

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
MORRIS CHARITON	:	DECISION
for Revision of a Determination or for Refund of Sales	:	DTA NOS. 819643
and Use Taxes under Articles 28 and 29 of the Tax Law for	:	AND 819644
the Period December 1, 1998 through August 31, 2001.	:	

Petitioner Morris Chariton, 32 Merry Lane, Westbury, New York 11590, filed an exception to the determination of the Administrative Law Judge issued on June 30, 2005.

Petitioner appeared by Isaac Sternheim & Co. (Isaac C. Sternheim, CPA). The Division of Taxation appeared by Christopher C. O'Brien, Esq. (Robert A. Maslyn, Esq., of counsel).

Petitioner did not file a brief in support of his exception. The Division of Taxation filed a letter 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 audit methodology employed by the Division of Taxation was reasonably calculated to reflect the sales and use taxes due.

II. Whether penalties should be cancelled.

FINDINGS OF FACT

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

During the period in issue, petitioner, Morris Chariton, was the sole proprietor of a retail jewelry store in Massapequa, New York known as the “Linda Shop.” In addition to sales of jewelry and watches, the Linda Shop also performed repair work.

On August 3, 2001, the Division of Taxation (“Division”) mailed a letter to petitioner which stated that a field audit had been scheduled on August 17, 2001 at 9:30 A.M. The letter requested that petitioner supply all of his books and records pertaining to his sales tax liability for the period September 1, 1998 through May 31, 2001. A checklist accompanying the letter requested that petitioner provide, among other things: sales invoices, merchandise purchase invoices, bank statements, cash receipts journal, cash disbursements journal, general ledger, sales tax returns, Federal income tax returns, and any necessary documentation to prove nontaxable sales.

On the morning of October 15, 2001, at 9:30 A.M., an auditor met with petitioner’s representative, Mr. Sternheim, in Mr. Sternheim’s office. Following the auditor’s explanation that he had come to look at the books and records of the Linda Shop, Mr. Steinheim proceeded to look through a series of boxes in order to locate the Linda Shop’s records. After half of the day passed, Mr. Sternheim was unable to find the records. Mr. Sternheim told the auditor that the taxpayer would get him the records. The auditor was also told that the taxpayer and his wife were in and out of the hospital and that this was one of the reasons that the taxpayer’s

representatives did not have the records. After conferring with his supervisor, the auditor returned to his office.

The following day, the auditor called Mr. Sternheim and asked if he had received the records from petitioner's accountant. Mr. Sternheim replied that he still did not have any records. In December 2001, Mr. Sternheim again told the auditor that he did not have any records for the auditor to review. Since the auditor was not presented with any of the Linda Shop's books and records, the auditor's supervisor told the auditor to utilize other information for the audit.

The auditor requested and received bank statements for one year from a bank account which petitioner maintained at the Bank of New York. Upon reviewing the bank statements, the auditor noticed that the bank deposits were greater than reported gross sales by approximately \$1,500,000.00. The auditor then requested bank statements for the entire audit period and ascertained that the ratio of bank deposits to reported sales was approximately two to one.

Documentary evidence of nontaxable sales, such as invoices or shipping records for items shipped out of state, was not produced on audit and petitioner did not report any nontaxable sales on his sales tax returns. Consequently, other than readily evident nonsale credits, such as checks which were returned for insufficient funds and the payment of sales tax, the auditor deemed all of the bank deposits to be taxable sales. Reported taxable sales were subtracted from audited taxable sales to determine additional taxable sales of \$2,856,412.41 and additional sales tax due of \$242,795.06.

The Division issued a Notice of Determination to petitioner and the Linda Shop, dated May 24, 2002 (Assessment L-020837871-8), which assessed sales and use taxes in the amount of

\$242,795.06 plus interest and penalty for a balance due of \$480,733.68. The Division also issued a Notice of Determination to petitioner, dated May 28, 2002 (Assessment L-020849746-9), which assessed sales and use taxes in the amount of \$242,795.06 plus interest in the amount of \$64,018.73 and penalty in the amount of \$177,686.40 for a balance due of \$484,500.19. The two notices are the same assessment issued under different identification numbers. The notice dated May 24, 2002 utilized the business's Federal tax identification number while the notice dated May 28, 2002 was issued under petitioner's social security number.

The Division assessed a fraud penalty because it concluded that petitioner's underreporting was consistent and substantial for each quarter of the audit period. The Division also noted that petitioner had been audited on two previous occasions which resulted in the issuance of notices. Since petitioner did not provide any books and records, the Division further determined that he was uncooperative during the audit. Lastly, the Division believed that the civil fraud penalty was warranted by the failure or refusal to explain the difference between the bank deposits and the reported gross sales on the sales tax returns. The Division also assessed an omnibus penalty because the additional tax due was more than 25 percent of the amount of tax reported.

Petitioner's wife, Carmelita Chariton, performed bookkeeping services for the Linda Shop and prepared most of the information that was given to the outside accountant. The records were prepared at the store. Petitioner also supplied the accountant with some information. It was petitioner's practice to sit with his accountant when the accountant prepared the income tax returns. Petitioner never prepared his own income tax returns.

The sales and use tax returns were primarily prepared by Carmelita Chariton. Mrs. Chariton would use the information, documents and records which she had available to prepare the sales tax returns.

According to the Federal Schedule C's which accompanied petitioner's U.S. individual income tax returns, the gross receipts of the Linda Shop were \$1,971,548.00 in 1999, \$1,977,719.00 in 2000 and \$1,910,504.00 in 2001.

The Linda Shop reported the following gross sales on its quarterly New York State and Local Sales and Use Tax Returns:

<u>Quarter Ending</u>	<u>Gross Sales</u>
November 30, 1998	\$292,915.00
May 31, 1999	\$151,430.00
August 31, 1999	\$149,794.00
November 30, 1999	\$221,061.00
February 29, 2000	\$253,890.00
May 31, 2000	\$145,824.00
August 31, 2000	\$143,321.00
November 30, 2000	\$61,591.00
February 28, 2001	\$176,650.00
May 31, 2001	\$152,721.00

Petitioner has been audited by the Division on two previous occasions. One audit, which was for the period December 31, 1994 through August 31, 1997, resulted in an assessment of \$110,595.07 plus interest of \$69,971.38 and penalty of \$42,674.70. The assessment was reduced at a conciliation conference to \$25,208.00 plus interest and no penalty. Following an audit for the period March 1, 1987 through November 30, 1991 sales and use tax was assessed in the

amount of \$152,819.00 plus interest of \$89,950.45 and penalty of \$49,355.80. After a conciliation conference, the assessment was reduced to \$90,702.42 plus interest and no penalty.

Petitioner has been in poor health. He had double bypass surgery and has needed repeated trips to the hospital.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

At the outset, the Administrative Law Judge noted that the standard for reviewing a sales tax audit where external indices are employed requires that the Division first determine the adequacy of a taxpayer's records by requesting (*Matter of Christ Cella, Inc. v. State Tax Commn.*, 102 AD2d 352, 477 NYS2d 858) and thoroughly examining (*Matter of King Crab Rest. v. Chu*, 134 AD2d 51, 522 NYS2d 978) the taxpayer's books and records for the entire period of the proposed assessment (*Matter of Adamides v. Chu*, 134 AD2d 776, 521 NYS2d 826, *lv denied* 71 NY2d 806, 530 NYS2d 109).

The purpose of the examination is to determine, through verification drawn independently from within these records (*Matter of Giordano v. State Tax Commn.*, 145 AD2d 726, 535 NYS2d 255; *Matter of Urban Liqs. v. State Tax Commn.*, 90 AD2d 576, 456 NYS2d 138; *Matter of Meyer v. State Tax Commn.*, 61 AD2d 223, 402 NYS2d 74, *lv denied* 44 NY2d 645, 406 NYS2d 1025; *see also, Matter of Hennekens v. State Tax Commn.*, 114 AD2d 599, 494 NYS2d 208), that they are, in fact, so insufficient that it is "virtually impossible [for the Division of Taxation] to verify taxable sales receipts and conduct a complete audit" (*Matter of Chartair, Inc. v. State Tax Commn.*, 65 AD2d 44, 411 NYS2d 41, 43; *Matter of Christ Cella, Inc. v. State Tax Commn.*, *supra*), "from which the exact amount of tax due can be determined" (*Matter of Mohawk Airlines v. Tully*, 75 AD2d 249, 429 NYS2d 759, 760) (*Matter of Your Own Choice*, Tax Appeals Tribunal, February 20, 2003).

The Administrative Law Judge pointed out that where the Division follows this procedure and determines that the records are incomplete or inaccurate it may resort to external indices to estimate tax (*Matter of Urban Liqs. v. State Tax Commn., supra*). The estimate methodology utilized must be reasonably calculated to reflect taxes due (*Matter of W.T. Grant Co. v. Joseph*, 2 NY2d 196, 159 NYS2d 150, *cert denied* 355 US 869, 2 L Ed 2d 75), but exactness in the outcome of the audit method is not required (*Matter of Markowitz v. State Tax Commn.*, 54 AD2d 1023, 388 NYS2d 176, *affd* 44 NY2d 684, 405 NYS2d 454). The taxpayer bears the burden of proving with clear and convincing evidence that the assessment is erroneous (*Matter of Scarpulla v. State Tax Commn.*, 120 AD2d 842, 502 NYS2d 113) or that the audit methodology is unreasonable (*Matter of Surface Line Operators Fraternal Org. v. Tully*, 85 AD2d 858, 446 NYS2d 451).

In this matter, the Administrative Law Judge observed, the Division requested an opportunity to examine the Linda Shop's books and records, but no records were produced. The Administrative Law Judge found that petitioner's failure to make the Linda Shop's books and records available for examination justified the use of an indirect audit methodology. The Administrative Law Judge also found it was reasonable to use bank deposits as a method to estimate the Linda Shop's gross sales and determine the amount of tax due (*see, e.g., Matter of D & V Liquor*, Tax Appeals Tribunal, March 10, 2005).

Petitioner argued that the audit method was flawed because it failed to take into account nontaxable sales. The Administrative Law Judge pointed out that the test of whether the audit methodology was reasonable is based upon the information available to the Division at the time the notice was issued (*Matter of Continental Arms Corp. v. State Tax Commn., supra*).

Petitioner in the instant matter, the Administrative Law Judge observed, did not report any nontaxable sales on his sales tax returns and did not offer any documentary evidence to the Division to support the existence of nontaxable sales. Therefore, the Administrative Law Judge found that in the absence of any evidence to the contrary, the Division properly assumed that all of the receipts were subject to tax (Tax Law § 1132; *see, Matter of Academy Beer Distribs. v. Commissioner*, 202 AD2d 815, 609 NYS2d 108, *lv denied* 83 NY2d 759, 616 NYS2d 14).

The Administrative Law Judge also found that petitioner may not rely on the modifications made at previous conciliation conferences to support adjustments to a notice. The record in this case does not explain the basis for adjustments made to prior assessments. Further, the Administrative Law Judge noted that discussions and adjustments made at conciliation conferences are in the nature of settlement negotiations and may not be considered as precedent or be given any force or effect in any subsequent administrative proceeding (Tax Law § 170[3-a]][f]; *see, Matter of Petak v. Tax Appeals Tribunal*, 217 AD2d 807, 629 NYS2d 547).

Next, the Administrative Law Judge addressed the issue of penalties. Tax Law § 1145(a)(2) provided in pertinent part:

If the failure to pay or pay over any tax to the commissioner within the time required by this article is due to fraud, in lieu of the penalties and interest provided for in subparagraphs (i) and (ii) of paragraph one of this subdivision, there shall be added to the tax (i) a penalty of fifty percent of the amount of the tax due, plus (ii) interest on such unpaid tax

The Administrative Law Judge noted on this issue that 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. The Division bears the burden of proving fraud. The Administrative Law Judge pointed

out that a finding of fraud requires the Division to show clear, 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*, Tax Appeals Tribunal, March 16, 2000). To satisfy its burden, the Division must produce evidence of a specific intent to deliberately evade payment of taxes which are due and owing in addition to proof of underreporting (*see, Matter of Flanagan*, Tax Appeals Tribunal, June 14, 1990). The Administrative Law Judge noted that factors evidencing intent include a consistent and substantial understatement of tax, the amount of the deficiency, a pattern of repeated deficiencies, the taxpayer's course of conduct and the taxpayer's failure to maintain adequate records (*Matter of Waples*, Tax Appeals Tribunal, January 11, 1990).

The Administrative Law Judge determined that the Division sustained its burden of proof of establishing fraud. Throughout the audit period, the Administrative Law Judge noted, amounts deposited in petitioner's bank account consistently and substantially exceeded the amount of reported sales on the sales tax returns. On the other hand, the bank deposits were consistent with the level of sales reported on the Federal income tax returns. Under the circumstances, the Administrative Law Judge found it reasonable to conclude that petitioner was aware that sales and use taxes were underreported on sales tax returns.

The Administrative Law Judge acknowledged that petitioner and his wife were in poor health. However, the Administrative Law Judge found no evidence that petitioner's health or his wife's health was the cause of the underreporting. Furthermore, the Administrative Law Judge noted, assuming that books and records existed, petitioner was under an obligation to make those

items available for the audit. Petitioner was not permitted to unilaterally decide when the books and records would be produced.

The Administrative Law Judge found unconvincing petitioner's claim that he could not locate the records. By his own admission, the records would have been in the store or at his home. If records were maintained, they should have been able to be located. As this was petitioner's third audit, he was certainly aware of the need to maintain adequate records. Accordingly, the Administrative Law Judge found that in addition to the consistent and substantial understatement of sales, the difference in the amounts reported on the sales tax returns versus the income tax returns, the pattern of repeated deficiencies and the failure to produce or maintain adequate records constitute evidence of an intent to deliberately evade payment of taxes due and owing (*see, Matter of Lefkowitz*, Tax Appeals Tribunal, May 3, 1990 [wherein the Tribunal found that consistent and substantial understatements of income is by itself strong evidence of fraud]).

The Tax Law also imposes a penalty where the taxpayer has omitted an amount from his return in excess of 25 percent of the amount required to be shown. The penalty may be abated if the taxpayer proves that the failure was due to reasonable cause (Tax Law § 1145[a][1][vi]); *Matter of Uncle Jim's Donut & Dairy Store*, Tax Appeals Tribunal, October 5, 1989). Here, the Administrative Law Judge noted, there is no evidence of reasonable cause. As discussed earlier, there is no evidence that illness played any role in the underreporting of the tax due and owing. Further, the Administrative Law Judge observed, petitioner never explained why the Federal income tax returns reported far greater sales than were reported on the State sales tax returns.

The Administrative Law Judge found that petitioner's failure to show evidence of reasonable cause precludes cancelling the penalty.

The Administrative Law Judge observed that since the Linda Shop was organized as a sole proprietorship, it did not exist independently of its owner. Therefore, the Administrative Law Judge determined it was erroneous for the Division to issue a notice of determination to the Linda Shop.

The Administrative Law Judge denied the petition of Morris Chariton and sustained the Notice of Determination issued to him.

ARGUMENTS ON EXCEPTION

Petitioner takes exception to so much of the determination of the Administrative Law Judge as sustained the fraud and omnibus penalties. Petitioner argues that poor health was the reason he did not maintain adequate books and records for audit. Petitioner claims that he did not have the intent to evade tax.

Petitioner did not take exception to the findings of fact of the Administrative Law Judge, the audit methodology or the amount of tax calculated due upon audit.

The Division argues that petitioner has failed to prove that his health was the reason he did not maintain or produce adequate books and records for audit. The Division notes that petitioner and his wife were healthy enough to operate the business during the audit period. The Division notes that this was the third audit and petitioner should have known what was required of him. The Division also notes that petitioner's underreporting was consistent for each and every quarter of the sales tax period in issue. Fraudulent intent, the Division argues, may be inferred from the failure to produce records. Finally, the Division points out that petitioner provided

neither sales records on audit nor documentation to prove alleged nontaxable sales and, furthermore, failed to cooperate on audit and consistently and substantially underreported and under paid sales tax due.

OPINION

We affirm the determination of the Administrative Law Judge for the reasons set forth therein. Upon review of the record in this matter, we find that the Administrative Law Judge has fully and correctly addressed each of the issues presented. We can find no basis to modify the determination of the Administrative Law Judge in any respect.

Accordingly, it is ORDERED, ADJUDGED, and DECREED that:

1. The exception of Morris Chariton is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petition of Morris Chariton is denied; and
4. The Notice of Determination, dated May 28, 2002, is sustained together with penalties and interest. The Notice of Determination dated May 24, 2002 is cancelled.

DATED: Troy, New York
May 25, 2006

/s/Charles H. Nesbitt

Charles H. Nesbitt
President

/s/Carroll R. Jenkins

Carroll R. Jenkins
Commissioner

/s/Robert J. McDermott

Robert J. McDermott
Commissioner