STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
ELIAS H. ATTEA, JR.	:	
for Redetermination of a Deficiency or Refund of New York State Personal Income Tax under Article 22 of the Tax Law for the Years 1992 and 1993.	:	DETERMINATION DTA NO. 820371

Petitioner, Elias H. Attea, 294 Ed Harris Road, Ashland, TN 37015, filed a petition for redetermination of a deficiency or refund of New York State personal income tax under Article 22 of the Tax Law for the years 1992 and 1993.

A hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on January 26, 2006 at 10:30 A.M., with all briefs submitted by May 12, 2006, which date began the six-month period for the issuance of this determination. Petitioner appeared by Schultz-Zarcone, LLP (Kelly V. Zarcone, Esq., of counsel). The Division of Taxation appeared by Mark F. Volk, Esq. (Michelle M. Helm, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation's issuance of a notice of deficiency to petitioner for additional personal income taxes determined to be due for the years 1992 and 1993 was arbitrary and capricious.

II. Whether petitioner was carrying on a trade or business in New York State and, if so, whether the Division's determination of tax on New York source income earned as a nonresident was proper.

III. Whether the Division of Taxation has the authority to tax the income of a federally licensed Indian Trader.

IV. Whether the Division of Taxation's determination of tax due from petitioner for the years in issue is a violation of petitioner's rights under the Due Process and Commerce Clauses of the United States Constitution.

FINDINGS OF FACT

Petitioner submitted with his brief 31 proposed findings of fact. Of the proposed findings, "1", "2", "3", "4", "10", "19" and "20" have been accepted and are incorporated into the facts below. Proposed findings "5", "6", "7", "8", "9", "11" through "18", "21", "23", "25", "27", "29" and "31" were rejected for lack of substantiation in the record. Proposed findings "22", "24", "26", "28" and "30" were found to be irrelevant and not incorporated into the findings of fact below. Petitioner resubmitted the same proposed findings with his reply brief, with the exception of proposed finding "15", which was rejected for lack of support in the record.

The Division of Taxation submitted 34 proposed findings of fact with its brief, all of which have been incorporated in the Findings of Fact below, except proposed findings "12", "13", "28", "33" and "34" which were statements of legal conclusions and not factual findings. In addition, proposed finding "5" was rejected as not having a credible basis in the record.

1. On or about April 11, 1993, petitioner filed a New York State Nonresident Income Tax Return for the year 1992 in which he allocated to New York $244,841.00 of the $7,779,513.00 set forth as his Federal adjusted gross income for that year.

2. On or about April 15, 1994, petitioner filed a New York State Nonresident Income Tax Return for the year 1993 in which he allocated to New York $190,827.00 of the $3,766,896.00 set forth as his Federal adjusted gross income for the same year.[1]

3. For both years in issue, petitioner was a nonresident of New York State who owned a business called "JR Attea Wholesale" located in Ashland, Tennessee, which had a separate address and tax identification number from petitioner, but accounted for its profits and losses on Schedule "C" attached to petitioner's Federal income tax return for both years in issue.

4. Petitioner was a federally licensed Indian Trader who did not have a license from New York to operate a tobacco products wholesale or warehouse business. Further, petitioner received bills and trade documents at the Ashland Tennessee business address.

5. The years in issue were originally included in the prior audit together with the years 1990 and 1991, but a separate case number was later assigned to the years in issue because the earlier years, 1990 and 1991, had to be assessed sooner due to the expiration of the applicable statute of limitations on assessment.

6. Due to the fact that all four years were originally part of the same case, the same letter was used to request petitioner's books and records for all years. Since the issue of petitioner's domicile and his statutory residency were not in issue, the only remaining issue for the years 1992 and 1993 was the proper allocation of petitioner's Federal Schedule "C" income from his tobacco activities.

7. In a letter to petitioner, dated December 28, 1994, the Division of Taxation informed him that it believed the income reported on Schedule "C" and derived from wholesale tobacco

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[1]The primary source of the income allocated to New York for both years was stated to be commission income.

sales to a reservation physically located within New York State was New York source income and should have been allocated to New York. The letter proceeded to state:

> In addition, please call this office immediately upon receipt of this letter so that a mutually convenient audit appointment can be scheduled. Failure to do so will result in an assessment based on the information at hand at this time.
>
> We will concentrate our audit efforts on your reported Schedule C business expenses. As such, we require the following items:
>
> 1) Supply a copy of your 1992 and 1993 Form 1040, as originally filed.
> 2) Supply a copy of your 1992 and 1993 Form IT-203.
> 3) You did not report the components of gross profit on your 1991 Schedule C. Supply a complete breakdown of Schedule C gross profit (gross receipts less cost of goods sold) for 1991. If you failed to indicate the breakdown on your 1992 and 1993 Schedule C, supply the same for each year.
> 4) We will require all relevant books, records and documents required to compute the three factor allocation percentage for each year under audit. We will also require any back-up (i.e. invoices, receipts . . .) that you have maintained to support all expenses claimed on Schedule C for each year under audit.

8. In addition to this request for books and records, the Division made several additional requests which went unheeded by petitioner. Petitioner failed to submit bank statements and any books of original entry, including sales journals, balance sheets, ledgers, invoices or expense receipts, trial balances, adjusting entries and income statements.

9. Pursuant to the auditor's log associated with the audit years in issue, petitioner was represented by no less than four individuals between 1997 and January 2004, to wit: Mr. Bailey, Mr. Cosgrove, Mr. Borek and Mr. Kanaley. None of these representatives produced the books and records requested by the Division prior to the issuance of the statutory notice herein.

10. By letters dated November 4, 2002 and April 18, 2003, the Division requested Mr. Borek to schedule an audit appointment to produce records which demonstrated how petitioner prepared his Schedule C. The record indicated that Mr. Borek did not respond to these requests.

11. The auditor's log indicated that on February 8, 2001, the Division was considering assessing tax for the years 1991 through 1997 and prepared an assessment for those years which included additional tax for 1992, 1993 and 1994 Schedule C income and disallowed Schedule C losses and net operating losses for the years 1995, 1996 and 1997. However, on January 15, 2002, the Division "changed course" and decided to assess only the years 1992 and 1993, which addressed the same issues addressed in the prior case involving 1990 and 1991.[2] The Division received word of petitioner's last legal appeal on November 4, 2002. Prior to this time, the Division was holding the 1992-1993 audit in abeyance pending the outcome of the 1990-1991 legal appeals.

12. The auditor met with Mr. Gary Kanaley, petitioner's representative, on October 3, 2003 and January 5, 2004 and was presented with some shipping documentation which could not be tied into the Federal Schedule C's. The auditor was told that the expenses for the tobacco business were not accurately presented on the Schedule C and that some of the expenses listed may have been for an unrelated horse farm business. The auditor also met with one Mr. Robert Haas at the January 5, 2004 appointment. Mr. Haas died prior to hearing.

13. Mr. Robert Haas was employed by A. N. Derrringer Company, a customs broker, located in New York State which prepared documentation for, calculated and paid duty on behalf of importers on goods imported through the foreign trade zone ("FTZ") in Hamburg, New York.

14. Mr. Haas became familiar with petitioner's importation of cigarettes and specific issues related to the "manipulation" of the cigarettes, i.e., the affixation of government required health warnings. Since this "manipulation" process was causing delays at the FTZ, in the fall of

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[2] ***Attea v. Tax Appeals Tribunal***, 288 AD2d 701, 732 NYS2d 722 ***lv to appeal denied*** by 98 NY2d 606, 746 NYS2d 457. Petitioner's appeals ended on June 13, 2002 in the prior case with respect to 1990 and 1991.

1991, petitioner caused Mr. Haas to be hired by the FTZ in Grand Island, New York, owned by Daniel Shea and also referred to as "Site 5". In addition to his wage from the FTZ, Mr. Haas also received a salary of $500.00 per week or $2,000.00 per month from petitioner. Petitioner's 1993 Federal Schedule "C", which was filed for his wholesale cigarette business, indicated $54,675 in wage expenses on line "26" while the Schedule "C" for 1992 did not list any wages paid by JR Attea Wholesale.

15. Mr. Daniel Shea was the owner of Danason's Border Services, Inc. ("Danason's") and the operator of FTZ, Site 5 in Grand Island, New York. The auditor visited the site and interviewed Mr. Shea. Mr. Shea operated a public warehouse business as well as a foreign trade zone in which product on which duty had not been paid was housed at FTZ 23. Mr. Shea maintained duty paid and unpaid product in separate areas separated by a white line in accordance with U. S. Customs regulations. Mr. Shea's largest customer was JR Attea Wholesale. He maintained a product from only a few small customers other than petitioner. There was no written contract between Mr. Shea and petitioner and most communications between them were by telephone.

16. Tobacco products were shipped directly to the FTZ in Grand Island, New York from outside the United States and other FTZs. Products from other FTZs were shipped to U. S. Customs in Buffalo, New York where Customs entry was made and then were sent to the FTZ in Grand Island. The latter shipments from U. S. Customs were marked with a "D" after their zone lot numbers. Since these would have been segregated from product on which duty had not been paid, they were housed in the public warehouse maintained by Mr. Shea at Site 5. Mr. Shea explained in an affidavit dated January 24, 2006, two days prior to hearing, that all records with regard to these "D" shipments were believed destroyed, but estimated that 20 to 30 percent were

"D" shipments. However, the auditor's review of documents while visiting Site 5 in November or December of 2005 yielded an estimate of 30 to 60 percent. This figure was confirmed in petitioner's documentation submitted at hearing which, for 1992, indicated that over 62 percent of the product shipped out by Mr. Shea could be traced to product which came to him with excise tax paid. The result was that this product went to his public warehouse for later shipment or customizing.

17. Other than warehousing the product in a segregated area, Mr. Shea also performed the additional service for petitioner of breaking down petitioner's shipments in order to fill custom orders for customers which involved unloading, repackaging and reloading product onto delivery trucks. Petitioner's product on which duty had been paid was stored in Mr. Shea's warehouse, from which it was either shipped "as is" or broken down and reconstituted as a custom order. While remaining in the public warehouse, the product constituted inventory of petitioner located in New York State. Although he maintained an inventory, petitioner did not disclose any information on inventory on his Federal Schedule "C" for 1992 or 1993. Petitioner also failed to state any information with respect to his cost of goods sold on those schedules or in any other document he provided to the auditor during the period of the audit.

18. Petitioner's trades generally involved importing tobacco products from outside of the United States through the aforementioned FTZ and then trucking the product by U. S. Custom's bonded common carrier to federally recognized Indian reservations. Two former U. S. Customs inspectors, Robert Rugnetta and Timothy Regan, observed documentation that indicated petitioner imported goods through the FTZ which was destined for Indian reservations and that they were not aware of shipments by petitioner to other locations within New York State.

19. In processing shipments on which duty had been paid in New Jersey, the Grand Island FTZ gave said shipments a designation number beginning with "D", indicating that duty had been paid prior to arriving at the FTZ. As noted above, this product was segregated from other product in a public warehouse on the same premises operated by Mr. Daniel Shea and located within New York State.

20. On audit, it was established that petitioner made sales and shipped goods within the boundaries of New York State and used the public warehouse at FTZ, Site 5 to store his product until ready to ship. However, on the basis of the shipping documents produced by petitioner, the Division was unable to "tie-in" to the gross receipts or purchases figures. The Division was never able to establish the cost of goods sold from the records produced or that all shipments went to Indian reservations. The expenses listed "below the line" of gross receipts could not be substantiated for the same lack of documentation.

21. Without adequate documentation to substantiate petitioner's income or expenses stated on his Schedule C's for 1992 and 1993, the Division issued a Statement of Personal Income Tax Audit Changes ("Statement"), dated February 19, 2004, which set forth an additional tax liability for 1992 of $716,291.32 and an additional tax liability for 1993 of $359,361.98. On the last page of the Statement, the Division set forth the following explanation of its adjustments:

> We have concluded that the income reflected on your Federal Schedule C has been generated from a business, trade, profession or occupation carried on in this state and therefore considered New York source income, taxable to you as a nonresident pursuant to Section 631 of the Tax Law. You have failed to meet your burden of proving that any of the income should be allocated to sources outside of New York.
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> Regulation Sec. 132.4 states, in part, "A business, trade, profession or occupation (as distinguished from personal services as an employee) is carried on within New York State by a nonresident when such nonresident occupies, has, maintains or

operates desk space, an office, a shop, a store, a warehouse, a factory, an agency or other place where such nonresident's affairs are systematically and regularly carried on, not withstanding [sic] the occasional consummation of isolated transactions without New York State. This definition is not exclusive. Business is carried on within New York State if activities within New York State in connection with the business are conducted in New York State with a fair measure of permanency and continuity. A taxpayer may enter into transactions for profit within New York State and yet not be engaged in a trade or business within New York State. If a taxpayer pursues an undertaking continuously as one relying on the profit there from [sic] for such taxpayer's income or part thereof, such taxpayer is carrying on a business or occupation."

It is our opinion that your activities as a seller of tobacco products are systematically and regularly carried on as a trade or business in this state with a fair amount of permanency and continuity. As such, this income would be subject to New York tax regardless of whether or not the activities were exclusively attributable to trade with Native Americans under your Indian Trader license.

Further, since you failed to provide substantiation for the expenses claimed on the Federal Schedule C, these items have been disallowed.

22. On April 22, 2004, the Division of Taxation issued to petitioner a Notice of Deficiency for the years 1992 and 1993 which stated that it was based upon a recent audit of petitioner's records and that additional tax was being assessed in accordance with the Statement of Proposed Audit Changes referred to above. The amounts of tax and interest due for each year was set forth as follows:

Tax Period	Tax	Interest	Penalty	Payments	Balance Due
1992	$716,291.32	$836,047.37	0	0	$1,552,338.69
1993	$359,361.98	$374,092.91	0	0	$733,454.89
Totals	**$1,075,653.30**	**$1,210,140.28**	**0**	**0**	**$2,285,793.58**

23. Following the issuance of the Notice of Deficiency on April 22, 2004, petitioner submitted voluminous documentation to the Division which sought to demonstrate that his

returns accurately represented the income reported. Specifically, petitioner submitted handwritten notes of Robert Haas which purported to show "cigarette shipments delivered".[3]

24. Petitioner also submitted summary sheets, applications for FTZ admission and shipping information for what was purported to be all imports by petitioner for 1992 and 1993. The documentation was broken down by zone lot numbers and contained detailed information on import dates, cases of product entering, purchase price, duty paid, number of cases shipped, shipment destination and date. However, the Division was unable to use the documentation received from Mr. Kanaley or the documents received at hearing to "tie into" or confirm petitioner's gross receipts, purchases or cost of goods sold.

25. It was established that inventory remained at Mr. Shea's FTZ from less than a day to more than 40 days; that goods upon which excise tax had been paid were received by FTZ 23, Site 5 and placed in the public warehouse, segregated from non-taxed goods in the FTZ.

STATEMENT OF THE PARTIES' POSITIONS

26. Petitioner argues that the assessment issued by the Division was arbitrary and capricious and without a rational basis. Further, petitioner contends that the assessment herein was based solely on the facts and conclusions reached in the prior audit of petitioner for 1990 and 1991.

27. Petitioner maintains that the methodology utilized by the Division was without a rational basis and was not reasonable.

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[3]The Haas notes were submitted by his lawyer, Edward Cosgrove, who averred that Mr. Haas had kept these notes of petitioner's trades in 1992 and 1993, although petitioner, in his affidavit, stated that he could not locate the Haas records for 1993. Further, in the 118 pages of the notes there is no mention or reference to petitioner or his business.

28. Petitioner contends that New York has no authority to tax income earned by him as a federally licensed Indian trader on trades with reservation Indians and that the records submitted provide substantiation that most of his shipments went to reservation Indians. Petitioner urges that any such taxation of this income is federally preempted.

29. Petitioner argues that to the extent that he has shown his trade was with Indians, New York State lacks the authority to tax his income therefrom. Further, petitioner contends that there is no evidence in the record to show that he traded with anyone other than Indians.

30. Petitioner argues that although New York does have jurisdiction over him by virtue of his filing tax returns for 1992 and 1993, it does not have authority to tax income from a business without any nexus with New York. He maintains that such taxation is a violation of his due process and commerce clause rights under the U. S. Constitution. Petitioner contends that he maintained no office in New York, had no employees in New York, rented no space, solicited no business nor advertised in New York and had no New York customers thus demonstrating that he carried on no business in New York.

31. The Division of Taxation contends that petitioner bears the burden of proving that the additional tax assessed was erroneous and that the voluminous documentation submitted by petitioner at hearing, not on audit, did not prove its assessment was erroneous, but did support its position that the majority of cigarettes received at Mr. Shea's FTZ were duty paid and that the majority of his services consisted of repackaging custom orders, warehousing and then shipping, all the while acting as agent of petitioner and hosting his employee, Mr. Haas.

32. The Division argues that it is not preempted from taxing petitioner's income under the circumstances presented in this matter and that the broad preemptive effect of older case law has been curtailed by more recent decisions of the U.S. Supreme Court.

33. Finally, the Division disputes petitioner's contention that its taxation of his income violates the Due Process and Commerce Clauses of the U. S. Constitution, contending that petitioner has met the minimum contact requirements with New York State, that the tax is fairly apportioned, does not discriminate against interstate commerce and is fairly related to services provided by New York State.

CONCLUSIONS OF LAW

A. Upon audit of petitioner, on December 28, 1994, the Division of Taxation made a very specific request for petitioner's books and records with respect to his New York State Nonresident Income Tax Returns filed for 1992 and 1993. Petitioner essentially failed to submit any documentation to substantiate his income listed on the returns prior to the issuance of the Notice of Deficiency on April 22, 2004, nearly ten years later.

Pursuant to Tax Law § 689(e), petitioner bears the burden of proving that an assessment is erroneous. (***See***, ***Delia v. Chu***, 106 AD2d 815, 484 NYS2d 204.) To this end, Tax Law § 658(a) provides that the tax commission may require any person to keep such records as it deems sufficient to show if that person is liable for tax under Article 22. The regulation promulgated thereunder, 20 NYCRR 158.1(a) provides:

> a) Every person subject to New York State income tax or liable for the collection thereof, and any person required to file a New York State return of information with respect to income, must keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits and other matters required to be shown by such person in any New York State income tax return or New York State return of information.

Having received returns from petitioner, the Division, for the purpose of ascertaining the correctness of the returns, was entitled to examine or cause to have examined by its agent or

representative, any books, papers, records, etc. bearing upon the matters required to be included in the returns (Tax Law § 697[b]).

There is no dispute that the Division had a right to ask for petitioner's substantiation and that petitioner had an obligation to both keep and have available for examination adequate records for the information provided on his returns. The fact that petitioner filed New York returns at all was an admission that he had New York income. Therefore, since it was petitioner's choice not to submit any substantiation to the auditor prior to the issuance of the notice, it cannot be said that the assessment was arbitrary and capricious.

Petitioner raised many possible reasons for his failures, including that the records were taken in the course of investigations and not returned and that the records were lost or destroyed over the long period of time involved in this case. However, he was unable to substantiate these claims or explain why so much documentation became available immediately before hearing, some eleven years after they were first requested by the Division. Based on what the Division was supplied, its assessment was not arbitrary or capricious. The Division was not given access to any original books of entry or any other documentation to substantiate the allocation petitioner made on his return.

Petitioner also raised a concern that the assessment violated the Division's policy that an assessment should never be based on the facts and conclusions reached for prior years. This contention was based on petitioner's interpretation of an entry in the auditor's log of January 15, 2002, where she stated that the Division had decided to "change course" and just assess petitioner for 1992 and 1993, which years addressed the same issues addressed in the prior case involving 1990 and 1991. However, an earlier entry in the log explained that the Division had been considering assessing 1992 through 1997, a decision which would have encompassed 1994

Schedule C income and disallowed Schedule C losses and net operating losses for the years 1995, 1996 and 1997. The Division decided against this broad approach and chose to assess the years in issue here because the legal appeals for the assessment concerning 1990 and 1991 had just ended and the agreement with petitioner to hold 1992 and 1993 in abeyance was ended. Therefore, the Division's decision to assess the years 1992 and 1993 was made because the court case involving 1990 and 1991 had ended and the current years were no longer being held in abeyance and the fact that the Division no longer believed that combining these years with future years was appropriate. The fact that the issues which presented themselves in 1990 through 1994 were the same or similar is irrelevant. The underlying audit policy for the guideline which cautions against issuing an audit adjustment based solely on the facts and conclusions reached in a prior audit was served in this case. Certainly, as in the prior case, petitioner produced very few books and records, but the records produced and the auditor's investigation were far different in the instant matter, providing an independent basis for the conclusions reached on virtually the same issues. (***See*** New York Audit Manual Income Tax Audit Guidelines 8.1.9.1.)

B. Having established that the Division of Taxation properly issued the assessment, it remains to be determined whether petitioner met his burden of proving that the deficiency was erroneous. (Tax Law § 689[e]; ***Delia v. Chu***, ***supra***.)

Petitioner provided virtually no support for its 1992 and 1993 returns prior to hearing. Although Mr. Kanaley, a prior representative, on October 3, 2003 and January 5, 2004 presented some shipping documentation which he could not tie in to the Federal Schedule C's, nothing of substance was submitted until hearing, when petitioner produced ten volumes of U. S. Customs documents, supplier invoices, shipping documents, handwritten notes from Robert Haas, and Danasons Border Services warehouse statements. In ***Matter of Jenkins Covington, N.Y.*** (Tax

Appeals Tribunal, August 25, 1988, ***confirmed*** 195 AD2d 625, 600 NYS2d 281, ***lv denied*** 82 NY2d 664), the Tribunal stated:

> Petitioners' failure to produce documentation concerning the transactions at issue during the audit is unfortunate since that was the appropriate time for adequate consideration by both parties of the documents and the nature of the transactions they represent. The formal nature of the hearing before the Administrative Law Judge operates against such discussion and analysis. While such documents can be reviewed post-hearing by the Administrative Law Judge, again the bilateral review and consideration that can occur during audit is absent.

As the Tribunal noted in ***Matter of Greenwald*** (Tax Appeals Tribunal, November 24, 1993), "it was petitioners who elected, for whatever unexplained reason, not to submit supporting documentation to the Division and any unanswered questions which arise as the result of our review of petitioners' evidence must necessarily weigh against them." Unfortunately, petitioner faces the same review here, where this forum has been deprived the bilateral consideration of such a voluminous amount of "new" evidence.

After the hearing, the Division examined the volumes submitted by the auditor and the affidavit of Edward Cosgrove, Esq. with attached handwritten notes of Robert Haas, and appended to the Division's brief a chart of the evidence submitted by petitioner for 1992 which listed information taken from petitioner's documents, including the FTZ site from which cases were shipped; the date first received at the FTZ; the date available to ship to Danasons; entry date at Site 5 with taxes paid at Site 5; date received at Site 5 with taxes paid elsewhere; purchase price; duty paid; tax paid; entry fee; processing fee; total cases received at Site 5; total cases not received at Site 5; ship date; zone lot number or "BL" number if from Aruba; and cases shipped from current lot Site 5. After performing the exhaustive and tedious task of extracting the information from petitioner's documentation, the Division proceeded to analyze the

information and draw its own conclusions therefrom, conclusions which not surprisingly were contrary to those drawn by petitioner from the same data.

In his reply brief, petitioner objects to the Division's chart and the conclusions drawn therefrom, arguing that it is misleading, and the conclusions reached are inflammatory and not based on evidence in the record. However, it was petitioner who submitted the voluminous documentation into the record and the Division is entitled to analyze it and draw its own conclusions, as it would for any other evidence, just as petitioner has analyzed the same information and based his arguments thereon. The chart is a graphic depiction of data in the record which it has incorporated into its arguments. As such, it was appropriately included in its brief. Petitioner, despite his protestations, does not challenge the facts set forth in the chart or the values tabulated by the Division for cases of product received at and shipped from Site 5 and where duty was paid.

C. Petitioner's return presented an immediate "red flag" or audit warning when it failed to allocate any tobacco sales from within New York State as New York source income. This mandated the request for substantiation of the allocation and when none was ever produced it left no alternative but to allocate all the income to New York.

Tax Law former § 631, in effect during the years at issue, provided as follows:

> (a) General. The New York source income of a nonresident individual shall be the sum of the net amount of items of income, gain, loss and deduction entering into his federal adjusted gross income, as defined in the laws of the United States for the taxable year, derived from or connected with New York sources, including:
>
> * * *
>
> (b) Income and deductions from New York sources.

(1) Items of income, gain, loss and deduction derived from or connected with New York sources shall be those items attributable to:

* * *

(B) a business, trade, profession or occupation carried on in this state;

* * *

(c) Income and deductions partly from New York sources. If a business, trade, profession or occupation is carried on partly within and partly without this state, as determined under regulations of the tax commission, the items of income, gain, loss and deduction derived from or connected with New York sources shall be determined by apportionment and allocation under such regulations.

The applicable regulation, 20 NYCRR former 131.4, in effect during the years at issue, provided that:

(a) (1) The New York adjusted gross income of a nonresident individual includes items of income, gain, loss and deduction entering into his Federal adjusted gross income which are attributable to a business, trade, profession or occupation carried on in New York State.

(2) A *business, trade, profession or occupation* (as distinguished form personal services as an employee) is carried on within New York State by a nonresident when such nonresident occupies, has, maintains or operates desk space, an office, a shop, a store, a warehouse, a factory, an agency or other place where such nonresident's affairs are systematically and regularly carried on, notwithstanding the occasional consummation of isolated transactions without New York State. This definition is not exclusive. Business is carried on within New York State if activities within New York State in connection with the business are conducted in New York State with a fair measure of permanency and continuity. A taxpayer may enter into transactions for profit within New York State and yet not be engaged in a trade or business within New York State. If a taxpayer pursues an undertaking continuously as one relying on the profit therefrom for such taxpayer's income or part thereof, such taxpayer is carrying on a business or occupation. However, see section 131.10 of this Part with regard to the effect of the purchase and sale of property by a nonresident for such nonresident's own account.

The Division maintains that based upon the records submitted and the facts which became apparent as a result of the Division's investigation, it must be concluded that petitioner was

conducting a business, trade or profession in New York State. Upon review of all the evidence submitted in this matter, it is determined that the Division's conclusion is correct.

The evidence adduced indicated that petitioner's goods were warehoused at FTZ 23, Site 5 by Mr. Shea at the request or on behalf of petitioner until they could be shipped or repackaged and shipped. However, even though goods were warehoused in New York, petitioner never produced records of a beginning and ending inventory for each of the years in issue and failed to provide the information on his Schedule "C" for either year. The fact that the documentation indicated that goods were kept by Mr. Shea in his public warehouse for petitioner prior to creating custom orders strongly suggested that the warehousing costs included the "rental" of space to house petitioner's goods in New York for various periods of time during the audit period. Petitioner failed to produce documentation to indicate otherwise, even though it was his burden to do so.

It was established that Mr. Shea was an agent of Mr. Attea operating in New York State. On many of the documents submitted by petitioner, Mr. Shea appears as an agent for petitioner. The Applications for Foreign-Trade Zone Admission and/or Status Designation list Mr. Shea as an agent for JR Attea Wholesale and the breadth of his involvement with petitioner's business was well documented. Nearly all of his business came from JR Attea Wholesale, which represented handling, breaking down, repackaging and facilitating shipping of hundreds of thousands of cases of cigarettes on behalf of petitioner. In fact, the documents reflect that in 1992 over 60 percent of the total cases coming to Mr. Shea's warehouse had excise tax paid and were sent directly to the public warehouse for eventual shipping and customizing. The operation was so big it was necessary for petitioner to request that Mr. Haas be placed at FTZ 23, Site 5 to assist in his business operations, paying him a substantial salary for doing so.

Despite the voluminous shipping documentation submitted by petitioner, it still remains that without books of original entry, the existence of which was never demonstrated, the Division was powerless to confirm whether or not JR Attea Wholesale was making sales and shipping product to places other than Indian reservations. Simply, without sales journals, bank statements, general ledgers, balance sheets, expense receipts or invoices and income statements, it was impossible to confirm the accuracy of the numbers entered on petitioner's return and Schedule "C" for the years in issue. Therefore, the Division was justified in reallocating petitioner's income to New York at 100 percent, where petitioner gave it no basis for making a more precise allocation.

Petitioner's affidavit and those of Mr. Shea, Mr. Haas, Mr. Rugnetta, Mr. Regan and Mr. Cosgrove are not helpful or probative of the ultimate inquiry into the conduct of the business affairs of JR Attea Wholesale or whether it made any sales other than those to Indian reservations. The former U. S. Customs agents, Mr. Rugnetta and Mr. Regan, stated only that they had observed only shipments to Indian reservations, never identifying the documentation underlying their conclusions. The affidavit of Mr. Haas confirmed that his salary was paid by petitioner, but his statement that no cigarettes imported by petitioner were ever warehoused in New York does not conform with the fact that petitioner's product remained in a New York warehouse pending repackaging and shipping. The Cosgrove affidavit states that attached to it were handwritten notes of Mr. Haas pertaining to trades made by JR Attea Wholesale in 1992 and 1993. However, there is no proof the notes were genuine or were in the handwriting of Mr. Haas. The affidavit of petitioner stated that he traded with Indian reservations and that he did not possess a New York cigarette agent license or a license to act as a wholesale or retail dealer.

Petitioner never stated in his affidavit that the records he produced included all his cigarette sales in New York.

Given the issues not addressed by the affidavits, their self-serving nature and conflicts with other facts in evidence, the finder of fact herein will not be bound to find facts based upon the contents of an affidavit. ***(Matter of Orvis v. Tax Appeals Tribunal***, Tax Appeals Tribunal, January 14, 1993, ***annulled*** 204 AD2d 916, 612 NYS2d 503, ***revd*** 86 NY2d 165, 630 NYS2d 680, ***cert denied*** 516 US 989, 133 L Ed 2d 426.)

D. The fact that Mr. Haas was employed by petitioner in New York to perform services here; that petitioner maintained an inventory at the public warehouse operated by Mr. Shea; and the fact that Mr. Shea was compensated for his services in warehousing petitioner's product all indicated that JR Attea had more than just the slightest presence in New York State.

The Court of Appeals was clear in its rationale in ***Orvis***:

> We think the foregoing survey of the decisional law discloses the true import of the physical presence requirement within the substantial nexus prong of the ***Complete Auto*** [***Complete Auto Transit v. Brady***, 430 US 274, 51 L Ed 2d 326] test under contemporary Commerce Clause analysis. While a physical presence of the vendor is required, it need not be substantial. Rather, it must be demonstrably more than a "slightest presence" (***see, National Geographic Socy. v. California Bd. of Equalization,*** 430 US 551, 51 L Ed 2d 631). And it may be manifested by the presence in the taxing State of the vendor's property or the conduct of economic activities in the taxing State performed by the vendor's personnel or on its behalf (***Matter of Orvis Co. v Tax Appeals Tribunal***, ***supra,*** 630 NYS2d, at 686-687).

It is determined that the Division's conclusion that petitioner was carrying on a business in New York State was valid and that the record established the business had nexus with New York.

E. Although the Division argues that there was insufficient documentation to determine an allocation percentage pursuant to Tax Law § 210(3)(a) due to the lack of substantiation for

receipts, property and payroll, this argument merely underscores the petitioner's failure to come forward with adequate documentation since the beginning of the audit to establish the accuracy of the information he provided on his returns for the years in issue, particularly the information on the Schedule "C".

F. Petitioner argues that the State of New York is without authority to tax income earned by a federally licensed Indian trader on his trade with Indians. However, this is not the issue presented herein. Petitioner, because he produced no books of original entry, never demonstrated that the sales he chose to disclose were all of his sales. The affidavits of Mr. Rugnetta and Mr. Regan did not prove that all of petitioner's shipments went to Indian reservations; they only said those they reviewed appeared to be going to Indian reservations. They did not say, as petitioner argues now, that petitioner traded only with reservation Indians. Therefore, the "pass down" theory of preemption that petitioner wants to invoke is merely the creation and destruction of a straw man, while downplaying his failure to produce meaningful records of his business.

Therefore, it is not necessary to reach the question of whether the Indian trader statutes preempt a state from applying its individual income tax directly to any income resulting from an Indian trader's on-reservation sales to reservation Indians. None of the case law or statutes relied on by petitioner precludes the State of New York from requesting the books and records of a trader's business to determine if, in fact, his business activities are as portrayed or if such activities include off-reservation trade or on-reservation trade with non-Indians. (***See Attea v. Tax Appeals Tribunal***, ***supra***, [where it stated that it was incumbent upon petitioners to come forward with evidence establishing that they traded exclusively with Native Americans residing on Indian reservations and had no income derived from or connected with New York sources . .

., including income earned from a business, trade, profession or occupation carried on in this State].)

G. Finally, Petitioner argues that New York is precluded by the Due Process and Commerce Clauses of the Constitution from taxing petitioner's income from his cigarette importing business because the State did not establish that there was a minimal connection, or nexus, between the interstate activities and New York, i.e., he maintained no office, rented no space, had no employees and undertook no business in New York.

However, the discussion above established that the evidence in this case demonstrated that petitioner had more than minimal contacts with New York and that petitioner was afforded ample opportunity to prove otherwise but did not. Further, petitioner's argument that, even if nexus existed, there was no rational basis for allocating an "overwhelming majority of business income to New York State" because the "brains and beauty" of the business lived in Tennessee is without merit. Petitioner did not meet his burden of proving that the overwhelming majority of his business income was derived elsewhere. By not producing any books of original entry for the business, the Division was powerless to draw the conclusions urged by petitioner.

H. The petition of Elias H. Attea, Jr. is denied and the Notice of Deficiency, dated April 22, 2004, is sustained.

DATED: Troy, New York
November 13, 2006

/s/ Joseph W. Pinto, Jr.
ADMINISTRATIVE LAW JUDGE