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Don't Ignore Obligation to Notify New York of Federal Changes!

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The most significant development in the State and City Tax Appeals Tribunals over the last several months has been the State Tribunal Decision in *Sherwin Williams*. That case, however, has already been written about extensively in the press and a meaningful examination of that case would require far more space than this column allows.

The column, therefore, will discuss two other cases that address issues that are or should be important to taxpayers and their representatives. In the first case, a seemingly minor failure on the part of a taxpayer and his representative resulted in a liability many times greater than should have occurred. In the second case, an auditor's failure to resolve contradictory positions resulted in major expense on the part of both the state and an innocent party and an apparent windfall to the party at fault.

The Report

The first case *Harry Corin* (NYS DTA 818674 April 17, 2003) demonstrates the potential disastrous consequences of ignoring the obligation to notify New York of federal changes. Mr. Corin was an investor in a tax shelter that was audited by the IRS. Mr. Corin settled his federal case in a manner commonly employed by the IRS. The challenged deductions were disallowed, creating additional federal income and a tax deficiency in 1982. The IRS agreed, however, that the income received from the shelter investment in 1983 and 1984 would also be eliminated, thereby creating refunds from those years. The 1982 deficiency and the 1983 and 1984 refunds were netted by the IRS and Mr. Corin paid the IRS with respect to the net liability.

Under Tax Law section 659, if a taxpayer's federal taxable income is changed by the IRS, the taxpayer must report such federal change to the Department of Taxation and Finance within 90 days after the final determination. Tax Law section 681(e)(1) provides that if a taxpayer fails to comply the Department may assess a deficiency based upon such federal change.[1] Mr. Corin failed to report any of the federal changes to New York State and, eventually, the State was notified of the changes directly by the IRS.[2] The Department proceeded to issue a notice of deficiency for 1982 without any offset for the refunds in 1983 and 1984.

Mr. Corin claimed that the additional state tax for 1982 must be netted against the refunds attributable to 1983 and 1984. The Administrative Law Judge concluded, however, that the only year before the Division of Tax Appeals is 1982, the year of the deficiency. The ALJ noted "Even if petitioner presented an iron clad case that the IRS settled tax years 1982 through 1984 with regard to the tax shelter adjustments, the Division is not bound to settle the case in the same manner, and, clearly, there is no power in this forum to

net an adjustment of the tax year before me, with tax years that are not." Accordingly, since the taxpayer could not demonstrate that the deficiency for 1982, standing alone, was incorrect, the State deficiency was valid.

Although not specifically addressed in the case, it is also clear that Mr. Corin could not file a separate refund claim for the overpayments in 1983 and 1984. Under Tax Law section 687(c) a refund claim based upon a federal change must be filed within two years from the time the notice was required to be filed with the Department (i.e. 90 days from the final federal determination).[3] As a result, the taxpayer's failure to file the notice prevented him from achieving the netting that he would otherwise have been entitled to receive and caused himself more problems than the Department.

Sales Tax Responsible Person Liability

Although the second case, *Robert P. Lanieri* (DTA 818993 July 31, 2003) involves the relatively mundane issue of responsible person liability for unpaid sales and use tax, the ALJ's Determination sets out a fascinating story of duplicitous behavior reminiscent of a film or novel.

Mr. Lanieri ("Petitioner") worked in the restaurant industry for over 25 years, at different times owning and managing restaurants and bars. In February 1997 he helped a friend, Mario Desena, open a restaurant in Miller Place, New York (the "Restaurant") which was owned by MMR Restaurant Corp. the ("Corporation"). Mr. Desena was the sole shareholder and director of the Corporation. Petitioner was a salaried employee. Petitioner and Roy Radzinsky were employed to operate the Restaurant with Petitioner overseeing the bar and Mr. Radzinsky the kitchen operations. Petitioner had a variety of duties at the Restaurant including opening the Restaurant, ordering food and beverages, stocking the cash drawer and minor maintenance and cleaning. Several persons including Petitioner and Mr. Desena closed the business on different days which involved checking the cash register tape and receipts and depositing cash in the safe.

Petitioner used his friendship with the property owner to help acquire a lease for the Restaurant. Petitioner, as an uncompensated favor to Mr. Desena, executed an undated guaranty which guaranteed the obligations of the tenant under the lease. Petitioner declared personal bankruptcy later that year and listed the landlord as a creditor in his bankruptcy proceeding.

Mr. Desena was engaged in an additional business venture during the audit period but was often at the Restaurant making bank deposits and reviewing business records. Mail, receipts, bills and deposits were left for Mr. Desena for his review. Mr. Desena designated Petitioner to receive the Corporation's mail at the Restaurant.

Mr. Desena directed his accounting firm, Advisory Associates, to prepare sales tax returns. Mr. Desena had maintained a professional relationship with the firm for over 20 years. One of the firm's employees testified that Mr. Desena forwarded information to Petitioner for delivery to the firm but that the firm always communicated with Mr. Desena.

Many of the facts in the ALJ Determination concern the conduct of the audit. The audit commenced in February 1999. Initially, the Corporation was represented by Advisory Associates. However, in May 2000, the auditor had a lengthy discussion with Joseph Rouse, CPA, the brother of the attorney representing Mr. Desena in a lawsuit with Petitioner for back wages. The focus of the discussion was Mr. Rouse's belief that the employees, not Mr. Desena, should be liable for sales taxes. Mr. Rouse provided several

documents which he said supported his contention that Petitioner and Mr. Radzinsky were persons responsible for sales tax including contracts signed by Petitioner, statements by two accountants at Advisory Associates generally stating that they believed Petitioner to be liable for sales and use tax, and statements and affidavits of certain other persons stating that they believed Petitioner was an owner of the business.

Questionnaire

Mr. Rouse prepared and submitted a "responsible person questionnaire" based upon the documentation and depicted Petitioner as the person responsible for running all aspects of the business. Petitioner also filed a responsible person questionnaire in his own behalf which differed substantially from the form submitted by Mr. Rouse. Petitioner denied responsibility for preparation or supervision of the preparation of sales tax returns or ensuring payment of tax. Petitioner also denied participation in significant business decisions and managing the business. Although he admitted he signed corporate checks, all payments were authorized by Mr. Desena and many employees had the authority to pay creditors.

According to the audit work papers, the auditor recorded the issuance of 26 cancelled checks signed by Petitioner. The auditor's only information concerning the actual operation of the business was gleaned from Mr. Desena's representative. The ALJ noted that the auditor conducted no investigation into the discrepancies between the two responsible person questionnaires but chose instead to rely on the information provided by Mr. Rouse.

The ALJ noted some additional significant facts, that Petitioner did not have authority to sign payroll checks which were drawn on another account but that Mr. Rouse stated, in the responsible person questionnaire he prepared that Petitioner had such authority. The address on the bank statements was Mr. Desena's personal address, not that of the Restaurant. Mr. Desena would deliver the bank statements to the restaurant and direct Petitioner to deliver them to his accountant. The personal address was listed on the operating account of the Corporation and was its official address with the Department of Taxation and Finance.

Legal Issue

In his discussion of the legal issue in the case the ALJ first noted that Tax Law section 1133(a) imposes personal liability upon a person required to collect sales and use tax who, in turn, is defined as "any officer, director or employee of a corporation … who as such officer, director or employee … is under a duty to act for such corporation … in complying with any requirement of [Article 28].[4] The determination of who is a responsible person depends upon facts and circumstances.

The ALJ noted "The relevant factors to consider when determining whether a person has such a duty to act for the corporation include, *inter alia*, authorization to sign the corporate tax return, responsibility for management or maintenance of the corporate books, authorization to hire and fire employees and derivation of substantial income from the corporation or stock ownership.[5]

The ALJ appeared to have little trouble deciding that Petitioner was not a responsible person. Petitioner, who handled the case *pro se*, testified at length and was found to be credible. A friend of Petitioner also testified to matters which she witnessed. On the basis of the testimony, the ALJ concluded that his role was that of a salaried employee with specific duties dictated by Mr. Desena. The ALJ found that Petitioner had no independent authority to spend the Corporation's funds. Rather each expenditure was subject

to approval by Mr. Desena. Petitioner's check signing capacity was for Mr. Desena's convenience. Petitioner was one of several employees who was directed to close the register, make bank deposits and deliver bank statements to Mr. Desena's accounting firm.

The Tax Division's case against Petitioner was based upon the questionnaire and documents delivered to the auditor by Mr. Rouse and the testimony of Ms. Eileen Gibson McCormick, an employee of Advisory Associates. The ALJ had no problem dismissing the evidence presented. He found the testimony of Ms. Gibson McCormick not credible given her memory lapses and contradictions. In her written statement provided to the auditor, she claimed that Petitioner provided her with all the accounting information needed to prepare the tax returns. Yet when she testified, she admitted that he only brought her the bank statements which had been sent to him by Mr. Desena. She also testified that she did not know where the bank statements were mailed (the personal address of Mr. Desena) even though she had used them to prepare the returns.

The ALJ was most vehement in his discussions of Messrs Rouse and Desena. In a scathing paragraph, he said, "Mr. Rouse did not let the facts get in the way when preparing a responsible person affidavit. … The clear motivation for Mr. Rouse's characterizations, and part of the reason he was hired, was to shift sales tax liability from his client to petitioner. Curiously, the one person with first hand knowledge of the facts who could have testified or submitted an affidavit did not do so. Instead, Mr. Desena chose to hire various professionals to carefully construct a case against petitioner which was then artfully presented to the auditor, who chose to accept these skewed facts without any independent investigation, despite the conflicting statements contained in the questionnaire submitted by petitioner."

Conclusion

It appears clear that the ALJ reached the right conclusion in dismissing the case against Petitioner. However, the ALJ treated the auditor and Tax Division far more generously than their actions deserved. In one of the mildest statements in the Determination, the ALJ noted "the Division's acceptance of information supplied to it by an advocate for a very hostile party with distinctly conflicting interests related to the very tax the Division sought to collect from petitioner was, at best, ill advised." A far harsher judgment against the Division's actions during the audit and in the handling of the case was warranted. It is not simply that Petitioner was required to devote enormous efforts on a *pro se* basis to defend against a claim which was created out of whole cloth and the ALJ, himself, was forced to draft an 18 page Determination dismissing the claim. Most significantly, by focusing on Petitioner to the exclusion of Mr. Desena, the Tax Division seems to have blown any chance of collecting the tax. Although not explicitly stated in the Determination, the Tax Division does not appear to have issued a responsible person notice of deficiency against Mr. Desena and, by now, it is almost certain that the statute of limitations has run with respect to his potential liability.[6] Ironically, therefore, despite the extensive criticism Messrs Rouse and Desena received from the ALJ, what appears to be their primary objective (eliminating Mr. Desena's personal liability) was accomplished!

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[1] Tax Law section 683 (c)(1)(C) and (c) (3) provide exceptions to the normal three (or six) year statutes of limitations for deficiencies attributable to final federal changes. If a taxpayer complies with the section 659 requirement to report, the Department has two years from the filing of such report to make an assessment. If no filing is made, there is no limit on the Department's ability to assess.

[2] Such disclosure is specifically authorized by Internal Revenue Code section 6103(d).

[3] See also, *Martin Levitin*, DTA No. 818413 (March 14, 2002). Although some taxpayers had previously argued that netting may be available under the theory of equitable recoupment, the Tax Appeals Tribunal rejected that argument in *James and Judith Boyle*, DTA No. 813970 (February 26, 1998).

[4] Tax Law section 1131[1].

[5] Citing, *Matter of Cohen v. State Tax Commission*, 128 AD2d 1022 (1987), *Matter of Blodnick* v. State Tax Commission, 124 AD2d 437 (1986), appeal dismissed 69 NYS2d 822 (1987) *Matter of Rosenblatt v. State Tax Commission*, 114 AD 2d 127 (1986) and *Matter of Vogel v. Department* (98 Misc 2d 222 (1979).

[6] Since sales tax returns were filed, the statute of limitations would have run unless a notice of deficiency was issued to Mr. Desana or, unless he executed an extension of the statute of limitations. See Tax Law sections 1138(c) and 1147(c). See also Matter of On-Site Petroleum Unlimited, Inc. Tax Appeals Tribunal February 8, 1996.