STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
1126 GENESEE STREET, INC. D/B/A A&N GAS MART	:	DECISION
	:	DTA NO. 817594
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, 1994 through August 31, 1997.	:	

Petitioner 1126 Genesee Street, Inc. d/b/a A&N Gas Mart, c/o 166 Park Street, Buffalo, New York 14201, filed an exception to the determination of the Administrative Law Judge issued on October 4, 2001. Petitioner appeared by Duke, Holzman, Yaeger & Photiadis LLP (Gary M. Kanaley, Esq., of counsel). The Division of Taxation appeared by Barbara G. Billet, Esq. (Robert A. Maslyn, Esq., of counsel).

Petitioner filed a brief in support of its exception and the Division of Taxation filed a brief in opposition. Oral argument was not requested.

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 to show that the imposition of the fraud penalty pursuant to Tax Law § 1145(a)(2) was proper.

II. Whether petitioner should be given an allowance for food stamp sales for the entire period of the audit not barred by the statute of limitations.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

1126 Genesee Street, Inc. ("petitioner") operated a grocery store/mini-mart known as the A&N Gas Mart at 1126 Genesee Street, Buffalo, New York at which gasoline, certain food items, cigarettes, beer, soda and candy were sold.

In October 1997, the Division of Taxation ("Division") commenced a field audit of petitioner's business. The auditor spoke by telephone to an individual at the business who referred him to Nagi A. Awas, petitioner's tax preparer. On November 6, 1997, the auditor sent a letter to Mr. Awas scheduling a field audit of petitioner's books and records pertaining to sales and use tax liability for the period December 1, 1994 through October 31, 1997. A subsequent letter revised the period under audit (December 1, 1994 through August 31, 1997). The letter asked that the following records be made available for examination: financial statements, journals, ledgers, sales invoices, purchase invoices, cash register tapes, sales and use tax returns, Federal income tax returns and exemption certificates.

At the scheduled meeting between the auditor and petitioner's representative, the following records were made available to the auditor: sales tax returns, Federal income tax returns, a daily sales log, profit and loss statements, bank statements, canceled checks and some purchase invoices. No cash register tapes or source sales records were produced. Petitioner failed to provide work papers supporting the sales tax returns, sales journals, cash receipts journals, check disbursements journal, purchase journal or food stamp allowance documentation. In addition, petitioner provided no documentation of sales tax collected or of taxable sales. The auditor made additional requests for records, both orally and in writing, to Mr. Awas; however, no additional records were ever provided.

The auditor determined that the books and records provided by petitioner were insufficient to perform a detailed audit. This determination was based upon the fact that there were no source sales documents such as cash register tapes or sales invoices and that there was no documentation of tax collected or of taxable sales. Moreover, there was a discrepancy between purchases as indicated on the purchase invoices and the canceled checks and the amount of purchases reported on petitioner's Federal income tax returns (the amounts reported on the returns were less than indicated by the purchase invoices and canceled checks). No information regarding food stamp sales was provided to the auditor.

The auditor discovered that petitioner's taxable sales were being reported by first calculating the increase in cash per day in the cash register and then multiplying that amount by a ratio of taxable to nontaxable sales determined by petitioner's tax preparer, Mr. Awas.

In an attempt to verify petitioner's purchases, the auditor sent out letters to various suppliers of soda, beer, cigarettes and groceries. The auditor learned the names of these suppliers from petitioner's purchase invoices. Most of the suppliers responded to the auditor's requests for information. Gasoline purchases and sales were not audited; therefore, no assessment of additional tax was made on petitioner's sales of gasoline.

From the suppliers which responded to the auditor's request for information, he determined that petitioner had made purchases totaling $185,515.00 for the period January 1, 1995 through August 31, 1997. Petitioner's purchase records for those vendors indicated taxable purchases of $20,158.00 for the same period. Petitioner did not have purchase records for all months of the audit period so the auditor determined an average monthly purchase amount and projected it to arrive at estimated taxable purchases from these vendors per petitioner's records in the amount of $21,773.00. Therefore, it was determined that petitioner had unreported taxable purchases, from these vendors alone, in the amount of $163,742.00 for the audit period.

Petitioner's sales tax returns indicated gross sales of $237,556.00 and taxable sales of $118,023.00 for the audit period. The auditor determined that petitioner's total purchases of taxable goods were $267,445.00 which included the purchases obtained from third-party information. Therefore, the auditor was able to ascertain that petitioner's purchases of taxable items exceeded its reported taxable sales for the audit period.

The auditor then marked up petitioner's taxable purchases by a percentage obtained from its Federal income tax return for 1995, i.e., petitioner's own markup percentage of 31.83 percent was utilized. The reason for applying the markup percentage from the 1995 return was that this was the only return that could verify and separate gasoline purchases from petitioner's other purchases. After applying this markup percentage, taxable sales were found to be $352,567.00. After the subtraction of reported taxable sales ($118,023.00), it was determined that petitioner had unreported taxable sales in the amount of $234,544.00. By applying the sales tax rate in Erie County (8 percent), the auditor found additional tax due in the amount of $18,763.00.

The Division issued a Statement of Proposed Audit Adjustment, dated July 17, 1998, to petitioner which asserted additional tax due of $18,763.00, plus penalties (including fraud penalty) and interest, for a total amount due of $38,559.98. A copy of the Statement of Proposed Audit Adjustment was also sent to petitioner's then representative, Nagi A. Awas.

The auditor met with Mr. Awas on August 28, 1998 but, at this meeting, the only issues raised by Mr. Awas were the markup percentage and abatement of penalties.

On December 17, 1998, a Notice of Determination was issued to petitioner in the amount of $18,763.00 plus penalties of $14,514.00 (which included fraud penalty) and interest of $6,751.37, for a total amount due of $40,028.37 for the audit period.[1]

Fraud penalty was imposed by the Division for the following reasons:

a. Consistent and substantial underreporting of sales and sales tax due over a period of 11 sales tax quarters;

b. A failure or refusal to produce complete purchase records and source documents to substantiate sales;

c. Audited taxable purchases were greater than petitioner's reported gross and taxable sales;

d. Petitioner maintained no record of taxable sales and sales tax collected;

e. Petitioner made purchases in cash which were not reflected in purchase records provided;

f. Petitioner substantially understated purchases on Federal income tax returns;

g. Petitioner's corporate principal controlled all aspects of the business yet neither he nor his representative during the audit (Nagi A. Awas) provided any explanation for the consistent and substantial underreporting.

[1] A Consent Extending Period of Limitation for Assessment of Sales and Use Taxes Under Articles 28 and 29 of the Tax Law (form AU-2.10) was signed by representatives of petitioner and the Division on January 22, 1998 and January 29, 1998, respectively, whereby it was agreed that taxes due for the period December 1, 1994 through May 31, 1995 could be assessed at any time on or before June 20, 1998.

The case was referred to the Division's Revenue Crimes Bureau for consideration as a criminal fraud case. It was not accepted because it did not meet the dollar threshold; however, the Revenue Crimes Bureau agreed that elements of fraud existed. Therefore, the case was completed as a civil audit including the imposition of civil fraud penalties.

Nagi A. Awas is in the business of tax preparation and accounting; he is not, however, a certified public accountant or a public accountant. He does not possess a degree in accounting although he took accounting courses in college. Mr. Awas collected the information from petitioner and prepared his sales tax returns from such information provided.

Petitioner kept track of its sales by its principal's counting the cash in the cash register and writing down the daily totals. Cash register receipts were not retained by petitioner. Mr. Awas prepared petitioner's sales tax returns from the information provided to him, to wit, the daily totals of cash as computed by petitioner's principal. He never compared petitioner's check disbursement journal with the purchase invoices.

Petitioner's business was located in a high crime area where shoplifting was prevalent. Petitioner maintained no records to substantiate how much was stolen from the business during the audit period nor was anyone ever prosecuted for a theft from the business.

At the hearing, the auditor, when questioned about the invoices from Try-It Distributing Co., Inc. ("Try-It"), admitted that he included, when calculating petitioner's purchases of beer and wine coolers, the amounts charged to petitioner by Try-It for beverage deposits ($.05 per bottle). Petitioner introduced into evidence an invoice from Try-It dated November 16, 1995 as well as a computer printout from Try-It which represented sales to petitioner for the month of November 1995.

For November 1995, the auditor utilized a purchase amount of $1,908.90. During that month, petitioner was charged the sum of $108.55 for deposits, which amount should not have been included when calculating purchases from Try-It. The auditor noted that Try-It was the only distributor (of those included in this audit) which broke out its pricing in this manner.

Pursuant to the auditor's analysis of petitioner's purchases, petitioner made purchases from Try-It totaling $19,985.00 for 1995, $21,204.00 for 1996 and $12,421.00 for the period January 1 through August 31, 1997, for a total of $53,610.00 for the audit period.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

In his determination, the Administrative Law Judge noted that every person required to collect tax must maintain sufficient records of all transactions and make these records available for audit. To determine whether a taxpayer's records are sufficient for the Division to verify taxable sales receipts and conduct a complete audit, the Division must first request and then thoroughly examine the taxpayer's books and records for the entire period of the proposed assessment.

The Administrative Law Judge found that the Division made a clear, written request for petitioner's records, and based on the records provided to the auditor, the Division appropriately concluded that petitioner's records were inadequate and insufficient for purposes of conducting a detailed audit to verify taxable sales and sales tax due. Accordingly, the Administrative Law Judge sustained the auditor's decision to go forward with an indirect audit methodology to estimate sales tax due on the basis of external indices.

The Administrative Law Judge observed that when the Division seeks to determine a taxpayer's sales tax liability on the basis of an indirect audit method, the methodology selected must be reasonably calculated to reflect the taxes due. However, exactness in the outcome of the audit method is not required and the taxpayer has the burden to show, by clear and convincing evidence, that the methodology employed was unreasonable or that the amount assessed was erroneous.

The Administrative Law Judge concluded that since petitioner had incomplete purchase records and failed to maintain source documentation to substantiate taxable sales and sales tax collected, the auditor's decision to obtain third-party verification of purchases from petitioner's suppliers was clearly reasonable. The Administrative Law Judge approved the auditor's method of calculating additional taxable sales of $234,544.00 to arrive at additional tax due of $18,763.00.

The Administrative Law Judge rejected petitioner's claim that petitioner was entitled to a theft or pilferage allowance, as no evidence was presented to substantiate the amount of theft or pilferage. Similarly, the Administrative Law Judge denied petitioner's assertion that it was entitled to a credit for purchases made with food stamps because, except for a computer printout for certain periods from 1993 to 1995 reflecting food stamp redemptions for certain months, no records were provided to show what items were purchased with food stamps or in what quantities they were purchased during the audit period.

The Administrative Law Judge found that petitioner was entitled to an adjustment in additional tax due based on the auditor's failure to correctly determine purchases made from Try-It because those purchases included the amount of bottle deposits paid by petitioner. This resulted in an adjustment of $321.73 from the amount of additional tax originally assessed, and penalties and interest were to be adjusted accordingly.

The Administrative Law Judge observed that the three-year statute of limitations for assessment of additional tax provided by Tax Law § 1147(b) was not applicable if petitioner was found to be subject to the fraud penalty. Relying on applicable case law, the Administrative Law Judge pointed out that the Division bears the burden of showing fraud under Tax Law § 1145(a)(2) by 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.

Also, the Administrative Law Judge noted that an individual or a corporation, acting through its officers, must have acted deliberately, knowingly, and with the specific intent to violate the Tax Law. However, fraud need not be established by direct evidence, but can be shown by surveying the taxpayer's entire course of business and by drawing reasonable inferences therefrom.

The Administrative Law Judge found that petitioner substantially underreported taxable sales and sales tax due for the entire audit period; petitioner failed to maintain books and records; petitioner either made substantial purchases in cash or paid for its purchases from a bank account the records of which were not provided to the auditor; petitioner’s sales were calculated by counting the cash in the cash register each day when it was clear that, after making cash purchases, such a method could not accurately reflect the amount of sales; and petitioner’s principal failed to appear to testify at the hearing to account for petitioner’s failure to maintain complete books and records of its purchases and sales. The Administrative Law Judge found that petitioner did not provide its accountant with sales invoices, cash register tapes or other source documents to substantiate sales, even though petitioner had been informed that more complete books and records were needed. As a result, the Administrative Law Judge concluded that the fraud penalty was properly imposed by the Division and the assessment of sales and use tax against petitioner for periods occurring more than three years beyond those covered by the consent was not barred by the statute of limitations.

ARGUMENTS ON EXCEPTION

On exception, petitioner argues that the Division has not met its burden of proof to establish fraud on the part of petitioner. As a result, the Division is barred by the statute of limitations from assessing additional sales tax for periods of time which occurred more than three years beyond the date of assessment. Petitioner maintains that the record is devoid of sufficient indicia of willful intent on the part of petitioner to evade taxes. Petitioner alleges that its president has a man of limited English-speaking ability who relied heavily on his accountant in matters of record keeping and tax preparation. Petitioner asserts that its cash register receipts did not accurately reflect actual sales due to the high turnover of employees in petitioner's business and the use of an outdated cash register. Therefore, petitioner failed to retain these records as they were inaccurate. Petitioner argues that the records that were presented to the auditor demonstrate that petitioner was attempting to comply with the Division's record keeping requirements rather than to evade tax. Further, despite the Division's referral of this case to its tax enforcement unit, petitioner points out that no criminal charges were filed against it. As petitioner's president was not required to appear at the hearing to testify, petitioner believes that there should be no presumption that any evidence that would have been offered by petitioner's president would be adverse to petitioner's claims. Additionally, petitioner argues that it is entitled to an allowance for food stamp sales for those periods within the three-year statute of limitations.

In opposition, the Division argues that petitioner failed to produce adequate books and records on audit and the Division was, therefore, justified in using external indices to calculate tax due. Further, the Division asserts that the Administrative Law Judge correctly found that petitioner willfully, knowingly and intentionally underreported taxable sales and sales tax due and that the fraud penalty was properly imposed. Based on the indicia of fraud found by the Administrative Law Judge, the Division maintains that it met its burden of proof to demonstrate fraud by petitioner. The Division also argues that there is no evidence in the record, other than the testimony of petitioner's tax preparer, that petitioner's principal had difficulty with the English language. The Division asserts that petitioner's principal should have appeared at the hearing to explain petitioner's failure to produce records and the substantial discrepancies found on audit. The Division maintains that it had no obligation to subpoena petitioner's principal as a witness. Rather, it was petitioner's obligation to rebut the evidence of fraud. The Division believes that it is entitled to a presumption that evidence, if offered by petitioner, would have been adverse to its claims. Further, the Division asserts that the failure of petitioner's president to appear and testify is itself evidence of fraud by petitioner. The Division maintains that the failure of the Division's Revenue Crimes Bureau to prosecute petitioner does not support petitioner's argument that there was no fraud present. Rather, the record was clear that the case did not meet the dollar value threshold for prosecution by that Bureau. Finally, the Division alleges that petitioner is not entitled to an allowance for food stamp sales because there were no records maintained showing what items may have been purchased with food stamps, whether such items were taxable or nontaxable, and in what quantities they may have been purchased.

OPINION

We affirm the determination of the Administrative Law Judge. Initially, we note that on exception petitioner has not challenged the methodology of the audit or the amount of additional tax found due and owing, except insofar as petitioner asserts that it is entitled to a credit for food stamp sales. Although petitioner provided evidence of food stamp redemptions by petitioner, there was no indication as to what items were purchased with these food stamps. Petitioner's claim that 70% of beverage and candy sales were paid for with food stamps is totally unsupported by the record. Pursuant to 20 NYCRR 528.27(b), "[r]eceipts from the sale of eligible food by retail food stores and other participants are exempt from State and local sales and compensating use taxes . . . when such eligible food is actually purchased with food stamps." In order to document entitlement to this exemption, 20 NYCRR 533.2(d)(7) required petitioner to maintain records of food stamp sales as follows:

> Records. In addition to the records required to be kept pursuant to this section, retail food stores and other participants approved for participation in the federal food stamp program are required to keep and make available to the department upon request the following:
>
> * * *
>
> (ii) records of receipts indicating whether payment is by food stamps; and
>
> (iii) true and complete copies of redemption certificates, validated by the bank; or true and complete copies of bank deposit slips or receipts showing the amount of food stamps deposited with, cashed at or otherwise tendered to the bank, validated by the bank; or both such redemption certificates and deposit slips or receipts, if available; and

> any other document validated by a bank as to the amount of food stamps deposited, cashed or otherwise tendered.

Had petitioner complied with this requirement, it would have been allowed a credit for otherwise taxable sales of eligible food purchased with food stamps. Without adequate documentation, however, no credit is available.

Finally, we consider petitioner's claim that the fraud penalty was improperly imposed against petitioner and, as a result, the assessment of additional tax for periods from December 1, 1994 through August 31, 1995 was time-barred pursuant to Tax Law § 1147(b). As set forth above, the Division issued a Notice of Determination to petitioner asserting additional tax, interest and fraud penalty pursuant to Tax Law § 1145(a)(2). That section provides for the imposition of a civil fraud penalty if the failure to pay or pay over any tax to the Division within the time required is due to fraud. Although Tax Law § 1147 generally provides a three-year period of limitation on assessments of additional tax, section 1147(b) contains an exception to that limitation for willfully false or fraudulent returns filed with the intent to evade tax.

Whether petitioner fraudulently failed to pay sales tax to the Division or filed willfully false or fraudulent returns with the intent to evade payment of tax are questions of fact to be determined upon consideration of the entire record (***Jordan v. Commissioner***, T.C. Memo 1986-389, 52 TCM 234; ***Matter of Drebin v. Tax Appeals Tribunal,*** 249 AD2d 716, 671 NYS2d 565). The burden of demonstrating this falls upon the Division (***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" (***Matter of Sona Appliances, supra***). In order to establish fraudulent intent, petitioner, acting through its officer(s), must have acted deliberately, knowingly and with the specific intent to violate the Tax Law (***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 (***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; ***Korecky v. Commissioner,*** 781 F2d 1566, 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, 62-1 USTC ¶ 9408; ***Bradbury v. Commissioner***, T.C. Memo 1996-182, 71 TCM 2775; ***Webb v. Commissioner***, 394 F2d 366, 68-1 USTC ¶ 9341; ***see also, Matter of AAA Sign Co.***, Tax Appeals Tribunal, June 22, 1989).

In this case, the evidence contained in the record underscores the correctness of the Administrative Law Judge's determination that petitioner willfully, knowingly and intentionally underreported and underpaid the sales and use taxes due and owing. By itself, substantial underreporting is not enough to establish fraud. However, where it continues throughout the audit period, it provides strong evidence of fraud (***see, Merritt v. Commissioner***, ***supra; Matter of Cousins Serv. Sta., supra***). The Administrative Law Judge found strong evidence of fraud in this case because petitioner substantially underreported taxable sales and sales tax due for the entire audit period. Petitioner's actual purchases of taxable items were greater than its reported taxable sales and were even greater than even its reported gross sales. Further, petitioner reported its sales based upon cash on hand without allowance for cash purchases made. Petitioner failed to maintain adequate books and records of its purchases and sales, providing further evidence of fraud (***see, Matter of Lefkowitz***, Tax Appeals Tribunal, May 3, 1990). Although petitioner's principal was not required to appear and testify at the hearing, his failure to do so and to offer an explanation for the absence of adequate records "is additional support for the finding of fraud" (***Matter of Waples***, Tax Appeals Tribunal, January 11, 1990). Finally, based on the testimony of petitioner's witness, petitioner did not provide its tax preparer, Mr. Awas, with sales invoices, cash register tapes or other source documents to substantiate sales. This is an additional indication of an intention to evade tax ***(Intersimone v. Commissioner*, *supra)***.

Based on the foregoing, we conclude that the evidence, considered as a whole, supports the determination of the Administrative Law Judge to uphold the imposition of the fraud penalty by the Division. As a result, the Division was not constrained by the three-year period of limitation imposed by Tax Law § 1147 for the assessment of additional tax for the entire audit period.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of 1126 Genesee Street, Inc. d/b/a/ A&N Gas Mart is denied;

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

3. The petition of 1126 Genesee Street, Inc. d/b/a/ A&N Gas Mart is granted to the extent indicated in Conclusion of Law "E" of the Administrative Law Judge's determination but is otherwise denied; and

4. The Division of Taxation is directed to modify the Notice of Determination issued on December 17, 1998 to reflect the reduction in additional tax due, penalty and interest in accordance with paragraph "3" above, but such notice is otherwise sustained.

DATED: Troy, New York
August 22, 2002

/s/Donald C. DeWitt
Donald C. DeWitt
President

/s/Carroll R. Jenkins
Carroll R. Jenkins
Commissioner

/s/Joseph W. Pinto, Jr.
Joseph W. Pinto, Jr.
Commissioner