STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
MEDIABUSS SYSTEMS, INC.	:	DETERMINATION DTA NO. 824190
for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Years 2001 through 2006.	:	

Petitioner, MediaBuss Systems, Inc., filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the years 2001 through 2006.

A hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals, One Penn Plaza, New York, New York, commencing at 11:45 A.M. on November 30, 2011 and concluding on December 1, 2011. All briefs were submitted by May 29, 2012, which date began the six-month period for the issuance of this determination. Petitioner appeared by Ballon Stoll Bader & Nadler, P.C. (Norman R. Berkowitz, Esq., of counsel). The Division of Taxation appeared by Mark Volk, Esq. (Marvis A. Warren, Esq., of counsel).

ISSUES

I. Whether the Division properly calculated additional corporation franchise tax due from petitioner for the audit period.

II. Whether the Notice of Deficiency was barred by the statute of limitations, in whole or in part.

III. Whether the Division of Taxation has established that the imposition of fraud penalty was warranted or, in the alternative, whether penalty under Tax Law § 1145(a)(1) should be imposed.

FINDINGS OF FACT

1. Petitioner, MediaBuss Systems, Inc., a New York corporation, was a systems integrator specializing in the installation of residential technologies, including home theaters, during the years 2001 through 2008 (audit period). At all relevant times, Steven Babel was the president and sole shareholder of petitioner.

2. The Division of Taxation (Division) began a corporation franchise tax audit of petitioner on or about June 21, 2007 with a written request for books and records for the period January 25, 2001 through December 31, 2005. The letter informed petitioner that if preliminary audit findings indicated a material effect on any other tax, it could result in a multi-tax audit. The request sought copies of federal unemployment reports; a written description of business activities within and without New York State; general ledger; purchase, disbursements and sales or receipts journals; payroll ledger; accountant's workpapers reconciling books to tax returns; an organizational chart identifying all related entities and any management agreements between petitioner and its affiliated companies; and common officers or employees of the related companies. In addition, the Division requested consolidated form 1120-S and New York corporation franchise tax returns; MTA surcharge returns; quarterly combined withholding, wage reporting and unemployment insurance returns; financial statements, and detailed information on executive compensation.

3. On or about March 25, 2010, the Division sent to petitioner's representative, Norman Berkowitz, Esq., another written request for information and documentation, this time for the extended audit period January 25, 2001 through December 31, 2008, which sought copies of all

forms 1099 issued by petitioner; details of independent contractor compensation; details of intercompany transactions between petitioner and any affiliates; copies of any loan agreements between petitioner and Mr. Babel; corporate tax returns that may have been filed in Connecticut; copies of any audits performed by a state or the Internal Revenue Service; detailed explanation and documentation of "other deductions," salary and wages and cost of goods sold shown on federal returns; and proof that petitioner had gone out of business, including the date and details of a transfer, if any. The request also included a copy of the first request, dated June 21, 2007.

4. The March 25, 2010 letter also included a copy of a previous written request, dated January 29, 2010, which requested detailed information regarding charges labeled "other business deductions," including the amount for Mr. Babel's draw account. The January 29, 2010 letter also sought the business purpose of the expense purchases, supporting documentation, project affiliation and any invoices associated with the expenses.

5. Additional requests for records were made orally at meetings with petitioner's representative on November 27, 2007, February 22, 2008, April 25, 2008, June 9, 2008 and September 10, 2008.

6. In response to all the requests for information and documentation, the Division received petitioner's forms 1120-S for 2004 and 2005 on or about December 6, 2007 and a bank transcript on or about February 29, 2008. Petitioner submitted no other information or documentation and did not submit any documentary or testimonial evidence in support of its petition at hearing, other than a letter from the Director of Tax Audits, Nonie Manion, to Mr. Berkowitz, dated March 16, 2010. The letter explained that the corporation franchise tax audit was the result of a sales tax audit of petitioner and the resulting tax found due therein. Ms. Manion noted that several corporate returns were not filed, deductions were being investigated and the Division was

awaiting additional information from Mr. Berkowitz. The letter also indicated that a Notice of Deficiency, notice number L-033395094-3, had been issued in error and was being canceled. In fact, a Consolidated Statement of Tax Liabilities, dated May 14, 2010, indicated that the assessment had been canceled, reflected in a $0.00 tax due for the period ended December 31, 2008.

7. Petitioner did not file federal or New York corporation franchise tax returns for the years 2001, 2003, 2006 and 2007. For the years 2002, 2004 and 2005 it filed both federal and New York State returns as a subchapter S corporation, although it had not applied for or been deemed a New York S corporation pursuant to Tax Law § 660. The New York returns were filed with the fixed dollar minimum tax of $100.00. Petitioner also filed a request for a six-month extension to file its 2006 New York S Corporation Franchise Tax return, dated March 7, 2007, but never filed said return.

8. In fact, the Division had instructed petitioner to file a CT-3, Corporation Franchise Tax Return, under article 9-A of the Tax Law, by Notice of Failure to File Corporation Tax Return, dated December 1, 2003 - - before it received petitioner's New York S corporation Franchise Tax Return for 2002 on or about December 30, 2003. The notice also specifically noted that petitioner might be liable for filing a Metropolitan Business Tax return. In addition, the Division informed petitioner of its failure to file the election to be treated as a New York S corporation by notices dated September 7, 2006, April 11, 2007, and April 22, 2009. Also, a letter was sent to Mr. Berkowitz, dated March 25, 2008, in which it was reiterated that petitioner had filed as an S corporation without authorization and was considered a C corporation, for which a new power of attorney was required. Petitioner never submitted a form CT-6, election by a federal S corporation to be treated as a New York S corporation.

9. The franchise tax audit was begun after the franchise field audit bureau in the Westchester District Office received a referral from the sales tax audit bureau concerning the discovery of additional sales and use taxes due from petitioner that may not have been included in the corporation tax returns filed by petitioner. Since petitioner did not submit the books and records requested by the Division, other than the bank reconciliation detail for the period ending December 31, 2005 and the federal forms 1120-S for 2004 and 2005, the Division used records collected by the sales tax auditors and the adjusted gross income and entire net income calculated by the sales tax bureau in its audit of petitioner. The franchise tax auditor also used the ratios calculated in the sales tax audit with respect to recurring expenses to determine cost of goods sold.

10. In light of petitioner's failure to produce almost all records requested, the Division utilized numerous records from the sales tax audit in performing the corporation franchise audit including check book stubs, the 2005 profit and loss statement, an operating account transcript, somewhat different from the bank reconciliation produced by petitioner to the franchise tax auditor, from which a draw account for Mr. Babel was constructed, and New York State corporation franchise tax returns for an S corporation for 2002, 2004 and 2005.

11. The auditor calculated petitioner's entire net income by adjusting the gross sales determined on the sales tax audit by information available to it, including expense information reported on the filed tax returns. Gross income was adjusted by the sales tax auditors to a calendar year basis. The auditor used the same computation utilized by the sales tax auditors: gross sales less cost of operations (43.7% of adjusted gross sales for all years except 2004 and 2005 for which the costs were taken directly from the federal returns). This determined adjusted gross sales, and in turn yielded unreported additional income for each year. The following chart

sets forth the income determined for corporation franchise tax as calculated from the sales tax audit results:

Year	AGI	Cost of Ops %	Cost of Ops	Gross Profit	Ordinary Income	Ordinary Income per return	Unreported Addt'l Income
2001	$1,491,744	43.7	$651,818	$839,926	$839,926	not filed	$839,926
2002	$2,424,358	43.7	$1,059,323	$1,365,035	$1,365,035	CT-3S $0	$1,365,035
2003	$2,190,005	43.7	$956,923	$1,233,082	$1,233,082	not filed	$1,233,082
2004	$1,440,670	1120-S	$686,349	$754,321	$754,321	$71,010 CT-3S	$683,311
2005	$1,980,064	1120-S	$1,924,371	$55,693	$55,693	CT-3S $139,343	($83,650)
2006	$786,626	43.7	$343,716	$442,910	$442,910	not filed	$442,910
2007	$1,743,120	43.7	$761,656	$981,464	$981,464	not filed	$981,464
2008	$1,743,120	43.7	$761,656	$981,464	$981,464	CT-3S $0	$981,464
Total	$13,799,707		$7,145,812	$6,653,895	$6,653,895	$210,353	$6,443,542

12. In examining the bank reconciliation statement that had been produced to the Division on the sales tax audit, it was apparent that many expenses were personal in nature. The auditor created a draw account profile from the information in the bank reconciliation that he believed reflected personal expenses paid by the corporation on behalf of Mr. Babel. Typical expenses included in the draw account were payments for Bloomingdales, bottled water, private schools, ATM withdrawals, Olympia pool service, Lord and Taylor, Capital One, Discover card and T & R Jewelers. Although the Division sought explanations of the payments from petitioner, it received none. As a result, the auditor disallowed these expenses as personal in nature and not business

related. The expenses so disallowed were deemed to be constructive dividends from petitioner to Mr. Babel and the disallowed deductions were added back to income.

13. To satisfy itself that this treatment of disallowed personal expenses was correct, the Division analyzed the information it had on hand for the year 2005, including the form 1120-S, a profit and loss statement and the prepared schedule of Mr. Babel's draw account. The result was that the Division found that petitioner had deducted the draw expenses identified for 2005 in the amount of $754,182.00 in determining its income, demonstrated by an almost identical deduction of $824,665.00, reported on the form 1120-S as other deductions, and found in statement 2 attached to the return.

14. The business allocation percentage was derived by the Division from its own observations on audit and reliance on figures calculated by the sales tax auditors. Since records were not provided by petitioner, and since it was a New York corporation with a New York address, the Division felt it was logical to assume all property was New York property and the allocation percentage was 100% for all years. The same assumption was made for the wage allocation, since a New York corporation's employees were presumed to be in New York in the absence of any proof to the contrary. The double-weighted receipts factor was determined by a ratio of out-of- state sales to sales everywhere. The values used to determine New York and everywhere receipts were the sum of gross sales per the sales tax audit, gross sales listed on the forms 1120-S, gross sales allocated to tangible personal property, gross sales allocated to services and other business receipts. A discreet business allocation percentage (BAP) was calculated for each year and is reflected in the table below in Finding of Fact 15.

15. The Division added the unreported additional income it calculated for each year to entire net income reported by petitioner on the returns it filed, other income discovered in the

sales tax audit and the disallowed expenses contained in Mr. Babel's draw account to find entire net income as adjusted. The calculated business allocation percentage was applied to this figure to arrive at allocated income, which, in each of the years audited, equaled the entire net income base to which the tax rate was applied to determine the tax due. The following chart illustrates this:

Year	Income Reported	Adjusted ENI	BAP %	ENI Base	Tax Rate %	ENI Base Tax
2001	0	$1,054,562	52.9170	$558,043	8	$44,643
2002	0	$1,597,633	65.0672	$1,039,535	7.5	$77,965
2003	$71,010	$1,605,156	77.0250	$1,236,372	7.5	$92,728
2004	$139,343	$1,380,908	68.9439	$952,052	7.5	$71,404
2005	0	$893,425	76.6780	$685,060	7.5	$51,380
2006	0	$781,425	77.9594	$609,194	7.5	$45,690
2007	0	$981,464	51.3879	$504,353	7.1	$35,809
2008	0	$981,464	51.3879	$504,353	7.1	$35,809

16. Since petitioner's sole place of business was within a metropolitan commuter transportation district (MCTD) district and it was determined additional franchise tax was due, petitioner was subject to the temporary metropolitan transportation business tax surcharge pursuant to Tax Law § 209-B. The Division computed the surcharge by applying the rate, 17%, to the net New York State franchise tax for each of the years in issue. The resulting metropolitan transportation business tax (MTBT) surcharge asserted by the Division for each year was:

2001	$8,538.00
2002	$15,905.00
2003	$18,916.00

2004	$14,566.00
2005	$10,481.00
2006	$9,321.00
2007	$7,717.00
2008	$7,717.00

17. Mediabuss paid the $100.00 fixed dollar minimum tax for the years it filed returns and was given credit for said payments. However, MediaBuss never paid the MTBT surcharge.

18. The Division requested from petitioner consents extending the period of limitations on assessment many times during the course of the audit. The auditor's log recites numerous exchanges of consents regarding the tax years 2004 and 2005 with the taxpayer's representative. These were the only two years petitioner filed returns, thus requiring consents to keep the period open for assessment by the Division. Although petitioner did file a return for 2002, the Division did not seek a consent because the period for assessment had expired prior to audit.

19. Despite the references to many consents in the auditor's log, the Division only submitted in evidence one consent extending the period for assessment of the years 2004 and 2005, which was executed by petitioner's representative on March 3, 2010 and the Division on March 9, 2010. It permitted a determination of additional tax or assessment at any time on or before June 15, 2010.

20. The Division determined that imposition of fraud penalty was warranted in this matter after a meeting among the auditor, his team leader and the group's section head on March 27, 2008. The reasons cited by the Division included the substantial and purposeful underreporting of tax as discovered on audit, due to overstating expenses and understating receipts. The payment of personal expenses of Mr. Babel, which were then deducted as business expenses by the

corporation, was seen as a clear tax avoidance scheme by the Division. In addition, petitioner failed to file any returns for the years 2001, 2003, 2006, 2007 and 2008, and those it did file were improperly filed as S corporation returns, avoiding the corporation franchise tax and the MTBT surcharge. Petitioner failed to file the proper returns even after being notified to do so on many occasions, including one written notification prior to filing its 2002 return. Petitioner also failed to cooperate on audit by producing books and records, producing only two forms 1120-S for the years 2004 and 2005 and a bank reconciliation schedule.

21. The Division issued a Notice of Deficiency to petitioner, dated June 7, 2010, for the years 2001 through 2008, which asserted additional corporation franchise tax due in the sum of $548,164.00, penalties of $451,757.20 and interest of $323,376.48 for a total amount due of $1,323,297.68.

22. At the Bureau of Conciliation and Mediation Services (BCMS) conference, the conferee canceled the tax, penalties and interest for the years 2007 and 2008 consistent with the cancellation of these periods in the sales tax audit. Therefore, the years remaining in issue are 2001 through 2006. The tax remaining due was recomputed to be $461,137.00, plus penalty of $406,223.00 and interest of $327,327.00.

SUMMARY OF THE PARTIES' POSITIONS

23. Petitioner contends that the Notice of Deficiency was not timely issued and that the Division provided no proof that the notice was mailed by registered or certified mail.

24. Petitioner argues that the Division's reliance on the sales tax audit for determination of taxable income was misguided because the sales tax audit was inaccurate and its estimates were erroneous. Petitioner believes that the estimates for 2007 and 2008 underscore the inaccuracy of

the estimates since petitioner was out of business in those years. It also points out that recurring expenses were not considered in the franchise tax audit.

25. Petitioner maintains the calculation of the business allocation percentage was flawed because it used 100% New York allocation for wages even though there was no payroll and most sales were out of state.

26. Petitioner argues that the testimony of all Division witnesses at hearing was not credible because of long, vague answers and lack of recall and an inability to express the consequences of a distribution to a shareholder in an S corporation.

27. Petitioner contends that the Division has not demonstrated fraud in this matter even though it has the duty to do so by clear and convincing evidence. Petitioner maintains that, based upon the facts in evidence, the Division has failed to meet its burden.

28. The Division argues that the Tax Law gives it the authority to examine and determine the amount of tax due from information in its possession if a return is not filed. Given the lack of books and records available for review, the Division contends that it properly determined additional tax due using a reasonable methodology, and it was petitioner's burden to show that the determination was erroneous.

29. With respect to the timely issuance of the notice of deficiency, the Division notes that for the year 2002 the statute will have run if it is unable to establish fraud for that year. However, the Division believes it did establish fraud and, therefore, it issued the notice within the statutory limits. With respect to 2004 and 2005, the Division notes that it issued the notice within the statutory limits due to the execution of consents to extend the period of limitation executed by petitioner. In the alternative, if fraud is proven for these years, the notice is timely. For all other

years in the audit period, since no returns were filed, the statutory period for issuance of a notice remained open.

30. The Division objects to petitioner's argument that no proof of mailing was presented to establish timely mailing of the notice on the grounds that it was a factual issue that had not been raised at any time prior to submission of briefs, thus precluding the Division from submitting any proof on the matter.

31. The Division believes that it has sustained its burden of proving fraud, or, in the alternative, negligence penalty. The Division believes it has identified a pattern of conduct by petitioner that confirms an intent to evade tax. It believes the substantial understatement of tax, deduction of personal expenses, filing as an S corporation when it had never applied for S corporation status and its failure to provide any meaningful books and records during audit constitute the proof necessary to prove fraud, or, at a minimum, negligence penalties.

CONCLUSIONS OF LAW

A. Initially, it is noted that the validity of multi-audits has been confirmed (***Matter of Giuliano v. Chu***, 135 AD2d 893, 521 NYS2d 883 [1987]; ***Matter of Cousins Service Station, Inc.***, Tax Appeals Tribunal, August 11, 1988; ***Matter of Costa***, State Tax Commission, June 28, 1985). In this matter, in light of the numerous requests for petitioner's books and records, not required in franchise tax audits, and petitioner's failure to satisfy said requests, the Division's reliance on its audit work and conclusions in its sales tax audit was appropriate. It is also appropriate for this forum to take notice of that audit and its results, since the record in that matter is one of which official notice may be, and is, taken.[1]

[1]Official notice is being taken of the record of another matter before the Division of Tax Appeals pursuant to State Administrative Procedure Act § 306(4), which provides that "official notice may be taken of all facts of which judicial notice could be taken and of other facts within the specialized knowledge of the agency." Courts of

B. Tax Law § 1081(a) provides, in part, as follows:

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

As the statute suggests, there is a profound difference between the audit methodologies required in sales tax and corporation franchise and income taxes. In ***Matter of Dujak Trucking Corp.***, (Tax Appeals Tribunal, April 1, 1993), the Tribunal stated:

> However, this argument ignores the critical distinction between section 1138(a)(1) and its franchise tax counterpart, section 1081(a). Section 1081(a) provides that if a taxpayer required to file a franchise tax return fails to do so, "the [Division] is authorized to estimate the taxpayer's New York tax liability from any information in its possession" (emphasis added). Unlike section 1138(a)(1), section 1081(a) contains no preconditions to the Division's use of estimate techniques. In our view, if the Legislature's intention was to require a complete examination of a non-filing corporation's records before estimation techniques are permitted, it would have stated this intention within section 1081(a). (***See also Matter of Mountain Star Co.***, Tax Appeals Tribunal, March 13, 2008.)

Similarly, in ***Matter of R & J Automotive*** (Tax Appeals Tribunal, June 15, 1989), the Tax Appeals Tribunal sustained a franchise tax deficiency and held that the audit standards required in sales and use tax cases was inapplicable, stating as follows:

> This standard, requiring demonstrably inadequate records before an indirect auditing technique may be used, has been explicitly rejected in audits of income for personal income, non-resident earnings and unincorporated business taxes (Matter of Giuliano v. Chu, 135 AD2d 893 [1987]; Matter of Hennekens v. State Tax Commn., 114 AD2d 599 [1985]). The distinction between an income tax audit and a sales tax audit

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the State of New York may take judicial notice of their own record of the proceeding of the case before them, the records of cases involving one or more of the same parties or the records of cases involving totally different parties (***Berger v. Dynamic Imports, Inc.***, 51 Misc 2d 988, 274 NYS2d 537 [1966]; 57 NY Jur 2d, Evidence and Witnesses, § 47). The record of the proceeding before the Division of Tax Appeals of which official notice is being taken is ***Matter of MediaBuss Systems, Inc.***, (Division of Tax Appeals, ALJ Unit, November 29, 2012), a copy of which was duly served on petitioner's representative (***see Matter of Kolovinas***, Tax Appeals Tribunal, December 28, 1990).

> centers on the type of tax being imposed (Hennekens v. State Tax Commn., supra). While sales tax audits seek recovery of taxes imposed directly upon verifiable receipts as evidenced by books and records which are required to be maintained (Matter of Licata v. Chu, 64 NY2d 873, 874 [1985]) audits involving the imposition of tax on income concern the receipt of income which cannot easily be verified by reference to books and records (Matter of Hennekens v. State Tax Commn., supra).

In this matter, although not required to make such an inquiry, the Division made numerous requests for petitioner's books and records in an attempt to accurately reconstruct petitioner's income for all the years it failed to file and to determine the accuracy of the few returns it did file. Petitioner only supplied federal form 1120-S for 2004 and 2005 and a bank reconciliation statement. Petitioner failed to produce any further evidence at hearing and, thus, did not meet its burden of proof. In this matter, that meant overcoming the deficiency by evidence showing that the methodology utilized by the Division and the deficiency itself were erroneous. (***Matter of Giuliano v. Chu***; Tax Law § 1089[e].)

C. Tax Law § 209(1) imposes franchise tax on the basis of entire net income or other basis as may be applicable, for the privilege of a corporation's exercising its corporate franchise, or of doing business or of employing capital or leasing property in New York. Tax Law § 209-B imposes a surcharge on said privilege when an office is maintained in a metropolitan commuter transportation district.

Petitioner incorrectly filed as a subchapter S corporation for the years it did file during the audit period, 2002, 2004 and 2005. In fact, petitioner has not disputed this finding. It never elected to be treated as an S corporation and was told numerous times since December 1, 2003 to file as an Article 9-A corporation. Despite the directives, petitioner continued to file as an S corporation, paying only the $100.00 fixed minimum tax and avoiding the MTBT surcharge pursuant to Tax Law § 209-B. Since petitioner's sole place of business was within a metropolitan

commuter transportation district and it was determined additional franchise tax was due, petitioner was subject to the temporary metropolitan transportation business tax surcharge pursuant to Tax Law § 209-B.

D. Following the directive of Tax Law § 1081(a), upon an examination of petitioner's 1120-S returns for 2002, 2004 and 2005, and noting the lack of returns for all other years in the audit period, the Division examined as much information as it had on hand to reconstruct petitioner's income. The Division calculated petitioner's entire net income by adjusting the gross sales determined on the sales tax audit by information available to it, including expense information reported on the filed tax returns. Gross income was adjusted by the sales tax auditors to a calendar year basis. The auditor used the same computation utilized by the sales tax auditors, subtracting the cost of operations (43.7% of adjusted gross sales for all years except 2004 and 2005, for which the costs were taken from the returns) from the sales tax figures for adjusted gross sales. This yielded unreported additional income for each year. In addition, the Division noted expenses of the business that were personal in nature. When petitioner did not respond to inquiries regarding these expenditures, the Division created a profile of a personal draw account and then disallowed these expenses, adding the amounts back to income and deeming them constructive dividends to Mr. Babel.

The Division added the unreported additional income it calculated for each year to entire net income reported by petitioner on the returns it filed, other income discovered in the sales tax audit and the disallowed expenses contained in Mr. Babel's draw account to compute entire net income as adjusted. The calculated business allocation percentage was applied to this figure to arrive at allocated income, which, in each of the years audited, equaled the entire net income base to which the tax rate was applied to determine the tax due. The Division computed the MTBT

surcharge by applying the rate, 17%, to the net New York State franchise tax for each of the years in issue.

E. Petitioner has failed to show evidence that either the methodology or the asserted deficiency was in error. On audit, petitioner submitted the federal tax returns it filed for 2004 and 2005 and a bank reconciliation statement. It submitted nothing to challenge the audit methodology or deficiency at hearing. Petitioner contends that the sales audit was flawed and therefore the corporation franchise tax audit, which relied on the sales tax audit outcomes, was likewise flawed. Petitioner also argues that it was not given credit for recurring expenses in the corporation franchise tax audit and that the business allocation percentage was wrongly calculated. These attacks are baseless, since petitioner offered no proof, either documentary or testimonial, in support of its positions. Further, the sales tax audit methodology has been sustained in a companion case to the instant matter, issued as a separate determination of even date hereof (***see Matter of Mediabuss Systems, Inc.***, Division of Tax Appeals, [November 29, 2012]).

Likewise, petitioner's contention that the payroll factor should not have been 100%, alleging that most of its sales were out of state, is baseless. Petitioner did nothing to demonstrate where any of its sales took place and never supplied information on employee locations, despite entering salaries on its federal 1120-S returns.

It is true, as petitioner argues, that a notice of deficiency that has no rational basis must be set aside (***Matter of Donahue v. Chu***, 104 AD2d 523, 479 NYS2d 889 [1984]; ***Matter of Rosenthal v. State Tax Commission***, 102 AD2d 325, 477 NYS2d 767 [1984]). However, it has not carried its burden of establishing that this was the case herein. (***Matter of Leogrande v. Tax Appeals Tribunal***, 187 AD2d 768, 589 NYS2d 383 [1992], ***lv denied*** 81 NY2d 704, 595 NYS2d

398 [1993].) It is concluded that both the audit methodology and the notice of deficiency had rational bases and are sustained.

Petitioner maintains that the auditors who testified at hearing were not credible, noting their failure to recall details or give direct answers to questions put to them. This was not the case. Although there were certainly times they could not recall specific details from a complicated audit file, the substantial portion of their testimony is corroborated by the audit log and the documentary evidence, i.e., audit workpapers, report and schedules. In addition, any answers that petitioner contends were abstract and vague, were often the result of vague and abstract questions. In sum, the auditors' testimony was credible and adequately supported the audit documentation. Further, petitioner's charge that the auditor lacked familiarity with S corporation distributions and distributive shares is meritless. Petitioner was not an S corporation, although improperly filing as one. To raise an issue with respect to the tax treatment of S corporations or its shareholder is frivolous.

F. Petitioner has raised a new factual issue for the first time in its brief concerning the issuance of the Notice of Deficiency. Petitioner contends that the Division failed to prove the notice was issued by certified or registered mail, as prescribed by Tax Law § 1081(a). The Tribunal has consistently held that the raising of new factual issues after the hearing would disadvantage the party who had the burden of establishing the disputed fact. (***Matter of Chuckrow***, Tax Appeals Tribunal, July 1, 1993; ***Matter of Sandrich***, Inc., Tax Appeals Tribunal, April 15, 1993.) Since the raising of an issue of fact is not permissible after the record is closed, petitioner's request for relief on this basis is denied.

G. Petitioner contends that fraud penalty asserted pursuant to Tax Law § 1085(f) should be canceled because the Division did not carry its burden of demonstrating that MediaBuss acted

deliberately, knowingly and with specific intent to violate the law. Petitioner maintains that the Division may not assert fraud on the basis of mere suspicion derived from surrounding circumstances.

The Division bears the burden of proving fraud herein. In ***Matter of Drebin*** (Tax Appeals Tribunal, March 27, 1997, ***affd*** 249 AD2d 716, 671 NYS2d 565 [1998]) the Tribunal stated:

> For the Division to establish fraud by a taxpayer, it must produce 'clear, definite and unmistakable evidence of every element of fraud, including willful, knowledgeable and intentional wrongful acts or omissions constituting false representation, resulting in deliberate nonpayment or underpayment of taxes due and owing'(citation omitted).

In addition, the Division does not have to prove fraud by direct evidence. It can establish it by circumstantial evidence that looks at the taxpayer's conduct on the whole in the context of the events in issue and draw inferences from said conduct. (***Matter of Cinelli***, Tax Appeals Tribunal, September 14, 1989.) A consistent and substantial understatement of income has been found to constitute strong evidence of fraud. (***Merritt v. Commissioner***, 301 F2d 484 [1962].)

For the following reasons, it is hereby determined that the fraud penalty was properly imposed by the Division:

(1) although petitioner correctly noted in its brief that suspicion of fraud from surrounding circumstances is not enough to establish it, and substantial underreporting alone is not enough to establish fraud, it is strong evidence of fraud (***Matter of Cousins Service Station, Inc.***; ***Merritt v. Commr.***). Here, MediaBuss not only underreported a substantial amount of tax ($461,137.00), it also failed to report any income when it was under a duty to do so in the years it never filed returns;

(2) the corporation consistently paid for and deducted personal expenses of Mr. Babel;

(3) petitioner failed to file any tax returns for the years 2001, 2003, 2006, 2007 and 2008;

(4) although sent a notice of failure to file a 9-A corporation tax return and a metropolitan business tax surcharge return for 2002, it failed to ever comply, instead improperly filing an S corporation return;

(5) although notified in writing by the Division on numerous occasions (some of the notifications coming while the audit was pending), petitioner never filed form CT-6, electing to file as an S corporation;

(6) petitioner failed to assist the Division on audit, failing to provide any books and records other than the two tax returns and the bank reconciliation statement, and generally concealing the true income and business operations;

(7) and petitioner failed to provide any information on the personal expenses paid by the corporation on behalf of Mr. Babel when confronted with evidence of said expenditures.

H. Petitioner argues that the notice of deficiency was issued after the time required in Tax Law § 1083. However, since fraud has been found and sustained, there is no limitation on the assessment pursuant to Tax Law § 1083(c)(1)(B).

Had fraud not been established, the years 2002, 2004 and 2005 would have been beyond the statute of limitations since the Division never acquired a consent to extend the period for limitation on assessment for 2002 and the one it submitted in evidence was executed beyond the period for assessment for 2004 and 2005. (Tax Law § 1083[c][2].)

I. The petition of MediaBuss Systems, Inc. is denied, and the Notice of Determination, dated June 7, 2010, as modified by the Conciliation Order, dated January 28, 2011, is sustained.

DATED: Albany, New York
November 29, 2012

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