

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition :  
of :  
ANNA DI PACIFIC, :  
A S PARTNER OF DI PACIFIC STEAK HOUSE :  
for Revision of a Determination or for Refund :  
of Sales and Use Taxes under Articles 28 and 29 :  
of the Tax Law for the Periods December 1, 1981 :  
through February 28, 1983 and June 1, 1983 :  
through August 31, 1983. :

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In the Matter of the Petitions :  
of :  
HELEN DI PACIFIC, :  
AS PARTNER OF DI PACIFIC STEAK HOUSE :  
for Revision of Determinations or for Refunds :  
of Sales and Use Taxes under Articles 28 and 29 :  
of the Tax Law for the Period December 1, 1981 :  
through May 31, 1983. :

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DETERMINATION

In the Matter of the Petition :  
of :  
ANNA DI PACIFIC AND HELEN DI PACIFIC, :  
AS PARTNERS OF DI PACIFIC STEAK HOUSE :  
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 September 1, 1983 :  
through November 30, 1984. :

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Petitioner Anna Di Pacific, Route 96, Victor, New York 14564, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the periods December 1, 1981 through February 28, 1983 and June 1, 1983 through August 31, 1983 (File Nos. 803113, 803943 and 803951).

Petitioner Helen Di Pacific, Route 96, Victor, New York 14564, filed petitions for revision of determinations or for refunds of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 1981 through February 28, 1983 (File Nos. 803112 and 803942).

Petitioners Anna Di Pacific and Helen Di Pacific, Route 96, Victor, New York 14564, filed a petition 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 September 1, 1983 through November 30, 1984 (File No. 804340).

A consolidated hearing was begun before Jean Corigliano, Administrative Law Judge, at the offices of the Division of Tax Appeals, 259 Monroe Avenue, Rochester, New York, on July 21, 1988 at 9:15 A.M., and continued to conclusion on August 30, 1988 at 9:15 A.M., with all briefs to be filed by December 9, 1988. Petitioners appeared by Thomas W. O'Connell, Esq. The Audit Division appeared by William F. Collins, Esq. (James Della Porta, Esq., of counsel).

### ISSUES

I. Whether the Division of Taxation was barred from assessing tax, penalty or interest for periods in which petitioners paid tax under the tax amnesty program.

II. Whether the Division has established that each petitioner's failure to accurately report and pay over sales tax was due to fraud.

III. Whether petitioners have established that the amount of sales tax assessed by the Division was incorrect or that the method of audit was unreasonable.

### FINDINGS OF FACT

1. Di Pacific Steak House is a restaurant located in Victor, New York, approximately one mile from the Finger Lakes Race Track. Petitioner Anna Di Pacific inherited the restaurant from her husband. In 1966, Anna Di Pacific formed a partnership with her daughter, petitioner Helen Di Pacific, to conduct and transact business as Di Pacific Steak House. A certificate of partnership, signed by Anna Di Pacific and Helen Di Pacific, was filed in the Ontario County Clerk's Office on September 28, 1966.

2. Following an audit of Di Pacific Steak House, the Division of Taxation issued to petitioners a series of notices of determination and demands for payment of sales and use taxes due as follows:

| <u>Date Issued</u>     | <u>Assessment No.</u> | <u>Period</u>    | <u>Petitioner</u> | <u>Tax Due</u> |
|------------------------|-----------------------|------------------|-------------------|----------------|
| 12/20/85<br>\$8,692.97 | S851220026R           | 12/1/81-11/30/82 | Anna Di Pacific   |                |
| 12/20/85<br>8,692.97   | S851220027R           | 12/1/81-11/30/82 | Helen Di Pacific  |                |
| 3/12/86<br>1,948.80    | S860312000R           | 12/1/82-2/28/83  | Helen Di Pacific  |                |
| 3/12/86<br>1,948.80    | S860312001R           | 12/1/82-2/28/83  | Anna Di Pacific   |                |
| 6/20/86<br>1,737.75    | S860620012R           | 3/1/83-5/31/83   | Helen Di Pacific  |                |
| 6/20/86<br>1,737.75    | S860620013R           | 3/1/83-5/31/83   | Anna Di Pacific   |                |

|                     |             |                 |                              |
|---------------------|-------------|-----------------|------------------------------|
| 9/12/86<br>1,737.75 | S860912000R | 6/1/83-8/31/83  | Helen Di Pacific             |
| 9/12/86<br>1,737.75 | S860912001R | 6/1/83-8/31/83  | Anna Di Pacific              |
| 12/8/86<br>4,970.42 | S861208001R | 9/1/83-11/30/84 | Anna and Helen<br>Di Pacific |

All of the notices were issued to Anna Di Pacific, Helen Di Pacific or both, as partners of Di Pacific Steak House. In addition to assessing tax due, each notice assessed a fraud penalty equal to 50 percent of the amount of tax due plus statutory interest pursuant to Tax Law § 1145(a)(2).

3. Anna Di Pacific did not file a petition with regard to assessment number S860620013R. Helen Di Pacific did not file a petition with regard to assessment number S860912000R.

4. On July 10, 1984, Helen Di Pacific and Anna Di Pacific each granted a power of attorney to Nathan W. Gordon to represent her before the Department of Taxation and Finance in connection with proceedings involving "sales tax for the periods September 1, 1981 through August 31, 1984".

5. Acting under the powers of attorney, Mr. Gordon executed two consents having the effect of extending the period of limitation for assessment of sales and use taxes for the period September 1, 1981 through May 31, 1982 to September 20, 1985.

6. Anna H. Di Pacific and Helen Di Pacific filed Federal partnership tax returns in 1981, 1982, 1983 and 1984. The Division of Taxation began a sales tax field audit of the partnership's books and records in May 1984, when a review of the partnership's 1982 Federal return disclosed a discrepancy of \$135,475.00 between taxable sales as reported on petitioners' sales tax returns for 1982 (with adjustments to conform sales tax quarters to calendar year) and gross receipts reported on the partnership's Federal return.

7. At the commencement of the audit, the auditor was referred to Mr. Gordon, petitioners' accountant, for any necessary information. The auditor made several telephone calls to Mr. Gordon, and they discussed which books and records would be required on audit. By letter dated June 12, 1984, an auditor asked that the following books and records be made available for the purpose of conducting an initial examination: copies of the partnership's 1981, 1982 and 1983 Federal returns; sales and purchase journals; and worksheets for preparing sales tax returns. The auditor also requested that the partnership complete a "Bar Fact Sheet" and "Questionnaire".

8. Mr. Gordon provided these records to the auditor: sales tax returns with related worksheets; Federal and State income tax returns with related worksheets; depreciation schedules; a sales journal; a purchases journal; a check disbursements journal; and some purchase invoices.

9. A review of the partnership's records revealed that the partnership had claimed a tax credit of \$5,940.99 in the quarter ended August 31, 1984 relating to capital acquisitions. The Division disallowed \$3,935.33 of this credit. The basis for the disallowance is not contained in the record. A review of individual invoices disclosed tax due of \$525.00 for the quarter ended February 28, 1984; thus, total tax due on recurring purchases and capital asset acquisitions was approximately \$4,460.00.

10. On November 14, 1984, the auditor visited the premises of Di Pacific Steak House and spoke with Anna Di Pacific. He was told that the restaurant's party rooms were not used until early in 1984. He was also told that the partnership owned a driving range and refreshment stand located near the restaurant.

11. The auditor's examination of records supplied by Mr. Gordon showed no discrepancy between sales recorded in the restaurant's sales journal and sales reported on sales tax returns. Bank deposits substantially correlated with gross receipts as shown on the Federal returns. Furthermore, the auditor identified no discrepancies between sales reported in 1983 and 1984 on sales tax returns and gross receipts reported on 1983 and 1984 Federal returns.

12. The auditor asked Mr. Gordon to explain the discrepancy between sales reported on sales tax returns and gross receipts reported on the Federal return in 1982. The explanation given was that the partnership had income from the rental of real property and from the rental of meeting rooms in the restaurant and these receipts were not subject to sales tax. The auditor requested documentation which would verify claimed nontaxable receipts. In or about May 1985, Mr. Gordon provided the auditor with two sets of worksheets listing the partnership's rental receipts for 1982. The first set was entitled "1982 Rental Received" and showed recurring monthly rentals of real property as follows:

| <u>Source</u>       | <u>Address</u>                   | <u>Amount</u> |
|---------------------|----------------------------------|---------------|
| Cardinal Transport  | Rt. 96, Victor, N.Y.             | \$ 500.00     |
| Ariel Amusement     | Rt. 96, Victor, N.Y.             | 1,000.00      |
| John Butler         | 1428 County Rd. 41, Acton, N.Y.  | 660.00        |
| Scott Smothers      | 18 Santa Circle, Pittsford, N.Y. | 595.00        |
| Rainbow Apts.       | Phoenix St., [illegible], N.Y.   | 125.67        |
| Bristol Harbor Sign | Rt. 96, Victor, N.Y.             | 50.00         |
| Barn Rental         | Hathaway Farm, Victor, N.Y.      | 300.00        |

In addition, the golf range was shown as rented to Terry Hart in the months of April through September for \$2,500.00 per month.

The second set of worksheets is entitled "1982 Rooms Rented Out - Provided People To Serve" and has this notation: "Source - 1982 Appointment book". By date, the worksheets list organizations to whom rooms were purportedly rented, the room charge, a labor charge and a total. There is also a column entitled food, but no entries were made here.

At hearing, Mr. Gordon denied preparing either set of worksheets and stated that he could not recall who prepared them and did not personally know how the information contained on the worksheets had been compiled.

13. After receiving the rental information described above, the auditor repeatedly requested documentation with which to verify the income shown on the worksheets. Over a period of several months, several audit appointments were scheduled with Mr. Gordon and later cancelled or postponed by him. In or about September 1985, Mr. Gordon presented the auditor with several letters which various organizations purportedly sent to Di Pacific Steak House in connection with the rental of rooms from the restaurant in 1982.

14. Upon receipt of the letters from Mr. Gordon, the Division of Taxation attempted to verify their authenticity. Eventually, telephone calls were made and letters sent, not only to the

authors of the letters submitted by Mr. Gordon, but also to other organizations shown on the rental worksheets described in Finding of Fact "12". The responses received by the Division's auditors established that the letters submitted by Mr. Gordon were fabrications.

(a) A letter on the letterhead of the American Cancer Society bears the signature of Betty Lou Capron. The letter is dated January 10, 1982 and states: "Enclosed please find payment for the room rental for our semi-annual meeting." The letter indicates that a payment of \$450.00 was enclosed. In response to an inquiry from the Division, Ms. Capron sent a letter stating that the signature on the letter was not hers, that she was not employed by the American Cancer Society until November 1983, and that the American Cancer Society did not use the facilities of the Di Pacific Steak House in January 1982. The rental worksheet submitted by Mr. Gordon showed no rental to the American Cancer Society in January 1982.

(b) A letter on the letterhead of Mobil Chemical Company is dated August 10, 1982 and bears the signature of Michael Johnson. The letter indicates that the company rented meeting rooms from Di Pacific Steak House on May 12 and August 5 at a charge of \$325.00 per day. In response to the Division's written inquiry, Mr. William A. Erickson, Supervisor of Receivables and Tax Accounting for Mobil Chemical Company, wrote: "We are unable to locate any payments made by us to DiPacific [sic] Steak House, Victor, NY for items listed by you for 1982."

(c) A customer letter from the Manchester Social Club bears the signature of Marianne Kent. The Division was unable to find a telephone listing for the Club or Ms. Kent. A letter sent to the address shown on the customer letter was returned to the Division marked "no such street".

(d) A letter dated March 1983 bears the signature, Jack Litzelman. The letter is on the letterhead of De-Kalb-Pfizer Genetics and indicates that such company held a seminar at the restaurant, paying \$750.00 for room rental. De-Kalb did not pay for or use any facilities at the Di Pacific Steak House in 1982, and Mr. Litzelman did not prepare or sign the letter addressed to Di Pacific Steak House.

15. Under questioning by the Divisions's representative, Anna Di Pacific expressed no knowledge of the customer letters. Mr. Gordon stated only that he had received them from "someone" at Di Pacific Steak House.

16. In 1982, Anna Di Pacific filed a New York State Resident Income Tax Return. An attached Federal schedule E shows income from her partnership interest in Di Pacific Steak House of \$6,314.00. In addition, the return shows income to Mrs. Di Pacific from rentals of two properties. The first property is shown as located at 1428 County Road #41, Victor, New York. The second property is shown as located at 1233 Route 332, Victor, New York. A worksheet states that the first property was owned by Anna Di Pacific and Peter Furfare as joint tenants and the second property was owned by Anna Di Pacific and Helen Di Pacific as joint tenants. Helen Di Pacific also showed rental income from this second property on a worksheet attached to her 1982 New York State Resident Income Tax Return.

17. The real property rental listings provided by Mr. Gordon show that Ariel Amusement rented property located at Route 96, Victor, New York from the partnership in 1982. Ariel never rented property from Di Pacific Steak House, although a predecessor corporation, K & W Vending Co., did.

18. In September 1985, the Division was contacted by an attorney, Thomas O'Connell,

who stated that he represented the Di Pacifics. A meeting was scheduled with Mr. Gordon, Mr. O'Connell and the Division's representatives on October 9, 1985. At this meeting, the Division asked that further business records be provided. Mr. O'Connell requested that Anna Di Pacific and Helen Di Pacific be provided with written assurance that no criminal investigation would ensue as a result of the audit. The Division's representatives stated that they had no authority to provide such assurance.

19. By letter to Mr. O'Connell dated October 16, 1985, the Division requested the following records of Di Pacific Steak House: 1984 Federal and State partnership returns; itemization and substantiation of all receipts from the rental of real property for 1983, 1984 and 1985; itemization and substantiation of nontaxable room rentals for 1983, 1984 and 1985; bank statements, deposit slips and cancelled checks for 1983, 1984 and 1985; sales and purchase journals for 1982, 1983, 1984 and 1985; and cash register tapes and guest checks for 1982, 1983, 1984 and 1985. None of these records were provided to the Division.

20. On or about December 13, 1985, Anna Di Pacific was served with a subpoena from the New York State Department of Taxation and Finance, commanding her, among other things, to produce certain records of the business. In response, she made a motion to quash in New York State Supreme Court. An affidavit accompanying the motion and signed by Anna Di Pacific includes these statements:

"7. That your deponent has been informed by her attorney, Thomas W. O'Connell and accountant, Nathan Gordon, that a tax agent working on your deponent's file had stated that the subpoenaed material could be used to lodge a criminal charge of conspiracy.

8. That considering the aforesaid facts, and upon the advice of Counsel, your deponent asserts the privileges guaranteed under the law against self-incrimination.

9. That as a gesture between your deponent and her only child Helen, your deponent allowed some documents to convey the impression that she and her daughter were partners.

10. That no articles of partnership were ever drawn between your deponent and her daughter.

11. That no certificate of partnership was ever filed in the Ontario County Clerk's Office."

21. A second affidavit signed by Anna Di Pacific and Helen Di Pacific contains these statements:

"1. That they are mother and daughter, sole proprietors of Di Pacific's Restaurant.

2. That all of the business records pertaining to the restaurant were prepared, kept, and maintained by your deponents, all in their own handwriting (attached hereto and made a part here are representative random samples of the records).

3. That no one else kept the records.

4. That the said records were kept for the personal and private use of your deponents, there are no other persons involved in the ownership of Di Pacific's.

5. That the restaurant itself does not have any distinct institutional identity."

22. The business records referred to in the affidavit show receipts from food, liquor and beer, but do not show rental receipts.

23. The Division eventually chose to withdraw the subpoena.

24. Since petitioners failed to present documentation to support their claim of nontaxable receipts from the rental of rooms and real property, the Division deemed the difference between reported sales per sales tax returns and gross receipts per the 1982 Federal return as unreported taxable sales, and on December 20, 1985, it issued assessments in accordance with this conclusion.

25. Gross receipts as shown on the partnership's 1983 and 1984 Federal partnership returns were substantially the same as sales reported on sales tax returns for the same period; however, the returns evidenced a change in the manner in which the partnership reported rental income, as compared with 1982.

In 1982, the partnership filed Federal partnership returns reporting gross receipts of \$502,100.00 and rental income of \$13,000.00.

In 1983, the partnership filed Federal partnership returns showing gross receipts of \$323,388.00 and rental income of \$99,300.00. The attached depreciation schedule lists a real property asset acquired in 1983 with a cost basis of \$98,154.00 and an expected useful life of 15 years.

In 1984, the partnership filed Federal partnership returns showing gross receipts of \$350,654.00 and rental income of \$41,350.00. The depreciation schedule lists a real property asset acquired in 1984 with a cost basis of \$246,928.00 and an expected useful life of 18 years. The depreciation schedule does not list the real property asset acquired in 1983, as shown on the 1983 return, and the return shows no capital gains, capital losses or casualty losses which would explain the absence of the 1983 asset.

By its letter of October 16, 1985, the Division requested substantiation of all real property rentals for 1983 and 1984. Petitioners failed to submit any documentation. Therefore, the Division deemed the rental income as shown on the 1983 and 1984 Federal partnership returns to be unreported taxable sales. Based on this determination, assessments were issued over a period of time as shown in Finding of Fact "2".

26. Late in 1985 or early in 1986, Di Pacific Steak House filed amended sales tax returns and amnesty applications for some, but not all, of the periods at issue. The Division granted amnesty for the periods and taxes designated on the applications. Because the partnership claimed a lesser tax liability under amnesty than the tax due determined by the Division, an outstanding balance remains for each quarter at issue. The schedule below shows the period at issue, the tax determined to be due by the Division, the amount of tax paid under amnesty, and the balance of tax due asserted by the Division at hearing.

| <u>Period Ended</u> | <u>Tax Due</u> | <u>Tax Paid</u> | <u>Balance</u> |
|---------------------|----------------|-----------------|----------------|
| 2/28/82             | \$1,580.54     | \$ 985.23       | \$ 595.31      |
| 5/31/82             | 2,370.81       | 1,123.26        | 1,247.55       |
| 8/31/82             | 2,370.81       | 876.25          | 1,494.56       |
| 11/30/82            | 2,370.81       | 1,332.66        | 1,038.15       |
| 2/28/83             | 1,948.80       | 499.39          | 1,449.41       |
| 5/31/83             | 1,737.75       | -- 1,737.75     |                |
| 8/31/83             | 1,737.75       | -- 1,737.75     |                |
| 11/30/83            | 1,737.75       | -- 1,737.75     |                |
| 2/28/84             | 1,061.69       | 525.00*         | 1,061.69       |
| 5/31/84             | 723.66         | -- 723.66       |                |
| 8/31/84             | 4,659.19       | 4,460.52*       | 723.66         |
| 11/30/84            | 723.66         | -- 723.66       |                |

\* These amounts represent tax due on petitioners' purchases of sales and services. The amended returns filed under amnesty were not submitted into evidence. Apparently the returns showed a greater tax due in the category of "use" tax than that which had previously been determined by the Division (see Finding of Fact "9"). All balances due as shown above and as assessed represent unreported taxable sales as determined by the Division.

After the amnesty application period expired, assessments were issued to petitioners covering the last seven periods shown above. The amount of tax assessed per the notices made allowance for tax paid under the amnesty program.

27. At hearing, Mr. Gordon testified regarding the method he used to determine petitioners' tax liability in conjunction with petitioners' amnesty applications. He stated that before the audit at issue occurred he believed (and apparently advised his clients) that the rental of rooms in the restaurant was not subject to sales tax if no food was served in connection with the room rental. After the audit, he became aware that petitioners could not prove that food was not served each time a rental occurred; therefore, he treated all room rentals as taxable sales.

In order to calculate taxable receipts from room rentals, Mr. Gordon began with the Division's statement of audited additional sales for each sales tax quarter. From this, he subtracted amounts he attributed to nontaxable receipts. The balance was considered to be unreported taxable sales. Tax was paid on these amounts under amnesty. As shown above, additional tax was calculated in this manner only for the period December 1, 1982 through February 28, 1983. At no time were documents substantiating the existence of room rentals submitted to the Division.

28. To demonstrate that additional revenues as shown on petitioners' 1982, 1983 and 1984 partnership returns represented income from other than taxable sales, Mr. Gordon prepared a worksheet captioned, "Di Pacific Steak House/ Deficiency per N.Y.S. Sales Tax." The worksheet calculations were performed in essentially the same manner as the calculations performed for the amnesty applications. Mr. Gordon's starting point was the balance of tax due for all periods at issue as asserted by the Division. He calculated audited taxable sales by dividing tax due by .07, and he subtracted from taxable sales amounts he deemed to be nontaxable receipts. This resulted in total sales tax due for all periods in issue of \$3,771.46. The worksheet lists two sources of income deemed by Mr. Gordon to be not subject to sales tax: "K & W Vending" and "Bldg & Sign Rental".

29. Petitioners presented two documents to explain and substantiate their claim of revenue not subject to sales tax.

(a) The first document is on the letterhead of K & W Vending Co., Inc. It is addressed to Di Pacific Steak House and lists dollar amounts, by month, for the year 1982. It is undated, unsigned and contains no explanatory material. Mr. Gordon testified that he obtained this document from someone at Di Pacific Steak House and presumed it to show commission income from vending machines placed on the premises, but he could provide no other details regarding the document.

(b) The second document is a two-page worksheet prepared by Mr. Gordon. Each page is captioned, "Di Pacific Steak House Rental Income Outside Properties." One page is denoted 1983 and the other is denoted 1984. The worksheet lists, among others, properties located at 1233 Route 332 and 1428 Route 332. The lessees are not identified. Mr. Gordon testified that he prepared the worksheet using a log book provided to him by either Anna Di Pacific or Helen Di Pacific, rental receipts from a printed receipt book and information provided by Anna Di Pacific and Helen Di Pacific; none of these documents were introduced at hearing.

30. In 1983, Anna Di Pacific and Helen Di Pacific each filed a New York resident income tax return. Each return showed rental income from jointly owned property located at 1233 Route 332, Victor, New York. In 1984, each woman's State income tax return showed rental income, but the property or properties on which rentals were received were not identified.

31. During the periods in issue, the sales journal of Di Pacific Steak House was prepared by Helen Di Pacific. Sales tax returns were prepared by Mr. Gordon based on the figures contained in the sales journal. Anna Di Pacific signed six sales tax returns filed during the periods at issue.

32. In 1982, the Division of Taxation conducted a sales tax field audit of Di Pacific Steak House for the period March 1, 1979 through November 30, 1981. Because no cash register tapes, guest checks or exemption certificates were produced during the audit, the Division deemed the restaurant's records inadequate to verify reported sales and resorted to a markup audit to estimate taxes due. The markup audit yielded additional taxable sales of \$210,503.38 for the audit period with a tax due on that amount of \$14,796.68. After a Tax Appeals Bureau conference, the tax due was reduced to \$8,856.36, and the petition filed in the matter was withdrawn. Mr. Gordon was the partnership's accountant during this time.

33. The Division of Taxation submitted 36 proposed findings of fact. In accordance with New York State Administrative Procedure Act § 307(1), these proposed findings of fact have been generally accepted and incorporated into this determination. Proposed findings of fact "14", "21", "25" and "26" have been rejected as containing statements not necessary to the determination. Proposed findings of fact "5" and "24" have been rejected as containing statements not supported by the record as a whole.

#### SUMMARY OF THE PARTIES' POSITIONS

34. It is petitioners' position that they are not liable for any amount of tax, penalty or interest for any quarterly period for which tax amnesty was granted by the Division. They concede additional taxable sales in other quarters of \$53,878.00 with a tax due on that amount of \$3,771.46. Furthermore, petitioners contend that other additional revenues, as shown on the

partnership's 1982, 1983 and 1984 Federal partnership tax returns, were from receipts not subject to sales tax.

Petitioners contend that they fully cooperated with the Division and provided the auditors with all books and records requested until the Division's requests became redundant and burdensome.

35. The Division maintains that the granting of tax amnesty had the effect of forgiving penalty on those taxes paid under amnesty. It continues to assert tax and fraud penalty on all amounts assessed and not paid under amnesty.

The Division contends that petitioners have not established that the partnership received either commission or rental income from any source, and thus, have failed to show that the Division's audit was incorrect.

It is the Division's position that the partnership knowingly filed incorrect sales tax returns for all periods at issue with the intent of evading payment of tax due and that the fraud penalty is properly asserted on all tax remaining due, even if it is found that the fraudulent conduct applied only to a failure to report receipts purportedly received from room rentals. In the alternative, the Division argues that petitioners failed to report all sales tax due and, in lieu of a fraud penalty, a penalty should be asserted under Tax Law § 1145(a)(1).

#### CONCLUSIONS OF LAW

A. The Tax Amnesty Program was adopted by New York State in 1985. The program provided:

"that upon written application by any taxpayer, and upon evidence of payment to the state of New York by such taxpayer of all designated taxes plus interest, [the State Tax Commission] shall waive any penalties which may be applicable and no civil, administrative or criminal action or proceeding shall be brought against the taxpayer relating to the designated taxes plus interest" (L 1985, ch 66, § 1[b]).

The term "designated taxes", as used in the quoted provision, means the taxes specified by the taxpayer on its written application for amnesty (L 1985, ch 66, § 1[a]).

Petitioners argue that because the Division accepted payments of tax in the amounts set forth on the amnesty applications it is now barred from assessing any tax due for those quarters covered by the application. This argument is without support in the statute. Payments under amnesty had the effect of waiving penalties on the taxes paid, whether or not a notice was issued assessing tax. It had no effect on taxes assessed and remaining unpaid, and it did not bar the Division from later issuing assessments for periods in which tax had been paid under amnesty.

B. The Tax Law imposes a tax on every retail sale of tangible personal property, except as otherwise excluded or exempted by statute (Tax Law § 1105[a]) and on the sale of food and drinks by restaurants and taverns (Tax Law § 1105[d][1]). Every person who is required to collect the tax is required to "keep records of every sale or amusement charge or occupancy and of all amounts paid, charged or due thereon and of the tax payable thereon, in such form as the [Commissioner of Taxation and Finance] may by regulation require" (Tax Law § 1135[a]).

Among the records required to be kept are the following: guest checks for a period of three years (20 NYCRR 533.2[a][4]); a true copy of any original sales document, e.g., sales slips, invoices, guest checks, ticket stubs, and cash register tapes (20 NYCRR 533.2[b][1]); and records and supporting documents for all exemptions, exclusions or exceptions allowed by law or claimed in filing sales and use tax returns (20 NYCRR 533.2[d][1]). Furthermore, vendors are required to keep certain informational records. The relevant requirement here is that "[e]very vendor who leases space on his premises to another vendor to operate a leased department or concession...must maintain the name, address and sales tax identification number of the lessee" (20 NYCRR 533.2[e][i]). Upon audit, a vendor must present all records described in 20 NYCRR 533.2 to the Division, kept in a manner suitable to determine the amount of tax due, together with any documentation, summaries and schedules as the Division may request (20 NYCRR 533.2[a][2]). If the records of a taxpayer are determined to be incorrect or insufficient or if requested records are not made available to the Division, the Division may determine the amount of tax due the State by using any information available or on the basis of external indices if necessary (Matter of Carmine Restaurant v. State Tax Commn., 99 AD2d 581; Tax Law § 1138[a][1]).

Here, the Division made repeated requests for source documents to verify petitioners' claim that the difference between the partnership's 1982 Federal return and its State sales tax returns was attributable to nontaxable rental income. The only documents presented were five letters purportedly written by customers of Di Pacific Steak House. Even if these letters were authentic, they would not have been adequate to verify that petitioners had nontaxable receipts from room rentals or from any other source. In this regard, the following facts are noted: the partnership's sales journal did not contain separate entries for room rentals; petitioners presented neither guest checks nor other original sales documents showing room rentals; worksheets listing rental income in 1982 indicated that the source of information was a 1982 appointment book, yet no such book was presented to the Division; and no deposit slips or other documents were presented to show that the partnership received income from either the rental of rooms or the rental of real property. In October 1985, the Division made a written request for documents which would substantiate petitioners' claim of nontaxable receipts in 1982, 1983 and 1984 and for guest checks and cash register tapes for these years. Petitioners did not respond to this request.

Petitioners maintain that the Division had access to the partnership's sales and purchase journals, bank statements, and tax returns for an extended period of time at the beginning of the audit and that further requests for these and additional records were an unnecessary interference with petitioners' business. Therefore, they argue, there is no basis for a finding that they failed to cooperate with the Division or to make records available upon request. This argument is rejected. Upon request, vendors are required to provide the Division with any books and records which the Division deems necessary to determine tax due. As petitioners failed to provide requested books and records, the Division was warranted in estimating tax due on the basis of information available to it (Matter of Carmine Restaurant v. State Tax Commn., supra; Tax Law § 1138[a][1]). Considerable latitude is given to the Division in estimating sales where adequate books and records are not made available. The audit will stand if there is sufficient evidence to establish that "a rational basis existed for the auditor's computation" (Matter of Grecian Square v. New York State Tax Commn., 119 AD2d 948).

Books and records provided by the partnership showed no receipts from sources other than taxable restaurant sales. Despite repeated requests, petitioners failed to provide any books and records to substantiate their claim of rental income. Under these circumstances, it was not unreasonable for the Division to conclude that no such income existed in any of the years under consideration. Accordingly, there was a rational basis for the Division's determination that gross

receipts as reported on the partnership's 1982 Federal tax return and rental income, as reported on the partnership's 1983 and 1984 Federal tax returns, were unreported taxable sales.

C. Where the taxpayer's records are insufficient to verify reported taxable sales and the Division has issued an assessment based upon a reasonable audit methodology, the burden of proof is on the taxpayer to demonstrate that the method of audit or the amount of tax assessed was erroneous (Matter of Surface Line Operators Fraternal Organization v. Tully, 85 AD2d 858). Here, petitioners were granted amnesty for designated taxes for the periods December 1, 1981 through February 28, 1983; December 1, 1983 through February 28, 1984; and June 1, 1984 through August 31, 1984. Petitioners' burden of proof then was to show that the balance of tax due, as asserted by the Division, was erroneous.

At hearing, petitioners claimed that all additional audited sales were, in fact, revenues to the partnership from two sources: (1) commission income received from K & W Vending Co., Inc. in 1982 and (2) income from the rental of real properties owned by the partnership in 1982, 1983 and 1984. They failed to provide any credible evidence to substantiate their claim.

The statement from K & W Vending was undated, unsigned and contained no explanatory material. Standing on its own, it was not sufficient to show nontaxable payments from K & W Vending to the Di Pacific Steak House. Petitioners presented no accounts receivable ledger, bank statements or other documents to verify the supposed payments. Mr. Gordon's was the only testimony regarding the statement, and he could only speculate as to its source.

Petitioners presented no source documents to verify their claim of real property rental income. Furthermore, the worksheets prepared by Mr. Gordon, purportedly from records or information provided by Anna Di Pacific or Helen Di Pacific, conflict with other documents in the record. In 1983, the Di Pacific Steak House reported rental income of \$99,300.00 on its Federal return, but the worksheet prepared by Mr. Gordon shows rental income of only \$42,168.04. Properties shown on the worksheet, namely those located at 1233 Route 332 and 1428 Route 332, appear to be the same properties on which Anna Di Pacific reported receiving rental income on her New York State personal income tax returns. Helen Di Pacific also reported receiving personal income from the property located at 1233 Route 332 in the years 1982 and 1983. These amounts were not shown as Anna Di Pacific's and Helen Di Pacific's distributive share of partnership income, but as personal income to each.

Based on the facts enumerated above, it is concluded that petitioners have not shown that the amount of tax assessed or method of audit was erroneous.

D. During the years in issue, Tax Law § 1145(a)(2) provided:

"If the failure to file a return or pay over any tax to the tax commission within the time required by this article is due to fraud, there shall be added to the tax a penalty of fifty percent of the amount of the tax due [plus interest as set by statute]."

E. In accordance with the amnesty statute, the Division does not assert a fraud penalty on any portion of the assessments paid under amnesty. It does assert that the fraud penalty properly continues to be imposed on the balance of tax determined to be due after the payments made under amnesty are applied. As to its burden of proof, the Division argues that if any portion of the sales tax deficiency paid under petitioners' amnesty application is proved to be attributable to fraudulent conduct, the fraud penalty is then applicable to the unpaid portion of the tax liability.

This argument is rejected as unnecessarily broad. It is sufficient to note that the amnesty statute does not prohibit the assertion of a fraud penalty upon taxes which are not "designated taxes" or taxes not specified on the taxpayer's amnesty application. Whether conduct directly associated with taxes paid under amnesty may support imposition of the fraud penalty on taxes remaining unpaid is a factual question which, like the issue of fraud itself, must be determined upon consideration of the entire record.

F. The Division of Taxation has the burden of proof to establish fraud by clear and convincing evidence, which means that for each quarterly period under consideration it must show that the partnership filed returns underreporting taxable sales, that petitioners knew the returns were false when made, and that petitioners filed false returns with the intent to evade tax due (Mitchell v. Commr., 118 F2d 308; Matter of Cousins Service Station, Tax Appeals Tribunal, August 11, 1988). Fraud need not be established by direct evidence, but can be shown by surveying the taxpayer's entire course of conduct and drawing reasonable inferences from such conduct (see \_\_\_\_\_, Korecky v. Commr., 781 F2d 1566). However, fraud must be proved affirmatively. The Division may not rely on the presumptive correctness of a tax notice to prove fraud (see \_\_\_\_\_, Matter of Cousins Service Station, supra). Even the taxpayer's concession that all or a part of a deficiency is correct does not, without more, sustain the Division's burden of proving fraud (Reherman v. Commissioner, 240 F2d 953, 954; Fulp v. Commissioner, 37 TCM 1567).

G. Upon review of all of the evidence presented, it is found that the Division sustained its burden of proving fraud for the period December 1, 1981 through November 30, 1982 and that petitioners' payment of a portion of the tax due under amnesty had no effect on the tax remaining unpaid. The facts relied on in arriving at this conclusion are these:

(1) The partnership filed Federal tax returns in 1981 and 1982 showing rental income as a separate item from gross receipts. In 1982, the partnership reported rental income of \$13,000.00. These returns evidence an awareness that rental income is not properly includible in gross receipts on the Federal return.

(2) Records provided on audit and at hearing were inconsistent and unreliable. The listing of the partnership's real property rental receipts for 1982 included properties on which Helen Di Pacific and Anna Di Pacific reported receiving personal (not partnership) income in 1982. Information regarding the exact location and ownership of real property and the identities of the persons to whom the property was rented was never provided. Source records, such as rental receipt books, appointment books and log books, were said to have provided the basis for the 1982 real property rental information provided to the auditors, but no such records were ever produced for the Division's review.

(3) Petitioners refused to cooperate with the Division and to make available requested books and records. While petitioners readily made available sales and purchase journals and bank statements for 1982, their cooperation ceased when the Division made inquiries into the source of unreported receipts as shown on the partnership's Federal return. From Spring of 1985 through October 1985, the Division made repeated oral requests for documents to substantiate petitioners' claim of nontaxable receipts. None were forthcoming. In October 1985, the Division made a written request for records. No records were made available. Petitioners' refusal to give the Division access to their records provides affirmative proof of fraud (Estate of Granat v. Commr., 298 F2d 397).

(4) In connection with their motion to quash a subpoena issued by the Division, Anna

Di Pacific and Helen Di Pacific signed and filed affidavits containing false statements, namely that no partnership existed between them and that a certificate of partnership was never filed in the Ontario County Clerk's Office. The inference drawn is that petitioners made false statements to avoid the production of records.

(5) Both Anna Di Pacific and Helen Di Pacific were experienced businesswomen with a certain amount of financial acumen. They successfully ran the Di Pacific Steak House for a period of over 15 years prior to this audit. The Audit Division had previously conducted a sales tax audit of the restaurant, thus petitioners were aware of the records required to be kept and the procedures generally followed on audit. Accordingly, the partnership's failure to pay over taxes due cannot be attributed to the partners' lack of experience or education.

(6) The partners submitted or allowed to be submitted on their behalf fabricated letters purporting to show nontaxable room rentals. While petitioners asserted that tax paid under amnesty was solely attributable to room rental receipts, there is no evidence in the record to support this assertion. Accordingly, there is no reason to confine the relevance of the fabricated letters to tax paid under amnesty.

H. The remaining notices were issued for the period December 1, 1982 through November 30, 1984. The basis for their issuance differs significantly from the basis for the assessments issued for the prior year. In 1983 and 1984, there was no significant difference between gross receipts per the Federal partnership returns and sales reported on State sales tax returns. Furthermore, petitioners made no claim of vending machine commissions or room rental receipts in 1983 and 1984. Accordingly, evidence of fraud as it relates to 1982 is not in itself sufficient to prove fraudulent conduct in 1983 and 1984, rather the evidence must be weighed separately for these years. It is concluded that the Division carried its burden of proof to show that petitioners' failure to pay over tax due in the periods December 1, 1982 through November 30, 1984 was due to fraud. Petitioners refused to cooperate with the auditors in providing records of rental receipts for these periods as well as for the earlier year. At hearing, petitioners' accountant claimed that no regular record of rental receipts was kept by the partnership. In light of the fact that the partnership reported receiving net rental income of \$99,300.00 on its 1983 Federal tax return and \$41,350.00 on its 1984 Federal return, it is difficult to believe that some consistent record of rental receipts was not maintained. Those records which were purportedly used by Anna Di Pacific and Helen Di Pacific to record some rental receipts, i.e., appointment books and log books, were not shown to the auditors or produced at hearing. The worksheet prepared by Mr. Gordon shows rental receipts in 1983 of \$42,168.04, while the 1983 Federal return shows a rental income of \$99,300.00. No explanation was offered for this seeming discrepancy. As in 1982, it appears that rental income claimed for the partnership was also reported as personal income to Anna Di Pacific and Helen Di Pacific. No information was offered to clarify the ownership of the various properties. In fact, petitioners presented no information to the auditors regarding rental income purportedly received by the partnership in 1983 and 1984, including the exact location of the rental properties or the names of persons renting the property. The worksheets showing rental income presented at hearing were similarly lacking in detail, and no source documents were offered to verify the accuracy of the worksheets. Poor recordkeeping may not in itself be sufficient to establish fraud; however, in this case, the fact that petitioners provided no records of the alleged rental receipts is strongly persuasive evidence of a fraudulent intent.

I. Tax Law § 1133(a) provides that every person required to collect tax shall be personally liable for the tax imposed under article 28 of the Tax Law. Included in the definition of "person required to collect tax" is "any member of a partnership" (Tax Law § 1131[1]). Since it has been

shown that Anna Di Pacific and Helen Di Pacific were members of a partnership, doing business and filing sales tax returns as Di Pacific Steak House, each is personally liable and was properly assessed for the taxes at issue. However, it does not follow that the filing of a fraudulent return by a partnership establishes that every member of the partnership is also guilty of fraud (Estate of Roe v. Commissioner, 6 TC 939; Jackson v. Commissioner, 23 TCM 2022, affd 380 F2d 661, cert den 389 US 1015). In order to establish fraud, the Division must show that the partner against whom the penalty was assessed knew of the underpayment of tax. There is substantial evidence in the record establishing that Anna Di Pacific and Helen Di Pacific were actively engaged in all aspects of the operation of Di Pacific Steak House, and hence were aware of the underpayment of tax. Anna Di Pacific signed six of the tax returns filed for the audit period. Helen Di Pacific maintained the partnership's sales journal. Both Anna Di Pacific and Helen Di Pacific provided Nathan Gordon with information and documents used by him to prepare sales tax returns and to prepare the worksheets of purported nontaxable receipts.

J. As no petitions were filed challenging notices numbered S860620013R and S860912000R, the Division of Tax Appeals is without jurisdiction over the subject matter of those notices (Tax Law § 1138[a][1]; § 2008).

K. The petitions of Anna Di Pacific and Helen Di Pacific are denied in all respects.

DATED: Albany, New York  
January 12, 1989

/s/ Jean

Corigliano \_\_\_\_\_

ADMINISTRATIVE LAW JUDGE