete

> audit from which the exact amount of tax due can be determined. Where the Division follows this procedure, and thereby demonstrates that the records are incomplete or inaccurate, the Division may resort to external indices to estimate tax. The estimate methodology utilized must be reasonably calculated to reflect taxes due, but exactness in the outcome of the audit method is not required. The taxpayer bears the burden of proving with clear and convincing evidence that the assessment is erroneous or that the audit methodology is unreasonable. In addition, considerable latitude is given an auditor's method of estimating sales under such circumstances as exist in each case (***see, Matter of Your Own Choice***, Tax Appeals Tribunal, February 20, 2003; ***Matter of AGDN, Inc.***, Tax Appeals Tribunal, February 6, 1997)" (***Matter of Abbasi***, Tax Appeals Tribunal, June 12, 2008).

Petitioner does not dispute that the Division made a proper request for its books and records. Rather, petitioner contends that the Division did not thoroughly review the records it provided in response to the Division's many requests; that such records were complete and sufficient; and that, therefore, the Division improperly estimated its tax liability.

Petitioner's claim that the Division did not thoroughly review the records it provided during the audit is plainly contrary to the record and is rejected. The facts herein clearly note the Division's receipt of various records and also note the Division's analysis of the quality or sufficiency of such records (***see*** findings of fact 7 through 19). In its briefs below and in its exception, petitioner focuses on the box of records provided by its former representative to the Division on April 23, 2007. The facts show, however, that the Division thoroughly reviewed such documentation.

As to the adequacy of the records provided on audit, the Administrative Law Judge correctly determined that such records were insufficient for the purpose of verifying petitioner's sales and use tax liability and that, therefore, the Division's use of estimated audit methods was justified.

With respect to sales, as the Administrative Law Judge noted, the lack of any prenumbering or sequential numbering on the invoices themselves, as well as the lack of any cash receipts journal, general ledger,[2] trial balances or other summary schedules, demonstrates a lack of internal control over the invoices and precludes the possibility of verifying the completeness of the sales invoices that were made available. The unexplained differences between sales according to the invoices that were provided and the bank deposits and the federal tax return further undermine the contention that petitioner submitted a complete set of sales invoices and indeed strongly suggest that the invoices were incomplete. With respect to purchases, the record shows that petitioner produced purchase invoices for only a portion of the audit period. Similar to the problems with the sales records, the lack of any general ledger or purchase journal made it impossible for the Division to ascertain the extent to which such invoices were complete. The Administrative Law Judge thus properly found that the records made available by petitioner were insufficient and that the Division's use of indirect audit methods to determine petitioner's sales and use tax liability was justified.

The Administrative Law Judge's conclusion regarding the adequacy of petitioner's records was premised in part on findings of witness credibility. Specifically, the Administrative Law Judge found that the two auditors who testified at the hearing were credible and that the testimony of Mr. Sanders, who testified for petitioner, was "simply not credible." The Administrative Law Judge also found the testimony of petitioner's other witness, Mr. Giampa, who expressed doubt as to the existence of complete books and records, to be credible.

[2] We observe that the Division reviewed a "reconstructed" general ledger for 2001 early in the audit. As noted in the determination below, the fact that it was necessary to create such a document is indicative of the insufficiency of petitioner's records.

This Tribunal has consistently deferred findings of witness credibility to the Administrative Law Judge. We have long held that:

> "the credibility of witnesses is a determination within the domain of the trier of the facts, the person who has the opportunity to view the witnesses first hand and evaluate the relevance and truthfulness of their testimony (***see Matter of Berenhaus v. Ward***, 70 NY2d 436, 522 NYS2d 478). While this Tribunal is not absolutely bound by an Administrative Law Judge's assessment of credibility and is free to differ with the Administrative Law Judge to make its own assessment, we find nothing in the record here to justify such action on our part (***see Matter of Stevens v. Axelrod***, 162 AD2d 1025, 557 NYS2d 809)" (***Matter of Spallina***, Tax Appeals Tribunal, February 27, 1992).

Similarly, there is nothing in the present record to warrant disturbing the Administrative Law Judge's findings with respect to witness credibility. Indeed, as the Administrative Law Judge noted, the auditors' testimony was corroborated by the contemporaneously prepared audit log, as well as the audit report, workpapers and schedules. Furthermore, his finding that petitioner's witness was not credible is supported by the witness's failure to recall with any specificity the records that he may or may not have reviewed.

As a final point on the adequacy of records issue, we note that petitioner did not produce any documents at the hearing purporting to constitute complete books and records for the audit period. If such records existed, it is reasonable to expect that petitioner would have produced them.

Turning to the reasonableness of the audit methods employed herein, the Division's determination of additional taxable sales for the period remaining at issue is based upon available invoices and upon a determination that the 2003 excess of bank deposits over taxable invoices and the 2005 excess of gross sales as indicated on petitioner's federal income tax return over taxable invoices constituted taxable sales (***see*** finding of fact 29). As the Administrative Law

Judge correctly noted, we have previously sustained indirect audits using bank deposits and gross sales as reported on income tax returns to estimate sales tax liability (***see e.g. Matter of Bianculli & Sons Private Sanitation***, Tax Appeals Tribunal, July 9, 2009; ***Matter of Stephen Gallagher, Inc.***, Tax Appeals Tribunal, August 3, 2000). We do so again under the instant facts and circumstances. We note that the Division made adjustments to both the bank deposits and the gross sales per the return to account for other income and sales tax collected. Petitioner failed to prove, however, that the source of the remaining excess of deposits and gross sales over invoices was something other than taxable sales. We also note that the Administrative Law Judge properly rejected claims of loans to petitioner. Moreover, petitioner made no allegations of error with respect to the invoices used to calculate the majority of the additional taxable sales. Petitioner has thus failed to meet its burden of proof and this portion of the audit must be sustained.

The audit methods used to estimate petitioner's recurring purchases and purchases of materials used in capital improvements were also reasonable under the circumstances. Both estimates use the calculation of audited net sales as a starting point. Similar to audited taxable sales, this calculation was premised on invoices, bank statements and gross sales as reported on the 2005 federal tax return. For the reasons indicated above, the estimate of audited net sales based on bank statements and tax returns was reasonable. The materials used in capital improvements estimate was based on samples or tests of invoices to determine, first, the ratio of materials purchases to capital improvement sales and, second, the ratio of capital improvement sales to total net sales. The recurring purchases estimate was based on a two-year test of the recurring expenses to audited net sales ratio. Petitioner offered no evidence to contest the ratios

used to estimate purchases, or to show that any of its purchases were nontaxable or that sales tax had been previously paid on any such purchases. Petitioner thus failed to show error in the audit method or result and this portion of the audit must be sustained.

Petitioner did complain that the audit methodology employed with respect to taxable purchases was "convoluted" and that the auditor's testimony regarding such methodology was contrary to the audit report. These contentions are without merit.

Petitioner's primary argument against the reasonableness of the audit methods employed by the Division is that such methods were devised solely to maximize petitioner's liability. This argument is premised on the use of bank deposits and an income tax return to estimate sales as discussed. As noted previously, however, these are well established as reasonable methods of estimating sales. Moreover, the Division's use of these methods to determine taxable sales herein is consistent with Tax Law § 1132 (c), which provides that all transactions upon which sales tax is imposed are subject to sales tax until the contrary is established and places the burden of proving that any receipt is nontaxable upon the person required to collect the tax. As discussed, petitioner has failed to meet this burden. The Division's audit methodology in this matter was thus not designed to maximize liability as petitioner asserts, but was, as required under the prevailing law, reasonably calculated to reflect tax due (***see Matter of W.T. Grant Co. v Joseph***, 2 NY2d 196 [1957], ***cert denied*** 355 US 869 [1957]).

The Administrative Law Judge fully and properly addressed all issues related to petitioner's submission, at the hearing, of purchase information from two entities that received third party confirmation letters from the Division during the audit.

The subject Notice of Determination asserts penalty pursuant to Tax Law § 1145 (a) (2). Such penalty is properly imposed where "the failure to pay or to pay over any tax . . . within the time required . . . is due to fraud." We have explained the standard for the imposition of the fraud penalty as follows:

> "The issue of whether a taxpayer willfully failed to file returns and timely pay tax was with the intent to evade payment of tax presents a question of fact to be determined upon consideration of the entire record (***see Matter of Drebin v. Tax Appeals Tribunal,*** 249 AD2d 716 [1988]). The burden of demonstrating this falls upon the Division (***see Matter of Sona Appliances,*** Tax Appeals Tribunal, March 16, 2000). Fraud is not defined in Tax Law § 1145. However, a finding of fraud requires the Division to show 'clear, definite, and unmistakable evidence of every element of fraud, including willful, knowledgeable and intentional wrongful acts or omissions constituting false representation, resulting in deliberate nonpayment or underpayment of taxes due and owing' (***see Matter of Sona Appliances, supra***). In order to establish fraudulent intent, petitioners must have acted deliberately, knowingly and with the specific intent to violate the Tax Law (***see Matter of Cousins Serv. Sta.***, Tax Appeals Tribunal, August 11, 1988).
>
> The sales tax penalty provisions are modeled after Federal penalty provisions and, thus, Federal statutes and case law may properly provide guidance in ascertaining whether the requisite intent for fraud has been established (***see Matter of Uncle Jim's Donut & Dairy Store,*** Tax Appeals Tribunal, October 5, 1989). Since direct proof of a taxpayer's intent is rarely available, fraud may be proved by circumstantial evidence, including the taxpayer's course of conduct (***Intersimone v. Commissioner***, T.C. Memo 1987-290, 53 TCM 1073 [1987]; ***Korecky v. Commissioner,*** 781 F2d 1566 [1986], 86-1 USTC ¶ 9232). Relevant factors held to be significant include consistent and substantial understatement of tax, the amount of the deficiency itself, the existence of a pattern of repeated deficiencies and the taxpayer's entire course of conduct (***see Merritt v. Commissioner***, 301 F2d 484 [1962], 62-1 USTC ¶ 9408; ***Bradbury v. Commissioner***, T.C. Memo 1996-182, 71 TCM 2775 [1996]; ***Webb v. Commissioner***, 394 F2d 366 [1968], 68-1 USTC ¶ 9341; ***see also Matter of AAA Sign Co.***, Tax Appeals Tribunal, June 22, 1989)" (***Matter of What a Difference Cleaning***, Tax Appeals Tribunal, May 15, 2008).

The continuous and substantial underreporting of taxable sales is strong evidence of fraud where such underreporting is affirmatively proven by the Division (***see Matter of Cousins Serv.***

Sta.). In the present matter, the Division has met this burden. Specifically, while the Division's determination of $2,471,755.02 in additional taxable sales relies in part on estimates derived from petitioner's 2003 bank deposits and its 2005 federal income tax return, it is primarily based on petitioner's own invoices. Such invoices indicate taxable sales of $1,438,340.60 for the December 1, 2000 through November 30, 2006 period. As petitioner reported zero taxable sales during the same period, the invoices affirmatively establish a continuous and substantial underreporting of taxable sales by petitioner.

Petitioner's consistent failure to file any sales and use tax returns for nearly the entire six-year audit period is also persuasive circumstantial evidence of fraudulent intent (***see Marsellus v Commissioner***, 544 F2d 883 [5th Cir. 1977], ***aff'g*** TC Memo 1975-368). That petitioner was aware of its obligation to file sales and use tax returns is supported by petitioner's use of resale certificates falsely indicating that petitioner held a certificate of authority and petitioner's occasional collection (without remittal) of sales tax from customers. Both of these actions betray a level of knowledge and sophistication with respect to the sales and use taxes such that petitioner's failure to file returns cannot be deemed to result from ignorance or mistake, but is properly considered to be indicative of fraudulent intent (***see Matter of AAA Sign Co.***). Such sophistication and knowledge also supports a finding that petitioner's failure to register as a vendor was similarly indicative of fraudulent intent. Additionally, the use of the resale certificates and the collection of tax are themselves strong, direct evidence of an intent to evade tax and thus support the imposition of fraud penalties.

As the Administrative Law Judge noted, petitioner's failure to maintain complete and adequate records is additional evidence of fraud (***see Matter of Lefkowitz***, Tax Appeals Tribunal,

May 3, 1990). As noted previously, petitioner had no internal controls over its sales invoices and maintained no general ledger, cash receipts journal or other summary schedules. Petitioner produced purchase invoices for only a portion of the audit period and the lack of any general ledger or purchase journal made it impossible for the Division to determine the completeness of the purchase invoices that were made available. Petitioner also failed to produce any documents at the hearing purporting to constitute complete books and records for the audit period.

Considering all of the facts and circumstances in the present matter, in particular the various indicia of fraud discussed above, we find that the Division has shown by clear and convincing evidence that petitioner willfully, knowingly and intentionally committed acts and omissions designed to facilitate the underpayment of sales and use taxes due and owing to the State. Accordingly, penalty imposed under Tax Law § 1145 (a) (2) is sustained.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of MediaBuss Systems, Inc., is denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petition of MediaBuss Systems, Inc., is denied; and

4. The Notice of Deficiency, dated December 7, 2009, as modified by the Conciliation Order, dated January 28, 2011, is sustained.

DATED: Albany, New York
March 18, 2014

/s/ Roberta Moseley Nero
Roberta Moseley Nero
President

/s/ Charles H. Nesbitt
Charles H. Nesbitt
Commissioner

/s/ James H. Tully, Jr.
James H. Tully, Jr.
Commissioner