STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petitions	:	
of	:	
ACADEMY BEER DISTRIBUTORS, INC. AND JAMES LYONS, AS OFFICER	:	DECISION DTA Nos. 806189 & 806190
for Revision of Determinations or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period March 1, 1981 through May 31, 1984.	:	

Petitioners Academy Beer Distributors, Inc. and James Lyons, as Officer, 3817 East Tremont Avenue, Bronx, New York 10465 filed an exception to the determination of the Administrative Law Judge issued on February 13, 1992 with respect to their petitions for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1981 through May 31, 1984. Petitioners appeared by Robert Plautz, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Michael B. Infantino, Esq., of counsel).

Petitioners filed a brief in support of their exception. The Division of Taxation filed a letter in lieu of a brief in opposition to petitioners' exception. Petitioners' request for oral argument was denied.

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

ISSUES

I. Whether the sales tax field audit conducted by the Division of Taxation utilized an audit method reasonably calculated to reflect the taxes due.

II. Whether petitioners have established that the result of the audit method used was unreasonably inaccurate or that the amount of tax assessed was erroneous.

III. Whether the Division of Taxation established that petitioners were liable for a penalty for failure to file a return or pay tax when due.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for finding of fact "11" which has been modified. The Administrative LawJudge's findings of fact and the modified finding of fact are set forth below.

On December 20, 1985, the Division of Taxation (hereinafter the "Division") issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due to petitioner Academy Beer Distributors, Inc. ("Academy") for the period March 1, 1981 through May 31, 1984 which assessed a sales tax liability of $192,171.54, plus fraud penalty (Tax Law § 1145[a][2]) and interest. On the same date, the Division issued an additional Notice of Determination and Demand for Payment of Sales and Use Taxes Due spanning the same period and assessing the same amounts as above to petitioner James Lyons, as officer of Academy. The notice indicated that he was personally liable as an officer of Academy for taxes determined to be due from the corporation. The notices were based upon the results of a field audit of the business operations of Academy as described hereinafter.

In September 1983, the Division sent a letter to Academy advising that the corporation's sales tax returns for the period September 1, 1980 through August 31, 1983 were scheduled for field audit. The letter requested that all books and records pertaining to the sales tax liability for the period under audit be made available. The letter further stated that the books and records provided should include journals, ledgers, sales invoices, purchase invoices, cash register tapes, exemption certificates and all sales tax records. Subsequently, the period of audit was adjusted to commence on March 1, 1981 as Academy had been recently audited through February 28, 1981.

On May 16, 1984, petitioner Academy executed a consent having the effect of extending the period of limitations for assessment of sales and use taxes for the period March 1, 1981

through May 31, 1981 to September 20, 1984. On September 5, 1984, petitioner Academy executed a second consent which extended the period of limitations for assessment of sales and use taxes for the period March 1, 1981 through November 30, 1981 to March 20, 1985. On February 13, 1985, petitioner Academy executed a third consent which extended the period of limitations for assessment of sales and use taxes for the period March 1, 1981 through May 31, 1982 to September 20, 1985. On September 17, 1985, petitioner Academy executed a fourth consent which extended the period of limitations for assessment of sales and use taxes for the period March 1, 1981 through August 31, 1982 to December 20, 1985. The four consents were signed by petitioner James Lyons as president or secretary of the corporation.

On March 1, 1984, the auditor met with petitioner James Lyons to review the books and records of the business operation. Academy was a wholesale and retail beer and soda distributor. William Dowling, James McSwigen and James Lyons were officers of the corporation.

The auditor was provided with the corporation's Federal and State income tax returns for the years 1982 and 1983, worksheets for the income tax returns and a general ledger. The auditor was advised by Mr. Lyons that cash register tapes were not available because they were discarded at the end of each day. Sales invoices pertaining to taxable sales or tax collected were also not maintained by the corporation. The corporation maintained only those invoices which related to wholesale transactions.

Mr. Lyons maintained a day book for the corporation in which he entered the retail, wholesale and gross sales on a daily basis. The corporation's accountant totalled the gross sales as shown on the corporation's daily books for each quarter to arrive at reported gross sales on the sales and use tax returns. Taxable sales as shown on the summary of the corporation's daily book were multiplied by the tax rate to arrive at the amount of reported tax due. However, the auditor learned that taxable sales were estimated in almost every quarter and then adjustments were made in the following quarter. The sales and use tax returns for the entire audit period at issue were signed by James Lyons as president of Academy.

Given the limited availability of records as described above and the lack of source documentation detailing the sales activities of Academy, including its gross and taxable sales or the amounts and contents of individual transactions, the auditor concluded that Academy had inadequate books and records for purposes of conducting a detailed audit of Academy's retail sales.

The auditor initially reconciled the gross sales as reported on the sales and use tax returns with the sales per the daily sheets and the sales as shown on the Federal income tax returns. As the sales as shown on the daily sheets were slightly higher, this amount of gross sales was used for purposes of the audit.

Due to the inadequacy of Academy's records, the auditor decided to perform a test of nontaxable sales for the quarter ended May 31, 1983. After the nontaxable sales test was performed, the auditor discovered that certain customers of Academy which were included in the test were not in business at the time of the sale as indicated on the wholesale invoice. As a result of this discovery, the auditor decided to review the nontaxable sales for the entire audit period, which had been extended to May 31, 1984. Therefore, the auditor requested that Academy provide its wholesale nontaxable invoices for the period March 1, 1981 through May 31, 1984.

During the period at issue, Academy had reported nontaxable sales in the amount of $2,565,250.00. In response to the auditor's request, Academy produced for review $1,180,229.24 in wholesale nontaxable invoices for the audit period. As petitioner was unable to substantiate the remaining claimed nontaxable sales, the auditor determined that $1,385,021.00 were taxable sales subject to the imposition of sales tax.

The second portion of the audit consisted of a review of the wholesale invoices supplied by Academy. The auditor, with the assistance of an investigator from the New York City Tax Enforcement Bureau, conducted an investigation of the vendors listed on these invoices. Of the 176 vendors listed on the wholesale invoices, the auditor attempted to contact 46 of the vendors to verify the information contained on Academy's invoices. The 46 vendors were sent

Information Document Request letters by the investigator which requested that the vendors state the amount of beer and soda purchased from Academy during the audit period. Ten of the vendors contacted completed and returned the information request letter. Nineteen other vendors were contacted by either a follow-up telephone call or field visit to the business premises. Of the 29 vendors from whom information was obtained, 20 indicated that they had made no purchases from Academy, 5 indicated that they had purchased less than that claimed by Academy and 4 indicated that they had purchased the amount claimed by Academy. The results of this investigation were recorded by the investigator on a worksheet which listed the vendor, method of contact, the amount claimed by Academy, the amount reported by the vendor and the difference. The worksheet bears a date of February 5, 1985. No testimony was presented by either party to explain the significance or purpose of this date. The 29 vendors accounted for $456,992.64 of the $1,180,229.24 in wholesale invoices supplied by Academy for review. The difference between the amounts claimed by Academy and the amounts reported by the vendors was $369,611.23. By dividing the difference by the amount claimed by Academy relating to these 29 vendors, the auditor determined a disallowance rate of 81% which was applied to the total of the wholesale invoices provided, resulting in additional taxable sales of $955,983.00. The tax as shown on the notice of determination is based upon the total of claimed nontaxable sales where there was no invoice and the disallowed nontaxable sales based upon the disallowance rate revealed by the investigation of the 29 vendors. Fraud penalty was imposed due to the amount of underreporting determined upon audit, the consistent taxable ratio that appeared on the sales and use tax returns, the reporting method employed by Academy in filing its sales tax returns and Academy's failure to maintain adequate books and records. In the alternative, the Division requested in its answer the penalty for late payment of taxes due.

In support of the information found on the worksheet detailing the 29 vendors contacted by the investigator, the Division introduced into the record of this matter the returned and completed Information Document Requests and the notes of the investigator relating to his contacts with the vendors. There was no documentation or notes relating to seven of the

vendors contacted. The Information Document Requests provided are either unsigned or, if signed, unclear as to the relationship of the individual to the vendor's business operation. The notes provide the name of the person contacted, which is either the owner, an employee or a relative of the owner of the vendor. Two of the persons contacted refused to provide written confirmation of their purchases from Academy. The Division did not attempt to corroborate the information received by reviewing the records of the vendors. In addition, the Information Document Requests are either undated or bear a date which is subsequent to the date appearing on the worksheet which summarizes the information received from the 29 vendors. The investigator's notes list the dates of the contacts with the vendors. Some of the dates are subsequent to the date appearing on the worksheet. Neither the auditor who performed the audit nor the investigator who obtained the vendor information testified at the hearing held with regard to this matter. The Division did offer at the hearing the testimony of the auditor's team leader.

The circumstances surrounding one of the 29 vendors deserve specific mention. During the course of the audit, the auditor recorded Academy's vendors, their addresses and amounts of their purchases during the audit period. One entry appeared as follows: "Silver Beach Deli (Tavern) 4 Plaza Place, Bronx, New York (4 Poplar Ave.?)"

At the hearing, Mr. James Duffy, owner of the Silver Beach Deli ("Deli") from July 1982 through December 1985 testified that there existed a business operation under the name of the Silver Beach Tavern ("Tavern"). The Tavern was situated near the Deli and was located on Poplar Avenue. Mr. Duffy testified that he purchased beer and soda from Academy and received with each delivery a purchase invoice detailing the items purchased. After being asked by the investigator to supply the Deli's purchases from Academy, Mr. Duffy reviewed those invoices to determine those purchases.

Introduced into the hearing was the testimony of Dr. Ira Perrelle, a professor of business, economics and psychology, who has taught statistics at several colleges and universities in New York and Pennsylvania. Dr. Perrelle holds a doctorate in psychology and has taken graduate

level course work in statistical analysis. He has been retained to do statistical analysis work for various corporate entities. It was Dr. Perrelle's opinion that the "sample" of 29 vendors used by the Division could not be used to project the results of the investigation onto the "universe" of 176 vendors.

Dr. Perrelle testified that he conducted computer statistical tests on the list of 176 vendors to determine whether the "sample" of 29 was representative of either the unsampled accounts or the total of 176 accounts. The representative characteristic looked for in each group was the amount of purchase. Dr. Perrelle's conclusion was that the "sample" of 29 was in no way representative of the entire "universe" of 176 or of the group that was not sampled. According to Dr. Perrelle, there was less than a one in 10,000 probability that the "sample" of 29 was representative of the "universe" of 176. He stated that this probability is unacceptable and that an acceptable probability would be between one in 20 and one in 100. Dr. Perrelle also testified that a statistically proper projection could have been made if the auditor had used a random number table to select approximately 25 accounts as a source of the information sought.

During 1985 the corporation and Mr. Lyons were indicted on 13 counts of Offering a False Instrument for Filing in the 1st Degree, a Class E felony under Penal Law § 175.35. The counts correspond to the 13 quarters in the audit period. On October 23, 1987, Mr. Lyons pled guilty to the lesser included offense of Offering a False Instrument for Filing in the 2nd Degree, for the quarter ended May 31, 1984, in satisfaction of the indictment. This offense is a Class A Misdemeanor under section 175.30 of the Penal Law. Mr. Lyons entered an Alford plea pursuant to North Carolina v. Alford (400 US 25 [1970]). An Alford plea involves the defendant entering a plea of guilty to avoid the risk of conviction on a more serious charge, even though disputing the evidence of guilt. In the Alford case, the Supreme Court held that it was proper for the trial court to accept the plea of guilty even though the defendant claimed to be innocent, because the plea represented a voluntary and intelligent choice among the alternative courses of action open to the defendant. The Court considered the plea valid when viewed in light of the evidence against him, which substantially negated his claim of innocence

and which further provided a means by which the judge could test whether the plea was being intelligently entered. The Court ruled that there must be a strong factual basis for the plea as demonstrated by the State's case, that is, the record must contain strong evidence of actual guilt, and that the defendant chose the plea to avoid harsher penalties if convicted at trial.

The record of the plea allocution of Mr. Lyons contains the following statements of the presiding justice of the Supreme Court of the State of New York:

> "Now, an Alford plea is that type of plea of guilty where a person pleads guilty, but does not admit his guilt. The Courts accept Alford pleas under certain circumstances. The Court must first determine from the records available to the Court that the People have witnesses and proof that would probably result in a conviction after trial."

The presiding justice further stated, in reference to various business owners to whom Academy claimed to have made tax-exempt sales during the period under audit, that:

> "the People have put sworn testimony before a Grand Jury and made available to me, which indicates that these individuals did not purchase beer or, if they did purchase beer, purchased in lesser amounts than the corporation gave to the tax people and that there was an underpayment of taxes or an improper credit.... [B]ased on the sworn testimony of these witnesses the People would have been able to make out a prima facie case for a number of felony counts contained in the indictment and that's the basis for my accepting the Alford plea."

The corporation entered a guilty plea, through Mr. Lyons, to the lesser included offense of Offering a False Instrument for Filing in the 2nd Degree, a Class A Misdemeanor, in satisfaction of the 13-count indictment. Mr. Lyons admitted that the corporation filed or caused to be filed a quarterly sales tax return for the period ended May 31, 1984 containing false information with the Department of Taxation and Finance. Unlike Mr. Lyons' plea, the corporation did not enter an Alford plea.

The corporation and Mr. Lyons each received a conditional discharge, were required to make restitution in the amount of $20,000.00 and each received a certificate of relief from civil disabilities.

Following an audit for the period March 1, 1978 through February 28, 1981, the corporation received a statement from the Division of Taxation that no additional tax was due.

Mr. Lyons conceded that he was a person required to collect tax on behalf of Academy during the periods at issue pursuant to Tax Law §§ 1131(1) and 1133(a).

We modify finding of fact "11" of the Administrative Law Judge's determination to read as follows:

> During the years at issue it was the policy of the Division that a beer distributor/wholesaler was not required to obtain a resale certificate when making sales at the wholesaler/retailer level. The Division's policy was that the purchasers who had a valid alcohol beverage license would have sufficient proof of their exempt status.
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> This policy was represented in a letter dated July 28, 1965 from the Director of the State Sales Tax Bureau to Stoll Beer Distributors, Inc., which provided, in relevant part, as follows:
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> > "A waiver is being granted to brewers and beer wholesalers from the requirements of receiving resale certificates on all sales to licensees or permittees holding a license or permit issued under the provisions of the Alcoholic Beverage Control Law.
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> > "This waiver will not apply to sales made to the ultimate consumer. The brewers and beer wholesalers are responsible for the collection of the sales tax upon sales made to the ultimate consumer and for the remittance of such taxes to the State Tax Commission" (Exhibit "11," emphasis added).
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> This policy was reiterated in a letter dated May 3, 1988 to M.H.S. Beer Inc., which provided, in relevant part, that:
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> > "It is still New York State Taxation Departmental policy that a beer distributor/wholesaler is not required to obtain the Form ST-120 Resale Certificate when making sales at the wholesaler/retailer level. Purchasers who instead hold a valid alcohol beverage license will have sufficient proof of their exempt status" (Exhibit "10").
>
> Petitioners' representative acknowledged that the Division's policy did not eliminate the need for petitioners to maintain sales invoices for any of their sales. Petitioners' representative indicated that petitioners relied on the Division's policy and did not obtain resale certificates for any of the sales they asserted were nontaxable on this basis. Petitioners maintained sales invoices for only a portion of the sales they asserted were nontaxable. For these sales, the auditor was able to determine the name and address of each purchaser, the dollar amount of beer and soda purchased by each purchaser for the period, and information as to why the sale was considered not taxable by petitioners (see, Exhibit "1," a

transcript, prepared by the auditor, from the sales invoices presented to the Division by petitioners).[1]

OPINION

The Administrative Law Judge determined that the Division made a proper request for petitioners' books and records for the period at issue; that the Division made a proper examination of such records; and that it was undisputed that petitioners' sales records were inadequate. Under the circumstances, the Administrative Law Judge concluded that the use of an indirect audit method was appropriate (Conclusion of Law "C").

The Administrative Law Judge concluded that the Division properly relied on the presumption of taxability in Tax Law § 1132(c) to determine as taxable all those sales for which petitioners did not have sales invoices since the absence of the invoices prevented the Division, on audit, from determining the status of these sales as nontaxable as asserted by petitioners (Conclusion of Law "G"). In so concluding, the Administrative Law Judge rejected petitioners' assertion that when a taxpayer's books and records are inadequate, Tax Law § 1138(1) requires the Division to estimate the tax due using an audit methodology reasonably calculated to estimate the tax due and that reliance on the presumption of taxability in section 1132(c) is not such a methodology.

The Administrative Law Judge also rejected petitioners' assertion that the results of the methodology used by the Division to verify those sales for which invoices were furnished were unreliable on their face and that the assessment was erroneous. The Administrative Law Judge determined specifically that, with the exception of Silver Beach Deli and Silver Beach Tavern:

> "[n]o other evidence was presented at the hearing which would require a determination that the Division's assessment was erroneous. Petitioners had the power to subpoena the vendors' records to dispute the assessment (see, Matter of Kucherov v. Chu, 147 AD2d 877, 538 NYS2d 339; Matter of Cousins Service Station, Inc., supra). They did not do so. Petitioners failed to come forth with any other evidence to refute the figures the Division maintained were the amount of purchases

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[1] We modified this finding of fact by adding the second through sixth paragraphs to indicate the source of the Division's policy, the fact that petitioners relied on the policy and to indicate the type of information derived from petitioners' invoices as represented by the auditor's transcript.

> made by the 29 vendors during the period in issue. The allegations and testimony, without more, are insufficient to warrant any further adjustments to the method of audit
>
> employed (Matter of Vebol Edibles, Inc. v. Tax Appeals Tribunal, supra; Matter of Mera Delicatessen, Inc., Tax Appeals Tribunal, November 2, 1989).
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> * * *
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> "At best, petitioners have only demonstrated that the Division's tax calculation may be subject to question; they have not, however, met their more onerous obligation of proving by clear and convincing evidence that the result of the method used was unreasonably inaccurate or that the amount of the tax assessed is erroneous (cite omitted)" (Conclusion of Law "E").

The Administrative Law Judge concluded that "[w]hile this audit may not be immune from criticism, the Division had no alternative in determining what portion of these nontaxable sales were sales for resale" (Conclusion of Law "G").

The Administrative Law Judge sustained the imposition of the civil fraud penalty against both Academy and petitioner Lyons for the quarterly period ending May 31, 1984. The Administrative Law Judge determined that Academy was collaterally estopped from challenging the civil fraud penalty asserted by the Division for the same period covered by the criminal conviction, i.e., for the quarter ending May 31, 1984. The Administrative Law Judge determined, with respect to petitioner Lyons, that the Division met the burden imposed on it to show by clear and convincing evidence that he was liable for the fraud penalty imposed for the quarter ending May 31, 1984. The Administrative Law Judge determined that the Division failed to meet its burden of proof for the remaining quarters of the audit period.

The Administrative Law Judge sustained the imposition of penalty asserted against petitioners by the Division pursuant to Tax Law § 1145(a)(1) on the basis that:

> "the Division has established that the underpayment of tax was due to willful neglect and not due to reasonable cause. The corporation failed to maintain complete records, it discarded its cash register tapes, it was indicted for filing false sales tax returns for 13 quarters, it entered a plea of guilty relating to one of the quarters and it was unable to substantiate over one million dollars in claimed nontaxable sales. In light of all these circumstances, the Division has shown that the failure to pay was due to willful neglect and the alternative penalty asserted

> against the corporation pursuant to Tax Law § 1145(a)(1) is sustained" (Conclusion of Law "K").

On exception, petitioners reassert their position at hearing. First, with regard to the sales for which invoices were not provided, petitioners assert that section 1138(1) requires the Division to use a method reasonably calculated to reflect the taxes due and that it was improper for the Division to rely on the presumption of taxability in section 1132(c) since that is not a "method" as envisioned by section 1138(1). Petitioners take issue with the determination of the Administrative Law Judge that the Division had no alternative in determining what portion of the nontaxable sales were exempt, stating that a markup test or an observation test were viable alternative audit methodologies (Petitioners' brief on exception, p. 10).

Second, with regard to the sales for which invoices were provided, petitioners assert that the Division did not use a method reasonably calculated to estimate the tax due. Petitioners assert that: 1) the sample is unreliable because it is not statistically valid and 2) the sample is inaccurate because proof for 7 of the alleged 29 confirmations does not exist. Petitioners further challenge the results of the Division's verification of the invoices, asserting that:

> "[i]n each one of the 'confirmations', at least one critical defect exists that either renders the 'confirmation' incredible as a matter of law or at least sufficiently suspect not to be taken at face value. Many have more than one defect" (Petitioners' brief on exception, p. 28).

Petitioners, citing Matter of Mobley v. Tax Appeals Tribunal, 177 AD2d 797, 576 NYS2d 412, appeal dismissed 79 NY2d 978, 583 NYS2d 195, assert that the evidences introduced by the Division concerning the verification of the invoices is "'not of the quality that a reasonable mind would accept as adequate' for proof of the facts alleged . . . [and] do not pass the test of Mobley" (Petitioners' brief on exception, p. 31).

Petitioners did not take exception to the Administrative Law Judge's sustaining of the section 1145(a)(1) penalty or the imposition of the fraud penalty for the period ending May 31, 1984.

The Division asserts that, under the circumstances in this case, it properly relied on the presumption of taxability in section 1132(c) with regard to those sales where petitioners did not

provide sales invoices; that the verification procedures it utilized with regard to petitioners' sales for which invoices were provided were proper; and that the Administrative Law Judge was correct in sustaining the section 1145(a)(1) penalty. The Division asserts that:

> "[t]he petitioners' failure to present evidence is the essence of the [Administrative Law Judge's] Determination's correct distinguishing of this matter from Mobley v. Tax Appeals Tribunal, ___AD2d___, (November 21, 1991), mot. for app. dnd. ___NY2d___, (April 3, 1992)" (Division's brief on exception, p. 4).

We modify the determination of the Administrative Law Judge.

Tax Law § 1105(a) imposes a sales tax on the receipts from every "retail sale" of tangible personal property except as otherwise provided in Article 28 of the Tax Law. A "retail sale" is "a sale of tangible personal property to any person for any purpose, other than . . . for resale as such . . ." (Tax Law § 1101[b][4][i], emphasis added). Tax Law § 1138(a)(1) provides, in relevant part, that if a sales tax return was not filed, "or if a return when filed was incorrect or insufficient, the amount of tax due shall be determined [by the Division of Taxation] from such information as may be available. If necessary, the tax may be estimated" on the basis of external factors (Tax Law § 1138[a][1], emphasis added). When acting pursuant to section 1138(a)(1), the Division is required to select a method reasonably calculated to reflect the tax due. The burden then rests upon the taxpayer to demonstrate that the method of audit or the amount of the assessment was erroneous (Matter of Surface Line Operators Fraternal Org. v. Tully, 85 AD2d 858, 446 NYS2d 451).

In order to foster the proper administration of the sales tax and to prevent tax evasion, former Tax Law § 1132(c) presumed that all receipts from the sale of property or services of any type (mentioned in subdivisions [a], [b], [c] and [d] of Tax Law § 1105) are subject to tax until the contrary is established, and the burden of proving that any receipt is not taxable is on the person required to collect the tax or the customer. For the period at issue, former section 1132(c) provided two exceptions to this presumption of taxability: 1) where a vendor takes a resale certificate from the purchaser to the effect that the property was purchased for resale; and 2) where a vendor takes a certificate from a purchaser to the effect that the purchaser is an entity

exempt from sales tax. Where such certificates were in proper form, the vendor was protected and the burden was on the purchaser to prove that the receipt was not taxable. However, unless such a certificate was taken by the vendor, "the sale [was] deemed a taxable sale at retail" (former Tax Law § 1132[c]).

For the period in issue, the Division's regulations mirrored the language of former section 1132(c) and provided that, in order to prove that a sale was exempt from tax because it was made for resale or the purchaser was an exempt organization, the vendor, "at the time of sale," was required to obtain a properly completed exemption certificate from the purchaser and retain the certificate in his files (former Tax Law § 1132[c], emphasis added). Such certificate satisfied the vendor's burden of proof (see, former 20 NYCRR 532.4[b][2]). The regulations provided for the use of individual resale certificates and for "blanket resale certificates" by a purchaser to cover additional purchases of the same general type of property or service from a vendor (former 20 NYCRR 532.4[d][4]). The regulations required a vendor accepting a resale certificate, for verification purposes, to maintain a method of associating a sale made for resale with the resale certificate on file (see, former 20 NYCRR 532.4[d][4]). A vendor was not relieved of the burden of proof when no exemption certificate or an improper certificate was furnished, or when the vendor had actual knowledge that a certificate furnished was false or fraudulent (see, 20 NYCRR 532.4[b][4]).[2]

Finally, during the period at issue, the Division's policy was that a beer distributor/wholesaler did not have to obtain a resale certificate for sales for resale (Exhibits "10" and "11").

Initially, we deal with the Division's treatment of petitioners' asserted $2,565,250.00 in nontaxable sales. We deal first with the $1,385,021.00 in sales for which petitioners did not

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[2]A certificate was considered to be properly completed when it contained the (i) date prepared, (ii) name and address of the purchaser, (iii) name and address of the vendor, (iv) identification number of the purchase as shown on the certificate of authority or exempt organization number as shown on the exempt organization certificate, (v) signature of the purchaser or the purchaser's authorized representative, and (vi) any other information required to be completed on the particular form (see, former 20 NYCRR 532.4[c][2]).

provide sales invoices and which the Division determined to be taxable based on the presumption of taxability in former section 1132(c).

We affirm the determination of the Administrative Law Judge and reject petitioners' assertion that with respect to these sales the Division was not entitled to rely on the presumption of former section 1132(c) because the "presumption" is not an audit method reasonably calculated to estimate the tax due under section 1138(c)(1).

In past cases, this Tribunal has rejected the Division's assertion that it can rely on section 1132(c) as an automatic justification for an audit methodology. We have held, instead, that the method used by the Division in any given case must be evaluated under all of the circumstances existing at the time of the audit (see, Matter of Bernstein-On-Essex St., Tax Appeals Tribunal, December 3, 1992; Matter of Auriemma, Tax Appeals Tribunal, September 17, 1992; Matter of House of Audio of Lynbrook, Tax Appeals Tribunal, January 2, 1992; Matter of Reference Lib. Guild, Tax Appeals Tribunal, August 4, 1988). As we stated in Bernstein:

> "[w]e believe that these . . . cases apply the proper rule because they ensure that the Division's duty to select a method of audit reasonably calculated to reflect the taxes due (Matter of Surface Line Operators Fraternal Org. v. Tully, 85 AD2d 858, 446 NYS2d 451) is a meaningful duty" (Matter of Bernstein-On-Essex St., supra).

The salient fact here is that petitioners maintained no invoices for the $1,385,021.00 of sales they asserted were not taxable. The Division accepted the dollar amount of the sales. However, absent the invoices, the Division could not know who was the purchaser and, thus, on audit had no way at all in which to determine the status of these sales as exempt as sales for resale, sales to exempt organizations or as exempt for any other reason, as asserted by petitioners. Under these circumstances, the Division was entitled to rely on the presumption of taxability in section 1132(c) for these sales (Matter of Savemart, Inc. v. State Tax Commn., 105 AD2d 1001, 482 NYS2d 150, appeal dismissed 64 NY2d 1039, 489 NYS2d 1029; Matter of Reference Lib. Guild, supra).[3]

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[3]The Division's policy of not requiring beer distributors and wholesalers to obtain resale certificates has no impact with regard to these sales since it did not absolve petitioners from the duty to maintain invoices of the sales. In addition, we fail to see how petitioners' suggestion that a markup of petitioners' purchases should have been

We deal next with the remainder of the $2,565,250.00 in sales, i.e., the $1,180,229.24 in sales, which petitioners assert are not taxable and for which petitioners provided sales invoices.

We reverse the determination of the Administrative Law Judge.

The Division has broad powers to prescribe methods for determining the amount of receipts and for determining which of them are taxable and which are nontaxable (Tax Law § 1142[4]; see, former 20 NYCRR 532.4[d][4]; Matter of Morano's Jewelers of Fifth Ave., Tax Appeals Tribunal, January 2, 1992).[4]

Here, the Division was within its authority in seeking to verify the information derived from petitioners' invoices, i.e., the tax exempt status of the sales as sales for resale, sales to exempt organizations, or as exempt for any other reason, by contacting petitioners' purchasers as to the dollar amount of beer and soda purchases made by them during the audit period.[5]

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performed would have any bearing on the tax exempt status of petitioners' sales. We also reject petitioners' assertion that the Division should have conducted an observation test to determine the percentage of these non-invoiced sales which were not taxable. The fact is that petitioners did not maintain sales invoices for taxable sales, accordingly, the absence of invoices for the sales at issue would indicate to the Division that the sales were taxable. Stated differently, there was nothing to indicate to the Division that these sales were not taxable (cf., Matter of Bernstein-On-Essex St., supra).

[4]In Morano's, this Tribunal held that:

> "[v]erification of books and records is an integral, accepted part of the audit process (see, Matter of Giordano v. State Tax Commn., 145 AD2d 726, 535 NYS2d 255 . . . [the former State Tax Commission was not required to accept the total accuracy of the records produced by petitioner since they were self-serving and not subject to independent verification]). In Matter of On the Rox Liqs. v. State Tax Commn. (124 AD2d 402, 507 NYS2d 503, 505), the court rejected the claim that the retention of an exempt organization certificate file which did not reflect specific sales to specific exempt organizations was adequate proof. The court stated, 'to state the proposition is to refute it. Carried to its logical conclusion, this course of reasoning justifies the patently unacceptable consequence of exempt sales, without providing any documentation whatsoever to verify those sales'" (Matter of Morano's Jewelers of Fifth Ave., supra, emphasis in original).

[5]We note that, for sales to exempt organizations or sales for resale where exemption certificates are provided, the verification by the Division is limited to determining if an improper exemption certificate was furnished to petitioners or that petitioners had actual knowledge that a certificate furnished was false or fraudulent (see, former 20 NYCRR 532.3[b][4]). In our view, verification of the dollar amount of the sales asserted by petitioners on their invoices is to the same effect as verifying whether petitioners accepted exemption certificates with knowledge that such certificates were fraudulent or false. The goal in both cases is to determine the validity of petitioners' assertion that the sales were exempt.

The crux of the matter is whether petitioners proved, by clear and convincing evidence, that the assessment produced by this verification process was without a rational basis (Matter of Mobley v. Tax Appeals Tribunal, supra). In Matter of Atlantic & Hudson Ltd. Partnership (Tax Appeals Tribunal, January 30, 1992), we reviewed the manner in which such proof can be determined and stated the following:

> "[t]he presumption of correctness raised by the issuance of the assessment, in itself, provides the rational basis, so long as no evidence is introduced challenging the assessment (see, Matter of Tavolacci v. State Tax Commn., 77 AD2d 759, 431 NYS2d 174; Matter of Leogrande, Tax Appeals Tribunal, July 18, 1991). Evidence that both rebuts the presumption of correctness and indicates the irrationality of the audit may appear: on the face of the audit as described by the Division through testimony or documentation (see, Matter of Snyder v. State Tax Commn., 114 AD2d 567, 494 NYS2d 183; Matter of Fortunato, Tax Appeals Tribunal, February 22, 1990); from factors underlying the audit which are developed by the petitioner at hearing (see, Matter of Ristorante Puglia, Ltd. v. Chu, 102 AD2d 348, 478 NYS2d 91; Matter of Fokos Lounge, Tax Appeals Tribunal, March 7, 1991 [where the petitioner proved that its utility meter readings bore no relationship to its level
>
> of business activity]); or in the inability of the Division to identify the bases of the audit methodology in response to questions posed at the hearing (see, Matter of Basileo, Tax Appeals Tribunal, May 9, 1991; Matter of Fokos Lounge, supra; Matter of Shop Rite Wines & Liqs., Tax Appeals Tribunal, February 22, 1991; Matter of Fashana, Tax Appeals Tribunal, September 21, 1989)" (Matter of Atlantic & Hudson Ltd. Partnership, supra).

Petitioners here showed that the proof offered by the Division concerning the dollar amount of petitioners' sales to their purchasers is unreliable and not sufficient to form the basis for the assessment of tax against petitioners.

Specifically, petitioners demonstrated that the 10 Information Document Requests provided are either unsigned or, if signed, unclear as to the relationship of the individual to the vendor's business operation (Exhibit "K"). In addition, the Information Document Requests are either undated or bear a date which is subsequent to the date on which the information was entered on the investigator's worksheet. Further, petitioners showed there was no documentation or "notes" to substantiate the information attributed by the Division to 7 of the 29 vendors contacted. Moreover, with respect to the follow-ups by telephone or field visits, the

dates of the contacts with the vendors on the investigator's notes are in some instances subsequent to the contact dates appearing on the worksheet. Finally, neither the auditor who performed the audit nor the investigator who obtained the vendor information testified at the hearing with regard to the matter. The audit team leader who did testify was uncertain as to the number of vendors contacted in the investigator's follow-up (Tr., p. 29); acknowledged that several of the Information Document Requests were not signed (Tr., p. 30); did not know the date of completion of follow-up by the investigator (Tr., p. 37); and could not explain why the worksheet indicated information from vendors as of February 5, 1985 when the other evidence such as the Information Document Requests was dated subsequent to the date (Tr., pp. 107-110). These facts lead us to conclude that this "information" is unreliable and insufficient to overcome the information derived from petitioners' invoices and that petitioners have proven, by clear and convincing evidence, that the assessment has no rational basis. We are guided in our analysis and our conclusion by the principle stated by the Court in Mobley that "a [Tribunal] determination is not supported by substantial evidence . . . where the relevant proof offered is not of the quality that a reasonable mind would accept as adequate to support a conclusion or ultimate fact on the record considered as a whole. In short, the proof should be of a substantial nature and have the ability to inspire confidence" (Matter of Mobley v. Tax Appeals Tribunal, supra).[6]

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Academy Beer Distributors, Inc. and James Lyons, as Officer is granted to the extent that the Notice of Determination dated December 20, 1985 is canceled with respect to those sales for which petitioners provided invoices, but is otherwise denied;

2. The determination of the Administrative Law Judge is modified to the extent indicated in paragraph "1" above, but is otherwise sustained;

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[6]In Mobley, the Court reversed a Tribunal determination that the third party information offered by the Division was sufficient to provide a rational basis for the assessment at issue.

3. The petition of Academy Beer Distributors, Inc. and James Lyons, as Officer is granted as indicated in paragraph "1" above, but is otherwise denied; and

4. The Division of Taxation is directed to modify the Notice of Determination as indicated in paragraph "1" above, but such Notice is otherwise sustained.

DATED: Troy, New York
January 21, 1993

/s/John P. Dugan
John P. Dugan
President

/s/Francis R. Koenig
Francis R. Koenig
Commissioner

/s/Maria T. Jones
Maria T. Jones
Commissioner