

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition :
of :
REFERENCE LIBRARY GUILD, INC. : DECISION

for Revision of a Determination or for Refund of :
Sales and Use Taxes under Articles 28 and 29 of :
the Tax Law for the Period September 1, 1981 :
through November 30, 1983. :

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on December 23, 1987 with respect to a petition by Reference Library Guild, Inc., petitioner, 2267 East 12th Street, Brooklyn, New York 11229. The petition was filed for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 1981 through November 30, 1983 (File No. 801766). Petitioner appeared by Lester H. Winick, president. The Division of Taxation appeared by William F. Collins, Esq. (Gary Palmer, Esq. of counsel).

Neither of the parties requested oral argument on this exception. The Division of Taxation filed a brief.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUE

Whether the Division of Taxation properly disallowed sales claimed to have been made outside of New York State and thus not subject to sales tax.

FINDINGS OF FACT

We find the facts as stated in the Administrative Law Judge's determination and such facts are incorporated herein by this reference. These facts may be summarized as follows.

Petitioner, Reference Library Guild, Inc. sold multi-volume reference books. All of petitioner's sales were generated from public transit advertising on buses and subway cars in large United States cities. Petitioner purchased display space on the basis of a certain number of buses and/or subway cars in a particular city for one month at a time. Petitioner's advertising expense, as reported on its Federal income tax returns, was \$49,812.29 for the fiscal year ending September 30, 1981 and \$86,134.30 for the fiscal year ending September 30, 1982. A potential customer would detach a postcard from one of petitioner's displays and mail it to petitioner's post office box in Brooklyn, New York. Petitioner would then forward the inquiry to one of its independent contractor salesmen located in the area where the prospect resided. If the sale was consummated, the customer usually signed an installment sale contract agreeing to pay for the books over a period of time.

Petitioner was selected for audit because of a Federal computer tape match program conducted by the Department of Taxation and Finance which found that gross sales reported by petitioner on its sales tax returns were substantially less than gross sales shown on its Federal income tax returns.

The audit was commenced by the Brooklyn District Office in July 1984.

Gross receipts reported by petitioner on its Federal income tax returns for the fiscal year ending September 30, 1982 were \$629,780.79. Gross sales reported on petitioner's sales tax returns for the comparable periods were \$41,332.00. The discrepancy translated into an error

percentage of 1,423.71 percent. The petitioner claimed that the gross sales not shown on the return were nontaxable out-of-state sales.

Gross sales reported by petitioner on its sales tax returns were the same as taxable sales reported by petitioner on said returns.

The auditor was advised by petitioner's president, Lester H. Winick, that the operation of business ceased in September 1983, due to his illness. While Mr. Winick was unable to work, the business could not meet its obligations and the corporation was forced into an assignment for the benefit of creditors. Petitioner's creditors removed almost all of petitioner's books and records. Much material was discarded by employees or agents of the creditors. The auditor determined that petitioner had inadequate books and records and the error percentage of 1,423.71 percent was applied to taxable sales reported by petitioner of \$94,230.00 to arrive at additional taxable sales of \$1,341,564.00 and audited taxable sales of \$1,435,794.00.

Tax due for the audit period was found to be \$118,453.01. After deducting tax paid of \$7,774.27, additional tax due was determined to be \$110,678.74.

On December 20, 1984 the Division of Taxation issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due to petitioner in the amount of \$110,678.74 in tax, \$26,038.25 in penalty, and \$30,630.35 in interest, for a total of \$167,347.34. The field audit report indicates that an officer assessment was also issued on that date, but it is not in the record of this proceeding.

At the hearing, petitioner produced a large quantity of postcard inquiries each with an office memorandum slip attached. These inquiries had been characterized by petitioner as "no good leads" (inquiries which did not result in sales) and dated from the latter part of 1983. A

cursory examination of the several thousand inquiries revealed that the cards were completed and mailed by residents of the following metropolitan areas:

Atlanta	Memphis	Norfolk
Baltimore	Milwaukee	Philadelphia
Boston	Nashville	Pittsburgh
Chicago	New Orleans	St. Louis
Dallas	New York	Washington

This material had been shown to the auditor by petitioner at a conference, in an attempt to prove out-of-state sales.

The Administrative Law Judge directed petitioner's president to contact petitioner's former advertising agencies and obtain breakdowns of its advertising expenditures for the various cities during the period at issue. The advertising agencies, Winston Network, Inc., New York Subways Advertising Co., Inc. and Aladdin Advertising Service, reported that they no longer had that information, but confirmed that they had placed transit advertising for petitioner in Boston, Philadelphia, Baltimore, Washington, Norfolk, Richmond, Chicago, Atlanta, Charlotte and Miami during the period at issue.

Petitioner was able to establish by documentary evidence that the following advertising invoices from Winston Network, Inc. were paid during the period at issue:

<u>Date</u>	<u>Number of Displays</u>	<u>Location</u>	<u>Cost</u>
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6/15/82	240	Philadelphia Bus & Subway	\$ 1,020.00
9/9/82	450	Philadelphia Bus & Subway	1,912.50
9/9/82	350	Baltimore	1,487.50
10/1/82	900	Washington Bus	2,478.60
11/9/82	450	Philadelphia Bus & Subway	1,912.50
11/9/82	350	Baltimore	1,487.50
1/1/83	900	Washington Bus (Included 1 mo. past due)	4,833.10
2/1/83	450	Philadelphia Bus & Subway	1,816.45
2/1/83	350	Baltimore	1,412.70

The above represents a portion, not all, of petitioner's out-of-state advertising expense during said period.

OPINION

The Administrative Law Judge determined that the method used by the Division of Taxation was not reasonably calculated to reflect petitioner's sales and use taxes due and cancelled the Notice of Determination and Demand for Payment of Sales and Use Taxes Due. The crux of the Administrative Law Judge's determination is found in conclusion of law "D", namely, that it was obvious that a very substantial portion of petitioner's business activity was conducted outside of New York State and it would follow that a similarly substantial portion of petitioner's sales were made outside of New York and thus were nontaxable. In view of the credible testimony of petitioner's president, the partial records produced by petitioner and the explained unavailability of other records, the Administrative Law Judge concluded that the methodology chosen by the Division was unreasonable. The inference is strongly made in the determination that the Division should have chosen an alternative method to estimate petitioner's tax liability. While we also are persuaded that the nature of the petitioner's business in this case did involve out-of-state sales, we nonetheless must disagree with the Administrative Law Judge's determination.

The law in this State is clear. Tax Law section 1132(c) presumes all of petitioner's sales are subject to tax until the contrary is established, and the burden of proving otherwise is upon the petitioner (Matter of Sunny Vending Co. v. State Tax Commn., 101 AD2d 666). To demonstrate that the sales at issue are not taxable, petitioner must be able to proffer documentation confirming the existence and accuracy of the allegedly exempt sale (In the Matter of On the Rox Liquors, Ltd. v. State Tax Commn., 124 AD2d 402).

Further, along this same line,

"[Persons] required to collect taxes are also mandated to keep records of every sale and the tax payable (Tax Law §1135). If necessary, the tax may be estimated on the basis of external indices (Tax Law §1138[a][1]). An estimate based on external factors is permissible when a rational determination is made that a failure to maintain proper records prevents exactness (Matter of Licata v. Chu, 64 NY2d 873, 487 NYS2d 552, 476 NE2d 997; Matter of Markowitz v. State Tax Commn., 54 AD2d 1023.9 388 NYS2d 176, affd 44 NY2d 684, 405 NYS2d 454, 376 NE2d 927) and makes it "virtually impossible" to verify taxable sales and to perform a complete audit (Matter of Chartair v. State Tax Commn., 65 AD2d 44, 46, 411 NYS2d 41).

[I]f persons required to collect taxes neglect to keep the requisite records, the method devised to ascertain taxes due is sufficient if it is reasonably calculated" to reflect the taxes due (Matter of Grant Co. v. Joseph, 2 NY2d 196, 206, 159 NYS2d 150, 140 NE2d 244)." (Ace Provision & Luncheonette Supply, Inc., et al. v. Chu, 523 NYS2d 208.)

The inability of the petitioner to submit direct documentary evidence to prove any out-of-state sales placed the Division in a position on audit of not being able to identify any individual exempt sales. As a result, the Division concluded that to accept gross sales on petitioner's Federal tax return as accurate and to treat all such sales as taxable for purposes of determining petitioner's liability was a reasonable audit methodology. While this audit may not be immune from criticism, we are unable to see what alternatives the Division had in determining petitioner's out-of-state sales. The fact that petitioner's business had ceased operation at the time the audit was commenced and the fact that there were no records of petitioner's sales for

any period under audit precluded the utilization of a "test period" or observation test of petitioner's business to estimate tax liability.

Under these circumstances, we are not prepared to say the method was not reasonable, (See, In the Matter of On the Rox Liquors, Ltd. v. State Tax Commn. , supra; Matter of Meskouris Brothers, Inc. , 139 AD2d , 526 NYS2d 679) or conclude that it was irrational on its face. (See, Matter of Snyder v. State Tax Commn., 114 AD2d 567; Matter of Grecian Square, Inc. v. State Tax Commn., 119 AD2d 948.)

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is granted;
2. The Determination of the Administrative Law Judge issued on

December 23, 1987 is reversed; and

3. The petition of Reference Library Guild, Inc. is denied and the Notice of Determination and Demand for Payment of Sales and Use Taxes Due dated December 20, 1984 is sustained.

DATED: Albany, New York
AUG 4, 1988

John P. Dugan
President

Francis R. Koenig
Commissioner
