New York City Tax Appeals Tribunal

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| In the Matter of | : | |
| | : | DECISION |
| RAYMOND AND ALICE MARQUEZ | : | TAT (E) 97-107 (UB) |
| Petitioners | : | |

Raymond and Alice Marquez ("Petitioners" or "Taxpayers") filed an Exception to a portion of a Determination of an Administrative Law Judge ("ALJ") dated March 8, 2006 (the "ALJ Determination"). The Commissioner of Finance of the City of New York ("Commissioner" or "Respondent") also filed an Exception to a portion of the ALJ Determination. The ALJ Determination modified a Notice of Determination dated February 11, 1997 (the "Notice") issued by the New York City Department of Finance (the "Department") asserting a deficiency of New York City Unincorporated Business Tax ("UBT") to exclude Petitioner Alice Marquez and to reflect a recomputed UBT liability against Petitioner Raymond Marquez based on unincorporated business taxable income of $1,460,651 for each of the tax years ended December 31, 1990 through December 31, 1993 (the "Tax Years"), plus penalties and interest thereon. The Commissioner was represented by Francis J. Henn, Esq., Senior Counsel, New York City Law Department. Petitioners were represented by R. David Marquez, Esq. The Parties filed briefs and oral argument was held before the Tribunal. Commissioner Robert J. Firestone did not participate in this Decision.

Petitioner Raymond Marquez's family has been involved in the operation of a gambling business, primarily involving "policy" or "numbers" betting in several locations

in New York City (the "City") for several generations.[1] After the death of Raymond Marquez's father, the business was divided between Raymond Marquez and his two brothers. Following the death of one of the brothers and the incarceration of the other, the business was divided into two operations, one headed by Raymond Marquez (the "Raymond Marquez Organization") and the other by his nephew, Robert Marquez, Jr., and others (the "Robert Marquez Organization"). After April 1994, the Raymond Marquez Organization was combined with the Robert Marquez Organization.

"Numbers" or "policy" wagering is a gambling activity that is not, in and of itself, illegal.[2] However, it is a violation of the New York Penal Law (the "Penal Law") to conduct a numbers operation. In City numbers gambling, the winning "number" is determined by the total moneys bet, or payoffs made, at specific New York racetracks or on specific races. Numbers gambling occurs either on the street or at a "spot" or "numbers hold," which is a fixed location where numbers are "bought." Spots are also referred to as "stores." Spots often group together to pool receipts through a "bank."

The principal personnel of a numbers gambling operation include: day and night "writers," "runners," and "collectors" who take the bets and deal with the customers, and "look-outs" who advertise the spots by standing outside and encouraging individuals to enter. The spot personnel report to "controllers" who are the agents or associates of the top management of the organization and often work for the bank. Controllers collect bets and money from the runners and in many cases run the day-to-day operations of the business. "Bankers" are the heads of the organizations or the top managers. The New York City Police Department (the "NYPD") Organized Crime Control Bureau Gambling Investigator's

[1] The ALJ's Findings of Fact, although paraphrased and amplified herein, generally are adopted for purposes of this Decision except as noted below. Certain Findings of Fact not necessary to this Decision have not been restated and can be found in the ALJ Determination. Both Respondent and Petitioners take exception to a number of Findings of Fact made by the ALJ. Except as noted below, we find that the ALJ's Findings of Fact accurately reflect the Record.

[2] New York City Police Department Organized Crime Control Bureau Gambling Investigator's Manual (January 1984). Taxpayers' Ex. 16, at 29.

Manual (the "Investigator's Manual") notes that bankers "accept the financial risks, covering short-term losses and keep all the profits."[3]

In 1993, the Raymond Marquez Organization operated approximately forty spots, or stores, in the City as well as banks and central offices.

Beginning in 1992, the Organized Crime Unit of the New York County District Attorney's Office (the "DA's Office") and the NYPD, Organized Crime Control Bureau, Manhattan North Public Morals Division, conducted an investigation of both Marquez gambling operations, which was known as "Operation Checkmate."[4] At the time of the hearing on Petitioners' Petition (the "City Hearing"), Walter Huthansel was a Detective with the NYPD serving with the Counter-Terrorism Division. From April 1992 until January 1995, he was with the Vice Division of the Midtown South Precinct and from February 1995 until November 1997, he was assigned to the NYPD's Organized Crime Control Bureau, Manhattan North Vice Investigation Division.[5] Beginning in 1992 he participated in the investigation of both Marquez gambling operations. His investigation initially focused on the Robert Marquez Organization and on activity in and around 65 St. Nicholas Avenue.[6] Detective Huthansel testified at the City Hearing.

During the course of the investigation, the NYPD obtained orders for trap-and-trace devices and/or pen registers[7] for telephones listed to several locations under investigation, as well as orders permitting eavesdropping.

Luis Ramirez was a Detective with the NYPD's Organized Crime Control Bureau, Manhattan North Public Morals Division in 1994. He had extensive training and experience

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[3] Investigator's Manual, 35.

[4] City's Ex. E, 11. Note that Respondent's exhibits are labeled "City's" exhibits.

[5] Tr. 239. Affidavit of Detective Huthansel, January 1995, Taxpayers' Ex. 7, Part 12, (the "Huthansel Aff."), para. 3.

[6] Unless otherwise stated, all addresses are located in the City.

[7] These devices, which are attached to individual telephone lines, enable an investigator to identify and record calls on that line. A trap-and-trace device identifies the telephone numbers of incoming calls, while a pen register identifies and records outgoing numbers as they are dialed. Tr. 331.

in investigating illegal gambling and was involved in the investigation that ultimately focused on the Raymond Marquez Organization, which began in 1992 and included the period of time of Operation Checkmate. An affidavit of Detective Ramirez issued in support of search warrants issued in April 1994 recited several incidents of surveillance and interception of telephone and facsimile transmissions.[8] The targeted locations included 3650 Broadway and 730 Riverside Drive.[9] Telephone calls and facsimile transmissions monitored and recorded included calls between Petitioner Raymond Marquez and Claudia Hernandez, who was the organization's "supervisor,"[10] and facsimile transmissions between various locations in New York State (the "State") and City and locations in Florida.[11]

Business records of the Raymond Marquez Organization were maintained at 730 Riverside Drive by Claudia Hernandez. In 1994, Ms. Hernandez was arrested and pleaded guilty to felony gambling charges and subsequently provided the DA's Office with information about the Raymond Marquez Organization. Ms. Hernandez did not testify at the City Hearing.

During the Tax Years, Petitioner Alice Marquez was engaged in several enterprises. She owned two hotels directly: the Grantmoor Motor Lodge located in Newington, Connecticut, and the Oakland East Motor Inn, in Fort Lauderdale, Florida.[12] She also owned the stock of NCDI Inc., which owned the Commack Motor Inn located in Commack, New York. There also was testimony that Ms. Marquez owned a house located on the Commack Inn property. Ms. Marquez's businesses were not located in the City.

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[8] City's Ex. X, Affidavit of Detective Luis A. Ramirez in support of an application for search warrants, April 10, 1994 (the "Ramirez Aff.").

[9] 3650 Broadway was identified by the NYPD as the bank of the Raymond Marquez Organization and 730 Riverside Drive as a central office of the organization. Ramirez Aff., para. 17, 22, 27, 66, 96.

[10] Ramirez Aff., para. 17.

[11] *See, e.g.,* Ramirez Aff., para. 27, 28.

[12] This hotel was subsequently known as the Oakland East Motor Lodge. Tr. 755.

Petitioners' personal residence was located in Great Neck, New York during the Tax Years. On occasion, Petitioners also stayed at the Oakland East Motor Inn in Ft. Lauderdale, Florida.

On April 19, 1994, Raymond Marquez, Alice Marquez and Julia Rojo were arrested for illegal gambling.

At or about the time of the arrests, several search warrants were executed at fifty-six locations in the City and Long Island, New York and at locations in Ft. Lauderdale, Florida. Those locations related to the Raymond Marquez Organization and to Petitioners personally. As a result of the searches, numerous documents, including gambling records, and tangible personal property were confiscated.

The gambling records seized were primarily spreadsheet records including daily and weekly records pertaining to the income and expenses of several gambling spots, specific records reflecting 1993 income from slot machines from various spots, a record of four months' expenses for "Con Ed," a record of rents for five months, a record of four months' payments for telephone services and weekly records of payments to employees of the gambling operation. One of the principal groups of records seized were "Volume Sheets." These sheets were prepared on a weekly basis and include the total amount of bets, or the "volume," of a particular spot, or store, and certain expenses, including the costs to the spot of supplies, and payments to certain employees according to category, *e.g.*, day-writers, night-writers, day look-outs and night look-outs. Other columns were designated "profit or loss" and "total expenses."

In an affirmation dated June 23, 2003, offered as evidence at the City Hearing, former Assistant District Attorney Anne B. Rudman ("ADA Rudman") stated that the seized gambling records of the Raymond Marquez Organization pertained to "certain periods of time." That statement was based upon several factors, including date labels, labels on folders

and specific records identification information provided by Claudia Hernandez.[13]

Two financial analysts working for the DA's Office, Evelyn Serrano and Edward Santiago[14] (the "Financial Analysts"), reviewed certain of the records seized including records purporting to be weekly records for each of the spots for the year 1993 described as "rib" sheets.[15] The Financial Analysts were assisted in their review of the seized documents by Virginia Urzi, a tax auditor with the Office of Tax Enforcement of the State Department of Taxation and Finance ( "State DTF"). The Financial Analysts concluded that in 1993 the Raymond Marquez Organization received the following net income from gambling and related activities: $588,757 from "straight action," $439,910 from "single action,"[16] $319,770 from slot machines, $107,285 from the rental of premises and $4,929 for the use of telephones. The DA's Office calculated the Raymond Marquez Organization's 1993 net profits to be $1,460,651.

On his individual Federal Income Tax Returns (Federal Forms 1040) and individual State Resident Income Tax Returns (State Forms IT-201) for the Tax Years, Raymond Marquez listed his occupation as "Executive" and reported wage/salary income from "Showcase Inns," interest income and $13,000 in other income from an undisclosed source. He reported the following amounts of federal taxable income: $60,585 in 1990, $60,006 in 1991, $63,093 in 1992 and $57,467 in 1993. His filing status was "married filing separately."

Petitioners did not file UBT returns for the Tax Years for the Raymond Marquez Organization and did not pay any UBT on the income of that business.

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[13] City's Ex. G (the "Rudman Affm.") para. 3(n). Petitioners objected to the ALJ's Finding of Fact 40, which stated that ADA Rudman affirmed that the seized records "pertained to the Tax Years." We have modified ALJ Finding of Fact 40 to more closely reflect the Record.

[14] Mr. Santiago is also referred to in the Record as Edwin Santiago. *See, e.g.,* Tr. 87-88.

[15] Tr. 400. As the Volume Sheets purported to cover the years 1990 and 1991, the Financial Analysts did not include the Volume Sheets in their estimation of income or expenses for 1993.

[16] Straight action bets are bets on a three-digit number while single action bets are bets on a one-digit number. Consequently, the odds of winning on each are considerably different.

On December 8, 1994, a New York County Grand Jury filed indictment No. 11856/94 against Raymond Marquez, Alice Marquez and Julia Rojo charging them with over 200 gambling-related crimes.

Subsequent to the 1994 indictment, Raymond Marquez returned to the gambling business, working with the Robert Marquez Organization. In 1995, under a second indictment, No. 386/95, Raymond Marquez was charged with three counts of promoting gambling and possessing gambling records pursuant to Penal Law sections 225.10(2)(a), 225.10(2)(b) and 225.20(2).

In August 1996, Petitioners entered into a Forfeiture Stipulation with ADA Rudman. Petitioners agreed to enter certain guilty pleas and waived any claims and interest in the property and money seized as a result of the execution of the search warrants. Pursuant to the Forfeiture Stipulation, certain property and bank accounts were forfeited and Raymond Marquez agreed to pay $1,000,000 in three installments.

On August 28, 1996, Raymond Marquez pleaded guilty to one count of Attempted Enterprise Corruption under Penal Law section 110/460.20, a class C felony, under Count One of the 1994 indictment, and one count of Promoting Gambling in the First Degree under Penal Law section 225.10(2)(a), a class E felony, under Count One of the 1995 indictment.[17] He admitted on the record that from January 1993 to April 1994, in the borough of Manhattan, he "intentionally attempted to conduct, participate, and engage in the affairs of the [criminal enterprise called the] Raymond Marquez Organization by participating in a pattern of criminal activity. . . ." He further admitted that the Raymond Marquez Organization consisted of "a series of gambling spots which were directed by a structure distinct from those gambling spots." He further stated that on January 13, 1995, he "advanced

[17] Exhibit D to Respondent's Affirmation in Opposition to Motion for Summary Judgment (the "Guilty Plea"). The Guilty Plea also pertained to Alice Marquez and Julia Rojo.

or profited from unlawful gambling activity" and received money and/or written records of gambling activities.[18]

On that same date, Alice Marquez pleaded guilty to one count of Possession of Gambling Records in the Second Degree, under Penal Law section 225.15, a class A misdemeanor, in full satisfaction of the 1994 indictment. She allocuted on the record that, "[o]n or about April 19, 1994, I was in constructive possession of a sheet of paper, which sheet of paper had entries on it which related to gambling, and I knew it was unlawful to be in constructive possession of such a sheet of paper." She further stated that she knew the contents of that piece of paper.[19]

Max Muhlberg is a Special Tax Auditor with the Department's Enforcement Division (the "City Auditor"). In 1996, he performed an audit of the Raymond Marquez Organization to determine Petitioners' UBT liability (the "City Audit"). He reviewed certain business records, newspaper articles and documents maintained by the DA's Office as part of the criminal investigation, including the Guilty Plea, the indictments, some of the original records seized under the warrants and various summary sheets prepared by the DA's Office.[20] The City Auditor reconstructed and/or estimated the unincorporated business gross income and certain expenses of the Raymond Marquez Organization for each of the Tax Years. He computed gross receipts for 1990 to be $23,621,490 based upon the Volume Sheets, and relied on the Financial Analysts' determination of the gross receipts for 1993 of $23,885,779. Based on the receipts figures for 1990 and 1993, the City Auditor estimated that gross receipts for 1991 and 1992 were $23,000,000 per year. He generally accepted the expenses reflected on seized records for payroll, rent, telephone and certain miscellaneous expenses. In several instances, the City Auditor used a figure purporting to reflect a weekly or monthly

[18] Guilty Plea, 14-15.

[19] Guilty Plea, 7-8. *See also* Taxpayers' Reply Affirmation in Further Support for Motion for Summary Determination, Ex. C.

[20] Taxpayers' Ex. 20 is the City Auditor's audit narrative, whereas City's Ex. E is a group of documents identified as the field audit report, which does not include the narrative.

expense and extrapolated that amount for each of the other weeks or months. For example, for 1993, he used an amount purported to be the December 1993 rent expense of $47,939 and multiplied it by twelve to arrive at an annual rental expense for that year of $575,268. The City Auditor used the 1990 Volume Sheets to compute weekly miscellaneous expenses, estimating this amount to be $62,535 and annualizing that amount to arrive at an annual amount of miscellaneous expenses of $3,251,820. During the City Audit, Petitioners did not provide any records of "payouts," *i.e.,* payments on winning bets, to the City Auditor, who testified that he assumed payouts were included in the amount reported as "total expenses" on the Volume Sheets.[21] Using this methodology, the City Auditor arrived at unincorporated business taxable income for each of the Tax Years as follows: $18,762,758 for 1990; $18,141,268 for 1991; $18,141,268 for 1992; and $19,027,047 for 1993.

Respondent issued the Notice asserting $2,962,893.64 in UBT for the Tax Years in the following amounts: $750,510.32 for 1990; $725,650.72 for 1991; $725,650.72 for 1992; and $761,081.88 for 1993. Fraud penalties, a substantial understatement of tax penalty, an interest penalty and a "Commissioner's" penalty[22] were added, totaling $2,394,474.50. Interest was computed to November 22, 1996 in the amount of $1,225,476.62. The total UBT deficiency asserted in the Notice was $6,582,844.76.

In May 1997, following the indictment of Petitioners and after the Notice was issued, the State Revenue Crimes Bureau referred the matter to the Income Tax Audit Unit of the State DTF to assess and collect additional income tax from Raymond Marquez for 1993. In 1997, State DTF Deputy Commissioner Robert Shepherd directed State DTF Income Tax auditor, Hedda Braun, to assess State Personal Income Tax from Raymond Marquez based on the information developed by the Financial Analysts and Ms. Urzi (the "State Audit"). Ms. Braun prepared a Personal Income Tax Notice of Deficiency asserting $228,921.41 of

[21] Tr. 104.

[22] While the penalty is identified on the Notice as a "Commissioner's" penalty, the reference appears to be to the penalty imposed at the discretion of the Commissioner for a failure to pay tax and/or file a tax return with fraudulent intent pursuant to section 11-525(g) of the New York City Administrative Code (the "Code").

State and City income tax as a result of Raymond Marquez's 1993 unreported income. Following the events of September 11, 2001, the State Audit was assigned to Francis Mastrianni, an auditor with the Schenectady office of the State DTF.[23] (Ms. Braun and Mr. Mastrianni are referred to herein as the "State Auditors".)

The State Auditors generally accepted the Financial Analysts' and Ms. Urzi's findings of additional net income, including the computations of income from slot machines, rent and the use of telephones.[24] The State Auditors concluded that the Raymond Marquez Organization had a net profit of $1,460,651 for 1993. This amount was attributed to Petitioner Raymond Marquez as 1993 unreported income.

On March 14, 2000, Acting Supreme Court Justice Laura E. Drager ordered that any grand jury testimonial evidence that had been released for "investigative purposes" could not be offered as evidence in this or any other proceeding. That evidence, which consisted of the testimony of Mr. Santiago and Ms. Urzi, was accordingly excluded from both the City Hearing and the hearing on the State DTF's assertion of personal income tax against Raymond Marquez (the "State Hearing").

Vito LaMonica, an accountant who had been affiliated with Michael J. Berger & Co. for eighteen years at the time of the City Hearing and who was a former Internal Revenue Service employee, provided accounting services to Petitioners including preparing personal federal and State income tax returns and corporate income tax returns for Ms. Marquez's businesses. The firm did not file UBT returns for either Petitioner. Mr. LaMonica testified at both the City Hearing and the State Hearing. Mr. LaMonica testified that he had never seen records such as those seized under the warrants and that he spent a week in Florida with Petitioner Raymond Marquez, Petitioner's representative, R. David Marquez, and Wallace

[23] Taxpayers' Ex. 6, transcript of the hearing on the State DTF's assertion of personal income tax against Raymond Marquez (the "State Transcript"), 85. References to the State Transcript are cited as "St. Tr. __."

[24] St. Tr. 40-41, 122-23.

Musoff[25] for the purpose of learning how to analyze the records.[26] Based on his review of the seized documents and his review of the City Auditor's work papers, Mr. LaMonica concluded that the City Auditor did not deduct the appropriate amount of expenses in computing net income from the Raymond Marquez Organization. Mr. LaMonica concluded that the business operated at a loss for three of the four Tax Years[27] and prepared schedules which purport to demonstrate this conclusion. He stated that he was unable to "cross foot" the records he reviewed[28] and he did not offer any other documentary or third-party evidence supporting the additional expenses.[29]

Mr. Musoff supported the methodology used and schedules prepared by Mr. LaMonica and offered testimony regarding payout percentages in a numbers operation. Mr. Musoff did not offer any documentation to substantiate his testimony regarding the expenses of a numbers operation or the payout percentages.

At the end of the City Hearing, the ALJ advised the Parties that Respondent would have additional time to review the deficiency in light of the evidence submitted but specified that there would be no new notice and no additional proceeding.[30] In her Post-Hearing Brief, Respondent advised Petitioner and the ALJ that Respondent would adopt for UBT purposes the State DTF's calculation of net income for 1993 and that Respondent would extrapolate that calculation to the other Tax Years.[31] Respondent adopted $1,460,651, the State DTF's

[25] Wallace Musoff, a former Special Agent with the U.S. Treasury Department Intelligence Division (subsequently the Criminal Investigation Division), and a former liaison to the NYPD, testified on behalf of Petitioners at both the City Hearing and the State Hearing. Tr. 511. At the State Hearing, he stated that he was being compensated for his testimony. St. Tr. 423. He made no statement at the City Hearing as to whether he was compensated for his testimony at the City Hearing.

[26] Tr. 365, 368, 402.

[27] Tr. 391, 407-8.

[28] Tr. 414.

[29] For example, while Mr. LaMonica asserted that income should be adjusted for car rental expenses, he testified that he had not reviewed any source documentation, such as receipts, supporting those expenses. Tr. 480.

[30] Tr. 781-82.

[31] Respondent's Post-Hearing Brief, 1-2.

computation of the 1993 net income of the Raymond Marquez Organization, as being the amount of unincorporated business taxable income subject to UBT for each of the Tax Years.

Respondent further asserted that this revised amount should be adjusted upward by adding ten percent of gross income as a disallowance of payments to proprietors or partners for services or the use of capital pursuant to Code section 11-507(3). In support of the latter assertion, Respondent argues that because Petitioners introduced evidence suggesting that numbers operations typically make payments to controllers of ten percent of the gross receipts and because the Raymond Marquez Organization did not employ controllers, Raymond Marquez must be both banker and controller and any deduction taken for payment to Raymond Marquez as controller should be disallowed as a payment to Raymond Marquez as partner/proprietor.

In their Exception, Petitioners assert that neither Raymond Marquez nor Alice Marquez was engaged in the unincorporated business referred to as the Raymond Marquez Organization during the Tax Years and that, in any event, the evidence presented indicates that the business operated at a loss during 1993 and, as Respondent has extrapolated the 1993 results for the other Tax Years, there is no net income for any of the Tax Years. Petitioners further assert that there is no rational basis for, or substantial evidence supporting, either the Department's original deficiency or its modified deficiency based on the State Audit. Finally, Petitioners argue that Respondent's adoption of the State DTF's audit findings and methodology after the conclusion of the City Hearing violated Petitioners' constitutional due process rights by denying Petitioners' the right to prior notice of the revised deficiency and an opportunity to respond, that Respondent is collaterally estopped from adopting the State Audit findings and methodology because the State Administrative Law Judge (the "State ALJ") determined that the State Audit had no rational basis[32] and that the State Determination is binding on Respondent under the doctrine of stare decisis.

[32] Matter of Raymond Marquez, DTA No. 818561 (State Division of Tax Appeals, June 5, 2003) (the "State Determination").

In her Exception, Respondent asserts that the ALJ correctly concluded that Raymond Marquez was a principal in the unincorporated business conducted by the Raymond Marquez Organization, that the net income of that business was $1,460,651 for each of the Tax Years and that Raymond Marquez failed to report income from the unincorporated business with intent to defraud the City of UBT for the Tax Years. Respondent asserts, however, that the ALJ erred in concluding that Petitioner Alice Marquez was not engaged in the unincorporated business of the Raymond Marquez Organization during the Tax Years and in concluding that there was no basis for adding an additional ten percent of the gross income to the net income of $1,460,651 for each of the Tax Years as an add back of payments to Raymond Marquez as controller.

For the following reasons, we modify the ALJ Determination to sustain a deficiency for the Tax Years against Raymond Marquez, based on unincorporated business taxable income of $1,450,651,[33] instead of $1,460,651, including interest and penalties thereon.

Respondent's adoption of the State Audit findings of $1,460,651 in net income from the Raymond Marquez Organization following the City Hearing presents us with a threshold issue regarding the status of the Notice. There is no assertion that the Notice was not validly issued. The question is whether Respondent effectively withdrew the Notice following the City Hearing or should be considered to have modified it as contemplated by the ALJ to reduce the deficiency to an amount based on unincorporated business taxable income of $1,450,651[34] for each of the Tax Years. At the City Hearing, the ALJ stated:

> My understanding is [Respondent's representative] would like to have her people review the assessment. I want to give her some time, and her auditors and audit staff of her client some

[33] While Respondent originally adopted the amount of income determined by the State DTF as the unincorporated business taxable income for each of the Tax Years, *i.e.,* $1,460,651, Respondent now asserts that the correct amount should be $1,450,651 after a deduction of $5,000 for the personal services of Raymond Marquez and $5,000 as a business exemption. Code §§ 11-509(a), 11-510(1). Respondent's Memorandum in Opposition to Exception, 2. This amount does not include the amount equal to ten percent of gross receipts that Respondent argues should be added back as having been paid to Raymond Marquez as controller.

[34] *See supra* n. 33.

> time to review the determination that was issued in light of the evidence that has been submitted.
>
> I would like to make clear on the record . . . we are not talking about a new notice. . . . We are talking about, at most, an adjustment to the existing notice. . . .[35]

In her post-hearing brief, Respondent indicated that as it was not possible to determine an amount of payouts on winning bets from the "cryptic and idiosyncratic" records Respondent had, and given that Petitioners had not disputed that "certain figures used by the State are net of all payouts on winning bets" Respondent would adopt the State DTF calculations.[36] In the ALJ Determination, the ALJ stated that "Respondent agreed to reduce the asserted UBT liability."[37] Based on the foregoing, it appears that the ALJ viewed Respondent's actions as modifying the amount of the deficiency asserted in the Notice rather than as a withdrawal of the Notice. Nothing in Respondent's briefs or argument on her exception indicates an intent to do otherwise. Thus, we agree with the ALJ that Respondent has reduced the deficiency in the Notice to an amount based on unincorporated business taxable income of $1,450,651[38] for each of the Tax Years. We note, however, that, having reduced the amount of the deficiency asserted in the Notice, Respondent bears the burden of proof as to any greater amount. Code § 11-529(e)(3).

For UBT purposes, an unincorporated business is "any trade, business, profession or occupation conducted, engaged in . . . by an individual or unincorporated entity. . . ." Code § 11-502(a). The Department's Rules relating to the UBT[39] (the "UBT Rules") at 19 RCNY section 28-02(a)(5) provide that in determining whether an activity constitutes an unincorporated business:

> all the relevant facts and circumstances must be considered. . . . Generally, the continuity, frequency and regularity of activities,

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[35] Tr. 781-82.

[36] Respondent's Post-Hearing Brief, 1-2.

[37] ALJ Determination, 27.

[38] *See supra* n. 33.

[39] Title 19 Rules of the City of New York ("RCNY"), Ch. 28.

> as distinguished from casual or isolated transactions, and the amount of time and resources devoted to the activity or transactions are the factors which are to be taken into consideration.

At the State Hearing, Raymond Marquez testified that he had been involved in numbers gambling for about fifty years but that in late 1989 or early 1990 he turned over his operation to his brother in exchange for acting as a consultant to the business.[40] In an interview with Selwyn Raab published in the New York Times on July 6, 1997 (the "Raab Article"),[41] Raymond Marquez similarly stated that he had been in the business since 1947 when he was seventeen, except for a period of eight years during which he was incarcerated on federal gambling and extortion charges, but did not mention leaving the business in 1989. In his allocution in connection with the Guilty Plea, he admitted that from January 1993 to April 1994, in the borough of Manhattan, he "intentionally attempted to conduct, participate, and engage in the affairs of the [criminal enterprise called the] Raymond Marquez Organization by participating in a pattern of criminal activity. . . ."[42]

In a telephone call recorded on March 22, 1994, Raymond Marquez was heard to state, "[w]ith me, you know every year that I'm in the number business, it gets better and better, I learn more." He also said that he gets "a bigger foothold" and "control."[43] In a telephone conversation recorded on November 20, 1993,[44] one male voice is heard to say "[w]ho's bringing the bag?" to another male individual who replies "Raymond." Numerous telephone conversations and fax transmissions in early 1994 between individuals at 3650 Broadway or 730 Riverside Drive and Raymond Marquez in Florida at the Oakland East Motor Inn indicated that Raymond Marquez was actively involved in the details of the operation at that time.[45] In his 1994 affidavit, Detective Ramirez stated that another NYPD

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[40] St. Tr. 179-80, 232.
[41] Taxpayers' Ex. 15.
[42] *See supra* n. 18.
[43] Ramirez Aff., para. 52.
[44] Taxpayers' Ex. 12.
[45] Tr. 357-58.

officer, Sergeant Frank Perez, saw Raymond Marquez outside 3653 Broadway, one of the Raymond Marquez Organization's gambling spots, approximately two years earlier, which would have been some time in 1992.[46] In addition, Detective Huthansel observed Raymond Marquez at 3650 Broadway in 1994 prior to Raymond Marquez's arrest in April.[47] Thus, there is affirmative evidence in the Record that Raymond Marquez was involved in the Raymond Marquez Organization at least through 1989 and from some time in 1992 until his arrest in 1994.

Other than his own self-serving testimony and that of his nephew, Robert Marquez, Jr., Raymond Marquez did not provide any evidence that he had transferred his operation to his brother, Robert Marquez, Sr., or had left the numbers business after 1989. On the contrary, in March 1994, Raymond Marquez was heard to say that every year he is in the numbers business and gains a bigger foothold and control, a statement that directly contradicts his testimony that he had transferred his numbers operation to his brother. At the State Hearing, Raymond Marquez's nephew, Robert Marquez, Jr., testified that in 1990 his father was very ill, which would seem an inopportune time for him to take over Raymond Marquez's business.[48] Robert Marquez, Jr. also stated that the combination of his father's business with Raymond's was done very slowly and the records kept separately to avoid alerting staff who might react negatively to the merger.[49] This testimony tends to undercut the credibility of both his and Raymond Marquez's testimony that the businesses were merged and taken over by Robert Marquez, Sr. in early 1990. Based on the foregoing, we conclude, as did the ALJ, that Petitioner Raymond Marquez, was engaged in an

[46] Ramirez Aff., para. 23.
[47] Tr. 351.
[48] St. Tr. 291.
[49] St. Tr. 290-91.

unincorporated business in the City during each of the Tax Years consisting of the numbers operation known as the Raymond Marquez Organization.[50]

In contrast, there is no direct evidence in the Record indicating that Petitioner Alice Marquez was engaged in the numbers business operated by her husband. She was not observed at any of the locations in the City associated with the business nor was she overheard or mentioned in any of the intercepted conversations from the business locations in the City. Respondent alleges that Alice Marquez was the money manager for the Raymond Marquez Organization but she pleaded guilty only to a single misdemeanor count of possession of gambling records, not to participating in a gambling operation. In her allocution, she admitted only to being in constructive possession of a single gambling record. Although Respondent presented evidence of financial transactions of her various corporations during the Tax Years, her name does not appear on any of the many money orders submitted as evidence. There is no evidence that Ms. Marquez was engaged in that financial activity individually or that she engaged in any such activity in the City during the Tax Years. Thus, we agree with the ALJ that Petitioner Alice Marquez was not engaged in the unincorporated business known as the Raymond Marquez Organization in the City during the Tax Years.

Having concluded that Raymond Marquez was engaged in an unincorporated business during the Tax Years, we turn next to the question of whether he derived any unincorporated business taxable income from that business during the Tax Years.

Code section 11-506(a) defines "unincorporated business gross income" as "the sum of the items of income and gain [of the unincorporated business] . . . includible in gross income for . . . federal income tax purposes. . . ." For the Tax Years, the Code defines unincorporated business taxable income to be "the excess of [the business'] unincorporated

[50] By his own testimony, Raymond Marquez was providing consulting services to the business after 1989. St. Tr. 180. While we agree with the ALJ that Raymond Marquez was actively engaged in the unincorporated business known as the Raymond Marquez Organization, we note that his provision of consulting services also would constitute an unincorporated business.

business gross income over its unincorporated business deductions, allocated to the city" adjusted for certain statutory deductions and exemptions. Code § 11-505.

The UBT Rules at 19 RCNY section 28-19(a) require every UBT taxpayer to keep "permanent books of account or records . . . as are sufficient to establish the amount of gross income, deductions, credits and other matters required to be shown by such taxpayer in any" UBT return. Subdivision e of that section requires a UBT taxpayer to make its books and records available to the Department for inspection. Subdivision a of Code section 11-521 provides that:

> If a taxpayer fails to file a return required under [Chapter Five of Title Eleven of the Code], the commissioner of finance is authorized to estimate the taxpayer's city unincorporated business taxable income and tax thereon, *from any information in the commissioner's possession*. . . . [Emphasis added.]

In a proceeding before this Tribunal, generally the taxpayer has the burden of establishing that the Department's asserted deficiency is incorrect. Code § 11-529(e). The taxing authority is not required to prove the correctness of such an assertion. Where a taxpayer's records are inadequate, the taxing authority cannot be required to perform a precise audit as the taxpayer's actions have made that impossible. W.T. Grant Company v. Joseph, 2 N.Y.2d 196, 206 (1957); Meskouris Brothers, Inc. v. Chu, 139 A.D.2d 813 (3d Dept. 1988). Rather, the taxpayer must "by clear and convincing evidence" establish that the deficiency and the method used to make it are erroneous. Blodnick v. New York State Tax Commission, 124 A.D.2d 437, 438 (3d Dept. 1986).[51] However, the taxing authority must "through witnesses or documents, be able to respond meaningfully to inquiries regarding the nature of the audit performed . . . to provide [the taxpayer] with an opportunity to meet its

[51] Petitioners acknowledge that they bear the burden of proof but argue that Respondent must provide substantial evidence to support the deficiency. We note that the "substantial evidence" standard of review applies in a proceeding under Article 78 of the New York Civil Practice Law and Rules, not to proceedings before this Tribunal. Matter of Small, New York State Tax Appeals Tribunal (August, 11, 1988). In any event, Petitioners have misconstrued that standard. It does not impose an affirmative obligation on Respondent, as suggested by Petitioners. Rather, an administrative determination must stand unless the courts find that it is not supported by substantial evidence. *See generally* 300 Gramatan Ave. Assoc. v. State Division of Human Rights, 45 N.Y.2d 176 (1978).

burden of proving such methodology unreasonable."[52] Matter of Basileo, New York State Tax Appeals Tribunal (May 9, 1991); Matter of Shop Rite Wines & Liquors, Inc., New York State Tax Appeals Tribunal (February 22, 1991).

While the Notice was based on the City Audit, Respondent subsequently adopted the State Audit conclusions after the City Hearing ended. Petitioners contend that Respondent's adoption of the State Audit conclusions after the City Hearing was completed and after the Record was closed deprives Petitioners of due process by denying them notice of, and an opportunity to respond to, Respondent's assertion of a modified deficiency. Code § 11-529(d)(3).

This Tribunal has held that new factual issues cannot be raised after the hearing if it would prejudice the party bearing the burden of proof as to that issue, whether raised by the parties or by the ALJ. Matter of Andal Corporation, TAT(E)93-179(GC) New York City Tax Appeals Tribunal (June 30, 1995). Respondent contends that Petitioners were not prejudiced by her actions because Petitioners had ample opportunity to protest the State Audit at the State Hearing and offered at the City Hearing much of the testimony and evidence they had presented at the State Hearing.[53] Respondent further contends that her adoption of the State Audit conclusions was not a new issue because at the end of the City Hearing, the possibility that the Department would adjust its deficiency was raised, although Respondent acknowledges that much of the discussion regarding any such adjustment was held off the Record.[54]

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[52] Respondent's adoption of the State Audit findings following the close of the City Hearing raises a question as to whether that action affected the Parties' evidentiary burdens in this matter. At the City Hearing, Respondent addressed exclusively the methodology used in the City Audit that was the basis for the Notice rather than the methodology behind the State Audit. As Petitioners have argued that Respondent should be precluded from adopting the State Audit findings after the conclusion of the City Hearing, Petitioners cannot simultaneously argue that Respondent's action relieved them of their burden of proof as to Respondent's original audit methodology. Consequently, we are of the opinion that Petitioners bore the burden of proving that the City Audit methodology was unreasonable.

[53] Respondent's Memorandum in Opposition to Exception, 10-11.

[54] Respondent's Memorandum in Opposition to Exception, 16.

We disagree with Respondent that her adoption of the State Audit findings is not a new issue. While the possibility of a modification of the deficiency was discussed at the end of the City Hearing, we do not believe that so much of that discussion as was held on the Record was sufficiently specific as to put Petitioners on notice that Respondent might adopt the State Audit findings as the basis for a revised deficiency. *See* Matter of Rubin Brothers Holding Co., New York Tax State Appeals Tribunal (May 18, 1995); Matter of Angelico, New York State Tax Appeals Tribunal (March 31, 1994); Matter of Clark, New York State Tax Appeals Tribunal (September 14, 1992).

The primary test as to whether a new factual issue may be raised following the close of a hearing is whether the party bearing the burden of proof on the new issue is prejudiced as a result. Matter of Chuckrow, New York State Tax Appeals Tribunal (July 1, 1993); Matter of Small, New York State Tax Appeals Tribunal (August 11, 1988). In the present case, Petitioners introduced into evidence all of the exhibits that they submitted at the State Hearing as well as the entire State Transcript. Petitioners assert that had they known that Respondent was going to adopt the State Audit methodology, they would have presented additional expert witnesses to testify as to the flaws in the State Audit and would not have introduced the State Transcript. Petitioners presented at the City Hearing all of the testimony and evidence presented by them at the State Hearing contesting the State Audit. However, we cannot substitute our judgment for that of Petitioners as to what strategy they might have pursued at the City Hearing had they known Respondent would adopt the State Audit methodology to support the UBT deficiency after the City Hearing was completed and the Record was closed. Therefore, we must conclude that Petitioners are disadvantaged by Respondent's action.

Having determined that Petitioners are prejudiced by Respondent's adoption of the State Audit findings, we need not address Petitioners' arguments that Respondent is bound by the result at the State Hearing under the doctrine of stare decisis or collateral estoppel.

The Rules of Practice and Procedure of the New York City Tax Appeals Tribunal (the "Tribunal Rules") at 20 RCNY section 1-13(f) provide:

> (1) The tribunal commissioners shall review the record and shall, to the extent necessary or desirable, *exercise all the powers which they could have exercised if they had made the determination*.
>
> (2) After such review, the tribunal commissioners shall issue a written decision, containing findings of fact and conclusions of law, affirming, reversing *or modifying the administrative law judge's determination*, or the tribunal commissioners may remand the case for additional proceedings before the administrative law judge. . . .[Emphasis added.][55]

Having concluded that Respondent is precluded from adopting the State Audit methodology, this Tribunal is authorized to review the Record and the evidence presented regarding the methodology used in the City Audit to determine whether that methodology was adequately described and whether it was reasonable.

The records available to the City Auditor were not typical business records and were difficult to understand.[56] Individual Volume Sheets did not "cross foot," *i.e.,* the column headed "total expenses" did not represent the total of the numbers in the same row nor could one derive the amounts described as "profit or loss" from the other amounts in that same row.[57] Petitioners' own witness, Mr. LaMonica, admitted that he could understand the records only after spending a week getting assistance from Petitioner Raymond Marquez and Mr. Musoff.[58] At no time during the course of either the City Audit or the State Audit, did Petitioners present alternative records for any of the Tax Years or for any other periods.

Petitioners contend that the records seized under the warrants did not belong to them and therefore the City Auditor was unreasonable in relying on them in conducting the City

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[55] Title 20 RCNY § 1-13(f). *See also* § 169(d) of the New York City Charter (the "Charter").
[56] Tr. 40.
[57] Tr. 41.
[58] Tr. 365, 368, 402.

Audit. Raymond Marquez's name does not appear on the seized records and there was no evidence presented to establish that he prepared them. However, Exhibit H to Petitioners' Reply Affirmation in Further Support of Motion for Summary Determination, dated January 31, 1999, includes photographs of documents seized under search warrants executed at 3001 North Federal Highway, Fort Lauderdale, Florida, which is the address of the Oakland East Motor Lodge. Photo number twelve shows a portion of a ledger page, the first column of which is headed "STORE" and lists store, or spot, locations identical to some of those appearing under that same heading on the Volume Sheets used by the City Auditor, *e.g.*, "AMST," "CANDY," "109," "JJ," "KEN," "HORT," etc., although not in the same order.

The City Auditor testified that he obtained the records he used from the DA's Office. In her affirmation, ADA Rudman stated that the records turned over to the Department were obtained under search warrants executed at the gambling spots and banks purportedly operated by Raymond Marquez and at Raymond Marquez's residences in New York and Florida and that Claudia Hernandez identified those records.[59] She further affirmed that from 1994 to the date of her affirmation, the seized records were in the custody of the DA's Office.[60] Detective Huthansel testified that he recognized the names on a sheet purportedly showing payroll expenses as the names of individuals working at the organization's bank at the time of his investigation.[61] Detective Huthansel further testified that he recognized the names of the stores listed on the Volume Sheets as spots controlled by the Raymond Marquez Organization.[62] Based on the foregoing, we are satisfied that the records used by the City Auditor were records of the Raymond Marquez Organization.

Petitioners further assert that there is no evidence that the records used by the City Auditor pertain to the Tax Years and thus those records cannot be used to support the City Audit. The Record indicates that the Volume Sheets were found in folders on which the

[59] Rudman Affm., para. 3(n).
[60] Rudman Affm., para. 5.
[61] Tr. 329.
[62] Tr. 348.

numbers "90" and "91" appeared, circled. ADA Rudman affirmed that Claudia Hernandez identified the records "as relating to a certain period of time" although that period of time is not identified. Petitioners' witness, Mr. Musoff, conceded that if records were found in a folder bearing a notation of a date, that he would consider that relevant in determining the date to which the records related.[63] Based on the foregoing, we are persuaded that the records used by the City Auditor related to the years 1990 and 1991.

However, even if it were not possible to attribute those records to a particular year, in the absence of complete records of an unincorporated business, the Department can rely on information in its possession to estimate the income and expenses of a business. Code § 11-521(a). As we have concluded that the records belonged to Raymond Marquez's business, in the absence of any other records or more reliable information as to the income and expenses of the business for the Tax Years, the Department was entitled to rely on them in estimating the unincorporated business taxable income of that business for the Tax Years even if the records cannot be definitively attributed to the Tax Years.

The City Auditor used the Volume Sheets purporting to be from the year 1990 to arrive at an amount of gross receipts for that year. He reduced that amount by the amount shown on those sheets as "total expenses" and further reduced that amount by an estimated amount for rent and telephone expenses extrapolated from monthly amounts for such expenses based on other sheets received from the DA's Office purporting to cover the month of December 1993.[64] He also deducted an amount for payroll expenses extrapolated from records purporting to be weekly payroll records for 1993, although he did not deduct an amount appearing on those same payroll records for "car rental." The City Auditor also did

[63] Tr. 548-49.

[64] The records described as reporting expenses for rent, telephone and "Con Ed" have columns for the months December through June although amounts appear only in the columns for December through April or March. No year appears directly on those sheets although some bear a printed date of January 12, 1994 and a time such as might have been made by a fax machine. Separate sheets included in the City Auditor's file states that the sheets represent the respective expense for December 1993 through April 1994 but it is not clear from the Record whether the separate sheets were original records seized pursuant to the warrants or were prepared by the DA's Office.

not deduct any amount for utility expenses based on a similar sheet purporting to show "Con Ed" expenses.

The City Auditor testified that he did not deduct any amounts from any of the other columns on the Volume Sheets as he did not understand those entries, nor did he allow any specific deduction for payouts on winning bets because he had no information as to what the appropriate amount should be, although he assumed payouts and the other expenses were included in "total expenses."[65] The City Auditor further testified that for 1993, he relied on the gross receipts amount calculated by the DA's Office of $23,885,779.[66] As that amount was similar to the amount of gross receipts for 1990 that he had calculated from the Volume Sheets, he estimated a figure of $23,000,000 for gross receipts for 1991 and 1992 and used the same amount for expenses for 1991, 1992 and 1993 as he had used for 1990. Based on the foregoing, we conclude that Respondent adequately explained the City Audit methodology sufficiently to permit Petitioners to challenge the reasonableness of the deficiency arrived at using that methodology. Matter of Basileo, New York State Tax Appeals Tribunal (May 9, 1991).

Petitioners attempted to establish that the City Audit was unreasonable primarily through the testimony of Mr. LaMonica. However, Mr. LaMonica admitted that he had no independent understanding of the records but rather relied exclusively on the explanations offered by Raymond Marquez and Mr. Musoff[67] going so far as to suggest that after meeting with Mr. Marquez and Mr. Musoff he had committed the records to memory.[68] When asked to elaborate on various statements he made regarding the Volume Sheets and the "rib" sheets,

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[65] Tr. 104.

[66] With regard to the weekly "rib" sheets purporting to be for the year 1993 from which the DA's Office derived its gross receipts for that year, Petitioner Raymond Marquez also contested whether those records pertained to that year. Again, however, in the absence of complete books and records, the Department may rely on whatever information is available.

[67] Tr. 368.

[68] *Id.*

Mr. LaMonica offered no explanation other than that he had reached his conclusions after discussions with Mr. Musoff and Raymond Marquez.[69]

Much of Mr. LaMonica's testimony consisted of criticism of the DA's Office calculations for 1993 based on the "rib" sheets[70] despite the fact that for the most part, the City Audit was not based on those calculations. The only amount from the DA's Office calculations for 1993 based on the "rib" sheets that the City Auditor used was the amount of gross receipts, which Mr. LaMonica did not dispute.[71] Mr. LaMonica conceded that in some respects the City Audit methodology did not suffer from the same defects he identified in the State Audit.[72]

Mr. LaMonica did demonstrate that the City Auditor had not deducted amounts for "Con Ed" expense and car rental expense.[73] He also identified certain computational discrepancies in the City Auditor's calculations.[74] These amounts were not substantial in relation to the amounts of gross receipts calculated by both the City Auditor and Mr. LaMonica.[75]

Apart from deducting expenses for "Con Ed" and car rental and certain computation discrepancies in the amounts used by the City Auditor, Mr. LaMonica's calculations for the years 1990 and 1991 varied from those of the City Auditor primarily in that he asserted that the column appearing in the middle of each Volume Sheet entitled "profit or loss" represented the gross profit or loss of each store after payouts on winning bets but before certain other expenses.[76] Based on that conclusion, he testified that before expenses, the

[69] Tr. 402-3, 414, 418.

[70] *See, e.g.,* Tr. 382, 396-404.

[71] Tr. 419-20.

[72] Tr. 377.

[73] Tr. 384, 472-73.

[74] Tr. 383-84.

[75] For example, the amount of "Con Ed" expense calculated by Mr. LaMonica was approximately $78,000 compared to gross receipts of over $23,000,000. The car rental expense amount was $1000 per month. Moreover, the total volume amounts determined by Mr. LaMonica for 1991 exceeded those used by the City Auditor by several millions of dollars ($29,829,935 compared to the $23,000,000 estimate used by the City Auditor). Tr. 385.

[76] Tr. 386-87, 389-90.

business realized a profit of $96,015 for 1990 and a loss of $117,917 for 1991.[77] He further testified that for 1993 the business realized a loss of $1,257,795.[78] While we find his testimony regarding expenses for "Con Ed" and car rental to be reasonable, his conclusion that this business must have realized losses for 1990, 1991 and 1993 conflicts with Raymond Marquez's own statement recorded in early 1994 that his numbers business "gets better and better."[79] We find it improbable that Petitioner would make such a statement shortly after a year in which his business lost over $1 million.

Mr. LaMonica's testimony also was inconsistent with other summary sheets that he prepared that showed the amounts of profit and loss for 1990 and 1991, respectively, as net of all expenses.[80] Moreover his testimony that the "profit or loss" column represented the gross profit or loss of each store after payouts but before expenses conflicted with testimony given by Petitioner Raymond Marquez at the State Hearing where he stated that:

> When single action bets are due or claims are due from single bets, it will come out of the single action money on the store level. When it's straight bets that are due, it will come from the bank level. The adjusted expense and the payroll for the stores would come from the store money.[81]

If, as was suggested by Mr. Musoff, that about half of the receipts of the Raymond Marquez Organization were from single action and half were from straight action[82] and if the total gross receipts from all types of bets were approximately $23,000,000, Mr. Marquez's statement would indicate that even after paying winning single action bets and store expenses, the Raymond Marquez Organization still would have over $11,500,000 (*i.e.,* fifty

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[77] Tr. 389-391, Taxpayers' Ex. 18. He further stated that after all expenses, the business would realize a loss for 1990 as well. Tr. 391.

[78] Tr. 392. It appears that no volume sheets for 1993 were available. In estimating the loss for 1993, Mr. LaMonica instead relied on the "rib" sheets, slot machine records and the sheets showing partial amounts for rent, telephone, "Con Ed" and payroll for 1993.

[79] Ramirez Aff., para. 52.

[80] Taxpayers' Ex. 25.

[81] St. Tr. 204.

[82] Tr. 520.

percent of $23,000,000) available to the banks from which to pay winning straight action bets and the expenses of the banks. Thus, we find that Mr. LaMonica's conclusion that this business operated at a net loss for three of the Tax Years lacks credibility.

The City Auditor testified that he did not allow any separate deduction for payouts on winning bets. Petitioner offered a variety of unsubstantiated evidence regarding payouts. Mr. Musoff, testified that in a numbers business one could expect a gross profit after payout of twenty-two and one-half percent, assuming half of the business consists of "straight action" bets and half consists of "single action."[83] He later testified that "eighty some-odd percent" of gross receipts are generally paid out on winning bets although he offered no support for that statement.[84] Both of those statements are inconsistent with the Raab Article, which states that after paying thirty-five percent of gross receipts as commissions to runners and controllers, a numbers business starts with a gross profit of sixty-five percent *before* payouts and other expenses.[85] Finally, Petitioners' representative at one point suggested that the column on the Volume Sheets headed "pay" might represent the payouts.[86] Given that the amount in the "pay" column generally is only about ten percent of the amount in the "volume" column, that suggestion also is inconsistent with Mr. Musoff's testimony regarding payouts. Due to the inconsistencies in Petitioners' evidence regarding payout percentages, we find none of it persuasive.

The failure of the City Auditor to allow a deduction for payouts does not render his methodology unreasonable, particularly in the absence of reliable evidence as to what amount should be allowed. Cohen v. Commissioner, 16 T.C.M (CCH) 763 (1957), *remanded on other grounds* 266 F.2d 5 (9th Cir. 1959). Similarly, the City Auditor's failure to allow deductions for expenses described as "Con Ed" or car rental does not render his methodology

[83] Tr. 522. He testified that the gross profit after payouts on straight action was 30% and the net profit after payouts on single action was 15%.

[84] Tr. 539.

[85] It is mathematically impossible for a business to pay both payouts of 80% of gross receipts and commissions totaling 35% of gross receipts.

[86] Tr. 107.

unreasonable where those amounts are not material in relation to the amount of gross receipts.[87] Based on the foregoing, we find that the City Auditor adequately explained the basis for the original deficiency and that, given the cryptic nature of the limited records available to him, his methodology was not unreasonable. Throughout the City Audit, Petitioners had the opportunity to explain the various entries on the Volume Sheets or to offer additional information regarding the income and expenses of the Raymond Marquez Organization. They did neither. With a few minor exceptions, Petitioners' attack on Respondent's methodology and calculations was limited to offering alternative interpretations of the Volume Sheets through Mr. LaMonica, who was not involved in creating the records and admittedly did not understand them until they were "explained" to him by Raymond Marquez and Mr. Musoff. Petitioners have not offered any tangible evidence, in the form of bills or receipts, or credible expert testimony to support their claim of additional expenses or payouts. While the amount of unincorporated business taxable income calculated by the City Auditor may not be precise, we conclude that Petitioners have not met their burden of proving that the City Audit methodology was unreasonable by clear and convincing evidence. Blodnick v. New York State Tax Commission, 124 A.D.2d 437 (3d Dept. 1986).

Although we agree with Petitioners that Respondent should have allowed deductions for "Con Ed" expenses, car rental expenses and, most significantly, payouts on winning bets, a finding of error in a portion of a deficiency does not make the entire deficiency erroneous or arbitrary or shift the burden of going forward as to the entire deficiency to the taxing authority. Wells v. Commissioner, 47 T.C.M. (CCH) 796 (1983). Moreover, as the Tax Court stated in Schwab v. Commissioner, 67 T.C.M. (CCH) 3004 (1994):

> Deductions are strictly a matter of legislative grace, and petitioners bear the burden of proving their entitlement to any

[87] *See supra* n. 75.

> deduction. . . . [Citations omitted.] This rule applies without regard to the presumption of correctness.

As noted above, the Tribunal Rules and the Charter authorize this Tribunal to make new findings of fact and to modify the determination of the ALJ where appropriate. While the City Audit methodology was not unreasonable, certain additional deductions for "Con Ed" and car rental expense and payouts should have been allowed. Respondent does not dispute the amounts of "Con Ed" and car rental expense calculated by Petitioners. Consequently we will adopt those amounts for purposes of this decision.

We could remand this matter for further proceedings to determine the appropriate amount of deductions for payouts on winning bets. However, the Parties have had ample time to present evidence regarding this issue and, given the inadequate nature of the records involved, we conclude that a remand would not be fruitful. *See* Matter of Shop Rite Wines & Liquors, Inc., New York State Tax Appeals Tribunal (February 22, 1991).

Despite the absence of persuasive evidence as to the appropriate payout percentage to be used in the present case, there was general agreement that a numbers business pays some amount on winning bets and that payouts should be deductible as an expense of the business. Under Cohan v. Commissioner, 39 F.2d 540, 544 (2d Cir. 1930), a reasonable approximation of payouts should be made "bearing heavily . . . upon the taxpayer whose inexactitude is of his own making. . . ."

As noted above, Raymond Marquez testified at the State Hearing that only payouts on single action bets are paid by the stores, or spots, along with store expenses, while payouts on straight action bets are paid by the banks.[88] Based on that testimony and Mr. LaMonica's testimony that the bank expenses were not included in the "profit or loss" column on the Volume Sheets,[89] we can assume that the total of the entries in the "profit or loss" column

[88] A taxpayer's own statements can provide the basis for an estimated assessment in the absence of adequate records if there is no basis for assuming those statements are inaccurate or involuntary. Myrtle Berlin, 42 TC 355 (1964).

[89] Tr. 389. The only records of bank expenses in the Record are the separate sheets showing monthly or weekly expenses for rents, payroll, telephone and "Con Ed" expenses for a portion of 1993. *See supra* p. 5.

on the Volume Sheets represents only the profit or loss of the stores, or spots, from single action bets after payouts on those bets and after some or all of the store expenses, and not the net profit or loss of the entire organization after payouts on all bets and store expenses, as Mr. LaMonica suggested.[90] Mr. LaMonica determined that for 1990 the total of the "profit or loss" column on the Volume Sheets was a net profit of about $96,000 and for 1991 the total was a net loss of about $118,000. In light of Raymond Marquez's statement at the State Hearing, we can infer that those amounts do not include the net profit or loss from straight action bets after payouts on those bets and after expenses of the banks.[91]

The Volume Sheets contain no breakdown between receipts from single action and straight action bets. However, the calculation done by the DA's Office for 1993 shows gross receipts of $23,885,779, of which $13,764,273, or approximately fifty-seven percent, was straight action receipts. Petitioners did not dispute the gross receipts figures or the breakdown between single and straight action reflected in those calculations. Mr. Musoff similarly used a fifty-fifty breakdown between single action and straight action bets in his testimony.[92] Using Mr. Musoff's fifty-fifty breakdown, which is more favorable to Petitioners, and using Mr. LaMonica's calculations of gross receipts and expenses, we can estimate the gross receipts before payouts on straight action bets and before bank expenses for 1990 and 1991 as follows:

[90] *See supra* text accompanying n. 76. Petitioners' witnesses' testimony was inconsistent as to whether they believed the "profit or loss" represented a net profit or loss after all expenses or only after certain expenses. Tr. 389-90, 416, 518-19, 544; Taxpayers' Ex. 18 and 25. Under the Cohan rule, we construe this inconsistency against Petitioners.

[91] As Petitioners did not offer this explanation to the City Auditor and it is not otherwise evident from the Volume Sheets, we do not find that the audit methodology was unreasonable because the City Auditor did not take this approach. This approach is consistent with the methodology apparently used by the DA's Office for 1993. *See* City's Ex. V, Part 1, Report of Virginia Urzi, 2.

[92] Tr. 520.

| | 1990 | 1991 |
|---|---|---|
| Total Gross Receipts (*i.e.,* Volume) (Taxpayers' Ex. 25) | $23,621,490 | $29,829,535 |
| x 50% (representing gross receipts from straight action bets) | $11,810,745 | $14,914,767 |

Respondent's and Petitioners' estimates of the expenses for the banks, consisting of payroll, telephone and rent, varied slightly. Taking Petitioners' slightly higher estimates for those expenses and adding Petitioners' estimates for "Con Ed" and car rental expenses, the total estimate of bank expenses, other than payouts on winning straight action bets, is $1,691,196.[93] Subtracting that amount from the estimated net receipts from straight action shown above leaves more than $10,000,000 in receipts from which winning payouts on straight action bets would be paid.

As noted above, we find that Petitioners presented no credible evidence as to what amount would be paid on winning straight action bets. However, using Mr. Musoff's estimated gross profit after payouts on straight action bets of thirty percent,[94] the resulting unincorporated business taxable income based on the above estimates is considerably more than the amount asserted by Respondent of $1,450,651.[95] Thus, we conclude that

[93] *See* Taxpayers' Ex. 25.

[94] Tr. 520.

[95] For 1990, the unincorporated business taxable income ("UBTI") would be $1,938,043 [$3,543,224 (30% of $11,810,745) - $1,691,196 = $1,852,028 + $96,015 (Mr. LaMonica's calculation of the net profit of the stores) - $10,000 (*see supra* n. 33)]. For 1991, the UBTI would be $2,655,317 [$4,474,430 (30% of $14,914,767) - $1,691,196 = $2,783,234 - ($117,917) (Mr. LaMonica's calculation of the net loss of the stores) - $10,000]. For 1993, using the amount of gross receipts from straight action determined by the DA's Office of $13,764,273 (City's Ex. E, 41), the UBTI would be $2,428,086 [$4,129,282 (30% of $13,764,273) - $1,691,196 = $2,438,086 - $10,000]. For 1993, there is no information in the Record as to the separate profit or loss of the stores from single action bets after store expenses as there were no Volume Sheets for 1993 contained in the Record. Therefore, for purposes of this estimate, we assume that any such net profit or net loss was $0. As there was no information in the Record regarding receipts or expenses for 1992, the City Auditor used the same estimated UBTI for 1991 and 1992. Based on the above estimated UBTI for 1990, 1991 and 1993, we agree with that methodology.

Respondent's estimate of unincorporated business taxable income for each of the Tax Years of $1,450,651 is reasonable.

Respondent further contends, however, that an additional amount should be added as a disallowance of a deduction for payments to Raymond Marquez as controller. While the Record indicates that the Raymond Marquez Organization did not have a separate controller,[96] we agree with the ALJ that there is no evidence that Raymond Marquez received ten percent of the gross receipts in that capacity or that any such amount was reflected in any of the expenses reflected in the Volume Sheets or allowed as deductions. Thus we affirm the ALJ's conclusion that no add back of any such amount is appropriate.

Respondent bears the burden of proving that Raymond Marquez's underpayment of UBT was due to fraud. Code § 11-529(e)(1). The standard of proof 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 Cinelli d/b/a Shoporama Car Wash, New York State Tax Appeals Tribunal (September 14, 1989), citing Matter of Ilter Sener d/b/a Jimmy's Gas Station, New York State Tax Appeals Tribunal (May 5, 1988). Fraud can be established through a taxpayer's entire course of conduct and drawing reasonable inferences therefrom. Matter of Cinelli, *supra*; Matter of Sona Appliances, Inc., New York State Tax Appeals Tribunal (March 16, 2000); Matter of Cousins Service Station, Inc., New York State Tax Appeals Tribunal (August 11, 1988). Further, a finding of fraud can be based on circumstantial evidence. Cohen v. Commissioner, 16 T.C.M. (CCH) 763 (1957), *remanded on other grounds* 266 F.2d 5 (9th Cir. 1959). Courts look for "badges of fraud" in examining a taxpayer's conduct for fraudulent intent including: "(1) consistent and substantial understatement of income; (2) failure to maintain adequate records; (3) failure to cooperate with an . . . investigation; (4) inconsistent or implausible explanations of behavior

[96] Tr. 342, 354-55.

and (5) awareness of the obligation to file returns and pay taxes.[citations omitted]" Campfield v. Commissioner, 133 F.3d 906 (2d Cir. 1997) (*full text at* 80 A.F.T.R.2d 7765). Other factors include failure to file returns, concealment of assets, engaging in illegal activities and dealings in cash to avoid scrutiny of finances. Bradford v. Commissioner, 796 F.2d 303, 307-8 (9th Cir. 1986).

By his own testimony, Raymond Marquez was engaged in the numbers business for fifty years. The Record establishes that he continued in that business until some time in 1994. No UBT returns were filed by the business for any of the Tax Years,[97] although the applicable statute required returns to be filed by any unincorporated business that had gross receipts in excess of $10,000. Code § 11-514(a). Thus, even if the business sustained losses during the Tax Years as contended by Petitioners, it was required to file UBT returns.[98] Mr. LaMonica conceeded as much.[99] Other than his general denial of being engaged in the numbers business during the Tax Years, Raymond Marquez offered no explanation for his failure to file UBT returns or pay any UBT with respect to that business. Although Petitioners retained the accounting firm of Michael J. Berger & Co. to prepare their individual tax returns and returns for Mrs. Marquez's corporations,[100] Raymond Marquez does not contend that he sought, or relied on, advice of his accountants with regard to his obligation to file UBT returns or pay UBT. Raymond Marquez testified at the State Hearing that he did not report any amounts received for providing consulting services to the business after 1989 on his personal income tax returns.[101] He argued that he was not required to report those payments because they represented a return of his investment in the business, but he

[97] While not entirely clear, it appears from the Record that the Raymond Marquez Organization did not file UBT returns for any years. Tr. 57, 409-10.

[98] Petitioners did not contest the amount of gross receipts determined by Respondent for the Tax Years.

[99] Tr. 409.

[100] Petitioners' Notice of Motion for Summary Judgment, Exhibit G, Affidavit of Michael J. Berger, CPA.

[101] St. Tr. 239-40. *See supra* n. 40. Raymond Marquez testified that he was entitled to receive up to $3000 per week for providing consulting services when funds were available but he could not recall how much he actually received. St. Tr. 180, 239. Similarly, in the Raab Article, Raymond Marquez asserted that his top weekly income from the business was about $3000.

provided no evidence of any such investment.[102] He also testified at the State Hearing that in his experience in the numbers business no taxes were withheld from wages paid to employees of the business.[103] These statements indicate an awareness of the tax laws. The Record indicates that the Raymond Marquez Organization was primarily a cash operation that also used large numbers of money orders in small denominations,[104] reflecting an intent to avoid detection of the amount of funds flowing through the business and the identities of persons receiving those funds. This is not surprising given the illegal nature of the business. Taken as a whole, we find that the Record establishes that Raymond Marquez failed to file returns or pay UBT for the Raymond Marquez Organization for any of the Tax Years with the intent to evade tax and, therefore, we find Petitioner liable for penalties under Code section 11-525 subdivisions (f) and (g) for each Tax Year. Moreover, because no amount of UBT was reported for any of the Tax Years, Petitioner also is liable for a substantial understatement penalty for each of the Tax Years pursuant to Code section 11-525(j).

Accordingly, the ALJ Determination is modified to reflect a deficiency based on an unincorporated business taxable income of $1,450,651, instead of $1,460,651, for each of the Tax Years, including penalties and interest thereon.[105]

Dated: May 16, 2007
New York, New York

_____
GLENN NEWMAN
Commissioner and President

_____
ELLEN E. HOFFMAN
Commissioner

[102] St. Tr. 240. Contrary to his testimony, in the Raab Article, Raymond Marquez stated that to go into the numbers business "you didn't need a lot of money . . . [y]ou needed a pencil, a pad and a little bit of luck."

[103] St. Tr. 235.

[104] St. Tr. 187, 196-97.

[105] We have considered all of the other arguments raised by Petitioners and find them unpersuasive.