

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petitions

of

**DISANCO HOME CENTER CORPORATION
AND CARMEN SANTORA, AS OFFICER**

for Revision of Determinations or for Refunds of Sales
and Use Taxes under Articles 28 and 29 of the Tax Law
for the Period September 1, 1982 through
November 30, 1985.

DECISION
DTA NO. 802961
AND 802962

Petitioners, Disanco Home Center Corporation and Carmen Santora, as officer, 890 Portland Avenue, Rochester, New York 14621, filed an exception to the determination of the Administrative Law Judge issued on July 14, 1988 with respect to their petitions for revision of determinations or for refunds of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 1982 through November 30, 1985 (File Nos. 802961 and 802962). Petitioners appeared by Paul H. Shanahan, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Michael B. Infantino, Esq., of counsel).

Petitioners filed a brief on exception. The Division submitted a letter reply in lieu of a brief. Neither party requested oral argument.

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

ISSUES

I. Whether, as the result of a field audit, the Division of Taxation correctly determined petitioners' sales and use tax liability.

II. Whether the penalties and interest in excess of the minimum which were imposed against the corporation and its president should be waived.

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. We find an additional fact as indicated below. The facts found by the Administrative Law Judge may be summarized as follows.

In 1982 petitioner Disanco Home Center Corporation ("Home Center") began operating a hardware store. The Home Center was located in an economically depressed area. Petitioner Carmen Santora was the president of the Home Center. During the period in issue, Mr. Santora also engaged in the building remodeling business. One advantage to Mr. Santora in opening the Home Center was that it enabled him to purchase items such as nails, locksets and hinges at wholesale prices, thereby reducing the cost of his remodeling business.

The Home Center began as a hardware store operating under a franchise. As a franchise, the Home Center was obligated to purchase certain items such as snowblowers and large lawnmowers which petitioner found did not sell well in a low income area. In order to attract more customers, the Home Center began selling beer and food products. In April 1985 the Home Center suffered a fire. When the Home Center reopened, city road construction rendered it difficult to gain access to the store by car.

In the course of the audit, the Division requested all of the Home Center's books and records pertaining to its sales tax liability including journals, ledgers, sales invoices, cash register tapes and exemption certificates. In response, the Home Center was unable to provide either cash register tapes or selling prices of the grocery store items. The Division found that the gross receipts reported on the Home Center's Federal income tax returns substantially exceeded the gross sales reported on the corporation's sales and use tax returns. The same discrepancy appeared between the gross sales reported on the Home Center's financial statements and the gross sales reported on the corporation's sales and use tax returns. The difference in gross sales was attributable to the Home Center's not including the remodeling sales in its gross sales on its sales and use tax returns.

On the basis of Division experience, the Division marked up hardware purchases by 100 percent and purchases of taxable grocery items by 30 percent to compute audited taxable sales for the period at issue. The foregoing analysis led the Division to conclude that the Home Center owed

sales tax in the amount of \$14,118.39 on unreported taxable sales. The Division also determined on the basis of the Home Center's records that the corporation owed tax in the amount of \$6,028.13 on the purchase of materials used in construction work. On the basis of the foregoing analysis, the Division, on December 19, 1985, issued two notices of determination and demand for payment of sales and use taxes due to the Home Center which in combination assessed a deficiency of sales and use taxes for the period September 1, 1982 through August 31, 1985 in the amount of \$20,146.54 plus penalty of \$4,335.86 and interest of \$4,633.98 for a total amount due of \$29,116.38. On the same date, notices were issued to Carmen Santora, as officer of the Home Center, assessing the same amount of tax, penalty and interest.

On or about January 31, 1986 petitioners filed a Tax Amnesty Application and paid \$5,355.85, representing the tax assessed on the purchase of materials used in construction work for the period September 1, 1982 through November 30, 1984. The penalty assessed for the corresponding period was cancelled pursuant to the amnesty application. On June 5, 1986 Carmen Santora, as president of the Home Center, signed a Statement of Proposed Audit Adjustment wherein the parties agreed to the tax due on the purchase of materials used in construction work for the periods ended February 28, 1985 through November 30, 1985. The amount of tax agreed to and paid was \$672.28 plus penalty and interest.

Following the issuance of the assessments on December 19, 1985, petitioners submitted information pertaining to a fire loss which had occurred in April 1985. This information showed that after the loss, petitioners' accountant wrote a letter to the Home Center's insurance company stating that the value of the ending inventory was estimated utilizing a 50 percent markup on cost. The 50 percent markup was, in turn, based on two financial studies of the retail industry. The Division weighted the hardware markup of 50 percent and the previous grocery markup of 30 percent in relation to total purchases to arrive at a weighted markup of 37 percent. The weighted markup was then multiplied by the purchases as reported on the financial statements to determine audited taxable sales. The amount of audited taxable sales was then reduced by taxes previously paid to determine that sales tax was due in the amount of \$6,850.51. On February 25, 1986 the

Division issued a revised Notice of Determination and Demand for Payment of Sales and Use Taxes Due to the Home Center assessing a deficiency of sales and use taxes for the period September 1, 1982 through November 30, 1984 in the amount of \$11,053.85 plus penalty of \$2,614.69 and interest of \$2,996.15 for a total amount due of \$16,664.69. On June 6, 1986 the Division issued a revised Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period December 1, 1984 through November 30, 1985 assessing a deficiency of sales and use tax in the amount of \$1,824.79 plus penalty of \$318.23 and interest of \$228.30 for a total amount due of \$2,371.32. On February 25, 1986 and June 6, 1986, the Division issued notices of determination to Mr. Santora as an officer of the Home Center which assessed the same amount of tax, penalty and interest which had been assessed against the Home Center. The amount of tax assessed was premised upon the revised amount of sales tax found due of \$6,850.51 and the tax found due on the purchase of materials in construction work of \$6,028.13. That is, the assessments of February 25, 1986 and June 6, 1986 did not take into account the amnesty application and payment or the payment remitted with the Statement of Proposed Audit Adjustment.

We find as an additional fact that Home Center's purchases, against which the weighted markup was applied, were determined for the entire audit period from Home Center's records (Home Center's financial statements).

After the issuance of the last assessment, petitioners attended a prehearing conference wherein invoices were submitted showing that 7.85 percent of the Home Center's purchases consisted of food which was exempt from sales and use tax. The Division also agreed to a two percent adjustment for theft. Consequently, the amount of tax currently asserted to be due is \$5,549.60 for the periods ending February 28, 1983 through May 31, 1985. As noted, in April 1985 the Home Center suffered a fire loss. As a result of this fire, the Home Center suffered an estimated inventory loss of \$40,000.00. When the Division performed its audit, no adjustment was made for the loss of inventory due to the fire. No evidence was presented as to the amount of the Home Center's beginning inventory.

It was the Home Center's practice to ring up sales on a cash register which contained keys for

taxable and nontaxable items. At the end of each day, Mr. Santora obtained a tape from the cash register which showed the total taxable and nontaxable sales. This information would be transcribed onto monthly ledger sheets and given to petitioners' accountant in order to prepare the sales and use tax returns. Some portion of the cash register printout sheets were destroyed in the fire of April 1985. The Division declined to utilize those printout sheets which were not destroyed by the fire when conducting its audit.

OPINION

In the determination below the Administrative Law Judge concluded that petitioners' records were not adequate for a direct audit to be performed. As a result, the use of an indirect audit method by the Division was upheld. Specifically, the markup method employed was deemed to be an acceptable estimate under the circumstances. Further, it was held that there was no evidence to establish that the failure of the Division to take into account the destruction of a portion of Home Center's inventory resulted in an incorrect determination of tax due. Lastly, the imposition of penalty and interest was upheld finding that petitioners did not establish reasonable cause to abate such penalty and interest.

On exception petitioners contend that the audit methodology was improper and unreasonable and that the statutory sales tax penalty should be waived. Specifically, it is argued that the destruction of a portion of inventory was never properly taken into account when determining sales. Further, petitioners claim that cash register tapes were disregarded by the auditor and that a test period audit should have been performed.

In response the Division contends the audit was properly performed. Specifically, the Division responds that sales were determined based on petitioners' purchases during the audit period, not on inventory, and it is petitioners' burden to prove a decrease in its inventory if it is to be taken into account. As a result, the Division contends that it was proper to use an estimation method that disregarded petitioners' inventory altogether. The Division also asserts that there is no evidence in the record that petitioners' records were disregarded on audit. Lastly, it is argued that statutory penalty and interest is proper in light of inadequate record keeping, underreporting and

underpayment of sales tax by petitioners.

We affirm the determination of the Administrative Law Judge in its entirety.

Tax Law section 1105(a) imposes tax on the retail sale of tangible personal property. Tax Law section 1132 requires petitioner to collect this tax and it also places the burden of proof on him to show that the receipt from any particular item is not taxable. Further, petitioner is required to maintain records of his sales for audit purposes pursuant to section 1135(a) and (c) of the Tax Law. When conducting an audit, Tax Law section 1138 requires the Division to determine tax due from the information that is available. If records are available from which the exact amount of tax can be determined then resort by the Division to estimation procedures is arbitrary and capricious and lacks a rational basis (Matter of Grant Co. v. Joseph, 2 NY2d 196, cert denied 355 U.S. 869; Matter of Korba v. State Tax Commn., 84 AD2d 655). However, when the records are not sufficient, resort to external indices is permissible (Matter of Murray's Wines & Ligs. v. State Tax Commn., 78 AD2d 947; Matter of Sakron v. State Tax Commn., 73 AD2d 989) and the Division is not required to compute the amount due with exactness (Matter of Meyer v. State Tax Commn., 61 AD2d 223, mot for lv to appeal denied 44 NY2d 645).

Petitioners' claim that the audit was unreasonable because the auditor failed to look at all of their records must be rejected. The record indicates that the only records offered by petitioners that were disregarded by the auditor were Home Center's cash register print out sheets for a portion of the audit period. As found above, these tapes indicated only a total of taxable and nontaxable sales.

Tax Law section 1135(a)(1) requires a taxpayer to maintain records of his sales in such form as the Commissioner of Taxation and Finance may by regulation require. The regulations, 20 NYCRR 533(b)(2), require that such records "must provide sufficient detail to independently determine the taxable status of each sale and the amount of tax due and collected thereon as may be substantiated by analysis of supporting records." Petitioners' sales records were not kept in a manner consistent with the law or regulations. The cash register tapes offered failed to indicate the specific sort of item that had been sold. The tapes merely indicated whether a sale was rung up on the register by the store employee as taxable or nontaxable. Such a record is clearly of no use in

determining whether petitioners correctly determined the taxable status of each sale and, thus, does not establish petitioners' sales tax liability for individual transactions. As a result, once a determination was made that the cash register tapes were of no use, the auditor did not have to utilize the remainder of the register tapes (see, Matter of Licata v. Chu, 64 NY2d 873).

Once it was determined that petitioners' sales records were not sufficient, it was permissible for external indices, specifically to be used in ascertaining petitioners' liability (Matter of Licata v. Chu, supra). Petitioners argue that a test period audit should have been performed in estimating their liability. When records are incomplete or insufficient, as petitioners are, it is the duty of the Division to select a method reasonably calculated to reflect tax due (Matter of Surface Line Operators Fraternal Organization v. Tully, 85 AD2d 858). The audit performed here was a markup of Home Center's purchases which were determined using Home Center's own records of their purchases throughout the audit period. We see absolutely no merit to petitioners' contention that an audit of a test period should have been performed instead of the audit based on Home Center's purchase records for the entire audit period.

After it has been determined that it is proper to use external indices in ascertaining a taxpayer's sales tax liability, the Division is not required to compute the amount due with exactness (Matter of Meyer v. State Tax Commn., supra). Petitioners contend that the amount calculated was done so in an unreasonable manner because it failed to take into account inventory which was destroyed by a fire. As stated above, this audit was based on purchases during the audit period. Thus, the audit did not use Home Center's inventory at the beginning of the audit period as a factor to determine sales during the audit period. To establish that the destruction of a portion of inventory during the audit period required a reduction in sales, petitioners would have had to prove that the amount of inventory destroyed exceeded the inventory at the beginning of the audit period. Since petitioners did not establish the beginning inventory, they have not satisfied their burden to prove a reduction in the assessment is required.

Lastly, petitioners claim that penalty and interest imposed pursuant to Tax Law section 1145 should be abated. We disagree. In order for such penalty and interest to be abated the burden is

upon the taxpayer to show that the failure to comply with the law was due to reasonable cause and not due to willful neglect. Petitioners have offered no evidence to prove the existence of reasonable cause and the lack of willful neglect. Thus, the imposition of the penalty and interest was proper.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of petitioners, Disanco Home Center Corporation and Carmen Santora, as Officer, is in all respects denied;
2. The determination of the Administrative Law Judge is affirmed; and
3. The petitions of Disanco Home Center Corporation and Carmen Santora, as Officer are denied and the notices of determination, as modified by conclusion of law "E" of the Administrative Law Judge's determination, are sustained.

Dated: Albany, New York
February 16, 1989

/s/John P. Dugan

John P. Dugan
President

/s/Francis R. Koenig

Francis R. Koenig
Commissioner