STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions of ACADEMY BEER DISTRIBUTORS, INC. AND JAMES LYONS, AS OFFICER for Revision of Determinations or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period March 1, 1981 through May 31, 1984.	:	DETERMINATION DTA NO. 806189 AND 806190

Petitioners, Academy Beer Distributors, Inc. and James Lyons, as officer, 3817 East Tremont Avenue, Bronx, New York 10465, filed petitions for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1981 through May 31, 1984.

A hearing was held before Thomas C. Sacca, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on March 27, 1990 at 9:15 A.M. Petitioners filed a brief on December 14, 1990. The Division submitted its brief on May 6, 1991 and petitioners filed a reply brief on May 20, 1991. Petitioners filed a supplement to their briefs on December 16, 1991 and the Division filed a supplement to its brief on December 19, 1991. Petitioners appeared by Robert Plautz, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Michael B. Infantino, Esq., of counsel).

ISSUES

I. Whether the sales tax field audit conducted by the Division of Taxation utilized an audit method reasonably calculated to reflect the taxes due.

II. Whether petitioners have established that the result of the audit method used was unreasonably inaccurate or that the amount of tax assessed was erroneous.

III. Whether the Division properly imposed a penalty for fraud, or whether, in the alternative, the Division established that petitioners were liable for a penalty for failure to file a return or

pay tax when due.

FINDINGS OF FACT

On December 20, 1985, the Division of Taxation issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due to petitioner Academy Beer Distributors, Inc. ("Academy") for the period March 1, 1981 through May 31, 1984 which assessed a sales tax liability of $192,171.54, plus fraud penalty (Tax Law § 1145[a][2]) and interest. On the same date, the Division of Taxation issued an additional Notice of Determination and Demand for Payment of Sales and Use Taxes Due spanning the same period and assessing the same amounts as above to petitioner James Lyons, as officer of Academy. The notice indicated that he was personally liable as an officer of Academy for taxes determined to be due from the corporation. The notices were based upon the results of a field audit of the business operations of Academy as described hereinafter.

In September 1983, the Division sent a letter to Academy advising that the corporation's sales tax returns for the period September 1, 1980 through August 31, 1983 were scheduled for field audit. The letter requested that all books and records pertaining to the sales tax liability for the period under audit be made available. The letter further stated that the books and records provided should include journals, ledgers, sales invoices, purchase invoices, cash register tapes, exemption certificates and all sales tax records. Subsequently, the period of audit was adjusted to commence on March 1, 1981 as Academy had been recently audited through February 28, 1981.

On May 16, 1984, petitioner Academy executed a consent having the effect of extending the period of limitations for assessment of sales and use taxes for the period March 1, 1981 through May 31, 1981 to September 20, 1984. On September 5, 1984, petitioner Academy executed a second consent which extended the period of limitations for assessment of sales and use taxes for the period March 1, 1981 through November 30, 1981 to March 20, 1985. On February 13, 1985, petitioner Academy executed a third consent which extended the period of limitations for assessment of sales and use taxes for the period March 1, 1981 through May 31,

1982 to September 20, 1985. On September 17, 1985, petitioner Academy executed a fourth consent which extended the period of limitations for assessment of sales and use taxes for the period March 1, 1981 through August 31, 1982 to December 20, 1985. The four consents were signed by petitioner James Lyons as president or secretary of the corporation.

On March 1, 1984, the auditor met with petitioner James Lyons to review the books and records of the business operation. Academy was a wholesale and retail beer and soda distributor. William Dowling, James McSwigen and James Lyons were officers of the corporation.

The auditor was provided with the corporation's Federal and State income tax returns for the years 1982 and 1983, worksheets for the income tax returns and a general ledger. The auditor was advised by Mr. Lyons that cash register tapes were not available because they were discarded at the end of each day. Sales invoices pertaining to taxable sales or tax collected were also not maintained by the corporation. The corporation maintained only those invoices which related to wholesale transactions.

Mr. Lyons maintained a day book for the corporation in which he entered the retail, wholesale and gross sales on a daily basis. The corporation's accountant totalled the gross sales as shown on the corporation's daily books for each quarter to arrive at reported gross sales on the sales and use tax returns. Taxable sales as shown on the summary of the corporation's daily book were multiplied by the tax rate to arrive at the amount of reported tax due. However, the auditor learned that taxable sales were estimated in almost every quarter and then adjustments were made in the following quarter. The sales and use tax returns for the entire audit period at issue were signed by James Lyons as president of Academy.

Given the limited availability of records as described above and the lack of source documentation detailing the sales activities of Academy, including its gross and taxable sales or the amounts and contents of individual transactions, the auditor concluded that Academy had inadequate books and records for purposes of conducting a detailed audit of Academy's retail sales.

The auditor initially reconciled the gross sales as reported on the sales and use tax returns with the sales per the daily sheets and the sales as shown on the Federal income tax returns. As the sales as shown on the daily sheets were slightly higher, this amount of gross sales was used for purposes of the audit.

Due to the inadequacy of Academy's records, the auditor decided to perform a test of nontaxable sales for the quarter ended May 31, 1983. After the nontaxable sales test was performed, the auditor discovered that certain customers of Academy which were included in the test were not in business at the time of the sale as indicated on the wholesale invoice. As a result of this discovery, the auditor decided to review the nontaxable sales for the entire audit period, which had been extended to May 31, 1984. Therefore, the auditor requested that Academy provide its wholesale nontaxable invoices for the period March 1, 1981 through May 31, 1984.

During the period at issue, Academy had reported nontaxable sales in the amount of $2,565,250.00. In response to the auditor's request, Academy produced for review $1,180,229.24 in wholesale nontaxable invoices for the audit period. As petitioner was unable to substantiate the remaining claimed nontaxable sales, the auditor determined that $1,385,021.00 were taxable sales subject to the imposition of sales tax.

The second portion of the audit consisted of a review of the wholesale invoices supplied by Academy. The auditor, with the assistance of an investigator from the New York City Tax Enforcement Bureau, conducted an investigation of the vendors listed on these invoices. Of the 176 vendors listed on the wholesale invoices, the auditor attempted to contact 46 of the vendors to verify the information contained on Academy's invoices. The 46 vendors were sent Information Document Request letters by the investigator which requested that the vendors state the amount of beer and soda purchased from Academy during the audit period. Ten of the vendors contacted completed and returned the information request letter. Nineteen other vendors were contacted by either a follow-up telephone call or field visit to the business premises. Of the 29 vendors from whom information was obtained, 20 indicated that they had

made no purchases from Academy, 5 indicated that they had purchased less than that claimed by Academy and 4 indicated that they had purchased the amount claimed by Academy. The results of this investigation were recorded by the investigator on a worksheet which listed the vendor, method of contact, the amount claimed by Academy, the amount reported by the vendor and the difference. The worksheet bears a date of February 5, 1985. No testimony was presented by either party to explain the significance or purpose of this date. The 29 vendors accounted for $456,992.64 of the $1,180,229.24 in wholesale invoices supplied by Academy for review. The difference between the amounts claimed by Academy and the amounts reported by the vendors was $369,611.23. By dividing the difference by the amount claimed by Academy relating to these 29 vendors, the auditor determined a disallowance rate of 81% which was applied to the total of the wholesale invoices provided, resulting in additional taxable sales of $955,983.00. The tax as shown on the notice of determination is based upon the total of claimed nontaxable sales where there was no invoice and the disallowed nontaxable sales based upon the disallowance rate revealed by the investigation of the 29 vendors. Fraud penalty was imposed due to the amount of underreporting determined upon audit, the consistent taxable ratio that appeared on the sales and use tax returns, the reporting method employed by Academy in filing its sales tax returns and Academy's failure to maintain adequate books and records. In the alternative, the Division requested in its answer the penalty for late payment of taxes due.

In support of the information found on the worksheet detailing the 29 vendors contacted by the investigator, the Division introduced into the record of this matter the returned and completed Information Document Requests and the notes of the investigator relating to his contacts with the vendors. There was no documentation or notes relating to seven of the vendors contacted. The Information Document Requests provided are either unsigned or, if signed, unclear as to the relationship of the individual to the vendor's business operation. The notes provide the name of the person contacted, which is either the owner, an employee or a relative of the owner of the vendor. Two of the persons contacted refused to provide written confirmation of their purchases from Academy. The Division did not attempt to corroborate the

information received by reviewing the records of the vendors. In addition, the Information Document Requests are either undated or bear a date which is subsequent to the date appearing on the worksheet which summarizes the information received from the 29 vendors. The investigator's notes list the dates of the contacts with the vendors. Some of the dates are subsequent to the date appearing on the worksheet. Neither the auditor who performed the audit nor the investigator who obtained the vendor information testified at the hearing held with regard to this matter. The Division did offer at the hearing the testimony of the auditor's team leader.

The circumstances surrounding one of the 29 vendors deserve specific mention. During the course of the audit, the auditor recorded Academy's vendors, their addresses and amounts of their purchases during the audit period. One entry appeared as follows: "Silver Beach Deli (Tavern) 4 Plaza Place, Bronx, New York (4 Poplar Ave.?)"

At the hearing, Mr. James Duffy, owner of the Silver Beach Deli ("Deli") from July 1982 through December 1985 testified that there existed a business operation under the name of the Silver Beach Tavern ("Tavern"). The Tavern was situated near the Deli and was located on Poplar Avenue. Mr. Duffy testified that he purchased beer and soda from Academy and received with each delivery a purchase invoice detailing the items purchased. After being asked by the investigator to supply the Deli's purchases from Academy, Mr. Duffy reviewed those invoices to determine those purchases.

Introduced into the hearing was the testimony of Dr. Ira Perrelle, a professor of business, economics and psychology, who has taught statistics at several colleges and universities in New York and Pennsylvania. Dr. Perrelle holds a doctorate in psychology and has taken graduate level course work in statistical analysis. He has been retained to do statistical analysis work for various corporate entities. It was Dr. Perrelle's opinion that the "sample" of 29 vendors used by the Division could not be used to project the results of the investigation onto the "universe" of 176 vendors.

Dr. Perrelle testified that he conducted computer statistical tests on the list of 176 vendors

to determine whether the "sample" of 29 was representative of either the unsampled accounts or the total of 176 accounts. The representative characteristic looked for in each group was the amount of purchase. Dr. Perrelle's conclusion was that the "sample" of 29 was in no way representative of the entire "universe" of 176 or of the group that was not sampled. According to Dr. Perrelle, there was less than a one in 10,000 probability that the "sample" of 29 was representative of the "universe" of 176. He stated that this probability is unacceptable and that an acceptable probability would be between one in 20 and one in 100. Dr. Perrelle also testified that a statistically proper projection could have been made if the auditor had used a random number table to select approximately 25 accounts as a source of the information sought.

During 1985 the corporation and Mr. Lyons were indicted on 13 counts of Offering a False Instrument for Filing in the 1st Degree, a Class E felony under Penal Law § 175.35. The counts correspond to the 13 quarters in the audit period. On October 23, 1987, Mr. Lyons pled guilty to the lesser included offense of Offering a False Instrument for Filing in the 2nd Degree, for the quarter ended May 31, 1984, in satisfaction of the indictment. This offense is a Class A Misdemeanor under section 175.30 of the Penal Law. Mr. Lyons entered an Alford plea pursuant to North Carolina v. Alford (400 US 25 [1970]). An Alford plea involves the defendant entering a plea of guilty to avoid the risk of conviction on a more serious charge, even though disputing the evidence of guilt. In the Alford case, the Supreme Court held that it was proper for the trial court to accept the plea of guilty even though the defendant claimed to be innocent, because the plea represented a voluntary and intelligent choice among the alternative courses of action open to the defendant. The Court considered the plea valid when viewed in light of the evidence against him, which substantially negated his claim of innocence and which further provided a means by which the judge could test whether the plea was being intelligently entered. The Court ruled that there must be a strong factual basis for the plea as demonstrated by the State's case, that is, the record must contain strong evidence of actual guilt, and that the defendant chose the plea to avoid harsher penalties if convicted at trial.

The record of the plea allocution of Mr. Lyons contains the following statements of the

presiding justice of the Supreme Court of the State of New York:

> "Now, an Alford plea is that type of plea of guilty where a person pleads guilty, but does not admit his guilt. The Courts accept Alford pleas under certain circumstances. The Court must first determine from the records available to the Court that the People have witnesses and proof that would probably result in a conviction after trial."

The presiding justice further stated, in reference to various business owners to whom Academy claimed to have made tax-exempt sales during the period under audit, that:

> "the People have put sworn testimony before a Grand Jury and made available to me, which indicates that these individuals did not purchase beer or, if they did purchase beer, purchased in lesser amounts than the corporation gave to the tax people and that there was an underpayment of taxes or an improper credit.... [B]ased on the sworn testimony of these witnesses the People would have been able to make out a prima facie case for a number of felony counts contained in the indictment and that's the basis for my accepting the Alford plea."

The corporation entered a guilty plea, through Mr. Lyons, to the lesser included offense of Offering a False Instrument for Filing in the 2nd Degree, a Class A Misdemeanor, in satisfaction of the 13-count indictment. Mr. Lyons admitted that the corporation filed or caused to be filed a quarterly sales tax return for the period ended May 31, 1984 containing false information with the Department of Taxation and Finance. Unlike Mr. Lyons' plea, the corporation did not enter an Alford plea.

The corporation and Mr. Lyons each received a conditional discharge, were required to make restitution in the amount of $20,000.00 and each received a certificate of relief from civil disabilities.

Following an audit for the period March 1, 1978 through February 28, 1981, the corporation received a statement from the Division of Taxation that no additional tax was due.

Mr. Lyons conceded that he was a person required to collect tax on behalf of Academy during the periods at issue pursuant to Tax Law §§ 1131(1) and 1133(a).

During the years at issue it was the policy of the Division that a beer distributor/wholesaler was not required to obtain a resale certificate when making sales at the wholesaler/retailer level. The Division's policy was that the purchasers who had a valid alcohol beverage license would have sufficient proof of their exempt status.

SUMMARY OF THE PARTIES' POSITIONS

Petitioners claim that the "sample" of 29 of the 176 wholesale accounts is unreliable and therefore cannot be projected onto the "universe" of the 176 accounts. According to petitioner, the "sample" is unreliable because the confirmations are unsigned, undated and unverifiable, as well as the fact that seven of the confirmations were not introduced into the record. In addition, petitioner claims that the Division failed to review the records of the vendors to verify the information received. Under these circumstances, the Division has not proved that the audit had a rational basis.

Petitioner's second argument with regard to the sales tax assessed based on the Division's review of the 29 wholesale accounts is that the probability that the "sample" of 29 was representative of the "universe" of the 176 wholesale accounts is too low to be an acceptable statistically drawn sample. Therefore, the "sample" used by the Division cannot be projected onto the entire "universe" of the 176 accounts.

In the supplement to their briefs, petitioners contend that the portion of the audit based upon the third-party verifications cannot be sustained, citing Mobley v. Tax Appeals Tribunal, (___ AD2d ___, 576 NYS2d 412). It is the position of petitioners that the Mobley case stands for the proposition that hearsay evidence in documentary form, which is introduced to support a sales tax determination, "must possess some indicia of trustworthiness and reliability from the face of the document", and that the confirmations used by the auditor in the instant matter do not satisfy this requirement.

With regard to the Division's assessment of sales tax based upon the disallowance of all unsubstantiated claimed nontaxable sales, petitioner asserts that no rational basis exists because the Division did not select a method reasonably calculated to reflect petitioners' sales tax liability, but simply deducted the amount shown on the 176 accounts from the total of all claimed nontaxable sales. Petitioner argues that Tax Law § 1138(a)(1) requires the Division to estimate the tax due, using some audit methodology, when a taxpayer's books and records are inadequate.

Petitioner also claims that its books and records were adequate as evidenced by the receipt of a "no change" letter concerning the earlier audited period and the ability of the Division to conduct the test period audit for the period ended May 1983.

Petitioner contends that the fraud penalty cannot be sustained for the following reasons:

a. the confirmation figures were not corroborated as being the actual figures received from the vendors.

b. The plea of guilty on behalf of the corporation by Mr. Lyons does not have any collateral estoppel consequences to the corporation because Mr. Lyons entered an Alford plea individually.

c. Both Mr. Lyons and the corporation received a conditional discharge and a certificate of relief from civil disabilities.

It is the position of the Division that, given the inadequacy of the corporation's records, it was proper to use external indices to calculate the tax liability of petitioners. The Division further contends that there is no requirement that the audit method yield a statistically valid result. The Division emphasizes that it is petitioners who have the obligation to prove by clear and convincing evidence that the result of the method used was unreasonably inaccurate or that the amount of tax assessed is erroneous. According to the Division, petitioners have failed to produce any adequate and verifiable source documentation which would establish the correct amount of nontaxable sales.

In response to petitioners' position concerning the Mobley case, the Division asserts that such decision is in error and should not be a consideration in this determination. According to the Division, the Appellate Division erroneously shifted the burden of proof to the Division to establish that the notice of determination was properly issued. Furthermore, the Division contends that it was an error for the court to substitute its judgment for that of the Tribunal in weighing the evidence of the hearing.

With regard to that portion of the audit which disallowed claimed nontaxable sales because no documentation was provided, the Division states that all receipts for tangible

personal property are subject to tax until the contrary is established, and petitioners have failed to meet their burden of establishing the nontaxability of the undocumented transactions.

The Division claims that it has met its burden of proving that the fraud penalty was properly imposed against both petitioners, relying on the following:

a. the estimation of taxable sales on the sales tax returns.

b. The lack of invoices for over half of the corporation's reported sales and the lack of cash register tapes.

c. The results of the audit which indicated substantial underreporting of taxable sales and sales tax due.

d. The consistent pattern of underreporting as exhibited by the consistent taxable ratios used throughout the audit period.

e. The corporation's plea of guilty to the charge of Offering a False Instrument for Filing in the 2nd Degree, a Class A Misdemeanor.

CONCLUSIONS OF LAW

A. Tax Law §§ 1135 and 1142(5) provide that a taxpayer is under a duty to maintain complete, adequate and accurate records of its sales and to make the same available for audit upon request. These records must be kept in a manner suitable to determine the correct amount of tax due and must be available for the Division's inspection upon request (Tax Law § 1135[d]; 20 NYCRR 533.2[a][2]). The regulations provide that among the sales records required to be maintained are:

> "sales slip, invoice, receipt, contract, statement or other memorandum of sale,...cash register tape and any other original sales document" (20 NYCRR 533.2[b][1]).

Tax Law § 1138(a) further provides that where adequate records are not maintained or made available, the Division of Taxation is entitled to resort to indirect methodologies, including external indices, in conducting audits and determining the accuracy of a taxpayer's returns as filed.

B. The Division of Taxation's resort to external indices as a method of computing sales

tax liability must be founded upon a determination of the insufficiency of the taxpayer's recordkeeping which makes it virtually impossible to verify sales receipts and conduct an audit (Chartair, Inc. v. State Tax Commission, 65 AD2d 44, 411 NYS2d 41). In such circumstances, the Division of Taxation must select a method of audit reasonably calculated to reflect tax due (Matter of Grecian Square v. State Tax Commission, 119 AD2d 948, 501 NYS2d 219), and the burden is on petitioner to establish by clear and convincing evidence either that the method used to arrive at the tax assessment was unreasonable or that the assessment itself is erroneous (Matter of Sol Wahba, Inc. v. State Tax Commission, 127 AD2d 943, 512 NYS2d 542).

To determine the adequacy of a taxpayer's books and records, the Division of Taxation must first actually request the books and records (Matter of Christ Cella, Inc. v. State Tax Commission, 102 AD2d 352, 477 NYS2d 858) for the entire period of the proposed assessment (Matter of Adamides v. Chu, 134 AD2d 776, 521 NYS2d 826, lv denied 71 NY2d 806, 530 NYS2d 109), and must make a thorough examination of such records (Matter of King Crab Restaurant, Inc. v. Chu, 134 AD2d 51, 522 NYS2d 978), before proceeding to external indices to determine the taxpayer's sales tax liability.

C. The Division of Taxation made a written request for the corporation's books and records relating to the period September 1, 1980 through August 31, 1983. Subsequently, the auditor orally requested that the corporation provide its wholesale nontaxable invoices for the period March 1, 1981[1] through May 31, 1984. It is undisputed that Academy's sales records were inadequate, given the lack of sales invoices relating to taxable sales, the lack of cash register tapes and the incomplete nontaxable invoices, as well as the discrepancies that existed between the sales tax returns and daily sheets and the estimated method of arriving at tax due on the returns. Furthermore, petitioners conceded that cash register tapes were discarded and sales records relating to taxable sales were not maintained. Under these circumstances, the use of an indirect audit method was appropriate (Matter of Licata v. Chu, 64 NY2d 873, 487 NYS2d 552;

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[1]The period September 1, 1980 through February 28, 1981 was not included in the current audit as it was part of an earlier audit.

NYS2d 678, lv denied 77 NY2d 803, 567 NYS2d 643). Thus, the only remaining issues with regard to the estimated portion of the audit are whether the particular methods employed, and the results thereof, were irrational or erroneous.

D. When a taxpayer's records are inadequate, the Division of Taxation must select an audit method reasonably calculated to reflect the sales and use taxes due (Matter of W. T. Grant v. Joseph, 2 NY2d 196, cert denied 355 US 869; Tax Law § 1138[a][1]). It is recognized that "the Audit Division is not responsible for demonstrating the propriety of the assessment, including the basis of its audit" (Matter of Blodnick v. State Tax Commission, 124 AD2d 437, 507 NYS2d 536, 538) and that "considerable latitude is given an auditor's method of estimating sales under such circumstances" (Matter of Grecian Square, Inc. v. State Tax Commission, supra, 501 NYS2d at 221). It is only necessary that sufficient evidence be produced to demonstrate that a rational basis existed for the auditor's calculations (Matter of Grecian Square, Inc. v. State Tax Commission, supra; Matter of Willy Savino d/b/a Willy's Service Station, Tax Appeals Tribunal, September 22, 1988). The burden is then placed upon petitioner to show that "the result of the method used was unreasonably inaccurate or that the amount of the tax assessed is erroneous" (Matter of Meskouris Bros. v. Chu, 139 AD2d 813, 526 NYS2d 679, 681).

E. Petitioners do not allege that the results of the audit methodology (verification of the corporation's claimed nontaxable sales by contacting the vendors to determine the amount of actual sales) lack a rational basis. Instead, petitioners initially claim that the confirmations received are so replete with defects, i.e., unsigned, undated, or without the name of the person supplying information, as to be unreliable on their face. In addition, petitioners point to the fact that the individual who obtained some of the information did not testify at the hearing, there was no review of the books and records of the vendors to verify the information and no confirmation existed for seven of the vendors.

As previously stated, petitioners bear the burden of demonstrating by clear and convincing evidence that the method of audit or the amount of the tax assessed was erroneous. The impact of this burden on taxpayers has been reinforced by attributing a presumption of correctness to tax assessments (Welsh v. Helvering, 290 US 112; Matter of Tavolacci v. State Tax Commn., 77 AD2d 759, 431 NYS2d 174; Matter of Cousins Service Station, Inc., Tax Appeals Tribunal, August 11, 1988). In order to rebut this presumption, petitioners were required to introduce evidence with regard to the accuracy of the figures in the audit report relating to the 29 vendors.

Petitioners established through the audit workpapers and testimony of Mr. Duffy that the Division combined the purchases of the Silver Beach Deli and the Silver Beach Tavern into one vendor but failed to verify the actual purchases of both establishments. Therefore, the difference of $10,000.00 is to be eliminated from the amount disallowed and the margin of error is to be adjusted accordingly.

No other evidence was presented at the hearing which would require a determination that the Division's assessment was erroneous. Petitioners had the power to subpoena the vendors' records to dispute the assessment (see, Matter of Kucherov v. Chu, 147 AD2d 877, 538 NYS2d 339; Matter of Cousins Service Station, Inc., supra). They did not do so. Petitioners failed to come forth with any other evidence to refute the figures the Division maintained were the amount of purchases made by the 29 vendors during the period in issue. The allegations and testimony, without more, are insufficient to warrant any further adjustments to the method of audit employed (Matter of Vebol Edibles, Inc. v. Tax Appeals Tribunal, supra; Matter of Mera Delicatessen, Inc., Tax Appeals Tribunal, November 2, 1989).

Furthermore, where a taxpayer's own failure to maintain adequate, accurate and complete books and records requires resort to indirect audit techniques, exactness is not required of the Division in arriving at its determination, and the consequences of recordkeeping failures in this regard weigh heavily against the taxpayer (Matter of Meskouris Brothers, Inc. v. Chu, supra). Petitioner cannot now claim that the indirect audit method employed by the Division does not

accurately reflect the tax liability of the corporation where the corporation failed to maintain the books and records and discarded the cash register tapes which the Division could have used to establish the corporation's business activities and sales tax liability. It is also noted that it is appropriate to rely on the auditor's report of hearsay statements by anonymous employees of the 29 vendors (see, Matter of Club Marakesh, Inc. v. Tax Commission of the State of New York, 151 AD2d 908, 542 NYS2d 881, lv denied 74 NY2d 616, 550 NYS2d 276). In administrative hearings, it is well established that hearsay is admissible and may constitute substantial evidence for an administrative determination (see, Matter of Kucherov v. Chu, supra; see also, Matter of Mira Oil Co. v. Chu, 114 AD2d 619, lv denied 68 NY2d 602).

In addition, where the taxpayer's books and records are undeniably inadequate, the Division cannot be required to compute the tax owed with a high degree of precision or be held to ensure that the amount arrived at accords with statistical norms, for an accurate reckoning has been thwarted by the corporation's failure to comply with the law regarding record keeping. At best, petitioners have only demonstrated that the Division's tax calculation may be subject to question; they have not, however, met their more onerous obligation of proving by clear and convincing evidence that the result of the method used was unreasonably inaccurate or that the amount of the tax assessed is erroneous (Matter of Meskouris Brothers, Inc., supra).

F. In Mobley v. Tax Appeals Tribunal (supra), the corporate taxpayer's records were deemed inadequate following a review by the Division. The corporation, Yel-Bom Service Center, Inc., operated a retail gasoline station. In order to conduct the audit, the auditor requested from the supplier a record of the taxpayer's purchases for the audit period. The auditor was provided with a list of the taxpayer's purchases for a 10-month period. Sales tax was estimated by the auditor based upon the supplier information and the average retail sales prices for gasoline. The Court agreed with the Tribunal's decision that the audit method was reasonably calculated to determine the tax due.

However, the Appellate Division annulled the determination of the Tribunal and held that petitioner had met its burden of establishing, by clear and convincing evidence, that the tax

assessment was erroneous. The Court stated that:

> "The evidence developed at the hearing revealed that Inwood Trucking delivered Yel-Bom's gasoline for General Oil during the audit period and submitted computations to General Oil of the number of gallons delivered on each occasion. At the hearing, petitioner submitted an affidavit from the delivery supervisor for Inwood Trucking, as well as testimony by a former vice-president of Inwood Trucking, establishing that Inwood Trucking did not deliver nor did petitioner sell anywhere near the amounts of gasoline indicated in the letter from General Oil. Additionally, the vice-president testified that he and petitioner were in frequent disputes concerning the number of gallons of gasoline delivered to Yel-Bom and that once an adjustment figure was agreed upon, petitioner paid the adjustment billing. It is unclear from the record whether General Oil's figures included all, some or none of those adjustment figures."

The Court went on to state that:

> "A determination is not supported by substantial evidence, however, where the relevant proof offered is not of the quality that a reasonable mind would accept as adequate to support a conclusion or ultimate fact on the record considered as a whole. In short, the proof should be of a substantial nature and have the ability to inspire confidence (see, 300 Gramatan Ave. Assocs. v. State Div. of Human Rights, 45 NY2d 176, 180). That is not the case here. Petitioner has demonstrated by clear and convincing evidence that General Oil's unsworn letter is unreliable and should not be utilized in computing his tax deficiency. Indeed, the Tribunal recognized the unreliability of that evidence in its decision when it observed that 'the evidence in the record discrediting [General Oil's letter] coupled with the tenuous connection of the report to petitioners [sic] renders the report inadequate to prove fraudulent underreporting, absent any verification of the [letter]'."

The Court further considered it inconsistent that the Tribunal found petitioner's evidence credible for the purpose of defeating a finding of fraud, and found the same evidence inadequate to establish that the information received from the supplier was unreliable for the purpose of establishing the tax assessed. The Court, citing Matter of Seagroatt Floral Co. (167 AD2d 586, 563 NYS2d 539, mod on other grounds 78 NY2d 439, 576 NYS2d 831), found no rational basis for crediting petitioner's evidence for one purpose and discrediting it for another.

The present matter is distinguishable from the facts and circumstances presented in the Mobley case. Underlying the Mobley decision was the taxpayer's ability to establish, through the introduction of an affidavit and testimony from individuals employed by the delivery company, that the information from the supplier concerning the number of gallons delivered was inaccurate. Here, except for the purchases listed for the Silver Beach Deli, petitioners have not introduced any evidence into the record of this matter which would establish that the

purchases assigned by the Division to the various customers are incorrect. Without such evidence, petitioners have failed to meet their burden of proof of establishing, by clear and convincing evidence, that the tax assessed was erroneous (Matter of Grace v. New York State Tax Commn., 37 NY2d 193, 371 NYS2d 715; Matter of Scarpulla v. State Tax Commn., 120 AD2d 842, 502 NYS2d 113).

G. Tax Law § 1105(a) imposes a sales tax on the receipts from every retail sale of tangible personal property except as otherwise provided in Article 28 of the Tax Law. Tax Law § 1101(b)(4)(i)(A) defines a retail sale as a sale of tangible personal property to any person for any purpose, other than "for resale as such or as a physical component part of tangible personal property." There is a statutory presumption that all receipts for property or services are subject to tax and the burden to prove otherwise rests with the taxpayer (Tax Law § 1132[c]; see, Matter of Savemart, Inc. v. State Tax Commission, 105 AD2d 1001, 482 NYS2d 150, 152, lv denied 65 NY2d 604). To demonstrate that the sales at issue are nontaxable, petitioners must proffer adequate documentation establishing the amount of the sales, the vendors of the goods sold and the basis for their claimed status as nontaxable. Without any means of identifying individual wholesale nontaxable sales, there was no way to determine, on audit, if any or all of such sales were made for resale (On the Rox Liquors, Ltd. v. State Tax Commission, 124 AD2d 402, 507 NYS2d 503, lv denied 69 NY2d 603). Unlike the claimed nontaxable sales for which Academy had invoices, the petitioners were unable to submit direct documentary evidence to prove that the remaining claimed taxable sales were for resale, placing the Division in a position on audit of not being able to identify any individual nontaxable sale for resale. As a result, the Division concluded that to treat as taxable all claimed nontaxable sales for which no sales invoices were provided for purposes of determining petitioners' liabilities was a reasonable audit methodology. While this audit may not be immune from criticism, the Division had no alternative in determining what portion of these nontaxable sales were sales for resale. Furthermore, the Division's method of determining the corporation's tax liability was consistent with petitioners' own practice of not maintaining sales invoices for taxable transactions. It is

because of this practice that the Division could not be expected to "test" the claimed nontaxable invoices provided in order to determine the percentage of nontaxable sales included in the claimed sales for resale total for which no invoices existed (see, Reference Library Guild, Inc., Tax Appeals Tribunal, August 4, 1988).

Under these circumstances, the method employed was not unreasonable, (see, On the Rox Liquors, Ltd. v. State Tax Commn., supra; Matter of Meskouris Brothers, Inc. v. Chu, supra) or irrational on its face (see, Matter of Grecian Square, Inc. v. State Tax Commn., supra; Matter of Snyder v. State Tax Commn., 114 AD2d 567).

H. Tax Law § 1145(a)(2) provides for the imposition of a civil penalty if the failure to file a return or pay over any tax is due to fraud. The burden of proving fraud by clear and convincing evidence has consistently been interpreted to reside with the Division (see, Matter of Ilter Sener d/b/a Jimmy's Gas Station, Tax Appeals Tribunal, May 5, 1988; Matter of A. Charles Cinelli, Tax Appeals Tribunal, September 14, 1989). The imposition of the fraud penalty requires "clear, definite and unmistakable evidence of every element of fraud, including willful, knowledgeable and intentional wrongful acts or omissions constituting false representations, resulting in deliberate nonpayment or underpayment of taxes due and owing" (Matter of Ilter Sener d/b/a Jimmy's Gas Station, supra, quoting Matter of Shutt, State Tax Commn., July 13, 1982; see, Matter of Cousins Service Station, Inc., Tax Appeals Tribunal, August 11, 1988). Thus, for a taxpayer to be subject to the civil fraud penalty, willful intent is a critical element; the individual or the corporation, acting through its officers, must have acted deliberately, knowingly, and with the specific intent to violate the law (Matter of Cousins Service Station, Inc., supra).

As the sales tax penalty provisions are modeled after Federal penalty provisions, Federal statutes and case law are properly used for guidance in ascertaining whether the requisite intent for fraud has been established (Matter of Uncle Jim's Donut and Dairy Store, Inc., Tax Appeals Tribunal, October 5, 1989; Matter of Ilter Sener, supra). Factors found to be significant include consistent and substantial understatement of tax, the amount of the deficiency itself, a pattern of

repeated deficiencies, the taxpayer's entire course of conduct and the taxpayer's failure to maintain bank accounts or adequate records (see, Merritt v. Commr., 301 F2d 484; Bradbury v. Commr., 30 TCM 266; Webb v. Commr., 394 F2d 366; see also, Matter of AAA Sign Co., Tax Appeals Tribunal, June 22, 1989). Because direct proof of the taxpayer's intent is rarely available, fraud may be proved by circumstantial evidence, including the taxpayer's entire course of conduct (Korecky v. Commr., 781 F2d 1566; Stone v. Commr., 56 TC 213, 223-224; Intersimone v. Commr., 52 TCM 1073). Fraud may not be presumed or imputed, but rather must be established by affirmative evidence (Intersimone v. Commr., supra). Hence, a finding of fraud should not be sustained where the attendant circumstances create at most only a suspicion of fraud (Goldberg v. Commr., 239 F2d 316). The issue of whether fraud with the intent to evade payment of tax has been established presents a question of fact to be determined upon consideration of the entire record (Jordan v. Commr., 52 TCM 234; see, Matter of AAA Sign Co., supra).

It is well settled that consistent and substantial underreporting of large amounts of taxable income over a period of years is strong evidence of fraud (Merritt v. Commr., supra; Jordan v. Commr., supra). It has also been noted that the mere understatement of income, standing alone, is not sufficient to establish fraud (Intersimone v. Commr., supra). Consequently, in order to establish fraud, it is necessary that other indicia of the taxpayer's specific and willful intent to evade the tax in conjunction with substantial understatement of income must be shown. Thus, along with proof of underreporting, the circumstances of the particular case must contain some affirmative indication of the required specific intent to deliberately evade payment of taxes due and owing (see, Korecky v. Commr., supra; Cirillo v. Commr., 314 F2d 478; Uncle Jim's Donut & Dairy Store, Inc., supra). Additionally, the Division cannot rely solely on the notice of determination to prove underreporting nor can it rely on the presumption of correctness accorded its tax assessment and notice of determination in sustaining its burden of proving fraudulent underreporting (Matter of Cousins Service Station, supra; see, George v. Commr., 338 F2d 221, 64-2 US Tax Cas ¶ 9855). To permit the Division to satisfy its burden of proving

fraud by relying on the assessment that was sustained only because the petitioners had failed to overcome it, would be to allow the Division "to raise [itself] by [its] own bootstraps" (Matter of Cousins Service Station, supra, quoting George v. Commr., supra; see, Jordan v. Commr., supra).

I. A taxpayer's conviction for fraudulently filing a false tax return collaterally estops the taxpayer from challenging the civil fraud penalty imposed pursuant to Tax Law § 1145(a)(2) only for the same period covered by the conviction (see, Plunkett v. Commr., 465 F2d 299 [7th Cir 1972]; Matter of A. Charles Cinelli, supra). Thus, Academy is liable for the fraud penalty imposed for the quarter ended May 31, 1984.

It is also found that the Division has established by clear and convincing evidence that petitioner Lyons is liable for the fraud penalty imposed for the quarter ended May 31, 1984. The corporation, through Mr. Lyons as officer, admitted that it had filed a false sales tax return for the quarter ended May 31, 1984, with the intent of underreporting its tax liability. Mr. Lyons was indicted, along with the corporation, on 13 counts of filing false sales tax returns for the period at issue. He was the president of Academy. He signed Academy's sales tax returns, entered the daily sales information in the day book and provided his accountant with the day book in order that the accountant could prepare the corporation's sales tax returns. He admitted he was a responsible officer of Academy. These circumstances establish that Mr. Lyons knew the sales tax return was false when made and that the false return was filed with the intent to evade tax due (Matter of A. Charles Cinelli, supra).

J. With regard to the remaining quarters of the audit period, the Division has the burden of demonstrating by clear and convincing evidence that petitioners consistently and substantially underreported the amount of tax due on their sales tax returns. The Division must show that the calculations giving rise to the assessment do not depend for their validity on a presumption of correctness attached to the notice of determination. (See, George v. Commr., supra; Goldberg v. Commr., supra.) Thus, the Division must affirmatively prove the underreporting and it cannot rely on the notice of determination itself to prove the

underreporting.

In the present matter, the Division has not established the underreporting of tax for the periods at issue. The auditor who performed the audit and the investigator who obtained the information from the vendors concerning Academy's sales did not testify at the hearing. The Division did not corroborate any of the sales information obtained by reviewing the records of the vendors. The Information Document Requests received by the Division in response to its request letter are insufficient, without further support, to establish petitioners' fraudulent underreporting of tax due. In one instance (Silver Beach Deli), the information in the audit report was incorrect. The other portion of the audit is based upon petitioners' inability to substantiate claimed nontaxable sales. Petitioners' failure to substantiate is not equivalent to establishing the underreporting of taxable sales. The lack of substantiation with regard to the vendor information, coupled with reliance on the notice of determination to find the assessment correct and the numerous questions raised concerning the third-party vendor information renders the audit report inadequate to prove fraudulent underreporting, absent any verification of the report. (See, Matter of Cousins Service Station, Inc., supra.) Although the Division has presented evidence to establish a strong suspicion of fraud, including the indictment, guilty plea of petitioners and failure of petitioners to maintain any sales records relating to its taxable sales, the Division did not establish by clear and convincing evidence that Academy substantially and intentionally underreported income during the periods at issue.

K. In its answer, the Division asserted, in the alternative, the penalty pursuant to Tax Law § 1145(a)(1) on the basis that the underpayment of taxes was due to willful neglect and not due to reasonable cause. When the Division waits until after the usual determination procedure to assert an alternative penalty, the burden of proof of establishing the propriety of the penalty is upon the Division (see, Matter of Ilter Sener, supra). That is, the Division must prove "that the taxpayer's failure or delay was due to willful neglect and was not due to reasonable cause" (Matter of Ilter Sener, supra).

It is concluded that the Division has established that the underpayment of tax was due to

willful neglect and not due to reasonable cause. The corporation failed to maintain complete records, it discarded its cash register tapes, it was indicted for filing false sales tax returns for 13 quarters, it entered a plea of guilty relating to one of the quarters and it was unable to substantiate over one million dollars in claimed nontaxable sales. In light of all these circumstances, the Division has shown that the failure to pay was due to willful neglect and the alternative penalty asserted against the corporation pursuant to Tax Law § 1145(a)(1) is sustained.

The Tax Appeals Tribunal has previously held that a responsible officer can be held liable for the penalty and interest imposed by Tax Law § 1145(a)(1). (See, Matter of Hall, Tax Appeals Tribunal, March 22, 1990, confirmed ___ AD2d ___, 574 NYS2d 862.) Since the requirements to file a return and pay over tax are among the most essential to comply with the sales tax law, there is a clear and logical integration between the personal liability provisions of section 1131(1) and the penalty and interest provisions of section 1145(a)(1). Mr. Lyons admitted he was a responsible officer of the corporation, he maintained the books and records which were provided to the accountant to prepare the sales tax returns, he signed the sales tax returns, he was indicted along with the corporation on 13 counts of filing false sales tax returns and entered the plea of guilty on behalf of the corporation. He was present at the hearing but failed to testify. Under these circumstances, the Division has shown that the failure to pay was due to willful neglect on the part of Mr. Lyons and the alternative penalty asserted against Mr. Lyons pursuant to Tax Law § 1145(a)(1) is sustained.

L. The Division is directed to modify the notices of determination and demands for payment of sales and use taxes due in accordance with Conclusions of Law "E", "H" and "J". In all other respects the petitions of Academy Beer Distributors, Inc. and James Lyons, as officer, are denied.

DATED: Troy, New York

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ADMINISTRATIVE LAW JUDGE