STATE OF NEW YORK

TAX APPEALS TRIBUNAL

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| In the Matter of the Petition | : | |
| of | : | |
| **KRYSTALLOS, INC. D/B/A DESIGN SOLUTIONS** | : | |
| 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, 1998 through February 29, 2004. | : | |
| | : | DECISION<br>DTA NOS. 821739 AND 821748 |
| In the Matter of the Petition | : | |
| of | : | |
| **STEPHEN STEFANOU** | : | |
| 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, 1998 through February 29, 2004. | : | |
| | : | |

Petitioners, Krystallos, Inc. d/b/a Design Solutions and Stephen Stefanou, each filed an exception with respect to the determination of the Administrative Law Judge dated June 11, 2009. Petitioners appeared by Cahill & Beehm (James N. Cahill, Esq., of counsel). The Division of Taxation appeared by Daniel Smirlock, Esq. (Osborne K. Jack, Esq., of counsel).

Petitioners did not file a brief in support of their exceptions. The Division of Taxation filed a letter brief in opposition. Petitioners filed a reply brief. Oral argument, at petitioners' request, was heard on November 18, 2009 in Troy, New York.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision. Commissioner Tully took no part in the consideration of this matter.

## *ISSUES*

I. Whether petitioners have sustained their burden of proof to show that the audit method employed by the Division of Taxation (Division) was unreasonable or that the amounts assessed against petitioners were erroneous.

II. Whether penalties assessed against petitioners should be abated.

## *FINDINGS OF FACT*

We find the facts as determined by the Administrative Law Judge except for findings of fact "20" and "21," which have been modified. We have deleted finding of fact "22" since such information is editorial in nature and was improperly included within the facts. We have also made additional findings of fact. The Administrative Law Judge's remaining findings of fact, the modified findings of fact and the additional findings of fact are set forth below.

Design Solutions, based in Dallas, Texas, is a designer and installer of displays (most notably holiday displays) for real property. In 2004, while auditing another unrelated business (a large building corporation in New York City), the Division's auditor came across an invoice in the name of Design Solutions, which had installed the holiday decorations for the New York City corporation. Since the invoice to the New York City corporation did not charge sales tax, the auditor did some research on the internet website of Design Solutions in an effort to determine to what extent Design Solutions was doing business in the State of New York. Thereafter, the auditor submitted the invoice, along with the website information, to his supervisors and an audit of Design Solutions was commenced.

By letter dated November 10, 2004, the auditor scheduled an audit of Design Solutions for January 17, 2005 at its office in Dallas, Texas. Pursuant to the letter, the audit period at issue was December 1, 1998 through November 30, 2004. Attached to the letter was a Records Requested List that requested the following: sales tax returns, worksheets and canceled checks; federal income tax returns; New York State corporation tax returns; general ledger; general journal and closing entries; sales invoices; exemption documents; chart of accounts; fixed asset purchase or sales invoices; expense purchase invoices; merchandise purchase invoices; bank statements, canceled checks and deposit slips for all accounts; cash receipts journal; cash disbursements journal; the corporate book; and depreciation schedules.

As a result of the letter, the auditor was referred to an accounting firm that represented Design Solutions. Another letter (along with a Records Requested List), dated May 18, 2005, was sent to the accounting firm, which scheduled a field audit for September 19, 2005 in Dallas, Texas. When the auditor visited Design Solutions' accountant in Dallas, he did not receive any records.

On November 14, 2006, the auditor sent a letter to Attorney James N. Cahill of Endicott, New York, petitioners' representative for the hearing held herein, which requested New York State sales figures for the audit period. The letter indicated that the auditor had been provided with federal income tax returns, but not with the New York State sales figures and stated that "[i]n light of the lack of New York sales figures, I will begin to calculate an assessment using the Federal Tax receipts unless the actual NY receipts can be obtained."

On November 22, 2006, the auditor sent another letter to Mr. Cahill, which stated as follows:

> In response to your November 20th letter, I acknowledge your objection to using the Federal Income Tax numbers to estimate a sales tax due for the above audit. However, as I'm sure you are aware, if a taxpayer does not supply a complete set of records for review, the department may use alternative means to approximate taxable receipts. As of this point, these records have not been supplied. Therefore, I would ask that Design Solutions please forward detailed sales receipts records for New York State for the above period by December 31, 2006.

On March 30, 2007, the Division issued a Notice of Determination to Design Solutions assessing additional sales and use taxes of $489,951.92, plus penalty and interest, for a total amount due of $1,204,531.15 for the period December 1, 1998 through February 29, 2004.

On April 20, 2007, the Division issued a Notice of Determination to Stephen Stefanou assessing additional sales and use taxes of $489,951.92, plus penalty and interest, for a total amount due of $1,213,001.36 for the period December 1, 1998 through February 29, 2004. The Notice of Determination advised Mr. Stefanou that he was being assessed as an officer or responsible person of Design Solutions.

As previously noted, when the auditor visited Design Solutions' accountant in Dallas, he did not receive any records. Subsequently, federal tax returns for the six-year audit period and some financial statements for some of the years at issue (financial statements for 1998 and 1999 were not made available to the auditor) were mailed to him. Based upon the records provided, the auditor determined that such records were insufficient to perform a detailed audit of Design Solutions.

No additional tax was assessed on fixed asset purchases since, as far as the auditor could ascertain, Design Solutions had no fixed assets in New York. In addition, no tax was assessed on expense purchases by Design Solutions.

Since the auditor never received information as to Design Solutions' New York sales, he attempted to determine the amount of New York sales from the federal tax returns. For the years 1998 and 1999, the auditor did not have any information from which he could determine the percentage of Design Solutions' sales that took place in New York.

For the year 2000 (February 2000 through January 2001), Design Solutions provided the auditor with a profit and loss statement. On the profit and loss statement, the cost of goods sold was broken out by state. Under the cost of goods heading, there was an item entitled "contract labor." Pursuant to the profit and loss statement, "Total Contract Labor - NY" was $122,484.84 and total contract labor (which included New York, Texas and Massachusetts) was $162,590.91. Therefore, the auditor concluded that the percentage of New York contract labor was 75.33% ($122,484.84 / $162,590.91). This percentage was applied to Design Solutions' gross sales for the year per its federal return.

For the year 2001, the auditor performed a similar analysis, determining the New York contract labor percentage and applying this percentage to the gross sales for the year per its federal return. However, on the income statement for the 12 months ending January 31, 2002, the auditor acknowledged that he used the incorrect figures, i.e., he utilized the figures from the column entitled "Current Month" rather than from the column "Year to Date." Accordingly, the auditor agreed that the New York percentage of contract labor originally calculated to be 29.11% for the year 2001 should be reduced to 22.82%. By virtue of this adjustment, the total assessment against each petitioner was reduced from $489,951.92 to $467,980.50, plus penalty and interest.

For the year 2002, using Design Solutions' cost of goods sold - contract labor in its income statement for the 12 months ending January 31, 2003, the auditor calculated the New York percentage of sales to be 14.15%.

For the year 2003, again using Design Solutions' cost of goods sold - contract labor in its income statement for the 12 months ending January 31, 2004, the auditor calculated the New York percentage of sales to be 17.72%.

Since the auditor did not have Design Solutions' financial statements for the years 1998 and 1999, he computed the New York percentage of sales by taking the average of the four years where he had financial statements, to wit, 2000, 2001, 2002 and 2003 and applying this percentage to the federal income reported on the 1998 and 1999 federal income tax returns, i.e., the gross receipts or sales reported on line 1 of the returns for each of the two years.

However, the auditor acknowledged that because of the error made for the year 2001 (***see,*** findings of fact above), the averages previously computed from years 2000 through 2003 needed to be recomputed. Accordingly, the average percentage for the years 1998 and 1999 was 32.51% rather than 34.08% percent as originally computed by the auditor. By virtue of the revised percentages for 1998 and 1999 (32.51%) and for 2001 (22.82%), the auditor recomputed New York sales for the audit period to be $5,672,490.00 rather than $5,894,009.00 as originally computed. It must be noted that this recomputation is accounted for in the reduction made by the auditor in the finding of fact above.

As a result of these recomputations, additional tax due is as follows:

| Year | Taxable Amount | Tax Rate | Additional Tax Due |
|---|---|---|---|
| 1998 | $503, 031.00 | .0825 | $41,500.06 |
| 1999 | $1,046,083.00 | .0825 | $86,301.85 |
| 2000 | $1,998,059.00 | .0825 | $164,839.86 |
| 2001 | $532,681.00 | .0825 | $43,946.18 |
| 2002 | $606,991.00 | .0825 | $50,076.76 |

| | | | |
|---|---|---|---|
| 2003 | $985,645.00 | .08625 | $85,011.88 |
| TOTAL | $5,672,490.00 | | $471,676.59 |

As indicated above, the auditor stated at the hearing that the total tax due was reduced to $467,980.50. From an examination of the above recomputation, it appears that the auditor applied a tax rate of 8.25 percent throughout all of the years at issue when, in fact, a rate of 8.625 percent should have been applied to the 2003 tax year. Since the auditor stated that the tax was reduced to $467,980.50, plus penalty and interest, that is the amount that shall be at issue herein.

The auditor determined that Design Solutions was a New York vendor required to collect and remit sales and use taxes on the basis of the invoice that he had seen during a previous audit, which indicated that the company was performing work in New York, as well as the company's website, which described how Design Solutions would go to the customer's location, observe the property and come up with ideas for a display. On the website, some of the customers for whom Design Solutions performed work were listed and these customers included New York City properties. The website stated that: "[a]fter a discussion of the ideas, objectives, and budgets, Design Solutions visits the proposed site to photograph and evaluate the parameters of the project." The website further stated that Design Solutions provides "turnkey service," which includes installation of the holiday displays.

In addition, documents received from Design Solutions contained references to a New York warehouse and a New York apartment that had been rented by the company during several of the years at issue herein.

The Division introduced into evidence an invoice dated October 21, 2002 from Design Solutions to Shorenstein Management (Shorenstein) of New York City in the amount of $25,000.00. On cross-examination, the auditor admitted that this was the customer of Design

Solutions that was being audited during 2004, which initially called into question whether Design Solutions was doing business in New York and which led to the audit at issue. The auditor stated that since, during the audit of Shorenstein, there was no evidence that Shorenstein had paid sales tax to Design Solutions (no sales tax was charged on the invoice), an assessment by the Division against Shorenstein included tax due on this invoice from Design Solutions, which assessment has been paid. Accordingly, the auditor admitted that the tax paid on this invoice ($2,062.50) should be credited against the assessment at issue in this proceeding. Accordingly, in addition to the revision in total tax due made as result of the use of an incorrect figure for the year 2001, discussed above, the total tax due must be further reduced to account for the $2,062.50 paid by Shorenstein. Total tax due at issue is, therefore, $465,918.00, plus penalty and interest.

On cross-examination, the auditor stated that he was aware that Design Solutions did not bill its customers for sales or use tax but, instead, on its invoices to its customers, instructed them to pay the tax directly to the proper taxing authorities. The auditor did not attempt to determine the identities of the New York customers of Design Solutions nor whether such customers had, in fact, complied with the directives on the invoices by paying the sales and use taxes directly.

The auditor stated that, with the exception of the year 2000, the format of the profit and loss statements furnished by Design Solutions to the Division was consistent. For the year 2000, the auditor determined the New York contract labor percentage to be 75.33% of total contract labor, while for the remaining years for which profit and loss statements were provided to the Division (2001, 2002 and 2003), the New York percentage ranged from a low of 14.15% to a high of 22.82%.

On cross-examination, the auditor stated that, for the 2000 year, he used the figures under the heading “Contract Labor” rather than “Total Labor.” Had “Total Labor” been used in the

computation, the New York percentage would have been 31.77%. The auditor further stated that he used "Contract Labor" because, "I knew on contract labor how much was New York versus how much was the other states." The auditor indicated that total labor includes the labor of the taxpayer's employees. The auditor indicated that when he sees abbreviations after a general ledger account such as contract labor, that would indicate to him that the work was done in the state designated.

At the hearing, the auditor, at the request of petitioners' counsel, recomputed the average New York percentage of sales for use in the 1998 and 1999 years (***see***, findings of fact above) using the 31.77% (total labor) as opposed to the 75.33% that he used in computing the assessment at issue. Using 31.77%, the average for 1998 and 1999 would be 21.62% instead of 32.51%. The auditor then computed New York sales for the years at issue using the total labor figure for 2000 (31.77%), which would reduce Design Solutions' New York sales for the audit period from $5,672,491.00 to $3,998,189.00.

Pursuant to a Responsible Person Questionnaire completed by the auditor, based upon information received from petitioners' representative, petitioner Stephen Stefanou is the president of Design Solutions, devotes 100% of his time to the business, manages the business, owns corporate stock, derives substantial income from the business and has the authority to sign checks, prepare sales tax returns, hire and fire employees and negotiate loans and borrow money for the business. No evidence was offered by petitioners to dispute the Division's determination that Mr. Stefanou is a person responsible for the collection and payment of sales and use taxes on behalf of Design Solutions.

We modify findings of fact "20" and "21" of the Administrative Law Judge's determination to read as follows:

Design Solutions introduced into evidence various invoices and proposals relating to services that the company performed for its customers. Invoice No. 6285, dated July 14, 2003, to Insignia ESG of New York City indicates that the invoice included rigging of all cables for hanging holiday decor. The invoices state that the price does not include sales tax and that all applicable sales tax is to be paid by the customer to the state and local taxing authorities, but the invoices do not separately state the amount of tax to be paid. None of these invoices indicate the name of the issuer or carry a letterhead of the issuer, and none show that the taxes had been paid.

A proposal to Oxford Bath Products of New York City provides that Design Solutions will trim two windows and provide signage. A five-year holiday proposal for 200 Park Avenue, New York, New York, presented by Design Solutions to Met Life on July 16, 2002 stated that the price includes design, production, shipping, installation, dismantling, removal to storage, and storage of all items for five holiday seasons beginning in 2002 and continuing through the 2006 holiday season. These proposals again state that the price does not include sales tax and that all applicable sales tax is to be paid by the customer to the state and local taxing authorities. None of these proposals separately state the amount of sales tax to be paid. None of the proposals have been signed by a customer or by a representative of Design Solutions. Petitioners did not present a witness to explain which, if any, of these unsigned proposals were accepted and actually performed. None of these proposals, if actually executed, show that the applicable taxes had been paid to the State and City of New York (***see,*** Exhibit "2").

Nevertheless, by letter dated August 25, 2008, five days after the record was closed at the conclusion of the hearing, James N. Cahill, Esq., sent a letter to the Administrative Law Judge stating that he had received correspondence from the Rockefeller Group on August 22, 2008, in response to a letter he had sent to them dated July 18, 2008. Mr. Cahill sent a copy of this letter to the Division's representative requesting that the correspondence and attachments be permitted to be considered as additional evidence. The Division did not consent, and petitioner did not make a motion to reopen the record.[1]

We find the following additional facts:

Petitioners' Exhibit "1" consists of a cover letter from the accounting firm of Schonbraun McCann Group, LLC relating to its client RCPI Landmark Properties, Ltd. faxed to Mr. Cahill, which relates to proposed sales tax audit

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[1] We have modified findings of fact "20" and "21" by consolidating them to more clearly reflect the record. We have deleted paragraphs 2 and 3 from finding of fact "21" since the information contained therein was improperly included within the fact.

changes for the period March 1, 2002 through February 28, 2006. The attached Statement of Proposed Audit Change asserts sales tax due of $32,829.92. Also, part of the exhibit is a copy of a check made payable to the NYS Department of Taxation and Finance for that amount. There is no indication in the document as to what this Statement of Proposed Audit Change relates to in terms of individual transactions.

This exhibit also contains a second Statement of Proposed Audit Change for Sales and Use Tax addressed to another taxpayer, RCPI Trust, 45 Rockefeller Plaza, New York, New York, which asserts tax in the amount of $534,226.35 for the tax period June 1, 1996 through May 31, 2001. Petitioners' counsel stated that this exhibit was offered for the purpose of showing that "the customer" has been audited and met its sales tax obligations (Tr., p. 96). However, petitioners did not present a witness to explain any document in this exhibit; specifically, the difference in the taxpayers' names. There is no breakdown of the amount due from individual transactions, and the record is silent as to how either notice ties into the tax asserted against Design Solutions, i.e., how much of the tax asserted against petitioners, if any, arose from work done for these two entities.

***THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE***

The Administrative Law Judge found that, while Design Solutions is a Texas-based company, the fact that it visits the corporate site of its New York customers, installed the holiday displays and maintained New York property (a warehouse and an apartment) during several of the years at issue provided evidence that a sufficient nexus with the State of New York existed to require it to collect and remit New York sales and use taxes as a vendor. Since petitioners did not dispute that Design Solutions made sales of its holiday display services to customers in New York, the Administrative Law Judge found that as a vendor of tangible personal property or services pursuant to Tax Law § 1101(b)(8)(i), Design Solutions was a person required to collect tax from its New York customers when collecting the price charged. The Administrative Law Judge stated that if the customer is given any sales slip, invoice or receipt showing the price paid

or payable, "the tax shall be stated, charged and shown separately on the first of such documents given to him" (Tax Law § 1132[a][1]).

The Administrative Law Judge noted that the amended petition of Design Solutions alleged that the services provided to its customers constituted capital improvements. No evidence was submitted to substantiate that allegation. Accordingly, the Administrative Law Judge found this argument unsupported by the record.

Moreover, the Administrative Law Judge noted that the invoices and proposals of Design Solutions established that the company either installed or serviced tangible personal property, serviced or repaired real property or provided decorating or designing services, all of which services are taxable.

Next, the Administrative Law Judge discussed the law governing the Division's power to conduct an estimated audit. In this case, the Administrative Law Judge pointed out that the auditor initially made two written requests for the books and records of Design Solutions by letter dated November 10, 2004 and May 18, 2005. On his initial visit to Design Solutions' accountant, the auditor was not provided with any records. Later, federal tax returns for the six-year audit period and financial records for some of the years were sent to him. Subsequently, on November 14, 2006, additional letters were sent to Design Solutions' representative seeking the New York State sales figures for Design Solutions for the audit period.

When Mr. Cahill objected to the use of the federal income tax figures to estimate sales tax due, the auditor, on November 22, 2006, sent another letter asking for detailed sales receipts records for Designs Solutions' New York sales for the audit period. These records were never provided. Accordingly, the Administrative Law Judge found that the auditor properly

determined that the records presented were insufficient to perform a detailed audit of Design Solutions.

The Administrative Law Judge rejected petitioners' attempt to transfer the obligation to their customers to pay the tax directly to the State and also rejected petitioners' attempt to shift the burden to the Division to ascertain the names of the customers, calculate the amount of tax due on Design Solutions' sales to these customers and then determine whether the customers paid the tax to the State.

As noted above, the auditor, at the request of petitioners' counsel, recomputed the average New York percentage of sales for 1998 and 1999 using total labor (31.77%) rather than using contract labor (75.33%), which resulted in a New York average for 1998 and 1999 of 21.62% instead of 32.51% as computed by the auditor. It is the figure of 21.62% that petitioners assert is the correct percentage. The Administrative Law Judge rejected petitioners' argument as without merit.

The Administrative Law Judge found that the auditor had a valid reason for using the amounts set forth in "Contract Labor" rather than "Total Labor" in the profit and loss statements supplied to him by Design Solutions. He indicated that "Contract Labor" was used because the auditor was able to determine how much work was performed in New York versus other states and that "Total Labor" includes the labor of Design Solutions' employees. The Administrative Law Judge noted that petitioners failed to introduce evidence to support their position, evidence such as actual New York sales figures or actual labor costs related to New York sales.

As to the computation errors, the Administrative Law Judge pointed out that they had been corrected and the additional tax due had been reduced from $489,951.92 to $465,918.00,

plus penalty and interest. The Administrative Law Judge observed that if the auditor made assumptions that were unsupported, it was a result of petitioners' failure to provide adequate books and records that mandated these assumptions. The Administrative Law Judge pointed out that petitioners could have produced, at any time during the audit or at the hearing, records that would have controverted the auditor's assumptions, but no such records were forthcoming. Accordingly, absent adequate books and records, the Administrative Law Judge found the audit methodology employed by the Division was reasonably calculated to reflect tax due; thus, he found that petitioners wholly failed to sustain their burden of proving, by clear and convincing evidence, that the assessment (after the recomputations) was erroneous or that the audit methodology was unreasonable.

Petitioner Stephen Stefanou offered no evidence in support of his petition. He did not deny his role in Design Solutions nor offer evidence to controvert the Responsible Person Questionnaire. Therefore, the Administrative Law Judge found that Mr. Stefanou was personally liable for the sales and use taxes due on behalf of Design Solutions as a person required to collect and pay such taxes pursuant to Tax Law § 1131(1) and § 1133(a).

The Administrative Law Judge next addressed the issue of submission of additional evidence by petitioners after the record had been closed. This issue was not addressed by either party in their briefs before the Administrative Law Judge. Nevertheless, the Administrative Law Judge addressed it in his determination. First, the Administrative Law Judge noted that the Division never consented to the submission of the evidence. Second, the Tax Appeals Tribunal has established a firm policy of not allowing the submission of evidence after the record is closed. As the Administrative Law Judge noted earlier, petitioners did not ask for, nor were they

granted, additional time for the submission of evidence after the conclusion of the hearing and the closing of the record. Moreover, the Administrative Law Judge opined that, even had such permission been sought and granted, the letters and attachments submitted post-hearing would not in any way result in an adjustment to the assessments herein.

The Administrative Law Judge concluded, based on this post-hearing submission of additional documents, that petitioners did possess some records of sales to New York customers but chose not to submit them. The Administrative Law Judge negatively inferred from such failure that the evidence would not have supported petitioners' arguments in this matter.

Finally, petitioners argued that penalties should be abated. The Administrative Law Judge observed that Design Solutions, despite doing business and maintaining property in New York, chose not to comply with the statutory requirements of the Tax Law by charging, collecting and remitting sales tax on sales to its New York customers. Moreover, Design Solutions failed to show that it maintained adequate records of its New York sales and it did not produce records as required by law. The Administrative Law Judge noted that we have held that the failure to maintain and provide records upon request justifies the imposition of penalties (***see***, ***Matter of Rosemellia***, Tax Appeals Tribunal, March 12, 1992). Therefore, the Administrative Law Judge sustained the penalties.

## *ARGUMENTS ON EXCEPTION*

Petitioners continue to claim that all of their proposals for design and installation submitted to their New York customers specifically provided that the customer was to be responsible for the payment of sales tax. Petitioners assert that such customers had the primary obligation to pay the sales tax pursuant to Tax Law § 1133(b). Accordingly, petitioners argue

that the Division is required to determine whether the customer, in each transaction at issue, has paid the tax and, if not, to assess and collect the tax, with appropriate penalties and interest, from the customer.

Petitioners also urge that the Division's request for all of petitioners' books and records was unreasonable. Petitioners state that the auditor should have asked for a list of petitioners' New York customers and proceeded from there.

Petitioners further claim that the Division's audit method and procedure were improper. Specifically, in this regard, petitioners argue that the auditor corrected an error in his audit result by making an adjustment to the New York labor percentage for the year 2001, which reduced the tax due from $489,951.92 to $467,980.50. Further, when tax in the amount of $2,062.50 had been paid by Shorenstein Management, the auditor reduced the tax due from petitioners by that amount, leaving a total tax due of $465,918.00 plus penalty and interest. Petitioners urge that these corrections in tax due are evidence of the Division's improper, unreasonable and inaccurate audit procedure in an attempt to collect the tax from both petitioners and their customers. Petitioners also state that the Administrative Law Judge erred in failing to make any finding regarding petitioners' Exhibit "1," which petitioners claim supports this argument. Petitioners do not argue that the Division had access to all of petitioners' books and records. Rather, petitioners take the position that even if the Division had all of their books and records, the audit method and result would still be erroneous.

Petitioners continue to argue that the figure used by the auditor for the New York contract labor percentage was in error. Petitioners claim that the auditor's calculation of the New York percentage of labor for the year 2000 of 75.33% was overstated. Petitioners urge that for 1998

and 1999 the correct average should be 21.62% rather than 32.51%. Further, petitioners argue that the Administrative Law Judge should have adopted the logical percentage for contract labor for the year 2001 of 31.77 % for an average of 21.62 %, rather than 32.51%.

Petitioners maintain that it was an error for the Administrative Law Judge to refuse to accept into evidence the materials submitted by petitioners after the record in the proceeding had been closed. According to petitioners, the fact that the Division remained silent after receiving petitioners' request to consent to the materials being admitted into evidence was sufficient consent. Petitioners argue that the absence of any objection by the Division must be interpreted as consent to the inclusion of the Rockefeller Group material in the record. Petitioners posit that this material demonstrates that certain of its customers paid sales tax to the State of New York, for which petitioners should have been given credit. Petitioners urge that if the same material had been received by the Division's attorney, he, too, would have forwarded it to the Administrative Law Judge.

Finally, petitioners state that penalties should be abated since much or all of the sales tax due on Design Solutions' sales was paid by its customers.

The Division urges, however, that since petitioners failed to produce a complete set of verifiable books and records that were sufficient to verify petitioners' New York sales, the Division was authorized to utilize an indirect audit method. The Division argues that the method chosen was reasonable.

The Division asserts that while petitioners bore the burden of proving, by clear and convincing evidence, that the audit method was unreasonable or that the resulting assessment was erroneous, they have failed to sustain their burden.

Finally, the Division argues that petitioners have failed to show reasonable cause for the abatement of penalties assessed herein.

Petitioners do not take exception to the following conclusions: i) that sufficient nexus exists between New York and petitioners to require them to collect and remit applicable New York sales and use taxes; ii) that Design Solutions is a "person" and a "vendor" required to collect tax as defined in Tax Law § 1101(b)(8)(i)(A) and (D) and § 1131(1); iii) that the installations and services of petitioners did not constitute capital improvements; and iv) that Stephen Stephanou is personally liable for any sales and use taxes that may be found due from Design Solutions.

Petitioners did challenge the imposition of penalties in their exceptions, but failed to argue that issue in their brief.

***OPINION***

We first address whether the Administrative Law Judge erred in refusing to accept certain documents into evidence that were not offered until after the hearing record had been closed.

Petitioners argue that the Administrative Law Judge erred in failing to admit the Rockefeller Group materials into evidence. According to petitioners, the Division's silence after receiving petitioners' request to consent to the admission of these materials was an implied consent to their inclusion.

The hearing in this matter was held on August 20, 2008. We note that petitioners waited until one month before the hearing to write to the Rockefeller Group, on or about July 18, 2008, requesting information that they might use to support their case. Petitioners knew that this audit had been pending since at least 2005 and yet they did not request this information until a few

days before the hearing in this matter. Not surprisingly, the information they requested from the Rockefeller Group did not arrive in time.

The Rules of Practice and Procedure of the Tax Appeals Tribunal make provision for a motion to reopen the record upon the grounds, *inter alia*, of:

> newly discovered evidence which, if introduced into the record, would probably have produced a different result and which could not have been discovered with the exercise of reasonable diligence in time to be offered into the record of the proceeding . . . (20 NYCRR 3000.16[a][1]).

No such motion was made by petitioners, perhaps because petitioners' counsel knew it was evidence not newly discovered. However, petitioners could have requested, at the conclusion of the hearing, that the Administrative Law Judge hold the record open pending receipt of additional evidence. No such request was made to the Administrative Law Judge. We have established a strict policy of not allowing the submission of evidence after the record is closed. In ***Matter of Saddlemire*** (Tax Appeals Tribunal, June 14, 2001), we stated:

> [w]e have held that in order to maintain a fair and efficient hearing system, it is essential that the hearing process be both defined and final. If the parties are able to submit additional evidence after the record is closed, there is neither definition nor finality to the hearing. Further, the submission of evidence after the closing of the record denies the adversary the right to question the evidence on the record (***Matter of Emerson***, Tax Appeals Tribunal, May 10, 2001; ***Matter of Schoonover***, [Tax Appeals Tribunal, August 15, 1991]).

That being the case, we find that the Administrative Law Judge properly denied petitioners' request to have the late-filed material included in the record.

The Tax Law provides, with respect to a person required to collect tax, that it must collect the tax from the customer when collecting the price charged and, "[i]f the customer is given any sales slip, invoice, or receipt or other statement or other memorandum of the price, amusement

charge or rent paid or payable, the tax shall be stated, charged and shown separately on the first of such documents given to him" (Tax Law § 1132[a][1]).

Tax Law § 1105(a) imposes a sales tax on the receipts from every "retail sale" of tangible personal property except as otherwise provided in Article 28 of the Tax Law. A "retail sale" is "[a] sale of tangible personal property to any person for any purpose, other than . . . for resale as such . . ." (Tax Law § 1101[b][4][i]).

Tax Law § 1138(a)(1) provides, in relevant part, that if a sales tax return was not filed, "or if a return when filed is incorrect or insufficient, the amount of tax due shall be determined by [the Division of Taxation] from such information as may be available. If necessary, the tax may be estimated on the basis of external indices . . ." (Tax Law § 1138[a][1]). When acting under the authority granted under section 1138(a)(1), the Division is required to select a method of audit reasonably calculated to reflect the tax due. The burden then rests upon the taxpayer to demonstrate that the method of audit or the amount of the assessment was erroneous (***see, Matter of Your Own Choice,*** Tax Appeals Tribunal, February 20, 2003).

The standard for reviewing a sales tax audit where external indices were employed was set forth in ***Matter of Your Own Choice***, as follows:

> To determine the adequacy of a taxpayer's records, the Division must first request (***Matter of Christ Cella, Inc. v. State Tax Commn.***, [102 AD2d 352 (1984)]) and thoroughly examine (***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).

Where the Division follows this procedure, thereby demonstrating that the records are incomplete or inaccurate, the Division may resort to external indices to estimate tax (***see***, ***Matter of Urban Liqs. v. State Tax Commn.***, ***supra***). The estimate methodology utilized must be reasonably calculated to reflect taxes due (***see***, ***Matter of W.T. Grant Co. v. Joseph***, 2 NY2d 196 [1957], ***cert denied*** 355 US 869 [1957]), but exactness in the outcome of the audit method is not required (***see***, ***Matter of Markowitz v. State Tax Commn.***, 54 AD2d 1023 [1976], ***affd*** 44 NY2d 684 [1978]; ***Matter of Cinelli***, Tax Appeals Tribunal, September 14, 1989). The taxpayer bears the burden of proving with clear and convincing evidence that the assessment is erroneous (***see***, ***Matter of Scarpulla v. State Tax Commn.***, 120 AD2d 842 [1986]) or that the audit methodology is unreasonable (***see***, ***Matter of Surface Line Operators Fraternal Org. v. Tully***, 85 AD2d 858 [1981]; ***Matter of Cousins Serv. Sta.***, Tax Appeals Tribunal, August 11, 1988). In addition, "[c]onsiderable latitude is given an auditor's method of estimating sales under such circumstances as exist in [each] case" (***see***, ***Matter of Grecian Sq. v. New York State Tax Commn.***, 119 AD2d 948 [1986]).

In the instant matter, the Division's auditor, by letters dated November 10, 2004 and May 18, 2005, requested the books and records of Design Solutions. Upon his initial visit to the office of the accountant for Design Solutions, the auditor was not given any records. Indeed, petitioners do not contest, on exception, that they failed to provide a complete set of books and records. Instead, they argue that even if such records had been provided, the audit method and

result would still be in error. Later, the auditor was provided federal tax returns for the six-year audit period and financial records for some of the years were sent to him. Source documents of individual sales transactions were never provided. Accordingly, we agree with the Administrative Law Judge that the records presented were insufficient to perform a detailed audit of Design Solutions.

On November 14, 2006, additional letters were sent to Design Solutions' representative seeking the New York State sales figures for Design Solutions for the audit period. When Mr. Cahill objected to the use of the federal income tax figures to estimate sales tax due, the auditor, on November 22, 2006, sent another letter asking for detailed sales receipts records for Designs Solutions' New York sales for the audit period, but such records were never provided.

The Division's regulations (20 NYCRR 533.2[a]) provide with regard to a vendor's duty to maintain records, in relevant part:

> (1) For the proper administration of the Sales and Use Tax Law and to prevent evasion of the sales tax, it is statutorily presumed that all receipts from sales and purchases of property or services . . . are subject to the tax until the contrary is established. The burden of proving that any receipt . . . is not taxable is on the vendor or the customer. To *satisfy his burden of proof, a vendor must maintain records sufficient to verify all transactions*.
>
> (2) *Upon audit* by the department, or at such other times as the department requests, *the vendor or user must present all the records described in this Part*, kept *in a manner suitable to determine the correct amount of tax due . . .* (emphasis added).

As relevant here, the regulations provide that the records of sales required to be kept by a vendor include a true copy of each of the following: sales slips, invoices, receipts, contracts, statements or other memoranda of sales (***see,*** 20 NYCRR 533.2[b][1][i]).

Design Solutions claims that the auditor requested the wrong information and that he should have asked petitioners to provide a list of New York customers in order to ascertain whether the customers had paid tax to the State of New York, thereby eliminating the possibility of double taxation. We reject this argument as overreaching and having no basis in law. Design Solutions, as a vendor, is required by the Tax Law to maintain a complete set of books and records showing its sales in New York, and to make them available to the Division upon request (***see,*** 20 NYCRR 533.2[a][2]). Neither the Tax Law nor the decisions of this Tribunal permit a taxpayer to dictate what records the Division may require upon audit.

As noted above, the Division made numerous written requests for Design Solutions' books and records. While such requests did not specifically seek a list of New York customers, the auditor was not required to request such a list. Petitioners argue that the amounts of New York sales could not be provided to the Division because dollar sales were not sorted by state. This argument appears to admit that petitioners' record keeping is not in compliance with the requirements of section 533.2 of the Department's regulations. At the very least, petitioners should have been able to provide a complete list of Design Solutions' customers, and invoices and proposals relating to sales to all of its customers, regardless of location, in response to the auditor's request.

Instead, petitioners stonewalled the Division's auditor at every turn. Petitioners urge that we adopt their position that the Division should have audited each and every one of Design Solutions' customers to determine if tax was paid on their purchases from Design Solutions. We note that at no time during the audit or during the hearing below, did petitioners offer to produce or, in fact, produce a list of all of their New York customers for the audit period. If a list of New

York customers was available, petitioners could have provided such list during the audit. Moreover, assuming that this list was in the possession of petitioners, the New York customers could have been contacted by petitioners and if, in fact, the customers had paid the tax directly to the State, credits against petitioners' assessments (such as the credit provided in the Shorenstein matter) could have been made. Petitioners' attempt to shift the burden of proof to the Division is rejected.

Petitioners argue that the Division is attempting to collect the tax twice, but if double taxation has occurred, it is petitioners' fault. The burden of proof is on petitioners to show that the tax has been paid to the State of New York not twice, but once. Petitioners have failed to meet that burden except to the extent to which they have already had their taxes reduced by the Administrative Law Judge. We also reject petitioners' attempt to treat the auditor's reduction of the tax due as proof that the audit and the audit result are erroneous. To the extent that such errors existed, they were corrected by the auditor based upon evidence produced at the hearing. We decline petitioners' invitation to treat small errors as systemic ones in the absence of evidence, i.e., source records of individual transactions showing independently verifiable sales. While we have included, at petitioners' request, reference to Exhibit "1" in the facts, we do not find that it provides proof of any individual sales transactions in support of petitioners' argument.

As to the corrected errors, the additional tax due has been reduced from $489,951.92 to $465,918.00, plus penalty and interest. If, however, the auditor made assumptions that are unsupported, it is petitioners' failure to provide adequate books and records that led to these assumptions. Petitioners could have produced, at any time during the audit or at hearing, records that would have controverted the auditor's assumptions, but no such records were forthcoming.

Accordingly, absent adequate books and records, it must be found that the audit methodology employed by the Division was reasonably calculated to reflect tax due, and petitioners have wholly failed to sustain their burden of proving, by clear and convincing evidence, that the assessments (after the recomputations) were erroneous or that the audit methodology was unreasonable.

Finally, petitioners assert that penalties assessed should be abated. Referring to the mandatory language of Tax Law § 1145(a)(1)(i), we have said that "the Legislature evidenced its intent that filing returns and paying tax according to a particular timetable be treated as a largely unavoidable obligation [citation omitted]" (***Matter of MCI Telecommunications Corp.***, Tax Appeals Tribunal, January 16, 1992, ***confirmed Matter of MCI Telecommunications Corp. v. New York State Tax Appeals Tribunal***, 193 AD2d 978 [1993]). In the instant matter, Design Solutions, despite doing business and maintaining property in New York, chose not to comply with the statutory requirements of the Tax Law by charging, collecting and remitting sales tax on sales to its New York customers. Moreover, there has no been showing that Design Solutions maintained adequate records of its New York sales and, clearly, it did not produce records as required. As we have held in other cases, the failure to maintain and provide records is reason to sustain the imposition of penalties ***(see***, ***Matter of Rosemellia***, ***supra***; ***see also, Matter of Shukry v. Tax Appeals Tribunal***, 184 AD2d 874 [1992]).

We have reviewed and considered petitioners' remaining arguments, and we find them equally without merit. Therefore, we affirm the determination of the Administrative Law Judge. We find nothing in this record, nor in the arguments presented by petitioners on exception, that would justify our modifying the determination.

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

1. The exceptions of Krystallos, Inc. d/b/a Design Solutions and Stephen Stefanou are denied;

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

3. The petitions of Krystallos, Inc. d/b/a Design Solutions and Stephen Stefanou are granted to the extent indicated in the recomputations table set forth in the findings of fact, as well as the credit of $2,062.50 from the Shorenstein Management invoice, but in all other respects are denied; and

4. The Division of Taxation is directed to modify the notices of determination issued to Krystallos, Inc. d/b/a Design Solutions dated March 30, 2007 and Stephen Stefanou dated April 20, 2007 in accordance with paragraph "3" above.

DATED: Troy, New York
May 13, 2010

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

/s/ Charles H. Nesbitt
Charles H. Nesbitt
Commissioner