STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
ROBERT W. FLANAGAN D/B/A MID ISLAND PLAZA MOBIL	:	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 December 1, 1978 through August 31, 1982.	:	

Petitioner, Robert W. Flanagan d/b/a Mid Island Plaza Mobil, 59 Cedar Street, Hicksville, New York 1180l, filed an exception to the determination of the Administrative Law Judge issued on July 27, 1989 with respect to his 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, 1978 through August 31, 1982 (File No. 802026). Petitioner appeared by John J. Lynch, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Gary Palmer, Esq., of counsel).

Neither petitioner nor the Division filed a brief. Petitioner did not request oral argument.

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

ISSUES

I. Whether the Division of Taxation properly determined sales and use taxes due from petitioner based on computer printouts of gasoline purchases obtained from petitioner's supplier, Mobil Oil Corporation.

II. Whether petitioner is liable for the fraud penalty under Tax Law § 1145(a)(2) or, in the alternative, the late payment penalty under Tax Law § 1145(a)(1).

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge and such facts are stated below.

During the period at issue, petitioner, Robert W. Flanagan d/b/a Mid Island Plaza Mobil, operated a Mobil gasoline service station at 216 North Broadway, Hicksville, New York 11801.

The Audit

An audit of petitioner's business was commenced by the Auditor's visit to the station on or about April 30, 1982. The gasoline station information sheet prepared by the auditor on said date shows the following:

a) Gasoline Pumps: There were two pumps selling regular leaded gasoline at $1.139 per gallon; two pumps selling unleaded gasoline at $1.189 per gallon; and two pumps selling super unleaded gasoline at $1.279 per gallon.

b) Employees: The auditor observed three mechanics and one gasoline attendant working at the station.

c) Hours of Operation: The station's business hours were noted to be from 7:00 A.M. to 10:00 P.M. Monday through Saturday and from 8:00 A.M. to 9:00 P.M. on Sunday.

d) Service Bays: The station had four service bays from December 1, 1978 through August 31, 1980, and two bays from September 1, 1980 through August 31, 1982. Two bays were rented to A & B Auto and Truck Service during the latter period.

The only records available for audit were check stubs for May and June 1980 and bank statements for August 1981 through September 1982. Upon audit, petitioner's accountant stated that all other records had been thrown out by mistake. At the hearing, petitioner's representative stipulated that petitioner's books and records were inadequate.

December 1, 1978 through August 31, 1980

For the period December 1, 1978 through August 31, 1980, taxable gasoline sales were determined by applying an average taxable selling price of $1.25 per gallon to average gallons of

gasoline purchased per month of 53,766, as reported to the Division of Taxation by Mobil Oil Corporation. Monthly taxable gasoline sales were thus $67,207.50, which represented $1,411,358.00 in total taxable gasoline sales for the 21 months from December 1, 1978 through August 31, 1980.

Repair sales were estimated, based on office experience, at $2,000.00 for each of four bays per week, for 91 weeks, to arrive at total taxable repair sales of $728,000.00.

Total audited taxable sales were $2,139,358.00. Petitioner had reported taxable sales of $127,675.00, resulting in additional taxable sales of $2,011,683.00 with additional tax due of $140,817.88.

On November 23, 1983 a Notice of Determination and Demand for Payment of Sales and Use Taxes Due was issued to petitioner for $140,817.88 in tax due, $70,408.92 as a fraud penalty, plus interest.

September 1, 1980 through August 31, 1982

For the period September 1, 1980 through August 31, 1982, average monthly gallonage per the Mobil verification was 54,082.14. Multiplied by an average taxable selling price of $1.25 per gallon, the average gallonage resulted in $67,602.68 per month in taxable gasoline sales. For the 24 months in the aforesaid period, total audited taxable gasoline sales were found to be $1,622,464.32.

Repairs were estimated based on office experience at $30.00 per hour times 60 hours per week for each of two bays, or $3,600.00 per week. Over the 104 weeks in the period September 1, 1980 through August 31, 1982, taxable repair sales totalled $374,400.00.

Total audited taxable sales for the period September 1, 1980 through August 31, 1982 were $1,996,864.32. As taxable sales reported were $159,895.14, additional taxable sales were $1,836,969.18. Additional taxes due were $131,037.77.

On March 20, 1984, the Division of Taxation issued a notice of Determination and Demand for Payment of Sales and Use Taxes Due to petitioner for $131,037.77 in tax due and $65,518.88 as a fraud penalty, plus interest.

Miscellaneous

The Federal Form 1040, Schedule C, filed by petitioner for each of the years 1979, 1980 and 1981, showed the following gross receipts or sales, compared with gross and taxable sales shown per sales tax returns for the corresponding period:

Year	Schedule C	Sales Tax Return
1979	$134,092.30	$ 63,947.00
1980	180,664.16	86,407.00
1981	196,735.20	78,555.00
Total	$511,491.66	$228,909.00

Petitioner offered no evidence to challenge the assessment.

In its answer, the Division of Taxation claimed that in the event the fraud penalty is not sustained, a penalty under Tax Law § 1145(a)(1) be imposed as an alternative.

OPINION

In the determination below, the Administrative Law Judge found that petitioner failed to prove that the Division's audit methodology was unreasonable or the assessment inaccurate. The Administrative Law Judge found that the Division proved that petitioner fraudulently failed to pay sales tax based on evidence of consistent underreporting of sales tax.

On exception, petitioner argues that he sustained his burden of proving the audit methodology was erroneous. Petitioner also contends the Division failed to prove he fraudulently failed to pay sales taxes due.

Petitioner maintains that he was not obligated to subpoena actual purchase records from Mobil Oil Company nor was he obligated to subpoena the auditor who actually performed the audit. Petitioner reasons that because the Division did not inform petitioner prior to the hearing that the original auditor would not testify and that a computer print-out of Mobil purchase records would be offered as evidence, it was solely the Division's obligation to subpoena the auditor and the purchase records.

Relying on its letter brief to the Administrative Law Judge, the Division argues that for lack of proof otherwise, the audit was reasonable and the assessment was accurate. The Division argues petitioner could have subpoenaed the auditor and the actual purchase records to prove his case but did not do so. The Division also argues that petitioner's failure to maintain sales records, and petitioner's underreporting of taxable sales supports the imposition of a fraud penalty.

We modify the determination of the Administrative Law Judge.

Tax Law § 1135(a)(1) places the responsibility upon a vendor to maintain adequate records of each sale and § 1135(d) requires a vendor to furnish these records to the Division upon request. If sales records are found to be inadequate after a specific request for them is made, the Division may resort to external indices to determine tax due (Matter of Licata v. Chu, 64 NY2d 873, 487 NYS2d 552; Matter of King Crab Restaurant v. Chu, 134 AD2d 51, 522 NYS2d 978; Tax Law § 1138[a][1]). The audit method chosen must be reasonably intended to reflect the taxes due although exactness in the outcome is not required where the taxpayer's own failure to maintain the proper records prevents it (Matter of W. T. Grant Co. v. Joseph, 2 NY2d 196, 159 NYS2d 150, 157, cert denied 355 US 869; Markowitz v. State Tax Commn., 54 AD2d 1023, 388 NYS2d 176, 177, affd 44 NY2d 684, 405 NYS2d 454). Petitioner has the burden of proving by clear and convincing evidence that the audit method chosen was unreasonable or the audit result was inaccurate (Matter of Sol Wahba v. State Tax Commn., 127 AD2d 943, 512 NYS2d 542; Matter of Surface Line Operators v. Tully, 85 AD2d 858, 446 NYS2d 451).

In this case, petitioner stipulated that his sales records were inadequate to conduct a complete audit. The only records available for audit were two months of check stubs and one year's bank statements. Petitioner asserted that the remainder of his records had been mistakenly misplaced.

Due to the inadequacy of the taxpayer's records, the Division's auditor contacted Mobil Oil Company, petitioner's gasoline supplier, and received a computer print-out of gallons purchased

during the audit period. The auditor relied on the print-out, the average regional gasoline selling prices and office estimates of repair services to assess $271,855.65 in taxes. In the absence of adequate sales records, estimating tax due is justified (Matter of Licata v. Chu, supra).

Petitioner offered no evidence whatsoever to dispute the assessment. Instead, petitioner attempted to discredit the gasoline purchase records based solely on the fact they were hearsay. It has long been held, however, that hearsay evidence can be used in an administrative hearing to support an agency's decision (Matter of Flanagan v. State Tax Commn., 154 AD2d 758, 546 NYS2d 205; Matter of Kucherov v. Chu, 147 AD2d 877, 538 NYS2d 339). In addition, petitioner could have subpoenaed Mobil Oil Company's actual purchase receipts had he chosen to do so (Tax Law § 2006[11]; 20 NYCRR 3000.6[c]).

Petitioner also asserted that it was incumbent upon the Division to subpoena the original auditor who conducted the audit. This argument lacks merit. Petitioner had the burden of proving the assessment inaccurate and he had the subpoena power to do so (see, Matter of Anray Service, Inc., Tax Appeals Tribunal, December 1, 1988). Petitioner failed to sustain his burden of proving that the audit method was unreasonable or that the assessment was inaccurate.

We reverse the Administrative Law Judge's finding of fraud.

When a taxpayer's failure to file accurate sales tax returns is due to fraud, a penalty of 50% is added to the tax (Tax Law § 1145[a][2]). The Division has the burden of proving fraud (see, Matter of Ilter Sener, Tax Appeals Tribunal, May 5, 1988). Fraud must be proven with clear and convincing evidence of a deliberate, willful intent to evade the full payment of taxes due (see, Raley v. Commr., 676 F2d 980, 82-1 USTC 9348;[1] Matter of Cinelli, Tax Appeals Tribunal, September 14, 1989). Fraud may be shown after assessing a taxpayer's entire course of conduct (see, Biggs v. Commr., TC Memo 1985-303, 50 TCM 203, 207). The proof of each element of

[1]We look to federal case law as a guide on the issue of fraud since New York penalties are modeled after federal law (Levin v. Gallman, 42 NY2d 32).

fraud must be clear and unmistakable (Matter of Shutt, State Tax Commn., July 13, 1982) and may not be presumed (see, Intersimone v. Commr., TC Memo 1987-290, 53 TCM 1073).

While substantial underreporting is strong evidence of fraudulent intent, alone, it is not enough to prove fraud (see, Merrit v. Commr., 301 F2d 484, 487; Intersimone v. Commr., supra).

Here, the Administrative Law Judge found petitioner had fraudulently failed to pay sales tax based solely on the underreporting asserted in the auditor's report. Other than the two indications of underreporting cited by the Administrative Law Judge, the record lacks evidence of fraud. "The mere understatement of income, standing alone, is not enough to carry the burden cast upon the [Division] in seeking to recover fraud penalties." (Merrit v. Commr., supra, at 487; see, George v. Commr., 338 F2d 221; see also, Matter of Cousins Service Station, Tax Appeals Tribunal, August 11, 1988.) Because underreporting was the only fact in the record which indicated fraud, the fraud penalty cannot be upheld.

In its answer, the Division requested an alternative willful neglect penalty for late payment of taxes due. We held in Matter of Ilter Sener (supra) that when the Division gives notice in its answer to the taxpayer of its intention to assert a late payment penalty as an alternative to the fraud penalty, doing so shifts the burden to the Division to prove petitioner's willful neglect. "Willful neglect" has been defined under federal law as meaning a "conscious, intentional failure or reckless indifference" (United States v. Boyle, 469 US 241, 85-1 USTC ¶ 13,602, at 88,255), a "designed" failure (Orient Investment v. Commr., 166 F2d 601, 48-1 USTC ¶ 9162, at 160), and a "voluntary" failure (Vaughan v. U.S., 536 F Supp 498, 82-1 USTC ¶ 13,463, at 84,297) to pay the taxes due. Because the Internal Revenue Service has a similar burden as the Division to prove willful neglect (see, Langston v. Commr., T.C. Memo 1977-421, 26 TCM 1703, 1709; see also, Matter of Ilter Sener, supra) we adopt these definitions as a guide. Proof of a taxpayer's intentions may be shown through the testimony of the taxpayer. In Bundy, Jr., Inc. v. U.S. (673 F Supp 318, 87-2 USTC ¶ 9657, at 90,041), the District Court found willful neglect where the taxpayer testified that she intentionally filed federal employment tax forms knowing the tax had

not been paid and that she did so based on the inaccurate assumption that she would be penalized less severely than was actually so. Such direct proof of willful neglect may not always be available. However, the Division did not even attempt to obtain it here. Although the Division has the same subpoena power as the taxpayer (see, Tax Law § 2006[11]; 20 NYCRR 3000.6[c]), it did not subpoena the taxpayer to testify.

In the absence of direct proof, indirect proof may be sufficient to show a taxpayer's intent. The auditor who performed the audit which provided the basis for the determination (or the auditor's supervisor since the auditor was no longer available) might have been able to testify to conduct during the audit which would have supported the conclusion that petitioner's failures were willful. For example, did petitioner mislead the auditor during the audit, was there evidence that petitioner knowingly used his resources for purposes other than his tax liability or that the underpayment occurred because of petitioner's reckless disregard for his tax responsibilities (see, Matter of Stephen G. Flax, Tax Appeals Tribunal, September 9, 1988).

The indirect proof here is insufficient to support the inference that petitioner's conduct was willful. Signing the two tax returns which showed a large difference between petitioner's personal income from the Mid Island service station and taxable sales from that station is some evidence that petitioner may have known full payment of sales tax was not made. However, it is not enough to prove willful neglect. If the Division had shown that petitioner understood the difference in the tax returns or at least that he was aware the difference existed and chose to overlook it, the tax returns could have been stronger evidence of willful neglect. The separate audit referred to by the Division's counsel does not establish petitioner's intent, design, or recklessness in failing to pay the sales tax due in this case. The audit in Flanagan v. State Tax Commn. (supra) was for the same period as this audit but for a different gas station owned by a corporation which petitioner controlled (see, Matter of Flanagan, State Tax Commn., August 28, 1987). It would appear that these audits occurred at approximately the same time. Thus, in the

absence of evidence to the contrary, the separate audit does not show that petitioner was placed on notice of his tax responsibilities or errors prior to the audit at issue here.

The only other evidence to support a finding of willful neglect is the undisputed contention that petitioner inadvertently misplaced his sales records and underreported his taxable sales. Without any evidence to suggest that these failures were the result of reckless behavior, we are unable to reach the conclusion that petitioner's conduct was due to willful neglect. For these reasons we find that the Division failed to prove that petitioner consciously, recklessly, voluntarily or with a design failed to pay sales tax due.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Robert Flanagan d/b/a Mid Island Plaza Mobil is granted to the extent that conclusion of law "E" is reversed, with the result that the fraud penalty is cancelled but the exception of petitioner is in all other respects denied;

2. The determination of the Administrative Law Judge, dated July 27, 1989 is modified to the extent set forth in paragraph "1" above but is in all other respects affirmed;

3. The petition of Robert Flanagan d/b/a Mid Island Plaza Mobil is granted to the extent provided in paragraph "1" above but the petition is in all other respects denied; and

4. The Division of Taxation shall modify the notices of determination dated November 23, 1983 and March 20, 1984 in accordance with paragraph "1" above but such notices are in all other respects sustained.

DATED: Troy, New York
June 14, 1990

/s/John P. Dugan
John P. Dugan
President

/s/Francis R. Koenig
Francis R. Koenig
Commissioner

/s/Maria T. Jones
Maria T. Jones
Commissioner