

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition :
of :
A & J AUTO REPAIR CORPORATION¹ : DECISION
for Revision of Determinations or for Refund : DTA No. 807021
of Sales and Use Taxes under Articles 28 and 29 :
of the Tax Law for the Period March 1, 1984 :
through February 28, 1987. :
:

Petitioner A & J Auto Repair Corporation, c/o Arismendi Blanco, Officer, 3810 Northwest 81st Terrace, Coral Springs, Florida 33065-2927, filed an exception to the determination of the Administrative Law Judge issued on September 19, 1991 with respect to its petition 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, 1984 through February 28, 1987. Petitioner appeared by Michael Yastrab, C.P.A. Mr. Yastrab withdrew as petitioner's representative on May 26, 1992. As an exception was filed on petitioner's behalf before this date, the action proceeds based on this exception, with petitioner deemed to be represented by its president. The Division of Taxation appeared by William F. Collins, Esq. (John O. Michaelson, Esq., of counsel).

Only the Division of Taxation filed a brief on exception. Oral argument was not requested by either party. The Division of Taxation's brief was received on November 20, 1992 which began the Tax Appeals Tribunal's six-month period for the issuance of this decision.

1

Arismendi Blanco, as officer, made a motion to reopen the default judgment rendered against him individually by the Administrative Law Judge in the determination below. This motion was denied. Mr. Blanco did not file an exception to the denial of the motion to reopen. Thus, he is not a party in the present action.

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

ISSUES

I. Whether the Division of Taxation made an adequate request for petitioners' books and records.

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

III. Whether there existed a rational basis for the estimation method employed by the Division of Taxation.

IV. Whether petitioners presented sufficient evidence to establish certain sales as sales for resale.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for findings of fact "1" and "8" which have been modified and finding of fact "11" which has been deleted.² The Administrative Law Judge's findings of fact and the modified findings of fact are set forth below.

We modify finding of fact "1" of the Administrative Law Judge's determination to read as follows:

On October 9, 1987, the Division of Taxation (hereinafter the "Division") issued two notices of determination and demands for payment of sales and use taxes due to petitioner A & J Auto Repair Corporation ("A & J") for the period March 1, 1984 through February 28, 1987 which assessed a sales tax liability of \$268,661.96, plus penalties (Tax Law § 1145[a][1][i], [vi]) and interest. The notices were based upon the results of a field audit of the business operations of A & J as described hereinafter.³

²Finding of fact "11" was deleted because it related to the default judgment rendered against Arismendi Blanco.

On February 19, 1987, the Division sent a letter to A & J advising that the corporation's sales tax returns for the period March 1, 1984 through February 28, 1987 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. Accompanying the letter was a document entitled "Required Records for Sales Tax Audit" which requested the corporation's general ledger, cash receipts journal, cash disbursements journal, Federal income tax returns for the last three years, sales tax returns and cancelled checks for the quarters of the audit period, all fixed asset invoices for fixed assets acquired during the audit period, resale, exempt and capital improvement certificates supporting nontaxable sales, the last New York State income tax withholding check, the last Employer's Quarterly Report of Wages Paid to Each Employee (Form WRS-2) and the last New York State General Business Corporation Franchise Tax Return (Form CT-3).

On April 2, 1987, the auditor met with petitioners' accountant to review the books and records of the business operation. A & J was in the business of automobile repairs, specifically automobile body repairs. Its president was Arismendi Blanco. The corporation had ceased doing business on March 2, 1987.

The auditor was provided with the corporation's Federal income tax returns for the fiscal years ended February 28, 1985 and February 28, 1986, a resale certificate and the corporation's

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We modified this finding to delete the second and third sentences as they pertained to the assessment issued to Arismendi Blanco, which is no longer at issue (see, footnote "1").

bank statements. No other records were provided at this meeting. The Federal income tax returns showed the corporation's gross income for the fiscal years ended February 28, 1985 and February 28, 1986 to be \$200,947.00 and \$235,880.00, respectively. The bank statements indicated that the corporation had two accounts: a payroll account with deposits totalling approximately \$265,000.00 during the audit period and a general business account with deposits totalling approximately \$655,000.00 during the audit period. The auditor testified that there were no transfers between the two accounts. The resale certificate, dated March 20, 1984, listed Winfield Auto Body ("Winfield") as the purchaser, bore the signature of the vice-president of Winfield and contained Winfield's certificate of authority identification number. The certificate stated that it was a blanket certificate for the purchase of tangible personal property for resale. During the course of the meeting, the auditor presented the accountant with a list of additional documentation needed for the sales tax audit. Included on the list were sales invoices to Winfield during the audit period, cancelled checks from Winfield to A & J during the audit period, a statement from Winfield that the checks represent all sales from A & J during the audit period and supplier invoices for supply expenses of \$45,209.00 for the fiscal year ended February 28, 1986. The auditor and the accountant scheduled a second appointment for May 12, 1987.

On May 4, 1987, A & J executed a consent which extended the period of limitations for assessment of sales and use taxes for the period March 1, 1984 through August 31, 1984 to December 20, 1987. The consent was signed by petitioner Arismendi Blanco, as president.

On June 12, 1987, following extensions requested by petitioners' accountant, the auditor reviewed, at the accountant's office, the expense invoices for the fiscal year ended February 28, 1986. During this meeting, the accountant advised the auditor that A & J did not maintain sales invoices because all of its work was done for Winfield. The accountant was also not able to provide Winfield's cancelled checks to A & J during the audit period. Additionally, the auditor requested, but was not provided with, A & J's Federal income tax return for the fiscal year ended February 28, 1987 and A & J's expense invoices for the fiscal years ended February 28,

1985 and February 28, 1987. The accountant was able to provide two letters from Winfield which stated that:

(a) A & J performed some sublet work for Winfield and that Winfield collected the sales tax from its customers and remitted it to New York State.

(b) Winfield paid A & J \$200,612.00 during the period March 1, 1984 through February 28, 1985 and \$202,562.00 during the period March 1, 1985 through February 28, 1986.

During the audit period, A & J filed New York State and local sales and use tax returns which indicated zero gross sales, zero taxable sales, zero purchases subject to use tax and zero tax due. The returns were signed by Arismendi Blanco, as president.

Given the limited availability of records as described above and the lack of source documentation detailing the sales activities of A & J, including its gross sales, its customers, or the amounts and contents of individual transactions, the auditor concluded that A & J had inadequate books and records for purposes of conducting a detailed audit and therefore determined to resort to indirect audit methodologies. More specifically, the auditor selected an audit method utilizing a rent factor obtained from the 1985 edition of the Almanac of Business and Industrial Financial Ratios.

We modify finding of fact "8" of the Administrative Law Judge's determination to read as follows:

The Division introduced two pages of the Almanac of Business and Industrial Financial Ratios ("Almanac"), published by Prentice Hall, into evidence.⁴ The Almanac contains financial data derived from Federal

4

At hearing, the Division sought to enter into evidence several introductory pages of the 1988 Almanac as a means of describing the source from which the information in the 1985 Almanac was compiled. This was done to establish that the introductory pages of these years (1985 and 1988) were the same. Although the Administrative Law Judge allowed the 1988 pages into evidence, he ruled that these pages could not be used to explain the table from the 1985 edition.

The Administrative Law Judge granted the Division 30 days, until February 15, 1991, to submit the introductory pages of the 1985 edition. These pages were eventually submitted by the Division on March 15, 1991. The Administrative Law Judge included these pages in the record (see, Exhibit "K-1"). However, no mention was made that the pages were submitted after the imposed deadline.

income tax return information obtained from the U.S. Treasury. These pages were used by the auditor in estimating the sales at issue. The first page was the cover page of the Almanac, listing the title of the publication, with "1985 Edition" printed below. The second page was a table of information and listed selected operating factors as a percent of net sales, including rent paid on business property. The factors were calculated based upon an analysis of information contained in 30,247 tax returns filed with the Internal Revenue Service for the accounting period July 1980 through June 1981. The business category selected by the auditor was "automobile repair, miscellaneous repair services," and the asset category used was "under \$100,000.00." The auditor ascertained petitioner's assets for 1984 and 1985 from the U.S. Corporation Income Tax Returns filed by petitioner for these years. These returns were included in the audit work papers. The table indicates that the average rent expense of enterprises falling within this category is 4.4% of net sales.⁵

In computing the additional taxable sales for the audit period, the auditor utilized the rent paid by the business for the fiscal years ended February 28, 1985 and February 28, 1986 as shown on A & J's Federal income tax returns, and for the fiscal year ended February 28, 1987 he used the total of rent paid as shown on cancelled checks. The amounts, as shown on the business's Federal income tax returns and cancelled checks, were as follows:

<u>Fiscal Year Ended</u>	<u>Amount</u>
February 28, 1985	\$42,000.00
February 28, 1986	48,000.00

5

The original finding of fact "8" of the Administrative Law Judge's determination read as follows"

"The Almanac of Business and Industrial Financial Ratios ("Almanac"), which was used by the auditor in estimating the sales at issue, was introduced into evidence. The Almanac contains financial information relating to 311 different industries, which are subdivided by asset size. For each industry, the Almanac provides the total number of returns filed in each subdivision, selected financial factors, selected financial ratios, and selected operating factors as a percent of net sales, including rent paid on business property. The ratio used in the audit was calculated based upon an analysis of information contained in 30,247 tax returns filed with the Internal Revenue Service for the accounting period July 1980 through June 1981. The business category selected by the auditor was 'automobile repair, services, garages,' and the asset category used was 'under \$100,000.00.'"

We deleted the second sentence and portions of the third and fourth sentences as this deleted text contained information obtained from the introductory pages of the 1985 Almanac which was improperly allowed into evidence by the Administrative Law Judge. We also added footnote "4" to explain the sequence of events with respect to the submission of the 1985 Almanac.

February 28, 1987

52,000.00

The Federal income tax return for the fiscal year ended February 28, 1987 was requested, but not provided, to the auditor. Total rent for each year was divided by the Almanac rent factor of 4.4% to arrive at audited sales for each fiscal year. The auditor totalled the yearly audited sales to arrive at additional taxable sales of \$3,227,272.00 and additional tax due of \$266,249.94 for the audit period.

In addition, the auditor reviewed the invoices relating to recurring expenses for the fiscal year ended February 28, 1986, the only year for which purchase invoices were provided by petitioners. Based upon his review, the auditor determined a margin of error between purchases on which tax was not paid and total purchases. This error rate was applied to the supply expense as shown on the Federal income tax returns for the fiscal years ended February 28, 1985 and February 28, 1986. To determine additional tax due on expense purchases for the fiscal year ended February 28, 1987, for which no Federal income tax return was provided, the auditor applied the margin of error to the supply expense amount for the fiscal year ended February 28, 1986 plus 12%, which was the percentage increase between the first two years of the audit period. As a result, additional tax due of \$2,412.00 on expense purchases was determined for the audit period.

The individual who prepared A & J's sales tax returns was a public accountant working for petitioner's representative as an independent contractor. The representative's knowledge of the business operation of A & J was based upon conversations with petitioner Arismendi Blanco and the public accountant.

The representative testified that Arismendi Blanco owned and operated a wholesale automobile repair business with one customer, Winfield Auto Body Corporation. A & J's business was located on the premises of Winfield and, according to the representative, the rent was paid to a company owned by the owners of Winfield. The representative further testified that the rent, which was paid weekly, was actually a fee which allowed the corporation to do

subcontract work for Winfield. Due to this subcontractual arrangement, it was the opinion of the representative that sales invoices were not required to be maintained by A & J.

According to the representative, petitioners made an error in completing the sales tax returns showing gross sales to be zero. The representative had not reviewed these returns at the time they were filed because it was his opinion that no sales or use tax was due. Finally, the representative testified that the money in the payroll account was transferred from the general business account and, therefore, the bank statements are consistent with the Federal income tax returns which show gross sales for the first two years of the audit period of approximately \$200,000.00.

OPINION

In the determination below, the Administrative Law Judge held that: 1) Arismendi Blanco was in default pursuant to 20 NYCRR 3000.10(b)(2); 2) because petitioner did not respond to numerous requests from the Division to make its books and records available for inspection, it was appropriate for the Division to resort to external indices to determine petitioner's tax liability; 3) the Division's use of an industry index to calculate sales tax due satisfied the requirement that the assessment have a rational basis; 4) the allegations and testimony of petitioner's representative alone were insufficient to establish that the results of the audit were unreasonable; 5) the documentation submitted by petitioner was insufficient to establish that petitioner's sales were sales for resale; and 6) petitioner failed to establish that its failure to pay the tax owed was due to reasonable cause and not willful neglect.

On exception, petitioner makes the following arguments: 1) the fact that no formal invoices were ever created to memorialize the transactions between petitioner and Winfield does not justify a finding that petitioner's records were inadequate in light of petitioner's close and exclusive business relationship with Winfield; 2) the Administrative Law Judge failed to explicitly rule on the propriety of the Division's reliance on an external index contained in the Almanac of Business and Industrial Financial Ratios which was used to calculate petitioner's tax liability, although the Almanac was not submitted into evidence.

In response, the Division argues that its audit method was reasonable and that the determination of the Administrative Law Judge should be upheld.

We affirm based upon the determination of the Administrative Law Judge. However, we find it necessary to clarify the evidence relied upon in finding that the assessment was supported by a rational basis (Matter of Grecian Sq. v. New York State Tax Commn., 119 AD2d 948, 501 NYS2d 219, 221).

At hearing, the Division entered into evidence several introductory pages of the 1988 Almanac as a means of describing the information contained in the 1985 Almanac. The Administrative Law Judge, in allowing these pages into evidence, ruled that these pages could not be used to explain the table from the 1985 edition (Tr., p. 49). He then left the record open until February 15, 1991 to allow the Division time to locate the introductory pages of the 1985 Almanac. These pages were eventually submitted by the Division on March 15, 1991.

It is the policy of the Tribunal to disallow the submission of evidence after the record has been closed. In expressing the reasoning behind this policy, we have stated that:

"[i]n order to maintain a fair and efficient hearing system, it is essential that the hearing process be both defined and final. If the parties are able to submit additional evidence after the record is closed, there is neither definition nor finality to the hearing" (Matter of Schoonover, Tax Appeals Tribunal, August 15, 1991).

The February 15 deadline set by the Administrative Law Judge represented the date that the record would be closed. Because the Division submitted this evidence after the imposed deadline, we conclude that these pages were improperly admitted into evidence by the Administrative Law Judge. Thus, these pages may not be considered in determining whether the assessment is supported by a rational basis.

Despite this conclusion, we find that the absence of the introductory pages from the 1985 Almanac does not undermine the Division's use of the rent factor in calculating the assessment. The testimony of the Division's auditor established that the financial data in the 1985 Almanac, which was published by Prentice Hall, is taken from Federal income tax return data obtained from the United States Treasury. The table containing this data, which was introduced into

evidence, is largely self-explanatory; it indicates that the financial data reflects the results of various enterprises for the period July 1980 through June 1981 and is classified according to: 1) the type of enterprise ("auto repair, miscellaneous repair services"); and 2) the value of its assets (in this case, enterprises with assets under \$100,000.00) (Exhibit "J").⁶ Although the "Number of Enterprises" listed on the table and corresponding number is not explained in the table, it was the Division auditor's uncontradicted testimony that these figures refer to the number of Federal returns considered in arriving at the financial data contained in the table. Based on these facts, we find that the Division's calculation of petitioner's sales tax liability from a rent factor contained in the 1985 Almanac provides a rational basis for the assessment (Matter of Grecian Sq. v. New York State Tax Commn., *supra*; *cf.*, Matter of Fashana, Tax Appeals Tribunal, September 21, 1989 [held that financial index used did not provide a rational basis for the assessment where the publisher and the date of the publication could not be determined from the record]).

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of petitioner A & J Auto Repair Corporation is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petition of A & J Auto Repair Corporation is denied; and

⁶The value of petitioner's assets was ascertained from its United States Corporation Income Tax Returns for the tax years 1984 and 1985.

4. The notices of determination dated October 9, 1987 are sustained.

DATED: Troy, New York
May 6, 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