

## New York prowling for tax cheats

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The conversation can last less than 30 seconds. But it's an exchange that has resulted in criminal fraud subpoenas, felony charges and jail time for business owners across New York state. And it usually goes something like this:

A customer walks into a high-end retail store and inquires about the most expensive item in the shop. Initially, he balks at the asking price.

"Is that the best you can do?" he asks.

"That depends," says the store owner. "Can you pay cash?"

"What difference does that make?" asks the customer.

"Well," says the owner, quickly scanning the store before leaning in close and whispering: "If you pay cash, I'm not going to charge you the sales tax."

Unfortunately for the store owner, the customer is really an undercover investigator with the state Department of Taxation and Finance. The merchant will soon learn this when the investigator returns with a search warrant from the local district attorney's office, authorizing a search for the true business records, the ones not reported to the IRS.

It's a sting operation that has been run repeatedly over the past two years, the result of an increased emphasis on catching tax-evading businesses that state officials say began in the Eliot Spitzer administration and has continued through David Paterson's. It's not entrapment, because the business owners volunteer the discounts. And it's remarkably effective.

"Some days we go out and do that at 10 or 15 different places and we get a 100 percent hit rate," said Bill Comiskey, deputy commissioner of taxation and finance. "In certain parts of the economy, noncompliance is almost a cultural thing."

In New York, billions of dollars in taxes — more than enough to plug the

state's budget gap — go uncollected each year, said Comiskey, who based his estimate on a national study from 2001 that \$345 billion in federal taxes are unpaid annually. The state's two-year effort to collect some of the unpaid taxes involves a number of new techniques to catch tax cheats, including the sting operation Comiskey described, and the hiring of 300 auditors to help with enforcement.

Twelve special investigation units have been established across the state, including one in Rochester, and subpoenas issued in criminal fraud investigations have increased from 199 in 2007 to 1,320 last year.

## **Local busts**

Delinquent businesses in the Rochester area have felt the effect of the crackdown. Last March, six lawyers who owed a combined \$60,000 in taxes were charged with tax evasion felonies. In July, David M. Alexander, a Spencerport resident who conducts commercial real estate seminars throughout the United States and Canada, was charged with tax evasion felonies for failing to pay more than \$200,000 in taxes.

Also that month, Gordon Schryver, owner of Canalside Clock Shop in Pittsford, was sentenced to probation after pleading guilty to a misdemeanor charge of not remitting \$17,000 in sales tax revenue to the state.

Two months later, John Wihlen, owner of Henrietta landscaper The Property Maintenance Co. LLC, was charged with second-degree grand larceny for failing to remit more than \$50,000 in sales tax.

In October, Alexander Bacon, owner of the Lumberyard Grille in Canandaigua, was sentenced to one to three years in prison and ordered to pay restitution after pleading guilty to second-degree grand larceny for failing to pay \$249,562 in sales tax from 2001 to 2007.

And on Dec. 9, the state announced the arrests of six Rochester-area professionals who, combined, owed more than \$150,000 in taxes. Those charged included James Walker, a former partner in the logging and lumber business Bigwood LLC, who was charged with tax fraud felonies involving more than \$95,000 in delinquent taxes.

State officials hope that each bust will make more business owners wary of filing a dishonest tax return. While Comiskey said that high-profile companies aren't their only targets, "part of what we do in enforcement is take actions to deter others from engaging in misconduct. When we make a case against a taxpayer business or individual that will gain attention ... that will increase our deterrent impact and get the message out."

## **Law toughened**

Charges against delinquent taxpayers were also dialed up last April, with some misdemeanor crimes being changed to felonies. Previously, one unfiled return could result only in a misdemeanor charge, regardless of how much tax liability an individual or business had. Now, one missed return with \$3,000 or more in liability can be deemed a felony, and the charges increase along with the dollar value.

The theory is that harsher penalties will be an incentive to file an honest and on-time tax return, but critics say the state hasn't done nearly enough to alert taxpayers to the changes.

"They're hurting a lot of people unnecessarily," said Jerry Dibble, whose Dibble & Miller law firm represents Wihlen and Walker. "They just start hitting people — nurses, doctors, lawyers, people who otherwise go through life as proper citizens — and to make them criminals? I've got a problem with that."

For the 35 years he has been practicing law, Dibble would tell clients with delinquent tax returns to work with an accountant and get their taxes paid, but advised them that the state wouldn't prosecute them criminally. He described Wihlen and Walker as "decent citizens running good businesses and making a living, who were not aware that their failure to file would become a criminal case."

"Neither one had any intent to not pay," Dibble said. "They were both already working with accountants when they were charged."

Alexander's attorney did not return messages seeking comment.

Regardless of a delinquent business' intentions, state officials said the increased enforcement will level the playing field for honest businesses that may have been lagging behind their tax-dodging competitors.

"In fairness to those that are paying what they should be paying, I think it's something that we should all support," said Sandy Parker, CEO of the Rochester Business Alliance. "We certainly support it as it pertains to individuals, and I think that businesses have the same obligation."

### **Looking for patterns**

Any mistake, honest or otherwise, that results in the underpayment of taxes will mean that the business owner will have to make restitution. But state auditors are looking for consistent patterns of abuse before they get serious. "If they find one year where there's a mistake, then they have the right to go back and look at three years of returns," said James Rahmlow, accountant and partner with Mengel Metzger Barr & Co. "If they see a pattern, then they start digging their teeth in a little more."

Such was the case with the Lumberyard Grille, said Vincent Scarsella, head of the taxation department's special investigations unit in Rochester. The restaurant was reporting quarterly sales tax remittances that were appropriate for a business doing about \$200,000 in annual sales, but its corporate tax returns were listing \$1 million in sales.

"We developed a case based on that information, and from 2001 to 2007 he'd embezzled about \$250,000 in sales tax funds that went in his pocket," Scarsella said.

More restaurants may soon find themselves under investigation because of legislation adopted in the spring that requires alcohol wholesalers to provide the state with annual reports of how much liquor they sold to each of their bar, restaurant and liquor store clients. So if a retailer underreports sales or exaggerates wholesale expenses, it's easy to compare the figures with the wholesalers' numbers.

The legislation set the same requirements for franchisors, who must now send financial information to the state so it can be compared with taxes remitted by franchisees. Likewise for car insurance companies, which also must provide the state with an annual report on how much money they've paid to auto repair shops.

High-end retailers remain easy targets. Most jewelers, for example, buy only a few extra-expensive gems from their suppliers each year. So if a jeweler hasn't reported the sale of a large emerald, but the emerald is nowhere to be found in the store, it's a good bet it was sold and the tax wasn't paid.

"We're creating a data warehouse with all the places in the state," Comiskey said. "Using the power of technology, we can examine a return by a business, score it, and decide whether this is a place we should audit."

### **Voluntary disclosure**

Ideally, increased enforcement would lead to a more honest population and, eventually, the diminished need for state auditors and investigators. But with full compliance a long way off, the Department of Taxation and Finance has started a voluntary disclosure program that offers eligible taxpayers who haven't filed their taxes in one or more years a chance to avoid criminal charges and monetary penalties if they come forward on their own.

From July 2008 to July 2009, some 2,500 taxpayers applied for the program, 1,850 were accepted, and the state has received or has plans to receive \$106 million in what Comiskey calls "found money."

“These are people we didn’t know about and weren’t under audit,” he said.

On Jan. 15, the state will also start a tax amnesty program that will allow delinquent taxpayers to save a portion of the penalty and interest they owe. People with unpaid bills from 2003 or earlier can get up to 80 percent of the accrued penalty and interest removed, while those with unpaid bills between 2004 and 2006 can save 50 percent. Bills less than three years old are ineligible. The state hopes that the two-month program will bring in \$250 million.

For business owners or individuals who need assistance in applying for either program or are worried about the stepped-up enforcement, Rahmlow, the Mengel Metzger Barr accountant, recommends working with someone who understands tax codes. With the new emphasis on collection, it’s not worth the risk to stumble unwittingly into tax evasion.

“It’s not a place where you should be trying to go around and circumvent the law,” said Rahmlow. “It’s a complicated enough area that I think getting a little help goes a long way.”