

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
FRANK AND DIANE BRUNO	:	DETERMINATION
for Redetermination of a Deficiency or for Refund of Personal Income and Unincorporated Business Taxes under Articles 22 and 23 of the Tax Law for the Years 1972 through 1979.	:	

Petitioners, Frank and Diane Bruno, 33 Joyce Drive, New City, New York 10956, filed a petition for redetermination of a deficiency or for refund of personal income and unincorporated business taxes under Articles 22 and 23 of the Tax Law for the years 1972 through 1979 (File No. 800259).

A hearing was commenced before Allen Caplowaith, Hearing Officer, at the offices of the former State Tax Commission, Two World Trade Center, New York, New York, on October 30, 1986 at 1:15 P.M. The hearing was continued before Timothy J. Alston, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on October 27, 1987 at 1:15 P.M., continued before the same Administrative Law Judge at the same location on May 17, 1989 at 1:15 P.M. and continued to conclusion before the same Administrative Law Judge at the same location on June 20, 1990 at 1:15 P.M. The record was held open for briefs through September 19, 1990. Petitioners appeared at all times by Barry I. Spiegler, Esq. The Division of Taxation appeared at the October 30, 1986 hearing by John P. Dugan, Esq. (Herbert Kamrass, Esq., of counsel) and at all other times by William F. Collins, Esq. (Herbert Kamrass, Esq., of counsel).

ISSUE

Whether the Division of Taxation properly determined additional personal income and unincorporated business taxes due for the years 1972 through 1977 by using the results of a prior sales tax audit and for the years 1978 and 1979 by an analysis of bank deposits .

FINDINGS OF FACT

On July 9, 1982, following an audit, the Division of Taxation issued to petitioners, Frank and Diane Bruno, eight notices of deficiency asserting personal income tax and unincorporated business tax ("UBT") due, plus penalties pursuant to Tax Law § 685(a)(1) and (2) and applicable interest, for the years 1972 through 1979.

The notices of deficiency asserted a total personal income tax deficiency of \$158,139.45 and a total UBT deficiency of \$55,823.15, exclusive of penalties and interest. The asserted deficiencies are set forth below by year:

<u>Year</u>	<u>Income Tax Due</u>	<u>UBT Due</u>
1972	\$ 21,757.82	\$ 8,141.71
1973	19,687.10	7,577.02
1974	19,674.80	7,572.51
1975	31,916.70	11,775.78
1976	36,936.02	9,615.82
1977	14,399.90	5,638.38
1978	5,854.35	2,399.95
1979	<u>7,912.76</u>	<u>3,101.98</u>
Total	\$158,139.45	\$55,823.15

Petitioner Frank Bruno owned and operated a grocery store and deli in Spring Valley, New York known at various times during the audit period as Frank's Superette and Frank's Deli. In 1976, petitioner also operated a store in Florida. Although he maintained a business checking account under the name Franklin Bruno, Inc., petitioner operated his business as a sole proprietorship at all times relevant herein.

All of the additional income found on audit results from the operation of petitioner Frank Bruno's grocery store and deli. Petitioner Diane Bruno, Frank Bruno's wife, is a party herein solely as a result of her having filed joint personal income tax returns with her husband for 1978 and 1979. Accordingly, all references to "petitioner" shall refer to Frank Bruno unless otherwise indicated.

The audit was commenced as a result of a referral from the Division's White Plains District Office, sales tax section, to its White Plains District Office, income tax section. A referral form (DTF-120[6/76] "Exchange of Field Audit Information") was transmitted to the

income tax section on July 13, 1977. The referral was completed by Ronald Cancellieri, the auditor who had performed a sales tax audit of the grocery store and deli owned and operated by petitioner Frank Bruno. The sales tax audit period was June 1, 1972 through February 28, 1977. The referral indicated that the sales tax audit had determined unreported taxable sales of \$1,187,414.56 for that audit period resulting in a sales tax deficiency of \$47,496.58. Under the heading "Records examined", the referral form indicated "Business check acct statements, checkbook stubs & daybook 9/1/75-6/30/76, Partial purchase invoices." Under the heading "Reasons for Referral", the form indicated, "Vendor stated he has not filed business or personal income tax returns since 1968, also appears to have people working 'off the books'."

On August 18, 1977, the Division issued to Franklin Bruno d/b/a Frank's Superette a Notice of Determination and Demand for Payment of Sales and Use Taxes Due. Said notice was premised on the results of the sales tax audit referred to above. Petitioner subsequently filed a petition protesting this notice of determination. Following a hearing on September 21, 1981, the former State Tax Commission, by a decision dated March 31, 1982, sustained the August 18, 1977 notice of determination issued to petitioner. The Commission's decision modified said notice only to account for the Division's failure to apply the appropriate taxable ratio to petitioner's audited gross sales to determine taxable sales. The Commission's decision did not modify, in any respect, gross sales as determined on the sales tax audit.

On audit for income tax purposes, the Division utilized the results of the sales tax audit to determine petitioner's income tax liability for the years 1972 through 1977 as follows:

(a) First, the Division used the gross sales amounts per the sales tax audit (which were calculated by sales tax quarterly reporting periods) to compute gross sales on an annual basis. Where sales tax quarters overlapped into two different years (the December 1-February 28 period), the Division apportioned the gross sales for such quarters into the appropriate year.

(b) For 1972, the sales tax audit covered only from June 1 forward. The Division therefore determined gross sales for January 1 through May 31 by determining the monthly average for gross sales for the seven months of 1972 covered by the sales tax audit and applying

this monthly average to the five months comprising the January 1 through May 31 period.

(c) For 1977, gross sales figures per the sales tax audit were available only through February. The Division took this two-month figure and projected it over the remaining ten months of 1977 to determine petitioner's gross sales for that year.

(d) Having determined gross sales for the 1972-1977 period, the Division next determined cost of goods sold and gross profit figures for each of these years using a markup of 63%, which figure was determined on the sales tax audit. Specifically, the Division divided the annual gross sales amount by 1.63 to reach cost of goods sold. The difference between gross sales and cost of goods sold resulted in gross profit for each of the years comprising the 1972-1977 period as follows:

<u>Year</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>
Gross Sales	\$408,873	\$382,309	\$382,099	\$579,827	\$550,138	\$291,114
Cost of Goods Sold	250,842	234,545	234,417	355,722	293,387	178,598
Gross Profit	158,031	147,764	147,682	224,105	256,751	112,516

(e) Except for cost of goods sold allowances, the Division allowed no other business expenses for the 1972-1977 period.

For 1978 and 1979, the Division used a bank deposits analysis to determine petitioner's income tax liability.

(a) The Division first examined bank statements in respect of petitioner's Chemical Bank account numbered 280-003773 to determine total deposits to this account for both of the years in question. (This Chemical Bank account was petitioner's business account.)

(b) Next, the Division determined petitioner's cash business expenses as follows:

1978: For 1978, the Division first determined petitioner's total business expenses by adding petitioner's schedule C expenses along with an estimated cash draw of \$10,400.00 and unexplained withdrawals of \$8,820.49. The basis for this unexplained withdrawal figure is set forth nowhere in the record. This addition resulted in total expenses of \$145,450.01. The Division then totaled checks written on account number 280-003773 in 1978 (\$130,056.05) and subtracted therefrom non-business checks written on the same account (\$4,301.02) to reach

total business checks written of \$125,955.03. The difference between total expenses and business checks written amounted to \$19,694.98 and was determined to be cash business expenses.

1979: For 1979, the Division determined petitioner's cash business expenses to be \$22,256.00 by using the same method as was used for 1978. This calculation included an estimated cash draw of \$10,400.00 and an unexplained withdrawal figure of \$17,616.60. This \$17,616.60 was explained by the Division only as "a figure [used] to come up with total checks written" and a figure "used to come up with a total of expenses" (Hearing Transcript, pp. 102, 103).

(c) The Division next determined petitioner's personal expenses:

1978: For 1978, the Division estimated deposits with petitioner's personal checking accounts at Chemical Bank and Banker's Trust of \$14,800.00 and \$15,000.00, respectively. These estimates were based on the actual amount of petitioner's deposits into these accounts during 1979. To this total the Division added \$7,500.00 in estimated cash living expenses. Finally, the Division subtracted \$10,400.00 to account for the estimated cash draw in this amount under the cash expenses category.

1979: For 1979, the Division analyzed petitioner's personal accounts at Chemical Bank and Banker's Trust and determined deposits into these accounts of \$14,846.15 and \$15,218.46, respectively. The Division next added estimated cash living expenses of \$7,500.00 and again subtracted \$10,400.00 to allow for the cash draw categorized under expenses.

(d) The results of the bank deposits analyses for 1978 and 1979 are summarized below:

	<u>1978</u>	<u>1979</u>
Total Deposits	\$130,828.26	\$210,499.22
Cash Expenses	19,694.98	22,256.00
Personal Expenses	<u>26,900.00</u>	<u>27,164.61</u>
Gross Sales Per Audit	\$177,423.24	\$259,919.83
Gross Sales Per Return	<u>128,410.00</u>	<u>190,285.00</u>
Additional Gross Receipts	\$ 49,013.24	\$ 69,634.83

On March 26, 1982, the Division issued to petitioner three statements of personal

income tax and three statements of unincorporated business tax audit changes. These statements listed the changes to petitioner's net business income for each of the years 1972 through 1979. These changes are set forth above (Findings of Fact "7[d]" and "8[d]") as "gross profit" and "additional gross receipts". The statements then set forth the computations resulting in petitioner's liability with respect to tax, penalty and interest subsequently set forth on the notices of deficiency dated July 9, 1982. It should be noted that, with respect to the computation of petitioner's income tax liability for 1972 through 1977, the Division allowed petitioner a standard deduction of \$2,000.00 and personal exemptions of \$3,250.00 for each of those years. Additionally, with respect to UBT, the Division made an allowance for taxpayer services of \$5,000.00 and a business exemption of \$5,000.00 for each of the years 1972 through 1977.

As noted, the audit herein was commenced following a referral from the Division's sales tax section to its income tax section. At that time (1977), the auditor assigned to the case was Julian Osadca. Mr. Osadca's supervisor was Mr. Cleveland Best. In January 1978, Mr. Osadca interviewed petitioner's then-representative, Mr. Arthur Batterman. Action on the income tax audit was then suspended until approximately December 1980, at which time Mr. Osadca met with Mr. Batterman and reviewed bank records pertaining to 1978 and 1979. Mr. Osadca generated workpapers based upon his review of such records. Mr. Best also generated workpapers based upon information prepared by Mr. Osadca. In June 1981, this matter was assigned to auditor Dominick Grosso. (Mr. Osadca apparently was no longer employed by the Division at that time.) Working with his then-supervisor, Mr. Best, Mr. Grosso computed the income tax and UBT deficiencies as described herein using information developed by Mr. Osadca and Mr. Best. In 1983, Mr. Cancellieri, the individual who conducted the sales tax audit of petitioner (see Finding of Fact "5"), became Mr. Grosso's supervisor. Mr. Cancellieri remained Mr. Grosso's supervisor through the time of the hearings herein.

A copy of petitioner's 1976 Federal Schedule C was introduced into the record. As noted, during this year petitioner operated a store in Florida in addition to his Spring Valley

store. The 1976 Schedule C indicated gross receipts, cost of goods sold, gross profit, total deductions and net profit as follows:

	<u>Spring Valley</u>	<u>Florida</u>	<u>Combined</u>
Gross Receipts	\$193,125	\$71,918	\$265,043
Cost of Goods Sold	<u>148,694</u>	<u>67,364</u>	<u>216,058</u>
Gross Profit	\$ 44,431	\$ 4,554	\$ 48,985
Total Deductions	<u>30,072</u>	<u>13,876</u>	<u>43,948</u>
Net Profit	\$ 14,359	(\$ 9,322)	\$ 5,037

Pursuant to discussions between the respective representatives at the October 30, 1986 hearing in this matter, the Division's auditors, Mr. Gross and Mr. Cancellieri, petitioner's representative (Mr. Speigler), and petitioner's accountant, Mr. Louis Profenna, met in the Division's White Plains District Office for the purpose of resolving, to the extent possible, the outstanding issues in the instant matter. This meeting took place on December 12, 1986, and at that time petitioner's accountant was in possession of certain documents encaptioned "Income Statements" which purported to set forth petitioner's gross receipts and expenditures for the years at issue. The accountant was also in possession of certain of petitioner's bank statements and cancelled checks pertaining to certain of the years at issue. Petitioner's representative and accountant reviewed with the Division's auditors the information in their possession pertaining to 1979. At the meeting, petitioner's representative sought to persuade the Division's auditors to reconstruct petitioner's income for the years at issue using the documentation brought to the meeting by petitioner's representative and accountant. The auditors refused to abandon the audit methods used to generate the deficiency notices previously issued to petitioner. Upon this refusal, petitioner's representative declined to offer to the auditors for their review documents in his possession pertaining to the other years at issue (specifically 1972 through 1978). Petitioner's representative and accountant also declined to leave the documentation brought to the meeting with the Division's auditors for their review at a later time.

As noted, at the December 12, 1986 meeting the auditors reviewed certain information with respect to 1979. As a result of such review, the Division reduced petitioner's audited additional business income for 1979 from \$69,635.00 (see Finding of Fact "8[d]") to

\$41,543.00. This reduction apparently resulted primarily from information which explained petitioner's (previously) "unexplained" withdrawals of \$28,013.00.

Petitioner's representative also met with the Division's auditors on May 29, 1987. At that meeting, petitioner's representative supplied the auditors with certain previously missing bank statements in respect of one of petitioner's personal accounts. The Division concluded that his information established that deposits to petitioner's personal bank accounts for 1979 should be reduced by \$1,474.00. Additionally, this information satisfied the Division that petitioner transferred \$4,000.00 during 1979 from his personal bank account to his business checking account. The Division thus conceded that petitioner's audited taxable income for 1979 should be further reduced by \$5,474.00.

At hearing, petitioner introduced into the record the documents encaptioned "Income Statements" and the cancelled checks and bank statements referred to in Finding of Fact "12". The "Income Statements" submitted were computer-generated statements dated September 6, 1986 which listed, in summary fashion, monthly and annual sales, costs of goods sold, and specific expense figures. These statements also purported to detail all payments made by check from petitioner's business checking account. Petitioner introduced such "Income Statements" in respect of 1972 through 1974 and 1976 through 1979. No statement was submitted in respect of 1975. Petitioner's accountant prepared the computer-generated statements purportedly using petitioner's business checking account statements and cancelled checks. Petitioner submitted such cancelled checks and bank statements with respect to the months of March through December 1972; January through October 1973; January through December 1974; January through December 1978; and January through December 1979. Virtually no checks or bank statements were submitted in respect of 1975 (2 checks submitted), 1976 (0 checks submitted) or 1977 (11 checks submitted).

The summary statements indicate "net sales" (gross sales less sales tax paid), cost of goods sold, gross profit, total operating expenses and net income as follows:

	<u>1972</u>	<u>1973</u>	<u>1974</u>
"Net Sales"	\$ 68,058.94	(\$ 2,608.12)	\$146,115.39
Cost of Goods Sold	<u>132,755.78</u>	<u>141,168.18</u>	<u>122,776.69</u>
Gross Profit	(\$ 64,696.84)	(\$143,776.30)	\$ 23,338.70
Total Operating Expenses	<u>12,691.25</u>	<u>22,549.36</u>	<u>13,194.20</u>
Net Income	(\$ 77,388.09)	(\$166,325.66)	\$ 10,144.50

	<u>1975</u>	<u>1976</u>	<u>1977</u>
"Net Sales"	(No information provided)	\$171,031.84	\$139,950.38
Cost of Goods Sold		<u>99,192.24</u>	<u>82,880.57</u>
Gross Profit		\$ 71,839.60	\$ 57,149.81
Total Operating Expenses		<u>41,478.76</u>	<u>30,799.65</u>
Net Income		\$ 30,360.84	\$ 26,350.16

	<u>1978</u>	<u>1979</u>
"Net Sales"	\$127,795.98	\$163,481.09
Cost of Goods Sold	<u>87,028.87</u>	<u>116,833.95</u>
Gross Profit	\$ 40,767.11	\$ 46,647.14
Total Operating Expenses	<u>25,393.28</u>	<u>23,646.88</u>
Net Income	\$ 15,373.83	\$ 23,000.26

Prior to 1983, petitioner filed no personal income or unincorporated business tax returns for any of the years 1972 through 1977. Indeed, the record indicates that petitioner had filed no such returns since 1968. Petitioner did file personal income and UBT returns for 1978 on June 16, 1979 and 1979 personal income and UBT returns dated April 14, 1980. These 1978 and 1979 returns were prepared by Arthur Batterman and indicated business income of \$10,026.00 for 1978 and \$13,520.00 for 1979.

In 1983, petitioner filed personal income tax returns for 1972, 1973, 1975 and 1977 and amended returns for 1978 and 1979. These returns were prepared by petitioner's then-representative, Duane P. Howell. None of the returns filed in 1983 listed any business income or loss. Each of these returns did list as "other income" a figure of \$5,200.00.

SUMMARY OF PETITIONER'S POSITION

Petitioner contended that the Division's use of the audit methods employed herein was improper. Petitioner contended that he maintained accurate records that were sufficient to determine his tax liability and that the Division was required to use such records to determine

his liability herein. Petitioner further contended that the Division's audit procedures in this case were tainted by the fact that the auditor in the sales tax matter subsequently became the supervisor of the auditor in the income tax matter. Petitioner took the position that this fact clouded the professional judgment of the income tax auditor thereby resulting in an unreasonable and improper refusal to consider and utilize petitioner's records in computing the tax deficiencies asserted against him.

CONCLUSIONS OF LAW

A. Tax Law § 681(a)¹ provides, in pertinent part, as follows:

"If upon examination of a taxpayer's return under this article the tax commission determines that there is a deficiency of income tax, it may mail a notice of deficiency to the taxpayer. If a taxpayer fails to file an income tax return required under this article, the tax commission is authorized to estimate the taxpayer's New York taxable income and tax thereon, from any information in its possession, and to mail a notice of deficiency to the taxpayer."

B. With respect to the years 1972 through 1977, petitioner did not file personal income or unincorporated business tax returns for these years prior to the issuance of the notices of deficiency in 1982. The Division was therefore authorized to estimate petitioner's personal income tax and UBT liability "from any information in its possession" (Tax Law § 681[a]). Here, the Division had information in its possession from the sales tax audit which indicated gross sales from petitioner's store for the 1972 through 1977 period. Pursuant to Tax Law § 681(a), the Division was authorized to use this information to estimate petitioner's personal income tax and UBT liability. Moreover, it is well established that the results of an audit conducted under one article of the Tax Law may properly be used in an audit conducted under another article of the Tax Law (see, Matter of Joseph and Dolores Bonanno, Tax Appeals Tribunal, December 13, 1990; Matter of Attilio Castaldo, State Tax Commn., February 15, 1985).

C. With respect to the years 1978 and 1979, again pursuant to Tax Law § 681(a), where there is some factual basis for deciding that tax returns as filed do not accurately reflect the true

¹Pursuant to Tax Law former § 722(a), the provisions of section 681 apply to UBT.

income received by a taxpayer, the Division may determine proper income by using indirect audit methods such as the bank deposits analysis employed herein (see, Holland v. United States, 348 US 121, 131-132; Hennekens v. State Tax Commn., 114 AD2d 599). Here, the Division's indirect audit analysis with respect to 1978 and 1979 revealed an underreporting of taxable income and the notice of such deficiency was therefore properly issued.

D. Where, as here, the Division properly issues notices of deficiency to a taxpayer, a presumption of correctness attaches to such notices (Matter of Tavalacci v. State Tax Commn., 77 AD2d 759, 431 NYS2d 174, 175; Matter of Charles W. Denn, Tax Appeals Tribunal, October 25, 1990). Petitioner bears the burden of proof to overcome this presumption (Tax Law § 689[e]).

E. The former State Tax Commission's decision in Matter of Franklin Bruno d/b/a Frank's Superette (State Tax Commn., March 31, 1982) operates to resolve the issue of gross sales for the period of the sales tax audit. Since petitioner has had the opportunity in the previous proceeding to fully litigate the issue of the validity of the sales tax assessment, he is collaterally estopped from contesting the Division's determination, for income tax purposes, of gross sales for the period covered by the sales tax audit, *i.e.* June 1, 1972 through February 28, 1977 (see, Matter of Joseph and Delores Bonanno, *supra*).

F. The deficiency herein arising from the periods January 1, 1972 through May 31, 1972 and March 1, 1977 through December 31, 1977 was projected from the results of the sales tax audit. Since these periods were not addressed in the sales tax case, petitioner is not estopped from challenging the Division's determination of gross sales with respect to the January 1, 1972 through May 31, 1972 and March 1, 1977 through December 31, 1977 periods.

G. Petitioner, however, has failed to establish that the Division's gross sales figures for these periods were improper. For 1972, petitioner's summary sheets show a gross loss of \$64,696.84. Under the instant circumstances, (especially the fact that the summary sheets show a gross loss of \$143,776.30 for 1973) and in the absence of any explanation as to how petitioner could sustain such losses, the 1972 figure is untenable on its face. Petitioner's 1977 gross sales

figure must also be rejected as no documentation establishing this figure is set forth in the record (see Finding of Fact "15").

H. Petitioner's operating expenses (other than cost of goods sold) during the 1972 through 1977 years were not part of the sales tax matter and may properly be challenged herein. In connection with such expenses, since petitioner was operating his business during the audit period, it is obvious that he incurred operating expenses throughout this period. He is thus clearly entitled to some amount of deduction in respect of such expenses. Under such circumstances, it is appropriate to estimate the deductible amount of these expenses (see Cohan v. Commr., 39 F2d 540). In making this estimate, it should be noted that petitioner has not proven the exact amount of the deductions. Specifically, with respect to 1976 and 1977, petitioner presented virtually no checks or bank statements to substantiate his claimed deductions. Moreover, the records provided for 1972 and 1973 are incomplete. Overall, though, the claimed operating expense deductions for 1972 through 1974 and 1976 through 1977 appear to be reasonable in amount and consistent with petitioner's operating expenses for 1978 and 1979 (which expenses were not disputed by the Division). Accordingly, the Division is directed to adjust petitioner's liability herein to allow deductions for petitioner's operating expenses for the following years and in the following amounts:

<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1976</u>	<u>1977</u>
\$12,691.25	\$22,549.36	\$13,194.20	\$41,478.76	\$30,799.65

Since petitioner presented no evidence of his 1975 operating expenses, there is no basis upon which to make any adjustment for that year.

I. Petitioner has failed to show that any further adjustments are warranted to the Division's deficiency determinations for 1978 and 1979. In order to refute the Division's bank deposits analysis (summarized herein in Finding of Fact "8[d]"), petitioner would have had to present evidence to show, e.g., personal deposits to his business account, transfers of funds between accounts and his actual cash living expenses. No such evidence was presented.

J. With respect to petitioner's first contention, regarding audit methods, as noted in

Conclusion of Law "A" the audit methods employed herein are well established as appropriate methods. As to the question of the adequacy of petitioner's records, there is no requirement in income tax that the Division establish the inadequacy of books and records before it may resort to an indirect method (Matter of Giuliano v. Chu, 135 AD2d 893, 521 NYS2d 883; Matter of Osung and Quan Lee, Tax Appeals Tribunal, October 11, 1990). Finally, as to the question of the sales tax auditor later becoming the supervisor of the income tax auditor, errors by the Division on audit resulting in tax liability may be resolved by offering sufficient evidence in respect of such errors at hearing. Except as noted in Conclusion of Law "H", petitioner has failed to prove any errors in the audit herein. That the sales tax auditor subsequently became an income tax supervisor in the instant case does not, by itself, constitute such an error.

K. The petition of Frank and Diane Bruno is granted only to the extent indicated in Conclusion of Law "H"; the petition is in all other respects denied. The Division of Taxation is directed to adjust the notices of deficiency herein in accordance therewith and in accordance with Findings of Fact "13" and "14". As modified, the notices of deficiency are sustained.

DATED: Troy, New York

ADMINISTRATIVE LAW JUDGE