STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
MICHAEL J. MACLEOD	:	DECISION DTA NO. 820992
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 June 1, 1999 through August 31, 2000.	:	

Petitioner, Michael J. MacLeod, filed an exception to the determination of the Administrative Law Judge issued August 9, 2007. Petitioner appeared by Vanacore DeBenedictus DiGovanni & Weddell (Thomas R. DiGovanni, CPA). The Division of Taxation appeared by Daniel Smirlock, Esq. (Michael J. Hall).

Petitioner filed a brief in support of his exception. The Division of Taxation filed a brief in opposition. Petitioner filed a brief in reply. Oral argument, at petitioner's request, was heard on January 16, 2008 in Troy, New York.

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

ISSUE

Whether the audit methodology was reasonably calculated to determine the sales and use taxes due.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for finding of fact "8," which has been modified. We have also made an additional finding of fact. The

Administrative Law Judge's findings of fact, the modified finding of fact and the additional finding of fact are set forth below.

During the period in issue, petitioner, Michael J. MacLeod, was the president and sole shareholder of MJM Studios of New York, Inc. ("MJM"). MJM engaged in the manufacturing of fiberglass reinforced concrete in order to create facades, marquees and signs for major construction projects. The corporation's offices were located in New Jersey.

On August 13, 2003, the Division of Taxation ("Division") sent a letter to Mr. MacLeod stating that MJM's sales and use tax records had been scheduled for a field audit on September 29, 2003. The letter further stated that the audit period was June 1, 1999 through May 31, 2003 and that "[a]ll books and records pertaining to the sales and use tax liability, for the audit period, must be available on the appointment date."[1] In an attached records request list, the Division specifically requested all exemption documents supporting nontaxable sales for the entire audit period including capital improvement certificates.

In a letter that was received by the Division on August 27, 2003, Mr. MacLeod responded that his company was in bankruptcy and he did not have any records. Mr. MacLeod also pointed out that the attorney handling his affairs was Leonard Walcyz, Esq. MJM referred the auditor to the bankruptcy attorney who, in turn, referred the auditor to the trustee of the bankruptcy proceeding. It was the auditor's understanding that the trustee was in possession of MJM's records. The auditor called and left a voice message for the trustee but the trustee never returned the call.

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[1] On February 9, 2004, petitioner executed a consent extending the statute of limitations for assessment of sales and use taxes for the period June 1, 1999 through August 31, 2001 to any time on or before September 20, 2004.

On January 8, 2004, the auditor sent a letter to petitioner stating that due to the lack of availability of records, he would be issuing an estimated assessment based upon bank deposits. It was explained that the deposits were adjusted to reflect sales made outside of New York State. The letter concluded with a request that petitioner provide the records needed to perform the audit.

On February 3, 2004, petitioner responded that the records were still in the possession of the bankruptcy trustee in Newark, New Jersey.

On May 11, 2004, the auditor sent another letter to petitioner explaining that the Division had not received the records that it had requested and that it was not the Division's responsibility to obtain the records from the bankruptcy trustee. Accordingly, petitioner was asked to provide the Division with the records that were in the custody of the trustee. The Division noted, among other things, that it would be issuing an assessment based upon the records it had.

On August 13, 2004, petitioner's representative advised the Division that the bankruptcy court lost most of petitioner's records. In response, the auditor again requested capital improvement certificates or exempt organization certificates from the customers.

We modify finding of fact "8" of the Administrative Law Judge's determination to read as follows:

> On November 24, 2004, the counsel to the bankruptcy trustee advised petitioner by letter that he could not authorize the release of the documents since the case was not closed. He did not think that there would be a problem releasing the books and records when the case was closed and the trustee's office had reviewed the materials. There is no indication in the record that petitioner or his representative made any attempt to seek permission from the trustee to make copies of the relevant records at his office.

On or about February 24, 2006, the bankruptcy trustee for MJM filed a notice of intent to abandon the documents it had in storage that were related to MJM's operations. If no objections

were filed with the Bankruptcy Court, the destruction would take place on or about March 20, 2006. There is no evidence in the record that, at this juncture, an effort was made to secure the documents.

The auditor discussed the lack of records with his supervisor and section head and they decided to subpoena the bank records of MJM from Warwick Savings Bank. The bank records were considered highly reliable because they were from a disinterested third party. The bankruptcy trustee was not subpoenaed because the Division questioned whether the subpoena would be honored outside of New York State.

In order to calculate the amount of tax due, the Division utilized MJM's bank records and proceeded upon the premise that all sales were deposited in the bank and that the bank deposits represented sales. On the basis of the New York State franchise tax returns, the Division determined the percentage of MJM's total sales that were New York sales. This percentage was multiplied by the bank deposits to calculate sales in New York. The sales in New York were then multiplied by the tax rate to determine the amount of tax due.

On the basis of the forgoing audit, the Division issued a Notice of Determination to petitioner, dated June 25, 2004 (Assessment no. L-023959610-9), which assessed sales and use taxes in the amount of $193,232.66, plus interest in the amount of $128,449.14 and penalty in the amount of $57,969.23 for a balance due of $379,651.03. The notice further explained that the Division's records indicated that petitioner was a responsible officer or person of MJM.

Petitioner requested a conference in the Bureau of Conciliation and Mediation Services ("BCMS"). In the course of proceedings before BCMS, the auditor was given the opportunity to review workpapers maintained by petitioner's accountant and, as a result, a Conciliation Order was issued that reduced the amount of tax assessed to $121,492.82.

At the hearing, petitioner offered portions of a contract pertaining to work performed by MJM at John F. Kennedy International Airport. On the basis of this contract and materials offered at the conciliation conference, the Division has agreed to the following adjustments:

Quarter Ending	Tax Originally Assessed	Tax Per BCMS Order	Tax Currently Sought
08/31/99	$7,600.36	$4,778.64	$4,778.64
11/30/99	27,602.47	17,354.74	17,354.74
02/29/00	26,433.85	16,619.98	16,619.98
05/31/00	47,856.59	30,089.28	1,689.86
08/31/00	83,739.39	52,650.18	2,956.91

In the course of auditing construction companies, the auditor would usually visit construction sites if records were available. Here, the auditor never visited petitioner's place of business or construction sites. He did not realize that the place of business was only three miles from the office.

We make the following additional finding of fact:

> Petitioner did not testify in support of his petition. Instead, petitioner's representative testified as to the general nature of MJM's work, which he said was capital improvement work. However, he admitted that he had no first hand knowledge of petitioner's activities with respect to specific construction projects during the audit period (***see***, Hearing tr., pp. 50, 52).

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge observed that the Division made several requests for books and records. These records were not provided because petitioner stated that the records were in the possession of the trustee in Bankruptcy. The Division then tried, without success, to obtain the records from the bankruptcy trustee. The lack of adequate records made it impossible to verify

taxable sales through a complete audit from which the exact amount of tax due could have been determined. Therefore, the Administrative Law Judge found that the Division properly resorted to the use of external indices in conducting their audit.

The Administrative Law Judge noted that petitioner raised no issue with respect to the use of the records to calculate sales. However, petitioner urged that once it was clear that petitioner would not able to produce MJM's business records, the auditor should have taken other steps to determine the kind of work performed by MJM and whether it was subject to sales tax.

The Administrative Law Judge rejected this argument, noting first, that the law presumes that all receipts are subject to tax (Tax Law § 1132[c]), and that it is petitioner's burden of proof to show if it had transactions that were not taxable. The Administrative Law Judge noted that petitioner's argument would improperly place the burden of proof upon the Division.

The Administrative Law Judge also rejected the second part of petitioner's argument, i.e., that the auditor should have gone to the individual construction sites to determine the kind of work done by petitioner and determine whether work at specific jobs was subject to tax. The Administrative Law Judge found that this argument was based on the faulty premise that by merely observing a structure that has been built, one can determine if it is a capital improvement for purposes of the Tax Law.

ARGUMENTS ON EXCEPTION

Petitioner, on exception, makes the same arguments that were presented below. Petitioner argues that he tried but was unable to produce the books and records of MJM for review by the auditor, since such records were in the hands of the bankruptcy trustee.

Petitioner argues that while the use of bank deposits to estimate sales may be reasonable in some situations, it is not here, because petitioner does not have taxable receipts, since MJM is in

the business of "capital improvement construction" (***see***, petitioner's brief, p. 2). According to petitioner, the use of this audit method was more appropriate for a taxpayer who makes retail sales, not a taxpayer engaged in capital construction.

Petitioner maintains that the auditor should have examined each job to determine if capital improvement work was undertaken, since the work itself was the only evidence available.

The Division argued that petitioner has not met his burden of proof to establish by clear and convincing evidence that the audit findings are erroneous.

OPINION

We affirm the determination of the Administrative Law Judge.

We note that repeated requests for records, petitioner's response was that his records were in the possession of the bankruptcy trustee. On November 24, 2004, counsel to the trustee indicated the he could not release the documents prior to the case being closed. However, we find it telling that there was no attempt made by petitioner or his representatives to seek permission to copy such records as might be relevant to this case, e.g. contracts, at the office of the trustee. The trustee may have refused, but no attempt was made based on this record. We find even more significant the fact that the bankruptcy trustee advised MJM on February 24, 2006 of his intent to abandon MJM's records, and to destroy them on or about March 20, 2006 *if no objections* were filed with the Bankruptcy Court, and neither petitioner nor his representatives took any steps to retrieve the documents. It does not appear that any objection was ever filed with the Bankruptcy Court to stay the destruction of the records. We find that these facts militate against petitioner's argument that it made a good faith effort to obtain MJM's business records for audit purposes.

Case law provides that where the Division's auditor properly requests and reviews copies of the taxpayer's books and records for the audit period and the records are found incomplete or

inaccurate, the Division may properly resort to external indices to estimate tax. While the method of estimation used must be must be reasonably calculated to reflect taxes due (***Matter of W.T. Grant Co. v. Joseph***, 2 NY2d 196 [1957], ***cert denied*** 355 US 869 [1957]), exactness of the audit is not required (***Matter of Markowitz v. State Tax Commn.***, 54 AD2d 1023 [1976], ***affd*** 44 NY2d 684 [1978]. It is the taxpayer's burden of proving by clear and convincing evidence that the assessment (***Matter of Scarpulla v. State Tax Commn.***, 120 AD2d 842 [1986]) or that the audit methodology is erroneous (***Matter of Surface Line Operators Fraternal Org. v. Tully***, 85 AD2d 858 [1981]).

In this matter, the Division made repeated requests for books and records and those records were not provided. Ultimately, the auditor determined MJM's taxable sales based on a corporate franchise tax report and an analysis of bank deposits. Petitioner claims[2] that the auditor's methodology would be correct for some businesses but not MJM. In any event, petitioner argues that the Division should have taken the further step of visiting MJM's job sites to determine whether particular jobs were taxable. Based on this record, we find no factual support for petitioner's legal argument and we conclude that the Division audit method was reasonable.

We also reject petitioner's claim that since MJM is a construction business, and it is the nature of its business to build capital improvements, it is not subject to tax. Petitioner did not testify to fill in the lack of documentation in this record. A taxpayer's testimony, without more, would rarely be sufficient to carry a petitioner's burden, but it might have helped. We only have the testimony of his representative, who candidly admitted he had no first hand knowledge of

[2]This appears to be a reversal from petitioner's position below, where he conceded that the auditor's methodology of using bank deposits to arrive at taxable receipts was reasonable.

MJM's specific projects. Specifics are very important if we are to make a determination of whether something is a capital improvement.

The term capital improvement is defined by Tax Law § 1101(b)(9)(i) as an addition or alteration to real property which:

> (A) Substantially adds to the value of the real property or appreciably prolongs the useful life of the real property; and
>
> (B) Becomes part of the real property or is permanently affixed to the real property so that removal would cause material damage to the property or article itself; and
>
> (C) Is intended to become a permanent installation.

Petitioner argues that, if the auditor had visited the individual construction sites, he would have seen that they were capital improvements and not subject to sales tax. First, we know of no legal requirement for the Division's auditors to visit individual job sites when performing an audit. Such visits may, in a particular case, be appropriate, but we do not require them. Further, even if the auditor had visited such sites and it turned out that one or more might possibly be a capital improvement, such visits would not disclose petitioner's specific role in its construction in the absence of contracts under which he was performing. What was MJM's role in the construction of a particular site? Did it build a sign that could be easily removed without damage to the structure? What were the *specific facts* regarding the manner of construction? The fact that a structure has been built would not show petitioner's role in its construction, its useful life or whether it was intended as a permanent installation. We are left with only petitioner's representative's testimony that MJM was in the business of "capital improvement construction." Based on the lack of specific documentary evidence in this record, petitioner's argument must be rejected.

The law presumes that all receipts are subject to tax (Tax Law § 1132[c]), and it is petitioner's burden to show if and to what extent his company's receipts from construction projects were not subject to tax. We conclude that petitioner has failed to carry his burden to show that the audit method is improper or that the amount of tax asserted is erroneous (***see, Matter of Scarpulla v. State Tax Commn., supra***; ***Matter of Surface Line Operators Fraternal Org. v. Tully, supra***).

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Michael J. MacLeod is denied;

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

3. The petition of Michael J. MacLeod is denied; and

4. The Notice of Determination dated August 9, 2007 as modified in finding of fact "14" of the Administrative Law Judge's determination together with such penalty and interest are sustained.

DATED: Troy, New York
July 3, 2008

/s/ Charles H. Nesbitt
Charles H. Nesbitt
President

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

/s/ Robert J. McDermott
Robert J. McDermott
Commissioner