

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
AAA SIGN COMPANY	:	DECISION
AND DONN COREY, 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 June 1, 1975 through	:	
May 31, 1980.	:	

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on July 21, 1988 with respect to the petition of AAA Sign Company and Donn Corey, as officer, c/o Boreanaz, NeMoyer & Baker, 736 Brisbane Building, Buffalo, New York 14203 for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the Period June 1, 1975 through May 31, 1980 (File No. 800496). Petitioners appeared by Boreanaz, NeMoyer & Baker, Esqs. (Patrick J. Baker, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Deborah J. Dwyer, Esq., of counsel).

Oral argument was heard on January 17, 1989. The Division of Taxation filed a brief on exception; the petitioners did not.

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

ISSUES

I. Whether the Division of Taxation has met its burden of proof to show that its imposition of the fraud penalty pursuant to Tax Law section 1145(a)(2) was proper.

II. Whether, if the fraud penalty is not properly imposed herein, certain of the periods at issue are time barred from assessment pursuant to Tax Law section 1147(b).

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge and such facts are stated below except that we modify finding of fact "4" as indicated below.

On December 7, 1981, following an audit, the Division of Taxation issued to petitioners herein notices of determination and demand for payment of sales and use taxes due, assessing against each petitioner \$60,975.09 in additional tax due plus interest for the period June 1, 1975 through May 31, 1980. Each of the notices herein also assessed fraud penalty under Tax Law section 1145(a)(2).

By their petition in this matter, petitioners raised certain issues regarding the adequacy of notice of the assessments given to petitioners. In its answer, the Division raised an issue as to the timeliness of the petition herein. As hearing was held on April 25, 1984 with respect to these issues and, in a decision issued on December 31, 1984, the former State Tax Commission declined to cancel the notices of determination, determined that the petition filed on behalf of petitioners was timely, and directed that a hearing on the merits of this matter be held.

Petitioner AAA Sign Company ("AAA Sign") was in the business of designing and manufacturing signs on a wholesale and retail basis. It maintained offices at S-3576 California Road, Orchard Park, New York. It also maintained a manufacturing plant at 162 Carrol Street, Buffalo, New York.

We modify finding of fact "4" of the Administrative Law Judge's determination to read as follows:

Petitioner Donn Corey was the president of AAA Sign during the period at issue. He controlled the corporation and did not dispute that he was a responsible officer thereof. Donn Corey was not present at the formal hearing.¹

¹The Administrative Law Judge's finding of fact "4" read as follows:

"4. Petitioner Donn Corey was the president of AAA Sign during the period at issue. He controlled the corporation and did not dispute that he was a responsible officer thereof."

This matter arose as a result of Division investigations and audits of certain other corporations. Donn Corey was president of such other corporations. These other audits resulted in assessments against the other corporations and Mr. Corey. Installment payment arrangements were agreed to by Mr. Corey and the Division with respect to these assessments. Mr. Corey subsequently defaulted on the installment payment arrangement. No fraud penalty was imposed with respect to these prior assessments.

On audit in this matter, the former Special Investigations Bureau made a request of Mr. Corey for certain of AAA Sign's Federal income and State sales tax returns and corporation franchise tax reports. Said request was made on August 26, 1980 by certified mail, return receipt requested, and was addressed to Mr. Corey at AAA Sign's offices located at S-3570 California Road, Orchard Park, New York. This request was returned to the Division on September 29, 1980 as "unclaimed". At the same time an identical request to the same address was made by first class U.S. mail. This request was not returned.

Subsequent efforts by the Division to personally serve Mr. Corey with a subpoena demanding the production of AAA Sign's records were unsuccessful.

In October 1980, the Division caused a subpoena to be delivered to the New York Secretary of State for service upon AAA Sign. In November 1980, the Division served a subpoena upon a shop foreman at AAA Sign's manufacturing plant. In response to these subpoenas, Mr. Corey appeared, with counsel, at the offices of the Division in Buffalo on December 9, 1980. At that time, Mr. Corey, by his counsel, invoked his privilege against self-incrimination under the Fifth Amendment and refused to answer any questions put to him by the Division. He also refused to produce the corporation's records. The Division did not advise Mr. Corey that criminal charges against him were not being contemplated.

The Division made no attempt to contact Mr. Corey following the December 8, 1980 meeting.

The Division subsequently obtained copies of the corporation's Federal returns and conducted an audit by comparison of gross sales as reported on the corporation's sales tax returns

and gross sales (less sales tax included in gross sales on the returns) as reported on the corporation's Federal income tax returns. This comparison revealed the following:

<u>Period</u>	<u>Gross Sales Reported</u>		<u>Difference</u>
	<u>Federal</u>	<u>Sales Tax</u>	
6/1/75-5/31/76	\$ 83,683.64	\$ 58,816.89	\$ 24,866.75
6/1/76-5/31/77	143,449.00	35,014.55	108,434.45
6/1/77-5/31/78	257,079.00	41,558.00	215,521.00
6/1/78-5/31/79	<u>289,551.00</u>	<u>159,915.91</u>	<u>129,635.09</u>
	\$773,762.64	\$295,305.35	\$478,457.29

Reported taxable sales, per sales tax returns, for the four periods set forth above, amounted to 76%, 87%, 92% and 84%, respectively, of gross sales reported per sales tax returns. The Division applied these percentages to the Federal income/sales tax gross sales differences set forth above to determine additional audited taxable sales for each of the sales tax periods at issue.

AAA Sign did not file a Federal income tax return for its fiscal year ended May 31, 1980. It did file sales tax returns for the quarters comprising that fiscal year and reported a total of \$302,485.02 in gross sales on said returns. Total taxable sales reported for the quarters comprising fiscal year ended May 31, 1980 were 92 percent of gross sales. To determine additional taxable sales for fiscal year ended May 31, 1980, the Division determined the average percentage of difference between gross sales reported for sales tax purposes and gross sales reported for Federal purposes for the four-year period June 1, 1975 through May 31, 1979 (\$478,457.29 divided by \$295,305.35). This amounted to 162 percent. This percentage was then applied to reported gross sales per sales tax returns to project a "difference" between Federal and sales tax gross sales figures for fiscal year ended May 31, 1980 of \$490,025.73. The reported taxable sales ratio of 92 percent was then applied to this amount to determine additional audited taxable sales for the period June 1, 1979 through May 31, 1980.

The corporation filed quarterly sales tax returns for all of the periods at issue. The returns for the quarters ended August 31, 1975 through August 31, 1977 and February 28, 1978 were stamped with the signature "Jerome Joseph". The returns for the quarters ended November 30,

1977 and May 31, 1978 through August 31, 1979 were signed "Carol Beyer". Returns for the periods ended November 30, 1979 and February 29, 1980 were not produced at hearing. The return for the period ended May 31, 1980 was signed "Donn Corey".

"Jerome Joseph" was a name used, on occasion, by Donn Corey. Carol Beyer ran AAA Sign's business office during the period at issue.

AAA Sign's Federal income tax returns and State franchise tax reports were prepared by an outside certified public accountant using the corporation's general ledger which was provided to the accountant by Carol Beyer. The accountant was not involved in the preparation of the corporation's sales tax returns as such returns were prepared within the corporation. Carol Beyer was described by the corporation's outside accountant as a "one-person office" who had difficulty "keeping up" with the volume of work generated by the corporation. The accountant advised Ms. Beyer that problems could result from the manner in which sales taxes were being reported.

At the commencement of the hearing, the Division asserted, as an alternative to the fraud penalty, the penalty for failure to file a return or pay tax imposed under Tax Law section 1145(a)(1). This alternative penalty was not asserted in either the notices of determination or the Division's answer.

OPINION

The Administrative Law Judge determined that petitioners failed to sustain their burden of proving by clear and convincing evidence that both the method used to arrive at the tax assessment and the assessment itself were erroneous. In addition, the Administrative Law Judge determined that while the Division failed to sustain its burden of proving that the imposition of the fraud penalty was proper, it did sustain its burden of proving that the penalty pursuant to Tax Law section 1145(a)(1) as an alternative to the fraud penalty was supportable. Consequently, in light of the Administrative Law Judge's determination that the Division did not meet its burden of proving the propriety of imposing the fraud penalty, he further determined that the assessment of

tax due against petitioners with respect to the period June 1, 1975 through August 31, 1978 was time barred pursuant to Tax Law section 1147(b), and was therefore cancelled.

On exception, the Division asserts in regard to the issue of fraud, that it proved the requisite elements of willful, knowledgeable and intentional wrongful acts or omissions constituting false representation, resulting in deliberate nonpayment or underpayment of taxes due and owing. The Division also contends that because it did sustain its burden of proving fraud, section 1147(b) of the Tax Law allows for the additional assessment of tax subsequent to the expiration of more than three years from the date of the filing of AAA Sign's return. Thus, it is argued, the notices of determination were in fact timely issued.

We sustain the determination of the Administrative Law Judge.

We first address the Division's effort to prove fraud.

Section 1145(a) (former [2]) provides in pertinent part as follows:

"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 tax due (in lieu of the penalty provided for in subparagraph [i] of paragraph one) plus interest" (Emphasis added.)

As stated above, according to section 1145(a)(2), the burden of showing fraud has consistently been interpreted to reside with the Division. (See, Matter of Ilter Sener d/b/a Jimmy's Gas Station, Tax Appeals Tribunal, May 5, 1988.) In regard to the relative weight of this burden, the standard of proof necessary to support a finding of fraud 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 Ilter Sener, *supra*, citing, Matter of Walter Shutt and Gertrude Shutt, State Tax Commn., July 13, 1982). The issue of fraud with intent to evade tax presents a factual question to be determined upon a consideration of the entire record

(Powell v. Granquist, 252 F2d 56; Beaver v. Commr., 55 TC 85, 92-93; Stratton v. Commr., 54 TC 255, 284).

Since the sales tax penalty provisions were, in effect, modeled after Federal penalty provisions, Federal statutes and case law are properly used for guidance (see, Matter of Ilter Sener, *supra*; Levin v. Gallman, 42 NY2d 32). In particular the factors to be considered as evidence of fraud which have been established by the Federal Court of Appeals are helpful. Among these are the amount of the deficiency itself, a pattern of repetition, in that repeated deficiencies bear heavily on the issue of willfulness, the conduct of the taxpayer after the investigation begins, and the taxpayer's attributes indicating a familiarity with the tax law if relevant to show an absence of ignorance or mistake (see, Webb v. Commr., 68-USTC 9341; Foster v. Commr., 391 F2d 727 [1968]; Granat's Estate v. Commr., 298 F2d 397 [2d Cir 1962]; United States v. Martilla, 434 F2d 834 [8th Cir 1970]).

The Administrative Law Judge, while noting the existence of certain of these elements, i.e., the consistent underreporting of AAA Sign's taxable sales during the period at issue, and in addition, Don Corey's lack of cooperation with regard to the Division's investigation which in other cases have constituted circumstantial evidence of fraud, (see, e.g., Gromacki v. Commr., 361 F2d 727; Miliken v. Commr., 798 F2d 830), nevertheless determined, based on the totality of the record, that the Division did not prove the requisite elements of knowledge and intent on the part of petitioners, such as to sustain the imposition of the fraud penalty by the Division.

The Division in its exceptions, demands that different inferences be drawn from the testimonial and documentary evidence in the record, than those drawn by the Administrative Law Judge. It is clearly the Division's view that if we adopt the inferences it suggests, there will exist enough circumstantial evidence to prove the intent necessary to find fraud. In so considering the Division's exceptions with regard to the findings of the Administrative Law Judge, we find nothing in the record which causes us to disagree with the inferences and conclusions drawn by the Administrative Law Judge.

First, the Administrative Law Judge refused to find as a fact that the petitioner, Donn Corey, evaded process servers. The Division contends that the record establishes that Donn Corey did evade process. Our review of the record indicates that the most direct evidence on this point was evidence in the record that Donn Corey denied he was himself when confronted by an auditor attempting to serve a subpoena. However, we find no evidence to establish whether or not the auditor identified himself or the purpose behind his inquiry during the time of the alleged evasion of process. The Division's assertion that Donn Corey evaded process because he failed to identify himself to an unidentified person is untenable. In addition, this testimony regarding whether or not Donn Corey intentionally and physically avoided being served was entirely based on hearsay. While the technical rules of evidence do not apply in an administrative hearing, it is within the discretion of the Administrative Law Judge to apportion whatever weight necessary to hearsay and conclusions (20 NYCRR 3000.10[5][d][1]). We therefore find no reason to take issue with this aspect of the Administrative Law Judge's determination.

Next, the Administrative Law Judge refused to conclude that the existence of prior sales tax assessments against petitioner Donn Corey and certain other corporations with which Donn Corey was associated implied the existence of fraudulent intent, and a level of sophistication on Don Corey's part. The Administrative Law Judge determined the existence of prior sales tax assessments against Donn Corey and these other corporations was evidence of negligent business practices on the part of the Donn Corey but not fraud.

The Division insists that these other connections of Donn Corey prove that Donn Corey was knowledgeable of the Tax Law. We acknowledge that this business activity could be relevant with respect to specific areas of knowledge, for example the requirements to register as a vendor and to file returns, but these are not the failures at issue here. We cannot conclude as urged by the Division that Mr. Corey's past business activity establishes that he was knowledgeable of the Tax Law generally.

In the same vein, the Administrative Law Judge refused to conclude that the consistent underreporting by AAA Sign compelled an inference of fraud. On this point the Administrative Law Judge found the testimony of Keva Richmond, AAA Sign's accountant during the years at issue, to be credible and persuasive. Mr. Richmond testified that in his opinion, AAA Sign's office manager, Carol Beyer, who was responsible for preparing the sales tax returns, was perpetually overwhelmed with the volume of bookkeeping which the business generated.

The Division would like us to infer that the continual underreporting of sales tax liability by AAA Sign proves the requisite intent on the part of Donn Corey to fraudulently deprive the Division of money owed. However, there is nothing in the record that indicates we should not defer to the Administrative Law Judge's evaluation of the credibility of Mr. Richmond. In addition, seven of these sales tax returns were indeed signed by the office manager, Carol Beyer. While again, the finding that Mr. Corey allowed Carol Beyer to haphazardly manage the office serves to illustrate Donn Corey's negligent handling of his business, it does not substantiate the Division's claim that Donn Corey knowingly intended to perpetrate fraud. We agree with the implicit assumption of the Administrative Law Judge that the fact that the office manager was responsible for preparing the returns serves to neutralize the fact of the underreporting as reflecting on Donn Corey's intent.

Donn Corey's use of the name "Jerome Joseph", as the Administrative Law Judge noted, is puzzling. However, we agree that the record fails to show such action was intended to defraud. Donn Corey did file a sales tax return that was signed by himself, using his given name. Certainly this open act of signing negates the Division's contention that Donn Corey was intending to mislead the Division or conceal tax liability. Further, we find no evidence in the record that Donn Corey attempted to deny or conceal his connection to or responsibility for the corporation. The Division would like us to infer that the use of the name "Jerome Joseph" was for the purpose of avoiding just such a connection or responsibility. However, as noted above, we can find no purpose behind the use of the name, fraudulent or otherwise.

To establish fraud, a specific intent to evade a tax believed to be owing must be shown (see, Mitchell v. Commr. [41-1 USTC section 9317], 118 F2d 308, 310 [5th Cir 1941]). Suspicion of fraud is not enough to sustain the penalty (see, Estate of Arnold Windsberg, 37 TCM 455). We sustain the determination of the Administrative Law Judge that the Division has failed to meet its burden with respect to proving a willful and a knowledgeable intent to defraud.

In that petitioners are not liable for the fraud penalty, the assessments in question were subject to the three-year statute of limitations pursuant to Tax Law section 1147(b). This section reads that the date of the issuance of the notice is the determinative date regarding when the assessment was made (see, Maplecrest Sausage Co., Inc. v. Tully, 67 AD2d 329). While a given amount of returns were not timely filed, there is nothing in the record to indicate the any of the returns for the period June 1, 1975 through August 31, 1978 were filed within three years of December 7, 1981, the date the notices of determination were issued herein. Therefore, the assessment of tax against petitioners regarding the period June 1, 1975 through August 31, 1978 is barred according to Tax Law section 1147(b) and is therefore cancelled.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is in all respects denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petition of the AAA Sign Company and Donn Corey, as officer, is granted to the extent indicated in conclusions of law "E", "J" and "K" of the Administrative Law Judge's determination, but is otherwise denied; and

4. The Division of Taxation is directed to modify the notices of determination and demand accordingly, but such notices are otherwise sustained.

DATED: Troy, New York
June 22, 1989

/s/John P. Dugan

John P. Dugan
President

/s/Francis R. Koenig

Francis R. Koenig
Commissioner