

STATE OF NEW YORK
DIVISION OF TAX APPEALS

In the Matter of the Petition
of
CAMPBELL INN, INC.
AND SHIRLEY A. WOOD, AS OFFICER
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 September 1,
1981 through November 30, 1984 and March 1,
1985 through August 31, 1985.

DETERMINATION

In the Matter of the Petition
of
STEL-ED OPERATING CORP.
D/B/A CAMPBELL INN
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, 1981
through August 31, 1985.

Petitioners Campbell Inn, Inc. and Shirley A. Wood, P.O. Box 219, Roscoe, New York 12776, 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 September 1, 1981 through November 30, 1984 and March 1, 1985 through August 31, 1985 (File No. 805828).

Petitioner Stel-Ed Operating Corp. d/b/a Campbell Inn, Tennenah Lake Road, Roscoe, New York 12776, 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, 1981 through August 31, 1985 (File No. 805711).

A consolidated hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on October 18, 1988 at 1:15 P.M., with all briefs filed by November 17, 1988. Petitioners Campbell Inn, Inc. and Shirley A. Wood, as officer, appeared by John J. Seffern, Esq. Petitioner Stel-Ed Operating Corp. d/b/a Campbell Inn appeared by Seligson, Rothman & Rothman (Stewart E. Rothman, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Anne W. Murphy, Esq., of counsel).

ISSUES

I. Whether, in the absence of books and records, the Division of Taxation properly

estimated the tax liability of Campbell Inn, Inc. for the period September 1, 1981 through August 31, 1985.

II. Whether Shirley A. Wood was a person required to collect tax on behalf of Campbell Inn, Inc.

III. Whether petitioner Stel-Ed Operating Corp. d/b/a Campbell Inn, as a bulk sale purchaser under section 1141(c) of the Tax Law, is liable for penalty and interest as well as for the taxes due from the bulk sale seller, Campbell Inn, Inc.

FINDINGS OF FACT

1. Petitioner Campbell Inn, Inc. (hereinafter "Campbell Inn") was a corporation engaged in the business of operating a resort hotel in Roscoe, New York between September 1, 1981 and August 31, 1985 (hereinafter the "audit period"), renting rooms and making sales of food and beverages.

2. During the audit period, petitioner Shirley A. Wood was the president and only officer of Campbell Inn. She signed sales tax returns during the audit period, maintained the books and records of the Campbell Inn at her home, had check-signing authority and managed the business on a day-to-day basis. Neither Ms. Wood nor her representative disputed that, as an officer of the corporation, she was liable for any sales tax the corporation might owe.

3. On or about September 4, 1984, the Division of Taxation began a field audit of Campbell Inn. Several calls were made to the Campbell Inn and its president, Shirley A. Wood, but due to a fuel oil spillage in Ms. Wood's basement, where the records of the Campbell Inn were kept, no books or records were produced.

4. Facing the expiration of the period for assessing taxes for some of the quarterly periods under audit, the Division of Taxation procured three consents extending the period of limitation for assessment of sales and use taxes for the taxable period September 1, 1981 through August 31, 1982 so that taxes for that period could be determined at any time on or before December 20, 1985. Each of the consents was properly executed by a representative of the Division, Steven Klimow, and by Shirley A. Wood on behalf of Campbell Inn.

5. Between September and December of 1985, a decision was made by the Division of Taxation to proceed with an estimated assessment against Campbell Inn and its president, Shirley A. Wood, due to the fact that no books or records had been made available for over a year, despite numerous requests for same. Using corporation income tax returns and information received from the Internal Revenue Service, the Division of Taxation used the unexplained difference between gross receipts reported on the Federal returns and taxable sales reported on New York State sales and use tax returns to calculate the understatement of taxable sales on the New York sales and use tax returns and, ultimately, the additional taxes due. For the years 1982 and 1983 the gross receipts stated on the Federal returns were utilized to calculate a percentage of error for each year, which was applied to reported taxable sales to compute the additional taxes due for those years. However, for quarters outside of the years 1982 and 1983, the Division of Taxation calculated a weighted average percentage signifying the margin of error to be applied to reported taxable sales for each of such quarters. As calculated by the Division of Taxation, the weighted average margin of error was 6.67. The appropriate margin of error was applied to taxable sales reported on the sales tax returns for each of the quarters in the audit period resulting

in additional tax due of \$53,781.03. Due to what was perceived as noncooperation of petitioners, penalty and statutory interest were assessed as well.

6. On December 20, 1985, a Notice of Determination and Demand for Payment of Sales and Use Taxes Due was issued to Campbell Inn, Inc. setting forth tax due of \$44,946.34, penalty of \$10,484.04 and interest of \$8,512.12, for a total amount due of \$63,942.50 for the period September 1, 1981 through November 30, 1984.¹ A second notice was issued to Campbell Inn, Inc. on the same date for the period March 1, 1985 through August 31, 1985 setting forth tax due of \$8,834.69, penalty of \$1,019.34 and interest of \$332.84, for a total amount due of \$10,186.87. On the same date, two notices were also issued to Shirley A. Wood, for the same periods, as a person required to collect tax on behalf of Campbell Inn, Inc., setting forth tax, penalty and interest identical to the sums determined to be due from Campbell Inn, Inc.

7. On November 16, 1987, a conciliation conference was conducted and the aforementioned notices were modified to reflect a decrease in the amount of tax due. The assessments for the period September 1, 1981 through November 30, 1984 were each reduced from \$44,946.34 to \$39,308.70. Those notices for the period March 1, 1985 through August 31, 1985 were each reduced from \$8,834.69 to \$8,092.93. Penalty and interest were sustained, but would be modified based upon the downward modification in the amount of tax due.

8. On or about May 2, 1986, the hotel was sold by Campbell Inn, Inc. to Stel-Ed Operating Corp. The Notification of Sale, Transfer or Assignment in Bulk filed with the New York State Department of Taxation and Finance on August 7, 1986 indicated a total sales price of \$350,000.00 and a sales price of furniture, fixtures, etc. of \$50,000.00. The terms and conditions of the sale set forth on said form were stated as follows:

"No contract of sale was entered into. It was simultaneous agreement to purchase and closing [sic]. This was sale of approximately 80 acres of land improved by some buildings and an old Inn heretofore operated by Seller during summer seasons as Campbell Inn. The Inn building contained old furniture and fixtures having an overall estimated value of no more than \$50,000.00. This was principally a real estate transaction with Seller taking back 15 year \$250,000.00 purchase money mortgage encumbering the land and buildings with a mortgage provision that the mortgage be reduced by \$5,000.00 per acre if ultimate survey determined less than 75 acres of land conveyed."

9. The form setting forth this information, ST-274, was accompanied by a cover letter dated July 31, 1986 and received by the Department on August 7, 1986. The letter stated that a check was enclosed in the sum of \$3,500.00, representing the 7 percent sales tax in effect in Sullivan County for the sale of furniture and equipment estimated to have a value of no greater than \$50,000.00. It also reiterated the terms of the sale set forth on the notification of sale, and contained the additional information that the subsequent purchaser, Stel-Ed Operating Corp., did not actually commence operations until the beginning of July 1986.

10. On August 14, 1986, the Division of Taxation, in response to the July 31, 1986 letter from petitioner Stel-Ed's attorneys, issued a Notice of Claim to Purchaser to "Steel Ed Operating

¹No tax was assessed for the quarters ended February 28, 1982, February 28, 1983 and February 29, 1984.

Corp." [sic], which informed Stel-Ed that no distribution of funds or property should be made until: a) the State Tax Commission had determined the seller's liability, if any; b) payment of said liability had been made to the State; or c) the Division had authorized Stel-Ed to release the funds or property. The notice stated that failure to comply with its terms would subject Stel-Ed to personal liability for any sales tax deficiency determined to be due from the seller.

On September 9, 1986, the Division of Taxation issued a Notice to the Seller to Campbell Inn, Inc., c/o Shirley A. Wood, requesting a remittance of all open assessments. It also informed the seller that the purchaser had been told that it was forbidden to make any distribution of funds or property to the extent of the State's claim for sales taxes determined to be due before a receipt of release authorization.

11. On November 5, 1986, a Notice of Determination and Demand for Payment of Sales and Use Taxes Due was issued to Stel-Ed Operating Corp. d/b/a Campbell Inn setting forth tax due of \$53,781.03, penalty of \$13,227.74 and interest of \$23,164.63, for a total amount due of \$90,173.40 for the period September 1, 1982 through August 31, 1985.² An explanation was contained on the notice which stated:

"The following taxes are determined to be due from Campbell Inn, Inc./Shirley A. Wood, and represents your liability, as purchaser, in accordance with section 1141(c) of the Sales Tax Law."

A Conciliation Order, dated April 15, 1988, indicated that a conciliation conference was held on November 16, 1987, that the above-stated notice of determination and demand for sales tax was modified, and that the amount of tax was lowered to \$47,401.63 plus penalty and interest.

12. As stated in Finding of Fact "3", petitioner Shirley Wood suffered damage from an oil spill in her basement on or about August 28, 1984, approximately one month before the audit began. Ms. Wood testified that all of the books and records of Campbell Inn were located in her basement and were destroyed by the oil spill. The only records provided by petitioner Campbell Inn, Inc. were bank statements for the Campbell Inn; two exempt organization certificates, one of which was dated outside of the audit period and the other failing to state a vendor; a copy of a promissory note due on demand by the Hancock National Bank in the sum of \$60,000.00; and a flier, undated, which described the Campbell Inn of Roscoe, New York as "a little Switzerland in the Catskills".

13. Although it was alleged at hearing that Campbell Inn did substantial business with exempt organizations, and a flier soliciting senior citizen groups was provided, there was no substantiation of any sales to exempt organizations other than the two exempt organization certifications mentioned above. Further, there was no substantiating documentation provided to tie these certificates into gross receipts or any journal or ledger entry. There were also allegations that the gross receipts set forth on the Federal returns included loans to the business, but the only evidence of said loans was the demand note in the sum of \$60,000.00 signed on April 14, 1982 by Ms. Wood. The corporate name Campbell Inn, Inc. does not appear anywhere on the face of the note and the proceeds could not be traced through the Campbell Inn's bank

²No taxes were assessed for the quarters ended February 28, 1982, February 28, 1983, February 29, 1984 and February 28, 1985.

account statements from the Sullivan County National Bank. Petitioners also offered a recomputation and reformulation of Campbell Inn's books and records and taxable sales for the audit period conducted by one Valentine Hassinger, the Campbell Inn's last accountant. However, Mr. Hassinger's reconstruction was based upon conversations with Ms. Wood and not upon any substantiating documentation produced at hearing.

Ms. Wood also testified concerning a notebook containing her recollection of transactions with bus companies and the dates of those transactions. Lamentably, said notebook was not produced in evidence. Further, Ms. Wood made no effort to contact any of the not-for-profit organizations she claimed she did business with during the audit period.

14. The bulk sale purchaser, Stel-Ed Operating Corp., submitted testimony and documentation at hearing with regard to a civil action in Supreme Court, Sullivan County, entitled STS Resort Corporation v. Campbell Inn, Inc., Stel-Ed Operating Corp. and State of New York Department of Taxation and Finance, including a Summons with Notice, an Interpleader Complaint, a Verified Answer of defendant Stel-Ed Operating Corp., an Answer of the State of New York Department of Taxation and Finance, a Notice of Motion filed by Campbell Inn, Inc. requesting dismissal of the complaint, and a Notice of Cross-Motion and attached documents filed by Stel-Ed Operating Corp. These documents were purportedly submitted into evidence in order to provide background information about the circumstances which arose subsequent to the issuance of the notices of determination at issue herein.

15. Although petitioner Shirley A. Wood's testimony with regard to the damage to her books and records is deemed reliable, her testimony with regard to many aspects of the operation of the resort hotel including sales to exempt organizations, loans to the business and her relationship with her former accountant, John Loucks, are not deemed to be creditworthy due to her lapses in memory and inconsistencies.

CONCLUSIONS OF LAW

A. It is clear and not in dispute that the corporation, Campbell Inn, Inc., did not have adequate books and records at the time they were requested by the Division of Taxation in September of 1984. The few records provided were not substantiated by source documents and provided no means to verify the accuracy of the sales tax returns as filed; therefore, the Division properly resorted to external indices to determine the tax due (S.H.B. Supermarkets, Inc. v. Chu, 135 AD2d 1048). In such circumstances, the Division is required to select a method "reasonably calculated to reflect the taxes due" (Matter of Grant Co. v. Joseph, 2 NY2d 196, 206, cert denied 355 US 869), and the burden is on the petitioner to establish by clear and convincing evidence that the method and the amount of the assessment are erroneous (Surface Line Operators Fraternal Organization, Inc. v. Tully, 85 AD2d 858, 859).

Petitioners Campbell Inn, Inc. and Shirley A. Wood, as president of Campbell Inn, Inc., have not sustained their burden of showing error in the audit methodology for the audit period. The only evidence they proffered in opposition to the Division of Taxation's estimate was an estimate performed by their witness, Valentine Hassinger, which estimate was not based on source documentation but on conversations with Ms. Wood, the documents submitted at hearing and the recollection of Ms. Wood, which was not credible. Essentially, they contend that their estimates are better than what they term the Division's "fantasy." Such a challenge to the audit fails on the grounds that any imprecision in the audit methodology is the product of the

corporation's inadequate recordkeeping and is not the product of arbitrary and capricious conduct on the Division's part (Matter of Sol Wahba, Inc. v. State Tax Commn., 127 AD2d 943, 944). Therefore, the notices of determination as modified by the conciliation orders are sustained to the extent of the tax stated thereon against Campbell Inn, Inc. and Shirley A. Wood, as president.

B. Petitioner Shirley Wood argues that the use of the United States tax returns filed by the corporation was unfair since those returns were "somewhat colored by the desire to sell the failing business of the Campbell Inn, Inc. and in the interim obtain enough borrowed money to allow the resort hotel to function unmolested by the demands of its creditors." The filing of false and/or misleading United States income tax returns will not be countenanced by this forum for any reason and the Division of Taxation was justified in relying on information supplied by the corporation to the Federal government on its United States income tax returns.

C. However, the penalties assessed against petitioners Campbell Inn, Inc. and Shirley A. Wood, as president and sole officer, should be cancelled for the quarters ended August 31, 1984, November 30, 1984, May 31, 1985 and August 31, 1985. Tax Law § 1145(a)(1)(i) provides that "any person failing to file a return or to pay or pay over any tax to the tax commission within the time required by...this article...shall be subject to a penalty...." Tax Law § 1145(a)(1) (former [ii]) says that if the Tax Commission determines that such failure or delay was due to reasonable cause and not due to willful neglect it shall remit all of such penalty and that portion of such interest that exceeds the interest that would be payable if such interest were computed at the rate set by the Tax Commission pursuant to Tax Law § 1142. The reasonable cause spoken of in section 1145(a)(1) (former [ii]) is expanded upon in the regulation at 20 NYCRR former 536.1(b) which provided that grounds for reasonable cause, where clearly established, may include the following:

"(2) Destruction of the taxpayer's place of business or business records by fire or other casualty...."

Since the corporation's books and records were destroyed by the oil spill referred to in Findings of Fact "3" and "12" above, prior to the first request by the Division of Taxation for books and records, there exists reasonable cause to remit the penalty and interest in excess of the minimum for the quarters mentioned above.

D. The Tax Law imposes personal liability for taxes required to be collected under Tax Law article 28 upon a person required to collect such tax (Tax Law § 1133[a]). Persons required to collect any tax imposed by article 28 include any officer or employee of a corporation who, as such officer or employee, is "under a duty to act for such corporation...in complying with any requirement of [article 28]" (Tax Law § 1131[1]). Whether an individual is a person required to collect tax depends upon the particular facts of each case (Stacy v. State, 82 Misc 2d 181, 183). Factors stated by the Division's regulations are whether the person was authorized to sign the corporate tax returns, was responsible for managing and maintaining the corporate books or was responsible for managing the corporation (20 NYCRR 526.11[b][2]). Since Shirley A. Wood was the only officer of the corporation, signed sales tax returns, had check-signing authority, managed the business on a day-to-day basis and kept the corporate books, she was an individual required to collect the tax.

E. The bulk sale of the business and miscellaneous items to Stel-Ed Operating Corp. occurred on or about May 2, 1986. Notification of said sale was made to the Division of Taxation on or about August 7, 1986. Petitioner Stel-Ed Operating Corp. argues that it should

not be liable for the penalties and interest assessed against Campbell Inn pursuant to its reading of Tax Law § 1141(c).

Tax Law § 1141(c) provides, in pertinent part:

"Whenever a person required to collect tax shall make a sale...in bulk of any part or the whole of his business assets, otherwise than in the ordinary course of business, the purchaser...shall at least ten days before taking possession of the subject of said sale...notify the tax commission...of the price, terms and conditions thereof whether or not the seller...has represented to, or informed the purchaser, ...that he owes any tax pursuant to this article, and whether or not the purchaser...has knowledge that such taxes are owing, and whether any such taxes are in fact owing."

In brief, there is an absolute requirement on a bulk purchaser to provide the statutory notification.

Section 1141(c) provides further, in pertinent part, that:

"Whenever the purchaser...shall fail to give notice to the tax commission as required by the preceding paragraph, or whenever the tax commission shall inform the purchaser...that a possible claim for such tax or taxes exist, any sums of money...or other consideration, which the purchaser...is required to transfer over to the seller... shall be subject to a first priority right and lien for any such taxes theretofore or thereafter determined to be due from the seller...and the purchaser...is forbidden to transfer to the seller...any such sums of money...to the extent of the amount of the state's claim. Within ninety days of receipt of the notice of sale...from the purchaser..., the tax commission shall give notice to the purchaser...and to the seller...of the total amount of any tax or taxes which the state claims to be due from the seller...to the state, and whenever the tax commission shall fail to give such notice to the purchaser...and the seller...within ninety days from the receipt of the notice of sale..., such failure will release the purchaser...from any further obligation to withhold any sums of money...or other consideration, which the purchaser...is required to transfer over to the seller.... For failure to comply with the provisions of this subdivision, the purchaser...shall be personally liable for the payment to the state of any such taxes theretofore or thereafter determined to be due to the state from the seller..., except that the liability of the purchaser...shall be limited to an amount not in excess of the purchase price or fair market value of the business assets sold...to such purchaser..., whichever is higher, and such liability may be assessed and enforced in the same manner as the liability for tax under this article." (Emphasis added.)

The purpose of section 1141(c) is twofold: (1) to provide the Division of Taxation with adequate time to determine whether there are any taxes due the State from the seller of a business prior to the consummation of the sale; and (2) to preserve the Division's ability to collect any of the seller's liability from the consideration for the assets of the business being transferred. The purpose is accomplished by requiring the purchaser to notify the Division of the proposed sale and by requiring the Division to notify the purchaser and the seller in order to secure its first priority right and lien against the consideration for the business.

Where the purchaser fails to comply with the requirements of section 1141(c), such section

provides that he is personally liable for the payment to the State of any taxes determined to be due the State from the seller up to the amount of the purchase price or fair market value of the business assets (see____, Matter of Giovanni Velez, Tax Appeals Tribunal, May 26, 1988).

The Division of Taxation has adopted regulations that provide that such a purchaser is also liable for penalty and interest for which the seller would be liable (20 NYCRR 537.4[a], [d]). These regulations holding the bulk sale purchaser potentially liable for penalty and interest due from the seller are correct in their interpretation of section 1141(c) of the Tax Law and consistent with the principle of derivative liability. Since Stel-Ed Operating Corp. has not established that its failure to comply with the bulk sale notification provisions of Tax Law § 1141(c) was not willful or with intent to evade or defeat the tax, it is liable for the penalty and interest assessed against Campbell Inn, Inc. (as modified) as its bulk sale purchaser. (20 NYCRR 537.4[f].)

F. The petition of Campbell Inn, Inc. and Shirley A. Wood is granted to the extent set forth in Conclusion of Law "C" above, but in all other respects it is denied; and the notices of determination issued on December 20, 1985 are sustained as modified by said Conclusion and by the Conciliation Order discussed in Finding of Fact "7".

G. The petition of Stel-Ed Operating Corp. is granted to the same extent as the petition of Campbell Inn, Inc., and is in all other respects denied; and the notice of determination dated November 5, 1986 is sustained as modified herein and by the Conciliation Order discussed in Finding of Fact "11".

DATED: Albany, New York
February 16, 1989

/s/ Joseph W. Pinto,

Jr. _____
ADMINISTRATIVE LAW JUDGE