STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
A. CHARLES CINELLI D/B/A SHOPORAMA CAR WASH	:	DECISION
for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period September 1, 1980 through May 31, 1983.	:	

Petitioner, A. Charles Cinelli d/b/a Shoporama Car Wash, 1307 Altamont Avenue, Schenectady, New York 12303, filed an exception to the determination of the Administrative Law Judge issued on July 14, 1988 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 September 1, 1980 through May 31, 1983 (File No. 802576). Petitioner appeared by DeGraff, Foy, Conway, Holt-Harris and Mealey (Howard M. Koff, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Thomas C. Sacca, Esq., of counsel).

Petitioner submitted a brief on exception. The Division submitted a letter in lieu of a brief. Oral argument was heard at petitioner's request on March 22, 1989.

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

ISSUES

I. Whether petitioner has established that the amount of sales tax assessed was erroneous or that the method of audit was unreasonable.

II. Whether the Division of Taxation established that petitioner's failure to accurately report and pay over sales taxes was due to fraud.

FINDINGS OF FACT

We find the facts as stated by the Administrative Law Judge and such facts are stated below, except that we modify finding of fact "3(b)"as indicated below. We also find additional facts as indicated.

On August 13, 1985, the Division of Taxation ("Division") issued to petitioner, A. Charles Cinelli d/b/a Shoporama Car Wash, a Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period September 1, 1980 through May 31, 1983, assessing sales tax in theamount of $408,997.31, plus a fraud penalty of $204,498.67 and interest of $225,553.75, for a total due of $839,049.73.

Petitioner executed four consents which taken together extended the period of limitation for assessment of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 1980 through May 31, 1982 to September 20, 1985.

The Division conducted an audit of petitioner's business for the period September 1, 1980 through May 31, 1983. Throughout the audit period, petitioner owned and operated a combination gasoline station, car wash and small convenience store. There were approximately 25 gasoline pumps on the premises.

We modify the Administrative Law Judge's finding of fact "3(b)" to read as follows:

> The auditor initially contacted Mr. Cinelli who directed the auditor to contact his accountant, Fred Freedman. The auditor sent Mr. Cinelli's accountant a letter which requested all records needed to perform an audit, including cash register tapes. The auditor received from Mr. Freedman: petitioner's sales tax returns for the audit period including related worksheets; petitioner's 1980, 1981 and 1982 Federal income tax returns with related workpapers and depreciation schedules; a sales journal; a check disbursements journal; purchase invoices; and cancelled checks. No cash register tapes or records of individual sales were received. However, all records provided were deemed to be in good condition.[1]

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[1]The Administrative Law Judge's finding of fact "3(b)" read as follows:

(b) The auditor initially contacted Mr. Cinelli who directed the auditor to contact his accountant, Fred Freedman. The auditor requested and received from Mr. Freedman: petitioner's sales tax returns for the audit period including

Gross sales as shown on petitioner's quarterly sales tax returns were compared to gross sales as shown on petitioner's books with only minor discrepancies noted. The names of petitioner's gasoline suppliers were gleaned from the gasoline purchase invoices. All gasoline suppliers were contacted, and each was asked to provide the Division with a record of all sales of gasoline, oil and related products made by the supplier to petitioner. Petitioner's records showed total gasoline purchases for the audit period of 2,803,844 gallons. Petitioner's suppliers reported that petitioner had purchased a total of 12,164,491 gallons of gasoline during the audit period.

The auditor obtained petitioner's average monthly gasoline selling prices from advertisements placed in a local newspaper. These selling prices were adjusted for excise and sales tax included in the price, and the results were applied to audited gasoline purchases to obtain audited taxable gasoline sales of $12,693,959.88 for the audit period.

Using petitioner's records and third-party verification of purchases from other vendors, the auditor estimated taxable sales of such items as cigarettes, kerosene and diesel fuel of $2,835,838.90. This was added to audited gasoline sales to obtain total audited sales of $15,529,798.68. Audited sales were reduced by reported sales, resulting in additional taxable sales of $10,019,932.68 with a tax due on that amount of $400,797.25.

A review of petitioner's purchases disclosed capital expenditures during the audit period of $205,001.59 with a tax due on these purchases of $8,200.06. This was added to sales taxes due to determine total tax due for the audit period of $408,997.31.

After reviewing evidence presented by petitioner at a Tax Appeals conference, the Division adjusted its calculation of tax due and at hearing asserted a tax liability of $354,347.83. The reduction represents adjustments made to audited cigarette, kerosene and

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related worksheets; petitioner's 1980, 1981 and 1982 Federal income tax returns with related workpapers and depreciation schedules; a sales journal; a check disbursements journal; purchase invoices; and cancelled checks. No records were requested which were not provided, and those provided were deemed to be in good condition.

We modify the Administrative Law Judge's finding of fact because the Administrative Law Judge's finding that all requested records were provided is completely contradicted by the record.

miscellaneous sales and a determination that tax due on purchases of capital assets amounted to $717.83.

On or about June 26, 1985, petitioner was indicted on eight counts of offering a false instrument for filing in the first degree, in violation of Penal Law § 175.35. The eight counts in the indictment corresponded to the first eight quarters of the eleven-quarter audit period.

On March 27, 1986, petitioner pleaded guilty to offering a written instrument for filing, with intent to defraud the State of New York, namely, filing a quarterly sales tax return for the period ended May 31, 1981 while knowing that the written instrument contained a false statement and false information, i.e., the amount of gross sales was understated. Petitioner's plea was accepted in satisfaction of all eight counts of the indictment. He was sentenced to three months in the county jail and five years' probation, fined $25,000.00 and ordered to pay restitution to the State.

At petitioner's hearing on his plea, the following exchange took place:

> "THE COURT: All right, Mr. Cinelli, you made it a practice, did you not, of getting all the documentation and all the information necessary for your accountant to file the quarterly sales tax return to the accountant, you were the genesis of all that information; that is correct?
>
> THE DEFENDANT: Yes.
>
> THE COURT: He didn't work in the gas station there and compile figures, you gave him all the figures that you deemed necessary for him to file this quarterly sales tax return; is that correct?
>
> THE DEFENDANT: Yes.
>
> THE COURT: And for that period of time you gave him certain information and you gave him certain documentation, upon which he made that quarterly sales tax return; is that correct?
>
> THE DEFENDANT: Yes, sir.
>
> THE COURT: And you knew for that period of time that you were understating what your business was during that period of time, so that you knew that based upon the information that you gave him for that quarter that he was going to understate your sales tax liability; that is correct, sir?
>
> THE DEFENDANT: The material was incomplete, yes.

> THE COURT: All right. And the purpose that it was incomplete is so that there would be somewhat of a lesser figure on the quarterly sales tax return and all the sales tax due and owing to the State of New York would not be paid; is that correct, sir?
>
> THE DEFENDANT: Yes.
>
> THE COURT: And that is the same with all these other counts; is that correct?
>
> THE DEFENDANT: Yes.
>
> * * *
>
> THE COURT: You knew as a result of the activity that you engaged in, by not giving him all of the information he needed, that that quarterly sales tax return would be understated with respect to your tax liability; that is correct?
>
> THE DEFENDANT: Yes."

Shortly before entering the guilty plea, Mr. Cinelli was hospitalized for a suspected cardiac condition. He was diagnosed as having hypertension controlled by medication. He was referred to the Behavioral Medicine Clinic of Schenectady for psychiatric evaluation and treatment. In written reports, his medical doctors made these observations: that Mr. Cinelli suffered from depression and suicidal thoughts; that he had difficulty in communicating with other people; that Mr. Cinelli had impairments of memory and concentration; and that he suffered periods of acute anxiety. Mr. Cinelli was treated with psychotropic medications as well as medications to control hypertension.

Mr. Cinelli had no formal education beyond high school. The business which was the subject of the audit was begun as a car wash in 1970 and later expanded to include a gas station and a convenience store. At the outset of the business, Mr. Cinelli hired Fred Freedman to act as his accountant. Mr. Freedman worked for Mr. Cinelli for 13 years.

Mr. Cinelli's wife was responsible for maintaining the daily records of the business in her home office. At the beginning and end of each day, Mr. Cinelli or an employee recorded readings from the gasoline pump meters. This provided a record of the number of gallons of gasoline sold each day. From these daily sheets, Mrs. Cinelli prepared a monthly summary. At the end of each month, Mrs. Cinelli provided Mr. Freedman with purchase receipts, i.e., bills of

lading, invoices and delivery tickets; the monthly summary of meter readings; bank statements and the business checkbook, including five endorsed checks. From the records provided by Mrs. Cinelli, Mr. Freedman's bookkeeper computed the tax due and prepared the quarterly sales tax return. She signed Mr. Cinelli's name to the returns and submitted them to the Division without Mr. Cinelli's review. Mr. Freedman returned some or all of the materials used to prepare the returns to Mrs. Cinelli.

In October 1983, petitioner engaged the services of International Software to provide him with a computerized recordkeeping and accounting system. After setting up a basic general ledger, payroll and inventory system, the computer salesperson, Kathleen Raeihle, asked to see petitioner's records for back years. Petitioner had available receipts, invoices and other source documents for 1983. He referred Ms. Raeihle to Mr. Freedman for any other records she might need. Mr. Freedman provided Ms. Raeihle with the monthly summary sheets for 1983 and income statements and balance sheets for 1982. He made no other records available to her. Because Ms. Raeihle believed that Mr. Freedman was being uncooperative, she recommended to petitioner that he obtain another accountant.

In April 1984, petitioner hired David Scott as his accountant. Mr. Scott met briefly with auditors from the Division, but he was not involved in their audit. After the notice of determination was issued, he obtained some of petitioner's records from the New York State Attorney General's Office and other records from Mr. Freedman, and he used these records to conduct his own analysis of petitioner's tax liability.

At his sentencing hearing, the Court instructed petitioner and his representatives to meet with the Division to see if they could agree on the exact amount of tax due. No agreement was reached. Following a hearing, the Court ordered petitioner to make restitution in the amount of $87,069.90. This was an amount which petitioner had conceded was owed to the State.

The restitution amount was based on an analysis of petitioner's books and records made by David Scott. He arrived at this figure, primarily, by subtracting from the Division's estimate of audited gasoline sales certain sales attributable to alleged purchases from two particular

suppliers, Kenneth B. Moyer Petroleum Products, Inc. ("Moyer") and Peterson Petroleum, Inc. ("Peterson"). Mr. Scott reviewed all Moyer and Peterson invoices and identified those he considered to be unreliable. His criteria for making this determination were based upon petitioner's description of his business practices. Petitioner told Mr. Scott that only petitioner, his sons and one other employee were authorized to sign for gasoline deliveries. Typically, the Moyer and Peterson invoices relied on by the Division were signed by employees purportedly not authorized to do so; many did not show exact meter readings; and some lacked a heading showing the name of the seller. Petitioner and Mr. Scott considered all such records to be unreliable.

Mr. Scott determined that petitioner owed sales tax of $87,069.90 for the audit period.

Mr. Scott aggregated all purchases from those invoices he considered unreliable for each month in the audit period. The selling price calculated by the Division was applied to these purchases. The resulting estimate of gasoline sales attributable to the questioned invoices and to purported arithmetic errors by the Division was $6,555,585.90.

Mr. Scott determined that the Division had made several calculation errors in its estimate of cigarette, kerosene and miscellaneous sales. On this basis he calculated a reduction in audited taxable sales of $97,225.75. This was in addition to other adjustments agreed to by the Division. The Division's calculations show that additional taxable sales, after adjustments agreed to by the Division, amounted to $8,822,803.37 plus additional tax due on the amount of $17,945.71, representing purchases of capital assets. Mr. Scott calculated "additional sales per audit" as $8,829,559.11. The discrepancy in the calculations was not explained. Mr. Scott calculated additional taxable sales of $2,176,747.46 by subtracting the adjustments he calculated for gasoline and other sales from "additional sales per audit" of $8,829,559.11. The tax due on these claimed additional sales was $87,069.90.

Based on his review of petitioner's records, Mr. Scott believes that Mr. Freedman calculated gross sales on the basis of bank deposits. This method, by failing to take into account cash purchases made from gross receipts before those receipts were deposited, would result in an

understatement of sales. Petitioner made gasoline purchases from cash, and all of his purchases from Peterson and Moyer were made in cash.

In addition to the facts found by the Administrative Law Judge, we find that petitioner's reported gross sales for the quarters of the audit period were as follows:

Quarter Ended	Reported Gross Sales
11/30/80	$ 847,163
2/28/81	$ 808,322
5/31/81	$ 749,767
8/31/81	$ 928,648
11/30/81	$ 692,411
2/28/82	$ 859,910
5/31/82	$ 866,308
8/31/82	$ 551,730
11/30/82	$1,240,642
2/28/83	$1,663,873
5/31/83	$1,742,636

The quarter ended November 30, 1982 was the first quarter where the amendments made by Chapters 454 and 469 of the Laws of 1982 to the imposition of sales tax on motor fuel were in effect. These amendments required the retail service station to pay tax on its purchases of fuel from a distributor rather than the retail service station collecting tax on its sales to consumers.

OPINION

In the determination below the Administrative Law Judge found that the Division properly concluded that petitioner's records were inadequate to verify taxable sales such that an estimate of petitioner's sales was warranted. He then found that petitioner failed to meet his burden of showing by clear and convincing evidence that the estimation procedures utilized were unreasonable or that the results obtained were erroneous. Lastly, the Administrative Law Judge found that the Division of Taxation had met its burden of proof regarding the imposition of the fraud penalty.

Petitioner disagrees with the Administrative Law Judge arguing that the audit methodology used was improper and that the results obtained were erroneous. Specifically, petitioner contends that the Division did not make an adequate request for and/or did not conduct a sufficient investigation of petitioner's books and records. Further, petitioner claims that he has met the

burden of proving by clear and convincing evidence that the audit methodology was unreasonable and the results obtained were erroneous because he presented "uncontroverted testimony" that the invoices upon which his sales tax liability was based were false and unreliable. Finally, the petitioner contends that the Administrative Law Judge erred when ruling that the Division of Taxation has met its burden of proof in regards to the fraud penalty imposed.

We affirm the decision of the Administrative Law Judge.

As established in Chartair, Inc. v. State Tax Commn. (65 AD2d 44, 411 NYS2d 41), the resort to external indices as a method of computing tax liability must be founded on a determination of the insufficiency of the taxpayer's record which makes it virtually impossible to verify sales receipts and conduct an audit. The Division must make an actual request for the petitioner's books and records that is more than weak and casual (Matter of Christ Cella, Inc. v. State Tax Commn., 102 AD2d 352, 477 NYS2d 858) which is for the entire period of assessment (Matter of Adamides v. Chu, 134 AD2d 776, 521 NYS2d 826, lv. denied 71 NY2d 806, 530 NYS2d 109) and must make a thorough examination of such records before looking to external indices (Matter of King Crab Restaurant, Inc. v. Chu, 134 AD2d 51, 522 NYS2d 978). Once this procedure is followed and the records are found to be incomplete or inaccurate, the Division may resort to external indices to estimate tax (Matter of Urban Liquors, Inc. v. State Tax Commn., 90 AD2d 576, 456 NYS2d 139). The estimate methodology utilized must be reasonably calculated to reflect taxes due, but exactness is not required from such a method (Matter of W.T. Grant Company v. Joseph, 2 NY2d 207, 159 NYS2d 150, 157; Matter of Markowitz v. State Tax Commn., 54 AD2d 1023, 388 NYS2d 176, 177).

The first issue to be considered is whether the Division made an adequate request for and conducted a sufficient investigation of petitioner's books and records. Tax Law § 1135 mandates that "Every person required to collect tax shall keep records of every sale . . . and of all amounts paid, charged or due thereon and of the tax payable thereon, in such form as the commissioner of taxation and finance may by regulation require . . . ." The record presents uncontroverted testimony that the auditor for the Division of Taxation sent a letter to the petitioner's accountant

(Mr. Freedman at this point) requesting the records needed to perform an audit, including cash register tapes.[2] Yet, the record indicates that no original records of individual sales, such as cash register tapes, were ever presented during the audit or the hearing. Further, the record indicates that such records do not actually exist. The petitioner has claimed that pump readings were available from which individual sales could be determined, however, we find this statement totally unfounded. No such pump readings were offered at the time of the audit nor at the petitioner's hearing. Further, the petitioner's own accountant testified that when he did his analysis as to petitioner's tax liability there was no documentation to look at other than delivery invoices.[3] Therefore, we find that an adequate request was made for the petitioner's books and records. We also find that the Division's resort to external indices was justified because petitioner did not have records to verify his taxable sales (Matter of Licata v. Chu, 64 NY2d 873, 487 NYS2d 552).

We next consider whether petitioner has met its burden of demonstrating by clear and convincing evidence that the audit methodology was unreasonable or the amount of assessment is erroneous (Matter of Surface Line Operators Fraternal Organization, Inc. v. Tully, 85 AD2d 858, 446 NYS2d 451). It is the petitioner's contention that some of the invoices which were used to determine his tax liability are totally unreliable and the results obtained through their use must be rejected. As proof of this, petitioner offered testimony at his hearing that some of the invoices used were not signed by a member of his family or a trusted employee as he claimed was an established business practice. The petitioner argues that this satisfies his burden of proof by showing clearly and convincingly that the audit methodology is unreasonable or that the amount assessed is erroneous. We do not agree.

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[2]Page 32 of the transcript presents questioning of the auditor by the Administrative Law Judge: Q: When you contacted petitioner's representative, did you specifically ask for cash register tapes? A: I sent them a cover letter, and on the cover letter it stated the various items I need. And cash register tapes is one of the items I had.

[3]Mr. Scott's cross examination; p. 110 of the record: Q: Was there any documentation looked at other than invoices to arrive at these figures? A: No. There was no other documentation available. Q: Again, did you ask Mr. Cinelli for any other documentation? A: I believe I probably did. I forgot if I exactly asked him. If I did that, he would have said he didn't have any. Otherwise I would have looked at it. A: So, no other documentation was used other than that? A: Right.

If persons required to collect taxes neglect to keep the requisite records, the method devised to ascertain taxes due is sufficient if it is "reasonably calculated" to reflect the taxes due. Exactness is not required (Matter of Grant Co. v. Joseph, supra, see also, Matter of Meskouris Brothers, Inc., 139 AD2d 813, 526 NYS2d 678). Because the petitioner failed to keep records of individual sales, the Division was justified in looking to the gasoline suppliers to estimate the taxable sales made. The evidence offered by petitioner to show the invalidity of the purchase invoices amounts to nothing more than his own testimony and the analysis of his sales tax liability made by his current accountant. The accountant's evaluation was based upon the petitioner's claim of an "established business practice" in regard to the purchase invoices. As such, the only evidence actually offered by the petitioner in an attempt to satisfy his burden of proof is, in total, his own testimony. We find petitioner has failed to prove that the audit methodology was unreasonable or the amount assessed erroneous.

The next issue to be considered is whether the Division has met its burden of proof regarding the fraud penalty imposed.

Tax Law Section 1145(a) (former [2]) provides in pertinent part:

> "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 . . . ."

The burden of showing fraud under to § 1145(a)(2) has consistently been interpreted to reside with the Division (Matter of Ilter Sener d/b/a Jimmy's Gas Station, Tax Appeals Tribunal, May 5, 1988; Matter of Nicholas Kucheror d/b/a Nick's Marine, State Tax Commn., April 15, 1987, affd Kucheror v. Chu, App Div 3d Dept, February 23, 1989, Yesawich, Jr., J). 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 and Gertrude Shutt, State Tax Commn., July 13, 1982).

For a taxpayer to be subject to a civil fraud penalty, willful intent is a critical element; the individual or the corporation, acting through its officers, must have acted deliberately, knowingly, and with the specific intent to violate the Tax Law (Matter of Cousins Service Station, Inc., Tax Appeals Tribunal, August 11, 1988). Fraud need not be established by direct evidence, but can be shown by surveying the taxpayer's entire course of business and drawing reasonable inferences therefrom (see, Korecky v. Commr., 781 F2d 1566 [11th Cir 1986]; Briggs v. Commr., 440 F2d 5 [6th Cir 1962]).

Petitioner has excepted to the Administrative Law Judge's conclusion that the Division satisfied its burden to prove fraud; however, the only argument advanced on this issue was that not all of the delivery receipts relied on to determine tax were signed.

We affirm the determination of the Administrative Law Judge in finding that the Division has carried its burden of proof regarding imposition of the fraud penalty.

We conclude that the evidence considered as a whole provides clear and convincing proof that the petitioner willfully, deliberately and intentionally sought to evade paying taxes that were legally due. The Division has established that petitioner consistently and substantially underreported his sales tax throughout the audit period (cf., Matter of Cousins Service Station, Inc., Tax Appeals Tribunal, August 11, 1988 where the petitioner's failure to prove the assessment erroneous was not itself proof of underreporting). Petitioner admitted, at the hearing on his guilty plea, that he provided his accountant with incomplete information for the purpose of underreporting the sales tax liability. Petitioner made this admission with respect to all of the counts of the indictment. The intentional failure to supply accurate information to the accountant, coupled with the consistent and substantial understatement of sales tax is strong evidence of fraud (see, Merritt v. Commr., 301 F2d 484).

Petitioner attempted in the hearing below to attribute the underreporting to his accountant's negligence. This allegation is completely controverted by petitioner's statements at the hearing on the guilty plea and his testimony in the hearing below where he described the control he exercised over the details of the business. It is simply incredible that petitioner, given his 18

years of experience in this business and his daily oversight of the business, was not aware of the underreporting of over $10 million in taxable sales.

Finally, the petitioner's plea of guilty to the criminal charge of filing a false instrument - the sales tax return - weighs heavily against him. Although the petitioner is collaterally estopped from contesting the civil fraud penalty only for that period to which he entered a plea of guilty to the criminal charge (see, Plunkett v. Commr., 465 F2d 299 [7th Cir 1972]), the plea of guilty and the statement offered with this plea are evidence of fraudulent intent for the entire period of assessment (see, Edrie Boyer Costine v. Commr., 14 T.C.M. [CC4] 34 [1955]).

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the petitioner A. Charles Cinelli d/b/a/ Shoporama Car Wash is in all respects denied;

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

3. The petition of A. Charles Cinelli is granted to the extent indicated in the Administrative Law Judge's conclusions of law "C" and "G", but in all other respects the petition is denied; and

4. The Division of Taxation shall modify the Notice of Determination issued on August 13, 1985 accordingly, but in all other respects the Notice is sustained.

DATED: Troy, New York
September 14, 1989

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

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

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