

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition :
of :
ALI N. DHALAI : DECISION
for Revision of a Determination or for Refund of Sales : DTA NO. 817629
and Use Taxes under Articles 28 and 29 of the Tax Law :
for the Period December 1, 1993 through November 30, :
1996. :

Petitioner Ali N. Dhalai, c/o 166 Park Street, Buffalo, New York 14201, filed an exception to the determination of the Administrative Law Judge issued on September 27, 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 his exception. 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 is required to reissue a Notice of Determination in this case since petitioner was not properly served with an original Notice of Determination.

II. 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.

FINDINGS OF FACT

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

From the middle of 1993 until April or May of 1999, Ali N. Dhalai (“petitioner”) operated a mini-mart at 977 Sycamore Street, Buffalo, New York at which certain food items, cigarettes, beer and soda were sold.

In March 1997, Thomas C. Klein, Tax Auditor I with the Division of Taxation (“Division”), sent a letter to Nagi A. Awas, petitioner’s bookkeeper and tax preparer, scheduling a field audit of petitioner’s books and records pertaining to sales and use tax liability for the period December 1, 1993 through November 30, 1996. 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, sales tax returns and related worksheets and Federal income tax returns and related worksheets were produced for the entire audit period. Bank statements and purchase records for certain periods were made available to the auditor (no records for December 1993, January 1994, February 1994, April 1994 and February 1995 were produced). The only sales record made available to the auditor was a sales sheet which recorded daily sales; no cash register tapes or other source documents were provided. Petitioner’s sales record contained no breakdown of taxable and nontaxable sales. The auditor made additional requests for records to Mr. Awas at various meetings; 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 purchase records were incomplete. A review of petitioner's check disbursements revealed that checks written for purchases were substantially less than petitioner's own purchase invoices. Accordingly, the auditor concluded that petitioner made purchases in cash or, in the alternative, paid for purchases from a bank account, the records from which were not made available by petitioner. In addition, the auditor was unable to reconcile petitioner's purchase records with his Federal income tax returns.

In an attempt to verify petitioner's beer purchases, the auditor sent out letters to beer distributors in the Buffalo area. He did not seek third-party verification of other taxable items sold by petitioner. Petitioner's records indicated total beer purchases for the audit period in the amount of \$88,142.13. The information obtained from the beer distributors disclosed beer purchases totaling \$236,335.12 for the period.

In order to determine petitioner's total purchases of taxable items, the auditor added the beer purchases obtained from the beer distributors to petitioner's claimed purchases of other items (soda, cigarettes and food). Since petitioner had no purchase records for five months of the audit period (*see*, above), the auditor calculated a monthly average of purchases of soda, cigarettes and food from petitioner's purchase records for the other 31 months to determine purchases for the 5 months for which no purchase records existed. Total purchases of taxable items calculated by the auditor, \$563,415.30, exceeded the amount of taxable sales reported by petitioner for the audit period (\$493,674.00).

Initially, the Division issued a Statement of Proposed Audit Adjustment, dated May 14, 1998, to petitioner which asserted additional tax due of \$67,278.00, plus penalty (including fraud penalty) and interest, for a total amount due of \$149,884.39. This Statement of Proposed Audit Adjustment was sent to petitioner at 977 Sycamore Street, Buffalo, New York 14212. A copy of the Statement of Proposed Audit Adjustment was also sent to petitioner's then representative, Nagi A. Awas. Mr. Awas raised some issues concerning State lottery moneys and cash purchases and, as a result of the auditor's discussions with Mr. Awas, these computations were revised.

From petitioner's Federal income tax returns, the auditor was able to compute a markup percentage of 23.32 percent (gross profit of \$156,635.00 divided by ending inventory of \$671,740.00) which when applied to petitioner's purchases (\$563,415.30) resulted in audited taxable sales of \$694,803.75. Petitioner's reported taxable sales (\$493,674.00) were subtracted to arrive at additional taxable sales in the amount of \$201,129.75 (an error rate of 40.74 percent). By applying the sales tax rate in Erie County (8 percent), additional tax due in the amount of \$16,089.82 was determined.¹ On August 21, 1998, a second (and revised) Statement of Proposed Audit Adjustment was issued to petitioner at 977 Sycamore Street, Buffalo, New York 14212 which asserted additional tax due in the amount of \$16,089.83, plus penalty (including fraud penalty) and interest, for a total amount due of \$36,596.81 for the audit period. A copy of the August 21, 1998 Statement of Proposed Audit Adjustment was also sent to petitioner's representative, Nagi A. Awas. When no response was received, the auditor closed the case.

¹ In computing additional sales tax due, credit for prepaid cigarette tax was given by the auditor where documentation showing payment thereof was provided.

On October 19, 1998, a Notice of Determination was issued to petitioner in the amount of \$16,089.83, plus penalty of \$13,597.11 (which included fraud penalty) and interest of \$7,429.74, for a total amount due of \$37,107.68 for the audit period.² The Notice of Determination was sent to Ali N. Dhalai, Sycamore Variety Store, 32 17th Street, Buffalo, NY 14213-2611. The Division did not send a copy of the Notice of Determination to petitioner's representative, Nagi A. Awas.

The 32 17th Street address was obtained from the Division's Taxpayer Indicative Data ("TID") System. Prior to April 1998, petitioner's address was listed in the TID System as 977 Sycamore Street. This address was entered into the TID System in July 1993 and originated from the Certificate of Authority issued to petitioner. While a vendor is responsible for notifying the Division of a change of address, the information in the Division's TID System can also be changed by employees of the Division if they receive information from the vendor or from other sources that there is a new address. As of April 22, 1998, petitioner's address in the TID System was changed to 32 17th Street.

The Notice of Determination which was issued to petitioner on October 19, 1998 and which was sent to 32 17th Street was returned to the Division as undeliverable. As a result thereof, the Division made a request to the United States Postal Service for residential information on petitioner and to verify his address; the reply indicated that petitioner had moved and had left no forwarding address. When asked if petitioner ever lived at 32 17th Street during the time that he knew and performed work for petitioner, his representative, Nagi A. Awas, replied, "Not that I know of."

² 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 petitioner and by a representative of the Division on May 13, 1997 and May 14, 1997, respectively, whereby it was agreed that taxes due for the period December 1, 1993 through November 30, 1994 could be assessed at any time on or before December 20, 1997.

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 3 years or 12 sales tax quarters;
- b. A failure or refusal to produce complete purchase records, bank statements and source documents to substantiate sales;
- c. Audited taxable purchases were greater than petitioner's reported taxable sales;
- d. Petitioner's check disbursements did not match his purchase records, i.e., checks written for purchases were considerably less than his own purchase invoices indicated;
- e. Petitioner's purchases were substantially underreported on his Federal income tax returns; and
- f. Petitioner controlled all aspects of the business yet he failed to provide any explanation for the consistent and substantial underreporting.

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 as was provided. He performed this service for petitioner ever since the business began in the middle of 1993. Mr. Awas did not receive a copy of the Notice of Determination issued to petitioner on October 19, 1998 and, since petitioner did not furnish him with a copy, does not believe that petitioner ever received the Notice of Determination.

On May 10, 1999, the Division issued a Collection Notice to petitioner. This notice was sent to 977 Sycamore Street, Buffalo, NY 14212-1423. Petitioner gave the Collection Notice to

Mr. Awas soon thereafter. This was the first time that Mr. Awas was made aware of the assessment.

Petitioner kept track of his sales by counting the cash in the cash register and writing down the daily (and monthly) totals. Mr. Awas told petitioner that he needed to keep “more proper” records.

Petitioner’s business was located in a low-income area where shoplifting was prevalent. Mr. Awas estimated that 10 to 15 percent of petitioner’s inventory was pilfered, but petitioner maintained no records to substantiate that percentage nor did he ever prosecute anyone suspected of theft.

Petitioner maintained two bank accounts into which deposits were made. Petitioner’s representative explained that one account was to provide State-authorized payment to customers who receive public assistance. For the audit period, deposits of \$1,097,170.78 were made into one account (Account No. 13890421) and deposits of \$7,656,227.95 were made into the second account (Account No. 10496867).

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge concluded that the Division properly resorted to performing an indirect audit to estimate sales tax due on the basis of external indices. The Administrative Law Judge emphasized that an audit appointment letter was mailed to petitioner specifying the sales tax records needed on audit and the only records made available were sales tax returns and related worksheets, Federal income tax returns and related worksheets, incomplete bank statements and purchase records, with absolutely no records for an entire five-month period during the audit period, and a sales sheet which recorded daily sales. The

Administrative Law Judge noted that without cash register tapes, sales invoices or other source documents to substantiate sales, the Division's auditor properly concluded that petitioner's records were inadequate for purposes of conducting a detailed audit of such records. Moreover, the Administrative Law Judge found that the audit methodology was reasonable and that petitioner failed to submit any evidence demonstrating that such methodology was flawed.

The next issue addressed by the Administrative Law Judge concerned the imposition of the fraud penalty against petitioner. The Administrative Law Judge extensively analyzed our decisions in *Matter of Cinelli* (Tax Appeals Tribunal, September 14, 1989) and *Matter of Waples* (Tax Appeals Tribunal, January 11, 1990) along with the pertinent statutory language and concluded that the fraud penalty was properly imposed by the Division. The major factors that were relied upon by the Administrative Law Judge which demonstrated fraud were: (1) petitioner substantially underreported taxable sales and sales tax due; (2) such substantial underreporting began at or about the time that the business was opened in 1993 and continued for the entire audit period; (3) petitioner failed to maintain books and records; (4) petitioner made substantial purchases in cash or, in the alternative, paid for such purchases from a bank account that petitioner has failed to submit any bank statements for; and (5) petitioner's failure to appear at the hearing before the Administrative Law Judge or to meet with the auditor to substantiate his representative's assertions that petitioner was a person of limited education and possessed limited proficiency in English. The Administrative Law Judge reasoned that after reviewing petitioner's entire course of conduct, the only conclusion to be drawn was that petitioner willfully, knowingly and intentionally underpaid the sales and use taxes due and owing.

While acknowledging that the Division assessed taxes against petitioner more than three years after the returns for such quarters were filed, the Administrative Law Judge found that since fraud was established, the assessment of sales and use taxes was not barred by the statute of limitations since, pursuant to Tax Law § 1147(b), assessment of such taxes could be made at any time.

The last issue to be addressed concerned whether the Notice of Determination was properly issued to petitioner. Although not directly addressing this issue due to his conclusions on the other issues presented to him, the Administrative Law Judge stated that, *assuming arguendo*, that the Division failed to properly mail the Notice of Determination to petitioner and that petitioner never received notice of the assessment until he received the Collection Notice dated May 10, 1999, it is clear and undisputed that petitioner was on notice of the assessment.

ARGUMENTS ON EXCEPTION

On exception, petitioner raises two issues. Petitioner argues that the Division has not met its burden of proof regarding fraud and, as such, is time barred from assessing additional sales and use taxes in this case. Moreover, *assuming arguendo*, that the Division is not time barred, petitioner claims that the Division must reissue the Notice of Determination to petitioner since petitioner has never been properly served with the Notice.

In response, the Division argues that the Administrative Law Judge properly drew an adverse inference from petitioner's failure to appear and testify at the hearing since many of petitioner's assertions in this matter were unsubstantiated and contradictory. Moreover, the Division states that substantial evidence of fraud exists in the record and, as such, provides the

basis for the Administrative Law Judge to conclude that the fraud penalty was properly imposed by the Division.

With respect to the mailing issue, the Division claims that it mailed the Notice of Determination to petitioner at the address obtained from the Division's TID (taxpayer indicative data) registry. The Division asserts that it does not have the burden of proof as to the mailing of the notice in issue and petitioner has not pointed to any case law or other legal authority in support of his claim. Therefore, the Division requests that the exception of petitioner be denied.

OPINION

We remand this matter to the Administrative Law Judge on the issue concerning whether the Notice of Determination was properly mailed in this case.

Petitioner claims that he did not receive the Notice of Determination dated October 19, 1998. Both the Administrative Law Judge and the Division conclude that whether or not petitioner received the Notice of Determination is irrelevant due to the fact that the fraud penalty imposed by the Division can be assessed at any time. However, such conclusion is reached in error.

Tax Law § 1138(a)(1) requires that the Division mail a Notice of Determination "by certified or registered mail to the person or persons liable for the collection or payment of the tax at his last known address in or out of this state."

Tax Law § 1147(a)(1) provides:

Any notice authorized or required under the provisions of this article may be given by mailing the same to the person for whom it is intended in a postpaid envelope addressed to such person at the address given in the last return filed by him pursuant to the provisions of this article or in any application made by him or, if no return has been filed or application made, then to such address as may be obtainable. A notice of determination shall be mailed promptly by registered or

certified mail. The mailing of such notice shall be presumptive evidence of the receipt of the same by the person to whom addressed. Any period of time which is determined according to the provisions of this article by the giving of notice shall commence to run from the date of mailing such notice.

Petitioner has argued that it never received the Notice at issue. The Administrative Law Judge found as a fact that the Notice of Determination, dated October 19, 1998, was issued to petitioner at an address of 32 17th Street in Buffalo and that such notice was returned to the Division as undeliverable. Petitioner, on the other hand, challenges this address claiming that at all times, his address was 977 Sycamore Street in Buffalo. Therefore, the Division has the burden of going forward to establish that it mailed the Notice to the taxpayer at his last known address (*see, Matter of Malpica*, Tax Appeals Tribunal, July 19, 1990). The evidence required of the Division consists of the following: (i) the establishment of a standard procedure for the issuance of such notices by one with knowledge of such procedure, and (ii) the introduction of evidence to show that this mailing procedure was followed in the particular case at hand (*see, Matter of Katz*, Tax Appeals Tribunal, November 14, 1991; *Matter of Novar TV & Air Conditioner Sales & Serv.*, Tax Appeals Tribunal, May 23, 1991).

In this case, there has been no evidence offered to show that the Notice was mailed to petitioner at his last known address. Without a valid notice before us, we do not have jurisdiction over petitioner.³ Therefore, we conclude that the issue of whether the Notice of Determination was properly issued to petitioner at his last known address must necessarily be resolved prior to a discussion of this case on the merits.

³However, we agree with the Administrative Law Judge and the Division that the Division can issue an assessment for the imposition of the fraud penalty at any time.

Accordingly, it is ORDERED, ADJUDGED and DECREED that this matter be remanded to the Administrative Law Judge for a hearing to be scheduled as soon as possible on the issue of whether the Notice of Determination was properly issued in this case.

DATED: Troy, New York
August 8, 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.