STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
MEDIABUSS SYSTEMS, INC.	:	DETERMINATION DTA NO. 824207
for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period December 1, 2000 through February 28, 2009.	:	

Petitioner, MediaBuss Systems, Inc., filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 2000 through February 28, 2009.

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 10:30 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. Petitioners 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 of Taxation was warranted in resorting to an indirect audit methodology in this matter.

II. If the Division of Taxation was correct in utilizing an indirect audit methodology, whether the methodology had a rational basis and was reasonably calculated to reflect the sales tax due for the period December 1, 2000 through February 28, 2009.

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. (MediaBuss), was incorporated in New York on January 30, 2001 and engaged primarily in the business of installing home entertainment and security systems during the period December 1, 2000 through February 28, 2009 (audit period).[1] At all relevant times, Steven Babel was the president and sole shareholder of petitioner.

2. The Division of Taxation (Division) began an audit of petitioner on or about February 2, 2004 with a written request for books and records for the period December 1, 1997 through November 30, 2003. The request sought all books and records pertaining to sales and use tax liability for the audit period including federal and state tax returns, general ledger, sales invoices, exemption documentation, fixed purchase and sale invoices, expense purchase invoices, bank statements, canceled checks, cash receipts journal and a cash disbursements journal. A second appointment letter was sent to petitioner's representative on January 26, 2005. A copy of the records request list was sent by facsimile transmission on February 28, 2005. Requests for records continued for a period of over five years.

[1] The Bureau of Conciliation and Mediation Services (BCMS) conferee determined that the business ceased operations by November 30, 2006.

3. The audit period was updated and modified by a formal request for records, dated May 11, 2005, which informed petitioner that the audit period was being modified and would cover the period December 1, 2000 through February 28, 2005. Petitioner was asked to produce all records previously requested and all records for the extended audit period as well.

4. Another written request for records was made on April 13, 2006, requesting the same records set forth in the second request. A request made on August 7, 2006 modified the audit period again, this time requesting all previous records and those for the extended period ended August 31, 2005. On February 20, 2007, the Division sent another written request to petitioner requesting all books and records previously sought and those for the extended period ended November 30, 2006. Additional written requests for books and records were made on April 27, 2007, December 20, 2007, August 6, 2008 and April 22, 2009. The last of these requests extended the audit period through February 28, 2009.

5. In addition to the written requests for records, the Division of Taxation made many oral requests for books and records, which were recorded in its audit log. These requests were made on March 5, 2004; June 15, 2004; March 18, 2005; April 27, 2005; June 9, 2005; June 17, 2005; June 21, 2005; September 29, 2005; April 18, 2006; May 22, 2006; August 25, 2006; November 13, 2006; December 7, 2006; February 13, 2007 and May 22, 2007.

6. Over the course of the audit, from February 2, 2004 through December 7, 2009, four Division auditors spent 529.75 hours attempting to determine the sales and use tax liability of MediaBuss for the audit period. During the same time period, the auditors dealt with four different representatives of petitioner.

7. In response to the requests for records, the Division received limited documentation. The written requests of February 2, 2004 and May 11, 2005 yielded some purchase invoices, an

incomplete set of bank statements, a copy of the 2004 U.S. Income Tax Return for an S Corporation, and approximately half of the sales invoices for 2004. It took petitioner's representative, Mr. Edward Broccolo, 16 months to assemble these documents, all the while assuring the Division that all records were available for audit. Mr. Broccolo told the auditor that all of petitioner's income was derived from capital improvements and thus exempt from sales tax but reported that sales invoices were not available to substantiate this claim. He also informed the Division that 95% of, if not all, sales were made out of state, although no proof of this was offered. Mr. Broccolo was presented with a vendor registration application, form DTF-17, on March 28, 2006.

8. The Division did not receive any further documentation until May 8, 2006, when Mr. Broccolo submitted additional bank statements and purchase invoices for the years 2001 through 2005. Although told on May 8th that a general ledger, federal and state income tax returns for all years under audit and a schedule of fixed asset acquisitions were needed, Mr. Broccolo informed the Division on May 31, 2006 that no other documents were available at that time.

9. Over the course of the next five months Mr. Broccolo did produce additional records, including purchase invoices from Staples for office supplies, income statements for the years 2004 and 2005, 2002 and 2005 U.S. income tax returns for an S corporation and the 2002 New York State S Corporation Franchise Tax Return.

10. A conference was held between Division representatives and Mr. Broccolo on November 1, 2006 during which he was reminded that he had not submitted a complete set of bank statements with an explanation of the source of deposits. Again, he was provided a form, the DTF-17, for registering petitioner for sales tax purposes since records submitted on audit indicated that petitioner was making New York sales and sometimes collecting tax on those sales.

11. Shortly thereafter, also in November 2006, Mr. Jeff Levine, the comptroller of Concierge Direct, a newly-created and related company owned by Mr. Babel, received a power of attorney from petitioner. He began the task of searching for the additional documentation requested by the Division and reconstructing the books and records of the company. He was also presented with a form DTF-17 for registering petitioner as a sales tax vendor. The form was submitted on November 16, 2006, and petitioner filed its first New York State sales and use tax return on December 20, 2006 for the quarter ended November 30, 2006. It stated gross sales of $73,683.00, of which none were taxable. A second quarterly sales and use tax return was filed on or about March 20, 2007 for the quarter ended February 28, 2007, indicating $41,495.00 in gross sales, of which $8,817.00 were listed as taxable. The return stated a tax due of $738.41, which was paid.

12. In a meeting with Mr. Levine on December 7, 2006 the Division reviewed a reconstructed general ledger for 2001, bank statements and supporting documentation. Mr. Levine offered to reconstruct the general ledger for the entire audit period, a task he wanted six months to complete, but the Division concluded that it still needed petitioner to amend its federal and state tax returns and submit balance sheets, income statements and detailed records for one of petitioner's more substantial customers known as Calloway. In addition, petitioner was asked to submit a formal letter requesting permission to complete its record reconstruction work in six months. Ultimately, petitioner chose not to submit any further documentation in following up on this meeting, and never requested permission to reconstruct its general ledger for the entire audit period.

13. Petitioner hired a new representative later in December 2006, Mr. Michael Buxbaum, who forwarded to the Division additional sales invoices for 2001 through 2005, which indicated

more New York sales than originally reported. It was noted at that time that the invoices produced were not sequentially numbered or prenumbered and provided no other internal controls for verifying sales.

14. At this juncture in the audit, the Division still had not received a complete general ledger or any confirmation on the Calloway sales it had requested. In addition, the bank statements it reviewed indicated a substantial number of unsupported bank deposits, leading the Division to conclude that there were substantial sales in addition to untaxed expense purchases.

15. On April 30, 2007, the Division received a letter from Mr. Buxbaum withdrawing as petitioner's representative and, soon thereafter, received notice that petitioner had obtained a new representative, Norman Berkowitz, Esq. Mr. Berkowitz was forwarded a records request, an audit method election form and a responsible person questionnaire. Ultimately, Mr. Berkowitz was able to produce copies of invoices for the period September 2005 through November 2006, bank reconciliation schedules and disbursements and a signed audit method election form. The Division believed it had received all bank statements through November 2006 by the time it finished the audit.

16. On or about August 1, 2007, the Division decided to send out third-party confirmation letters to petitioner's customers, whose identities had been mined from checks associated with the bank statements and invoices. The form of the letter was approved by Mr. Berkowitz, and the responses were used to confirm sales by petitioner and help the Division determine a more accurate projection of New York taxable sales.

17. Although an audit method election agreement was signed by petitioner and returned to the Division, after a thorough review of all the books and records received, specifically those received after the audit method election agreement was drafted, it was determined that the

documentation did not support using a test period to determine petitioner's sales tax liability and the agreement was rescinded.

18. The auditors reviewed all the sales records produced by petitioner. Based upon the lack of internal controls over the sales invoices, including sequential numbering or prenumbered invoices and the failure to ever provide summary schedules, a cash receipts journal, a sales journal, trial balances or an original and complete general ledger, the Division concluded that it could never be assured it had received all sales invoices and concluded that the records were inadequate to perform a detailed audit. The Division concluded that the lack of records made tracing any transaction to its original source or final total impossible.

19. The Division's analysis of petitioner's bank statements revealed that its deposits exceeded total sales invoices for some periods and also sales totals reported on federal income tax returns. Since no sales tax returns were filed by petitioner until December 2006, no reconciliation could be made with the federal returns, and the federal returns were not in agreement with the sales that could be determined for those periods.

20. From the information available to it, the Division devised a methodology to ascertain total audited sales by using the highest value of the following records that had been made available to it: check deposits discerned from bank statements; federal income tax returns; and actual sales invoices. For the years 2001, 2002 and 2004, sales invoices were used to determine total audited sales of $5,356,771.00; for 2005, the federal income tax return was used to determine total audited sales of $1,980,064.07; and for the years 2003 and 2006, the Division determined total audited sales from bank deposits of $2,976,631.50. Other income and sales tax collected was subtracted from total bank deposits for purposes of computing net sales per audit. Total audited sales were calculated to be $10,313,466.82, which number includes gross sales from the above

sources for the years 2001 through 2006, net of other income and sales tax collected and exclusive of capital improvements. The Division's rationale for the methodology was straightforward: for those years in which the sales invoices equaled or exceeded the deposits to the bank account and the gross sales set forth on the federal returns filed, the sales invoices were accepted as petitioner's gross sales. All sales per the invoices were considered New York sales unless they established out-of-state sales or exempt sales. For those years that the bank deposits exceeded both sales invoices and the gross sales per the federal tax returns, the deposits were accepted as petitioner's sales. For the years the federal income tax returns stated gross sales that exceeded both the sales invoices and the bank deposits, the reported gross sales were accepted as petitioner's sales. Since petitioner's own failure to establish its sales through complete books and records was the reason the Division could not conduct a detailed audit, and the Division could not ascertain an accurate calculation of tax due, it was incumbent on the Division to use a methodology that would protect the state's interest, and it argued that this methodology accomplished that goal.

21. As mentioned, the invoices analyzed by the Division revealed total sales tax charged and collected by petitioner but not remitted, as follows: $1,179.00 for 2002; $1,526.77 for 2004; and $937.58 for 2005. Petitioner was not a registered vendor during these years and did not file sales tax returns.

22. Some of the invoices uncovered that indicated New York sales tax charged on invoices, and exemplary of petitioner's practice, were: Mr. Doug Benach, $479.20, July 2002; Michael Boatman, $297.35, June and July 2004; Schiller, $96.53, July to September 2004; Thompson, $96.19, June 2004; Gleysteen, $1,146.15, August 2002; Gleysteen, $337.50, November 2002; Gleysteen, $7,494.37, November 2002; and Murphy Brothers, $288.75, June 2002.

23. While attempting to confirm sales with parties with whom petitioner conducted business, the Division received copies of resale certificates issued by petitioner to its suppliers to enable petitioner to purchase materials free of sales tax. One blanket resale certificate was issued to Key Distribution of New Hyde Park, New York, on February 27, 2003. Another blanket certificate, undated, was issued to Bosch Security Systems of Chicago, Illinois. Both certificates were signed by petitioner's president, Steven Babel, and each stated that MediaBuss held a valid certificate of authority, number 1596937. A third supplier of materials to petitioner, Power Door Products, Inc., of Brewster, New York, sent a letter to the auditor, dated September 5, 2008, which stated that it had done business with petitioner during the period 2003 through 2007 and that it had a resale certificate from MediaBuss on file during that period, but had lost the document in a flood. During the audit period, petitioner also accepted a resale certificate from a customer, Continental Lighting Corp.

24. In order to calculate the additional sales and sales tax due for the extended period including the quarters ended February 28, 2007 through February 28, 2009, the Division took total audited sales for the period January 1, 2001 through November 30, 2006, $10,313,466.82, divided by the number of months, 71, and found average audited sales per month of $145,260.10, or $435,780.29 per quarter. The Division applied this figure to each of the additional nine quarters to arrive at additional audited sales for the extended period of $3,922,022.59, or total net sales for the audit period of $14,235,489.41.

25. As with sales records requested, petitioner did not produce complete and adequate expense records for the entire audit period. The Division reviewed purchase invoices for materials that were made available by petitioner for the period March 2001 through December 2005. The Division sought invoices that clearly showed subcontractors, the work completed and

the materials used. The Division believed these to be purchases of materials used in capital improvements. By isolating these invoices from those with no breakdowns, the Division was able to establish the percentage of sales that were materials purchases. The audited sales calculated from these invoices was $3,903,253.95 and the materials purchases indicated on those invoices amounted to $1,805,495.51. The ratio of material purchases to sales was computed to be .46256163. When this ratio was then applied to the calculated quarterly audited net sales for the audit period January 1, 2000 through December 31, 2009, it yielded capital improvement material purchases of $655,665.66, which resulted in a tax due thereon of $48,850.73.

26. The Division assumed that tax was due on all expenses incurred by petitioner since its offices were located in New York. The Division calculated recurring taxable expenses by using the explanatory schedule attached to petitioner's 2004 and 2005 federal income tax returns for "other deductions," listed on line 19 of page 1. With the exception of accounting expenses, bank charges, commissions, fuel, insurance, legal and professional expenses, which were excluded from its calculation, the Division treated all other listed deductions as taxable recurring expenses. It made an allowance for office supplies in the sum of $5,000.00 in each year because petitioner was able to produce invoices from Staples that indicated sales tax having been paid.

27. For the year 2004, taxable recurring expenses were determined to be $257,902.00 and for 2005, $1,106,442.00. These figures were added together and divided by the audited sales total for the same two years of $3,420,733.74, to arrive at the ratio that showed recurring expenses as a percentage of audited sales, or .398845424. The Division then applied this ratio to total audited sales of $14,235,489.41 to arrive at total taxable expense purchases of $5,677,759.82 and tax due of $425,072.59.

28. Although the Division broke out the utility tax expense for the extended audit period March 1, 2006 through February 28, 2009 due to petitioner's move to New Rochelle where school taxes may have affected the jurisdictional rates applied to utility bills, the computation was ultimately mooted by the shortened audit period.

29. The Division issued to petitioner a form AU-346, Statement of Proposed Audit Change, for the period December 1, 2000 through February 28, 2009, which asserted total additional sales and use tax of $991,427.39, plus penalties of $914,423.14 and interest of $816,932.96. The tax was determined based upon additional taxable sales from a detailed analysis of invoices ($1,438,340.60), unsupported deposits and sales from the federal income tax returns ($1,033,414.42) and sales projected for the extended audit period December 1, 2006 through February 28, 2009 ($3,922,022.61). In addition, it included use tax on expense purchases ($5,677,759.70) and materials purchases associated with capital improvements ($655,665.67). The total additional taxable sales and purchases was determined to be $12,727,203.06, which yielded additional tax due of $991,427.39.

30. Fraud penalty was imposed because petitioner was found to have charged and collected but never remitted sales tax on numerous invoices. Petitioner never registered as a New York vendor for sales tax purposes until November 2006, having made sales in New York for almost four years prior. Petitioner filed no sales and use tax returns until it filed its quarterly return for the period ended November 30, 2006, immediately after filing its vendor registration.

31. The Division also imposed fraud penalty because of commingling of funds between the two companies owned by Mr. Steven Babel, MediaBuss and Concierge Direct, and personal transactions on behalf of Mr. and Mrs. Babel. In the first instance, while investigating whether petitioner had ceased operations in 2006 and performing an audit of another company owned by

Mr. Babel, Concierge Direct, the Division found that MediaBuss had made unexplained deposits to the bank account of Concierge Direct. In the second instance, the Division discovered invoices that revealed a provider of services to MediaBuss, Mohawk White Plains, issued two refund checks to Mr. and Mrs. Babel in June and July of 2004. In addition, MediaBuss bank statements recorded payments for apparent personal expenses made to Bloomingdales, a gynecology and obstetrics practice, and the Bonnie Briar Country Club. On another occasion, as mentioned above, petitioner issued resale certificates with a registration number, even though it was not a registered vendor.

32. Petitioner initially represented to the Division that it made few or no New York sales but documentation that was ultimately provided proved otherwise, and demonstrated that materials were being delivered into New York and also that services were being performed in the state as well. Responses to third-party confirmation letters demonstrated that petitioner was charging and collecting tax in numerous instances and not remitting the tax collected.

33. Petitioner reported gross sales of $115,178.00 and taxable sales of $8,817.00, paying tax of $738.41 with its quarterly sales and use tax return for the quarter ended February 28, 2007. Petitioner received credit for this payment when the Division calculated additional sales tax due.

34. Of the $724,591.14 in total penalties asserted by the Division for the audit period that ended November 30, 2006, $714,348.33 was attributed to failure to pay tax due to fraud; $10,000.00 was attributed to operating a business without a certificate of authority; and $242.81 was attributed to fraudulently issuing an exempt resale certificate.

35. The Division of Taxation issued to petitioner a Notice of Determination, notice number L-033085647, dated December 27, 2009, which asserted additional sales and use taxes due of

$991,427.39, plus fraud penalty of $914,423.14 and interest of $829,184.46 for the period December 1, 2000 through February 28, 2009.

36. Pursuant to a Bureau of Conciliation Services (BCMS) Order, dated January 28, 2011, the Notice of Determination was recomputed, eliminating the quarters ended February 2007 through February 2009. The resulting tax due was $525,605.14, plus penalty of $724,591.14 and interest of $903,091.26. The conferee concluded that there was no further business activity by MediaBuss after November 30, 2006.

37. Petitioner's witnesses, Jay Sanders, CPA, an accounting consultant, and Greg Giampa, a self-described "temp" at MediaBuss, each related that Frank Galasso was the father-in-law of Steven Babel and that he made advances or loans to MediaBuss as Galasso Trucking. However, neither gentleman could recall when such loans were made, in what amounts, and they never saw any loan documentation. Both witnesses believed there were adequate records to perform an audit but only Mr. Sanders said that he had reviewed such records, including a complete general ledger, whereas Mr. Giampa believed that Mr. Jeff Levine, the comptroller of Concierge Direct who was brought in to assist in the audit, had tried to reconstruct the books and records because the company had not retained vendor's bills or its own invoices. Mr. Giampa was aware that MediaBuss had made New York sales and Mr. Sanders said he was aware of the Tax Law requirement that entities making New York sales had to be registered as a vendor.

38. Petitioner did not produce any books and records at hearing other than a copy of one confirmation response from Arthur Bell CPAs on behalf of Delaware Investment Properties LLC, which contained seven purchase schedules for the years 2000 through 2006, all of which indicated no New York purchases. None of the sheets were date-stamped "received" by the Westchester District Office, a stamp seen on all other pages of confirmations in evidence, but the cover letter

did have such a stamp. The response listed purchases for the years 2002, 2003 and 2006. The totals listed for each year were: 2002, $132,590.00; 2003, $99,438.00; 2006, $41,228.72. The total for all three years was $273,166.72. The Division's totals, based upon the bank statements and checks associated therewith, were: 2003, $232,028.00; 2005, $37,656.12; and 2006, $106,784.46. All of the Delaware Investment Properties sales were listed on the audit workpapers as New York capital improvements and the Division excluded all such sales from its calculation of net sales.

Also, petitioner submitted purchase information from United House Wrecking, Inc., of Stamford, Connecticut, which indicated that Mr. Babel had purchased items from it and was subsequently issued a refund check. The insinuation was that this sum had been incorrectly included in sales. This item appeared in the Division's analysis of check deposits as a refund and was excluded from sales, the net effect of which was that the $2,987.76 deposit on September 20, 2002 was correctly labeled and excluded as "other income" from sales invoices and bank deposit totals for purposes of calculating sales.

SUMMARY OF THE PARTIES' POSITIONS

39. Petitioner contends that the Division violated its duty to thoroughly examine the records that were produced by petitioner pursuant to the requests made. Petitioner claims that the auditor testified that she received sales invoices and bank statements for the entire audit period. Further, the Division entered into a test period agreement with petitioner, which it argues can only be done when the Division is satisfied that the books and records are complete and adequate. Petitioner concludes that the Division did not have the legal basis to resort to external indices and estimate the tax due.

40. Petitioner argues in the alternative that even if the Division properly determined that its records were inadequate, the methodology it chose to calculate petitioner's tax liability was not reasonably calculated to reflect the proper tax due; rather it was chosen merely to establish the highest possible sales and use tax. Petitioner contends that by utilizing the highest sales established by bank records, federal income tax returns and sales invoices, the Division exposed its intent to extract the highest amount of tax rather than the reasonable and appropriate tax.

41. Petitioner contends that this forum should place little weight on the testimony of the Division's witnesses since it believes their answers were vague, confusing and evasive and lacked credibility. Petitioner cites the instances where the auditors could not recall facts or adequately explain their work.

42. Petitioner also maintains that the Division has not carried its burden of establishing fraud. It does not believe the Division has shown clear, definite and unmistakable evidence of every element of fraud, including willful, knowledgeable and intentional wrongful acts or omissions constituting false representation that resulted in nonpayment or underpayment of tax.

43. The Division maintains that it made many proper requests for petitioner's books and records and only received incomplete sales invoices, three years of federal income tax returns, one New York corporate franchise tax return, bank statements and profit and loss statements for two years. The sales invoices were not sequentially numbered or prenumbered and other internal controls were lacking. No summary schedules, cash receipts journal, general ledger or trial balances were ever received, making a detailed analysis of sales invoices impossible because the Division could never determine if petitioner had presented all sales invoices. Bank records and federal income tax returns were not in agreement with sales invoices. As a result, the Division

determined that the records produced were incomplete and inadequate and resort to an estimated audit methodology was warranted.

44. The Division's methodology included confirming the sales it could verify, then taking the highest of three sources of sales that had been made available to it: bank statements, sales invoices and federal income tax returns. The Division argues that using the highest value was warranted because it knew there were at least that number of sales according to bank statements, federal income tax returns and sales invoices, whereas it had no way of determining whether there were more sales, and, if so, what that amount would have been. Therefore, it concludes that the methodology was reasonable.

45. As with the sales records produced, the expense purchase records were also deemed inadequate and the Division utilized records produced, primarily the federal income tax returns and sales invoices, to create a ratio of expenses (both recurring and capital improvement) to audited sales, which was applied to sales for each quarter of the audit period to arrive at expense purchases.

46. The Division contends that its assertion of fraud penalty was warranted given the fact that petitioner had New York sales on which it collected and failed to remit tax; it conducted business in New York without a certificate of authority to do so; it issued tax exempt resale certificates while unregistered and provided a false registration number; it commingled personal and corporate expenses; and failed to cooperate with the Division in the conduct of the audit. In the alternative, the Division argues that negligence penalty was warranted and petitioner has not offered any evidence to support a finding of reasonable cause for the nonpayment of tax due.

CONCLUSIONS OF LAW

A. 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 § 1110(a) imposes a compensating use tax on tangible personal property purchased at retail for use within New York, to the extent that such property has not already been subject to sales tax. A "retail sale" is a "sale of tangible personal property to any person for any purpose, other than . . . for resale as such . . ." (Tax Law § 1101[b][4][I]). Tax Law § 1138(a)(1) provides, in relevant part, that if a sales tax return was not filed, "or if a return when filed is incorrect or insufficient, the amount of tax due shall be determined [by the Division of Taxation] from such information as may be available. If necessary, the tax may be estimated on the basis of external indices. . . ." (Tax Law § 1138[a][1].) When acting pursuant to section 1138(a)(1), the Division is required to select a method reasonably calculated to reflect the tax due. The burden then rests upon the taxpayer to demonstrate that the method of audit or the amount of the assessment was erroneous (***see Matter of Your Own Choice, Inc.***, Tax Appeals Tribunal, February 20, 2003).

B. The standard for reviewing a sales tax audit where external indices were employed was set forth in ***Matter of Your Own Choice, Inc.*** as follows:

> To determine the adequacy of a taxpayer's records, the Division must first request ***(Matter of Christ Cella, Inc. v. State Tax Commn.***, ***supra***) and thoroughly examine (***Matter of King Crab Rest. v. Chu***, 134 AD2d 51, 522 NYS2d 978) the taxpayer's books and records 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). The purpose of the examination is to determine, through verification drawn independently from within these records (***Matter of Giordano v. State Tax Commn.***, 145 AD2d 726, 535 NYS2d 255; ***Matter of Urban Liqs. v. State Tax Commn.***, 90 AD2d 576, 456 NYS2d 138; ***Matter of Meyer v. State Tax Commn.***, 61 AD2d 223, 402 NYS2d 74, ***lv denied*** 44 NY2d 645, 406 NYS2d 1025; ***see also***, ***Matter of Hennekens v. State Tax Commn.***, 114 AD2d 599, 494 NYS2d 208), that they are, in fact, so insufficient that it is "virtually impossible [for the Division of Taxation] to verify taxable sales

> receipts and conduct a complete audit" (***Matter of Chartair, Inc. v. State Tax Commn.***, 65 AD2d 44, 411 NYS2d 41, 43; ***Matter of Christ Cella, Inc. v. State Tax Commn.***, ***supra***), "from which the exact amount of tax due can be determined" (***Matter of Mohawk Airlines v. Tully***, 75 AD2d 249, 429 NYS2d 759, 760).
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> Where the Division follows this procedure, thereby demonstrating that the records are incomplete or inaccurate, the Division may resort to external indices to estimate tax (***Matter of Urban Liqs. v. State Tax Commn.***, ***supra***). The estimate methodology utilized must be reasonably calculated to reflect taxes due (***Matter of W.T. Grant Co. v. Joseph***, 2 NY2d 196, 159 NYS2d 150, ***cert denied*** 355 US 869, 2 L Ed 2d 75), but exactness in the outcome of the audit method is not required (***Matter of Markowitz v. State Tax Commn.***, 54 AD2d 1023, 388 NYS2d 176, ***affd*** 44 NY2d 684, 405 NYS2d 454; ***Matter of Cinelli***, Tax Appeals Tribunal, September 14, 1989). The taxpayer bears the burden of proving with clear and convincing evidence that the assessment is erroneous (***Matter of Scarpulla v. State Tax Commn.***, 120 AD2d 842, 502 NYS2d 113) or that the audit methodology is unreasonable (***Matter of Surface Line Operators Fraternal Org. v. Tully***, 85 AD2d 858, 446 NYS2d 451; ***Matter of Cousins Serv. Station***, Tax Appeals Tribunal, August 11, 1988). In addition, "[c]onsiderable latitude is given an auditor's method of estimating sales under such circumstances as exist in [each] case" (***Matter of Grecian Sq. v. New York State Tax Commn.***, 119 AD2d 948, 501 NYS2d 219, 221).

C. In this matter the Division made a proper request for books and records, in fact many of them, over a period of years, which petitioner does not dispute. In response to the requests, petitioner produced three federal income tax returns and one New York corporation franchise tax return[2]; sales invoices, the adequacy of which could not be discerned; some purchase invoices; a reconstructed general ledger for 2001; bank statements; and bank reconciliation schedules.

The Division used invoices and bank statements to identify petitioner's customers and sent them third-party confirmation letters to enable it to more accurately determine sales. What became apparent from the responses was that petitioner had more New York sales than had been disclosed and that there were discrepancies between the sales per invoices, bank statements and

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[2]In her testimony, one of the auditors mentioned that more than one corporation franchise tax return was reviewed, but only the 2002 return is in evidence.

the available federal returns. Since petitioner did not file any New York sales and use tax returns until December 2006, the Division was forced to rely on less direct indicators of petitioner's sales, i.e., bank records, three federal returns and available sales invoices.

Based on the inadequacy of the records produced, the Division determined that a detailed audit of petitioner's books and records to determine sales was impossible and decided to implement an estimated audit methodology using records generated or produced by petitioner, its suppliers or customers. The Division discovered that petitioner's records for materials purchases for capital improvement projects and recurring expense purchases were as incomplete as its sales records and needed to be estimated as well. Purchases were also determined from information taken from petitioner's own records.

The Division's examination of petitioner's sales records revealed that transactions could not be traced from source documentation to final totals and that sales invoices had no apparent internal controls like prenumbering or sequential numbering that, when considered with the fact that petitioner produced no cash receipts journal, general ledger, trial balances or other summary schedules, made a coherent, detailed analysis of petitioner's sales impossible, since the Division could never establish that it had accounted for all of petitioner's sales.

The fact that petitioner did not file sales and use tax returns, maintained no summary schedules and produced three federal income tax returns and bank statements which belied the sales totals demonstrated by its own invoices, demonstrated that the Division's decision to utilize an indirect, estimated audit methodology was justified.

Petitioner argues that all books and records were available and presented to the Division, which ignored them. However, the record does not substantiate this claim.

First, two of the four auditors assigned to this audit credibly testified that they were not provided with complete books and records. This was corroborated by the audit log, Form DO-220.5, a contemporaneously prepared record of events, which carefully described each request for records and the responses to those requests. In the course of an audit that spanned almost four years and four auditors, not once is there an entry that mentioned production of all records requested; rather, there were numerous entries that described the lack of records, including a general ledger, cash receipts journal and other summary schedules.

Second, petitioner produced only one witness who averred that he had seen complete books and records and that they were produced to the Division. That witness, Mr. Jay Sanders, CPA, was a consultant hired by petitioner to assist Mr. Jeff Levine in record production on audit. His testimony was not credible based on his statement that he had seen and assisted in producing on audit original purchase invoices, sales invoices, bank statements, an accounts receivable schedule and, notably, a general ledger for the entire audit period. In fact, Mr. Levine, who was reconstructing petitioner's records, offered to reconstruct the general ledger for the Division for the entire audit period after his meeting with them on December 7, 2006, in which he produced a reconstructed general ledger for only 2001. Later, he told the Division that he would not produce any further documentation.

In addition, Mr. Sanders had trouble recollecting numerous facts about the records he saw or might have seen. He was not sure if he prepared petitioner's tax returns; he could not recall how he was sure he had reviewed all sales invoices; he was not sure he had reviewed a sales journal or a purchase journal; and he relied on a statement by Mr. Levine that bank deposits attributed to "Galasso" were loans, even though he admitted he never saw any loan documentation. With no documentation and a poor memory to substantiate his claims of complete records, his testimony was simply not credible.

Further, the only employee of petitioner to testify, Mr. Greg Giampa, credibly stated that he had not seen the original records Mr. Sanders claimed he saw, and doubted they existed since Mr. Levine was reconstructing the books during the audit, a term he defined as having to locate original data and use it to create journals and ledgers. Although Mr. Giampa was aware of a Quickbooks program used by petitioner, he never saw original invoices.

Therefore, it is concluded that the Division's decision to resort to an estimated audit methodology was justified, since the record amply established that complete books and records were not available on audit or produced at any time since the audit.

D. The Division chose an audit methodology that it believed was reasonably calculated to determine petitioner's sales and use tax liability. Although petitioner's records were incomplete, the Division still managed to utilize the records available to fashion an audit methodology that was rooted in petitioner's own records and therefore reasonably calculated to reflect the sales and use taxes due. By using the sales invoices for 2001, 2002 and 2004, the bank deposits for 2003 and 2006 and the federal income tax return for 2005, the Division assured itself that in those years where federal income tax returns or bank deposits exceeded sales invoices, it would protect the state's interest by ensuring that a minimum sales tax liability would be asserted, since it had no way to test for sales with exactness, given the lack of records. The Division could never determine what maximum sales could have been.

Petitioner's argument that the methodology was only chosen to maximize the sales and use tax asserted is both disingenuous and in error. The argument ignores the context of this audit. Petitioner was a New York corporation that made sales and consumed goods and services in New

York, yet never registered as a vendor and never filed a sales tax return. It represented to the Division that it had few if any New York sales until that claim was proven false by documentation discovered upon examination of invoices and correspondence from customers produced long after the audit began. By denying the existence of New York sales and not registering and filing sales tax returns, petitioner erased another important part of the audit trail, a summary schedule, which further underscored the need for the Division's methodology. Certainly, the use of petitioner's own sales invoices would have been the most accurate basis for the determination of tax due. However, the use of bank deposits has long been accepted as an alternative method when books and records were incomplete. A bank deposit analysis has been used by the Division in numerous sales tax audits and such an analysis has been found to be a reasonable audit method (***see Matter of MacLeod***, Tax Appeals Tribunal, July 3, 2008; ***Matter of D&V Liquors***, Tax Appeals Tribunal March 10, 2005). The same is true of the use of federal tax returns to establish sales. (***Tides Inn, Inc***., Tax Appeals Tribunal April 2, 1992). As noted above, the use of this available information, all emanating from petitioner's own records, was justified. The use of all three sources of information was also justified, since bank deposits and the federal income tax returns indicated that there were more sales than those substantiated by petitioner's invoices. Since the Division was provided with no evidence that the higher amounts on the bank statements or the federal returns were not additional sales, it was valid to conclude that they were. Petitioner submitted no evidence at hearing to prove otherwise.

Petitioner maintained very few books and records that would have established its true sales and expense purchases, most notably a general ledger and original source documentation. Clear evidence of this deficiency was Mr. Levine's futile reconstruction efforts during the audit, where he tried to find sales documents and expense invoices to create a general ledger for the year 2001.

Mr. Giampa's testimony reinforced the obvious - - that there were no books and records, which is why it was necessary to reconstruct them.

Finally, although given the opportunity to do so, petitioner produced no records at hearing to prove that it had, in fact, maintained them or to prove the Division's methodology incorrect. Indeed, petitioner never offered any evidence to challenge the deposits to the bank account found to be in excess of sales invoices or the gross sales set forth on the federal income tax returns.

E. The audit methodologies used to estimate both the capital improvement expenses and the recurring expense purchases were also reasonably calculated to determine petitioner's use taxes. In the case of the former, the Division isolated invoices for the period 2001 to 2005 that were associated with capital improvements and totaled the materials component of said invoices. The ratio of those materials purchases to sales was computed to be .46256163. When this number was then applied to the calculated quarterly audited net sales for the audit period it yielded the total materials purchases associated with capital improvements.

For recurring expense purchases the Division resorted to the federal income tax returns for the years 2004 and 2005 where it found a listing of expenses. After eliminating expenses for accounting expenses, bank charges, commissions, fuel, insurance, legal and professional expenses and allowing a credit of $5,000.00 each year for substantiated office expenses, the Division was able to calculate a ratio of recurring expenses as a percentage of audited sales, or .398845424. The Division then applied this ratio to total audited sales to arrive at total taxable expenses purchases and the resulting tax due.

The methodologies utilized by the Division were reasonable given the records available to it and the burden then rested on petitioner to demonstrate that the method of audit or the amount of the assessment was erroneous (***see Matter of Your Own Choice, Inc.***). It is concluded that petitioner did not meet its burden.

F. Petitioner submitted purchase information from House Wrecking, Inc., of Stamford, Connecticut, that indicated that Mr. Babel had purchased items from it and was subsequently issued a refund check. However, this item appears in the Division's analysis of check deposits as a refund and was excluded from sales. The net effect was that the $2,987.76 deposit on September 20, 2002 was correctly labeled and excluded as other income from sales invoice and bank deposit totals for purposes of calculating sales.

Petitioner also submitted a response to a third-party confirmation letter from Delaware Investment Properties LLC, which purported to list all purchases by Delaware Investment from petitioner for the years 2001 through 2006. As noted above, the cover letter from Arthur Bell CPAs was date-stamped by the Westchester District Office while the seven sheets from Delaware Investment Properties were not, leaving the impression that they had never been received by the District Office. The response listed sales for the years 2002, 2003 and 2006. The totals listed for each year were: 2002, $132,590.00; 2003, $99,438.00; 2006, $41,228.72. The total for all three years was $273,166.72. The Division's totals, based upon the bank statements and checks associated therewith, were: 2003, $232,028.00; 2005, $37,656.12; and 2006, $106,784.46. The total for the three years was $376,468.58, or $103,301.86 more than the third-party confirmation response. However, the worksheet revealed that the Division categorized each of the sales to Delaware Investment Properties as New York capital improvements and excluded all such sales from its calculation of net sales. Therefore, notwithstanding any issues of accuracy or discrepancies of amounts listed, none of the Delaware Investment Property sales were used in determining additional tax due for purposes of the notice of determination that was issued herein.

G. Having determined that the Division's audit methodology was reasonably calculated to reflect taxes due, it was petitioner's burden to prove with clear and convincing evidence that the assessment was erroneous. Petitioner submitted no documentary evidence or credible testimony. Instead, it argued that the Division's audit methodology was only devised to maximize the tax due. This argument is rejected for the reasons set forth in detail above.

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 voluminous audit file created three to five years earlier, the substantial portion of their testimony is corroborated by the audit log and the documentary evidence, i.e., audit work papers, 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.

Finally, petitioner contends that fraud penalty 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.

H. In ***Matter of Cinelli*** (Tax Appeals Tribunal, September 14, 1989), the Tribunal provided the following guidance in determining whether a taxpayer may be subject to a civil fraud penalty:

> The burden of showing fraud under § 1145(a)(2) has consistently been interpreted to reside with the Division (***Matter of Ilter Sener d/b/a Jimmy's Gas Station***, Tax Appeals Tribunal, May 5, 1988; ***Matter of Nicholas Kucherov d/b/a Nick's Marine***, State Tax Commn., April 15, 1987, ***affd Kucherov v. Chu*** [147 AD2d 877, 538 NYS2d 339]). The standard of proof necessary to support a finding of fraud 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*, *supra***, citing, ***Matter of Walter and Gertrude Shutt***, State Tax Commn., July 13, 1982).

For a taxpayer to be subject to a 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 Tax Law (***Matter of Cousins Service Station, Inc.***, Tax Appeals Tribunal, August 11, 1988). Fraud need not be established by direct evidence, but can be shown by surveying the taxpayer's entire course of business and drawing reasonable inferences therefrom (***see***, ***Korecky v. Commr.***, 781 F2d 1566 [11th Cir 1986]; ***Briggs v. Commr.***, 440 F2d 5 [6th Cir 1962]).

In ***Matter of Waples*** (Tax Appeals Tribunal, January 11, 1990), the Tribunal summarized some of the relevant considerations as follows:

> Because 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.***, T.C. Memo 1971-63; ***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 (***Intersimone v. Commr.***, T.C. Memo 1987-290; ***Stone v. Commr.***, 56 T.C. 213, 223-224; ***Korecky v. Commr.***, 781 F2d 1566). 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.***, T.C. Memo 1986-389; ***see***, ***Matter of AAA Sign Co.***, ***supra***).

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

a. MediaBuss failed to register as a vendor with the State of New York as required by Tax Law § 1134 even though it made New York sales, admitted making New York sales on audit and was told to register on several occasions. Petitioner operated as a New York vendor from its incorporation in 2001 until it finally registered in November 2006.

b. MediaBuss collected sales tax from some of its customers in the years 2002, 2004 and 2005 in the sum of $3,643.35, but failed to remit the tax to the Division. It first paid sales and use tax with its return filed for the quarter ended February 28, 2007.

c. MediaBuss maintained no general ledger, sales or purchase journals from which it could be determined whether all sales were deposited into its bank account. Few purchase invoices were made available from which the auditors could determine if sales tax had been paid on materials purchased by MediaBuss in performing nontaxable capital improvement jobs or on recurring expenses. The failure of a taxpayer to maintain a complete and accurate set of records is evidence of fraud (***Matter of Lefkowitz***, Tax Appeals Tribunal, May 3, 1990). Even though Mr. Sanders testified that he observed complete records and that they were provided to the Division on audit, his testimony has been deemed not credible in light of the testimony of Mr. Giampa, the auditors, the audit log and the documentation submitted by the Division. In contrast, his testimony was further eroded by the fact that petitioner offered almost no books and records at hearing and made no attempt to present evidence to establish its true tax liability.

d. 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, it failed to report when it was under a duty to do so from 2001 through 2006.

e. MediaBuss issued and received exemption certificates while unregistered. It accepted a blanket resale certificate from Continental Lighting Corp. and issued resale certificates to Key Distribution and Bosch Security Systems, in which petitioner boldly provided a fabricated certificate of authority number.

f. MediaBuss's banking records indicated that there was commingling of corporate funds with the personal funds of Mr. Babel. Mohawk White Plains, a vendor that had sold items to MediaBuss, issued two refund checks to Mr. and Mrs. Babel, personally, in June and July of 2004. In addition, MediaBuss's bank statements revealed payments for apparent personal expenses, including checks to Bloomingdales, a gynecology and obstetrics practice and the Bonnie Briar Country Club.

J. Petitioner did not contest the penalties asserted for its failure to register as a sales tax vendor or fraudulently issuing and accepting a resale certificate while an unregistered vendor and those penalties are sustained. (Tax Law § 1145[a][3][I]; [5].)

K. The petition of MediaBuss Systems, Inc. is denied, and the Notice of Determination, dated December 28, 2009, as modified by the BCMS Order, dated January 28, 2011, is sustained.

DATED: Albany, New York
November 29, 2012

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