STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
MNS CARDS & GIFTS, INC. D/B/A HALLMARK CARDS & GIFTS	:	DECISION DTA No. 807119
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 May 1, 1979 through October 31, 1986.	:	

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on January 17, 1991 with respect to the petition of MNS Cards & Gifts, Inc. d/b/a Hallmark Cards and Gifts, c/o Barry P. Fox, Leeds, Epstein & Fox, 25 West 43rd Street, New York, New York 10036 for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the the Tax Law for the period May 1, 1979 through October 31, 1986. The Division of Taxation appeared by William F. Collins, Esq. (Carroll R. Jenkins, Esq. of counsel). Petitioner appeared by Barry P. Fox, Esq.

Both parties filed briefs on exception. Oral argument, at the Division of Taxation's request, was heard on November 14, 1991.

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

ISSUES

I. Whether the audit method used by the Division of Taxation was reasonably calculated to estimate petitioner's tax liability.

II. Whether an extension of an audit period to an earlier period without asking for the books and records of that period is valid.

III. Whether penalties asserted under Tax Law § 1145 against a bulk sale purchaser are valid.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for findings of fact "1(b)," "3(b)," "3(c)," "3(d)," "5," "6(a)," "6(b)," "7(a)," "8(a)," "8(b)," "8(c)," "8(d)," "10," and "11(a)" which have been modified. We have also made an additional finding of fact. The Administrative Law Judge's findings of fact, the modified findings of factand the additional finding of fact are set forth below. We have also changed the order of some of the findings of fact in order to have the facts in chronological order.

On October 14, 1986 petitioner, MNS Cards & Gifts, Inc., purchased, through a broker, a card and gift shop located at 22 John Street, New York, New York from Fourteen Wellington Corporation ("Wellington"). The purchase price was $310,000.00 (with a downpayment of $70,230.76 and notes due thereafter at about two a month until January 15, 1992). The fixtures and equipment were valued at $5,000.00.

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

> Petitioner acknowledged that section 1141 of the Tax Law required it to file a notice of bulk sale with the Division of Taxation and that it did not file such a notice because (a) it was informed by the seller at the closing that no taxes were due to the State of New York, i.e., the State was not a creditor, and (b) based on the prior experience of petitioner's representative that "where a notice was sent to the State ten days or more before closing, the State has not in any singular instance ever responded within that 10-day period. So it is actually irrelevant whether or not the State is notified ten days before [the sale] or not" (Hearing Tr., pp. 11-16).
>
> The totality of petitioner's position at hearing is stated in its petition as follows:
>
> > "[a]t the time of the closing when the petitioner purchased the business, the principal of Fourteen Wellington Corp. and Sixth Ave., Cards Shop, Inc., stated in an affidavit that he had no creditors, and that he did not owe taxes to any taxing authority. Despite the foregoing, an escrow of promisory notes was created, in the event that the Seller was mistaken and actually did owe taxes. The principal of Fourteen Wellington Corp. and Sixth Ave., Cards

> Shop, Inc., is presently deceased. It is inconceivable that at a conciliation hearing his representative could agree that Fourteen Wellington Corp. and Sixth Ave., Cards Shop, Inc. was indebted to the New York State Department of Taxation and Finance in any amount, based upon the affidavit given to the petitioner at the closing" (Petitioner's Exhibit "B").[1]

A request by the Division of Taxation on audit to examine the records of Wellington from September 1983 to date was made by letter dated September 16, 1986.

Wellington produced certain purchase records, but nothing else.

When the auditor was in the store, the store used cash registers which produced tapes. These tapes were not used in the audit.

No request was made for books and records of Sixth Avenue Card Shop.

Fourteen Wellington Corporation, 22 John Street, New York, New York, was not registered as a vendor prior to February 1986 when a request from the Division of Taxation prompted it to register. Its only officer and stockholder was Francis M. Owens of 14 Wellington Place, Westwood, New Jersey. He is now deceased.

Fourteen Wellington Corporation had been formed in September 1983. Previously, the premises were being used, apparently also as a card and gift shop, by Sixth Avenue Card Shop, Inc., also owned by Francis M. Owens and had been so used, according to Division of Taxation withholding records, since May 1979.

Prior to the sale to petitioner, Fourteen Wellington Corporation had filed and paid sales taxes only for the periods ending February 28, 1986 and May 31, 1986. These were paid in June and July 1986 and totalled $6,699.47.

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[1]The Administrative Law Judge's original finding of fact "1(b)" read as follows:

> "(b) No notice of bulk sale was filed with the Division of Taxation."

We have modified this fact to more fully reflect the record.

We modify findings of fact "3(b)," "(c)," and "(d)" of the Administrative Law Judge's determination to read as follows:

> After the sale to petitioner and during the course of the audit, the auditor requested that all unfiled sales tax returns be submitted directly to the attention of the auditor at the district office. Wellington submitted returns pursuant to this request for the periods ending November 30, 1983 through August 31, 1986. These returns were all dated December 31, 1986 and received by the auditor on January 6, 1987. The auditor compared each of these returns to their corresponding Sales Tax Master File Transcript - Return. The figures reported on the returns did not match the transcripts for the periods ending February 28, 1986, May 31, 1986 and August 31, 1986. For the period ending November 30, 1984 there was no transcript. The figures from the transcripts, which differ from the returns received on January 6, 1987 only in the four instances noted, show gross sales of $775,477.00.[2]

We modify finding of fact "5" of the Administrative Law Judge's determination to read as follows:

> The accountant for Wellington, Mr. Thomas Murray, provided the auditor with a transcript of purchases for the period September 1, 1983 to August 1986 in the amount of $735,428.50. Since the amount of the reported purchases ($735,488.50) was

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[2]The Administrative Law Judge's original finding of fact "3(b)," "(c)," and "(d)" read as follows:

> "(b) After the sale to petitioner, Fourteen Welling Corporation filed sales tax returns for the remaining quarters of the audit period. These were filed in November 1986, February 1987 and May 1987.
>
> "(c) The tax returns show gross sales of $957,860.00, taxable sales of $899,273.00 and tax paid of $74,190.04.
>
> "(d) The Sales Tax Master File of the Division of Taxation shows postings for each quarter of the audit period except for the quarter ended November 30, 1984. (The postings for the quarters ending February, May and August 1986 do not agree with the returns in the record.) These postings show (excluding the quarter ended November 30, 1984) gross sales of $775,977.00, taxable sales of $732,297.00 and tax paid of $62,780.71. For the quarter ending November 30, 1984, the gross and taxable sales shown on the returns were $73,581.00 and $69,282.00. When these are added into the amounts for the other quarters, the gross sales are $849,058.00 and the taxable sales are $801,579.00."

We modified this finding to more correctly reflect the record.

> approximately the amount of the gross sales as shown on the Sales Tax Master File Transcripts ($775,477.00), the auditor determined to use external indices to estimate Wellington's taxable sales and sales tax liability.[3]

We modify finding of fact "6(a)" and "(b)" of the Administrative Law Judge's determination to read as follows:

> According to a copy of a single page of a publication introduced at the hearing (Division's Exhibit "E-4"), and stated in the auditor's report and testimony to be published by Dun and Bradstreet, the cost of operation of "other retail stores" of less than $100,000.00 in assets is estimated to be 61.7% of receipts. The volume from which this single page was taken was not placed in evidence. A request to the attorney for the Division of Taxation to produce that volume has not been honored. Based upon the cost of operations of 61.7%, the sales would be 61.55% higher. This percentage was not used by the auditor in estimating taxable sales. Rather, the auditor used a mark-up percentage of 50%.[4]

We modify finding of fact "7(a)" of the Administrative Law Judge's determination to read as follows:

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[3]The Administrative Law Judge's original finding of fact "5" read as follows:

> "The accountant for Fourteen Wellington Corporation, Mr. Thomas Murray, estimated purchases for the period September 1, 1983 to August 1986 to be $735,428.50."

We modified this fact to more correctly reflect the record.

[4]The Administrative Law Judge's original finding of fact "6(a)" and "(b)" read as follows:

> "(a) According to a copy of a single page of a publication, stated in the auditor's report and in his testimony to be published by Dun and Bradstreet, the cost of operation of 'other retail stores' of less than $100,000.00 in assets is estimated to be 61.7% of receipts. Based upon the cost of operations of 61.7%, the sals would be 61.55% higher. This percentage was not used by the auditor in estimating taxable sales.
>
> "(b) The volume from which this single page was taken was not placed in evidence. A request to the attorney for the Division of Taxation to produce that volume has not been honored."

We modified this fact to more fully reflect the record.

> The auditor determined to use the sales figure of $775,477.00 shown on the Sales Tax Master File Transcript as a purchase figure, and applied the 50% markup. The result came to $1,163,215.50. To this he added $104,760.00 representing gross sales for the period ending November 30, 1984 (for which a return was not filed). This figure is the average of the preceding four quarters. The resulting gross sales, totalling $1,267,976.00, were subjected to tax at 8.25% resulting in tax of $104,608.03. From this, the auditor subtracted the taxes of $6,699.47 paid before the bulk sale to arrive at a tax due for petitioner of $97,908.56. To this was added $412.50 for the period ending October 31, 1986, representing the sales tax due on the $5,000.00 bulk sale of fixtures for a total of $98,321.06.[5]

The determinations for the periods May 1, 1979 through August 31, 1983 were arrived at by projection from certain figures for 1984 as already determined. The audited gross sales for the quarters ending February 29, 1984, May 31, 1984, August 31, 1984 and November 30, 1984 (this quarter being an average of the preceding four quarters) were assigned to the corresponding quarters of the earlier years. These figures were then discounted for inflation by use of an annual average index figure of the U.S. Bureau of Labor Statistics, Consumer Price Index for urban wage earners for New York and Northeastern New Jersey. The index numbers found were 295.1 for 1984, 285 for 1983, 274.1 for 1982, 259.9 for 1981, 236.8 for 1980, and 212.8 for 1979.

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[5]The Administrative Law Judge's original finding of fact "7(a)" read as follows:

> "(a) For the period September 1, 1983 through August 31, 1986 (when Fourteen Wellington Corporation operated the business), the auditor deemed that the sales figure of $775,477.00 shown on the late-filed returns was actually a purchase figure. This figure was then increased by a 50% markup (this was the same as increasing purchases by 58%). The result came to $1,163,215.50. To this he added $104,760.00 representing gross sales for the period ending November 30, 1984 (for which a return was not filed). This figure is the average of the preceding four quarters. The resulting gross sales, totalling $1,267,976.00, were subjected to tax at 8.25% of $104,608.03. From this the auditor subtracted the taxes of $6,699.47 paid before the bulk sale to arrive at a tax due for petitioner of $97,908.56. To this was added $412.50 for the period ending October 31, 1986 representing the sales tax due on the $5,000.00 bulk sale of fixtures for a total of $98,321.06."

We modified this fact by adding the first sentence to indicate clearly the source of the purchase figure to which the auditor applied the 50% markup.

These discounts were computed to be 96% for 1983, 92% for 1982, 86% for 1981, 75% for 1980 and 60% for 1979. (These computations are slightly wrong and were corrected in a redetermination made after a conciliation conference.) The adjusted gross sales thus arrived at totalled $1,758,323.00. The tax due thereon (at 8% to August 31, 1981 and 8.25% thereafter) came to $142,917.00, with $105,195.00 for the quarters prior to August 31, 1982 and $37,722.00 for the quarters thereafter.

An omnibus penalty was computed at 10% of the computed tax due from Fourteen Wellington Corporation for the periods involved and not on the higher amounts due from petitioner. Fourteen Wellington Corporation had received credit for the taxes paid after the bulk sales and before the dates of the notices, as well as the taxes paid for February and May 1986.

We modify finding of fact "8(a)," "(b)," "(c)," and "(d)" of the Administrative Law Judge's determination to read as follows:

> On July 27, 1987, four notices of determination and demands for payment of sales and use taxes due were issued to petitioner. These notices were for the following amounts:
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> (a) for the period May 1, 1979 through August 31, 1982 (S870727005Q) for tax due of $105,195.00, penalty under Tax Law § 1145(a) of $26,298.75 and interest of $114,012.78, for a total amount due of $245,506.53;
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> (b) for the period September 1, 1982 through August 31, 1983 (S870727006Q) for tax due of $37,722.00, plus penalty under Tax Law § 1145(a) of $9,430.50 and interest of $24,960.30, for a total amount due of $72,112.80;
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> (c) for the period September 1, 1983 through October 31, 1986 (S870727007Q) for tax due of $98,321.06, plus penalty under Tax Law § 1145(a) of $24,954.64 and interest of $32,789.31, for a total amount due of $156,060.01; and
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> (d) for the period September 1, 1985 through August 31, 1986 (S870727012Q) for a penalty under Tax

> Law § 1145(c) (the "omnibus" penalty) in the amount of $1,355.41.[6]

On July 27, 1987, notices were also sent to Fourteen Wellington Corporation a/k/a 6th Avenue Card Shop, Inc. a/k/a Hallmark Cards & Gifts. Also on July 27, 1987 notices were sent to Francis Owens, as officer of Fourteen Wellington Corporation.

We modify finding of fact "10" of the Administrative Law Judge's determination to read as follows:

> At a conference, the determinations of tax due issued to petitioner were reduced as follows: from $105,195.00 by $9,828.21 to $95,366.79; from $37,722.00 by $4,075.16 to $33,646.84; from $98,321.06 by $27,158.96 to $71,162.10; and from $1,355.41 by $574.56 to $780.85.[7]

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

> The conciliation conferee recomputed the tax for the period September 1, 1983 to August 31, 1986. He began with the taxable sales posted in the Division of Taxation's file of $732,297.00 and added the amount of $69,286.00 shown on the return for the quarter not posted, November 30, 1984 (see Finding paragraph 3[d]), for a total of $801,579.00 and multiplied this by an error rate of 35.38%. The error rate was computed by comparing such reported taxable sales with an audited taxable sales figure derived from a list of purchases for the period supplied by Wellington's accountant. These purchases totalled $735,428.50. The conferee reduced this by $50,000.00 to allow for an increase in inventory over the period. He then allowed a 2% pilferage rate to arrive at a figure of $671,719.93. To this he applied a markup of 61.55%. This markup was derived from figures for the cost of operations of corporations with and without income for "other retail stores" which, according to the audit report and the auditor's testimony, was compiled by Dun and Bradstreet. (After the hearing, the auditor, at the request of the Administrative Law Judge made during the hearing, mailed to the Administrative Law Judge further

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[6]We modified finding of fact "8(a)," "(b)," "(c)," and "(d)" of the Administrative Law Judge's determination by adding the numbers of the notices issued to petitioner to distinguish them from the notices issued to the seller.

[7]We modified finding of fact "10" of the Administrative Law Judge's determination by adding the phrase "issued to petitioner" to make it clear that the notices modified at conference were those issued to petitioner.

information concerning the source of the index which revealed that the data came from a different source: "The Almanac of Business and Industrial Financial Ratio," 1985 edition, by Leo Troy, Ph.D., published by Prentice-Hall, Inc. The record does not indicate why the entire volume from which the index came was not forwarded to the Administrative Law Judge.) Those figures showed that the cost of operations was 61.9% of total receipts (this is equivalent to the receipts being 161.55% of the cost of operations). This markup applied to the audited purchases resulted in audited sales of $1,085,163.55, which is 135.38% of the taxable sales of $801,579.00. This resulted in total tax due of $89,522.17. The tax paid with the late-filed returns was $62,780.71. Wellington, the vendor, was given credit for this entire amount, therefore, its additional tax was $26,746.46. MNS, the purchaser and the petitioner herein, was given credit only for the payments made prior to the purchase. These were for the quarters ending November 30, 1985 and February 28, 1986 and were in the amounts, respectively, of $5,406.14 and $3,913.47, for a total of $9,319.61. The resulting tax due from petitioner was therefore $80,207.56.[8]

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[8]The Administrative Law Judge's original finding of fact "11(a)" read as follows:

> "(a) The conciliation conferee recomputed the tax for the period September 1, 1983 to August 31, 1986. He began with the taxable sales posted in the Division of Taxation's file of $732,297.00 and added the amount of $69,286.00 shown on the return for the quarter not posted, November 30, 1984 (see Finding paragraph 3[d]), for a total of $801,579.00 and multiplied this by an error rate of 35.38%. The error rate was computed by comparing such reported taxable sales with an audited taxable sales figure derived from a list of purchases for the period supplied by Wellington's accountant. These purchases totalled $735,428.50. The conferee reduced this by $50,000.00 to allow for an increase in inventory over the period. He then allowed a 2% pilferage rate to arrive at a figure of $671,719.93. To this he applied a markup of 61.55%. This markup was derived from figures for the cost of operations of corporations with and without income for 'other retail stores' which, according to the audit report and the auditor's testimony, was compiled by Dun and Bradstreet. (After the hearing, the auditor, in an ex parte communication, revealed the data comes from a difference source: the 'Almanac of Business and Industrial Financial Ratio' by Leo Troy.) Those figures showed that the cost of operations was 61.9% of total receipts (this is equivalent to the receipts being 161.55% of the cost of operations). This markup applied to the audited purchases resulted in audited sales of $1,085,163.55, which is 135.38% of the taxable sales of $801,579.00. This resulted in total tax due of $89,522.17. The tax paid with the late-filed returns was $62,780.71. Wellington, the vendor was given credit for this entire amount so its additional tax was $26,746.46. MNS, the purchaser and the petitioner herein was given credit only for the payments made prior to the purchase. These were for the quarters ending November 30, 1985 and February 28, 1986 and was in the amounts, respectively, of $5,406.14 and $3,913.47, for a total of $9,319.61. The resulting tax due from petitioner was therefore $80,207.56."

The determination for the period May 1, 1979 through August 31, 1983 was arrived at by projection of the figures for 1984. The adjusted gross sales for the quarters ending February 28, 1984, May 31, 1984, August 31, 1984 and November 30, 1984 (this quarter being an average of the preceding four quarters) were assigned to the corresponding quarters of the earlier years. These figures were then discounted for inflation. The index numbers used were the same as used in the audit. The discounts were computed to be 96.58 for 1983, 92.88 for 1982, 88.07 for 1981, 86.74 for 1980 and 67 for 1979. These are slightly less favorable to petitioner than those calculated by the auditor. The adjusted taxable sales thus arrived at totalled $1,587,705.20. A tax on this was computed to be $129,013.63. This is $95,366.79 for the period May 1, 1979 through August 31, 1982 and $33,646.84 for the period September 1, 1982 through August 31, 1983.

The determination of the omnibus penalty was computed as 10% of the tax due, as before, from Fourteen Wellington Corporation for the relevant periods and not on the higher tax due from petitioner.

Petitioner's assertions that the Division of Taxation is always delinquent in meeting its obligations under Tax Law § 1141(c) to give notice of tax due to bulk sale purchasers is unsupported by any evidence whatsoever. Petitioner does not cite any actual cases where it asserts this has happened.

We also find an additional finding of fact to read as follows:

> At the hearing, the Administrative Law Judge asked the attorney for the Division if penalties were being asserted against petitioner and, if so, if there was not a problem in view of Matter of Velez v. Division of Taxation (152 AD2d 87, 547 NYS2d 444). The attorney for

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We modified this finding of fact to indicate how and why the auditor communicated with the Administrative Law Judge after the hearing concerning the source of the index.

> the Division indicated that penalty and interest were being asserted and that Velez might apply. The Administrative Law Judge indicated that he would take the matter under consideration.[9]

OPINION

The Administrative Law Judge rejected the audit methodology used by the Division of Taxation (hereinafter the "Division") and cancelled the assessment for the entire period except for that portion ($412.50) attributable to the $5,000.00 bulk sale of fixtures which was not contested by petitioner at hearing. The grounds for rejection of the audit methodology was that the Administrative Law Judge could not understand the basis for the estimated tax liability of petitioner.

While not stated in his determination, it seems clear that in view of the Administrative Law Judge's cancellation of the assessment, he believed that he did not have to deal with the issue of whether there is statutory authority to assert penalties and interest against petitioner as a purchaser at bulk sale in light of Matter of Velez v. Division of Taxation (supra).

The Division, on exception, asserts that petitioner was liable for the tax since it failed to file a notice of bulk sale as required in section 1141(c) of the Tax Law, and that petitioner has

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[9]The relevant portion of the transcript at hearing reads as follows:

> "Administrative Law Judge: I wanted to ask you, it just occurred to me, are there penalties being imposed here as well as taxes?
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> "Mr. Jenkins: Yes.
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> "Administrative Law Judge: Isn't there a Velez situation?
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> "Mr. Jenkins: Yes. I do know --
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> "Administrative Law Judge: Wouldn't that apply here?
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> "Mr. Jenkins: I think it could.
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> "Administrative Law Judge: I will have to consider that" (Hearing Tr., pp. 57-58).

failed in its burden of proving that the methodology used by the Division to estimate the tax of the seller was not reasonably calculated to reflect the tax of the seller.

The Division, in its brief on exception, asserts that the Administrative Law Judge decided the case on issues not raised by the parties, but raised by the Administrative Law Judge himself and, in so doing, exceeded his statutory authority.

The Division, in its exception, concedes that taxes for the earlier period, i.e., May 1, 1979 through August 31, 1983, cannot properly be asserted against petitioner.[10]

The Division, in its brief on exception, concedes that under Velez, petitioner is not liable for the omnibus or other penalties asserted by the Division (Division's brief, p. 11).

On exception, petitioner relies on the determination of the Administrative Law Judge.

We modify the determination of the Administrative Law Judge.

We deal preliminarily with the admitted failure of petitioner to comply with the notice requirements of section 1141(c). Petitioner's assertion that, based on the past experience of its representative, compliance with section 1141(c) by a bulk sale purchaser is irrelevant, is totally without merit and of no probative value. Petitioner's failure here to comply with section 1141(c) renders it "personally liable for the payment to the State of any such taxes . . . determined to be due from the seller . . . limited to an amount not in excess of the purchase price or fair market value of the business assets sold . . . whichever is higher . . ." (Tax Law § 1141[c]).

We deal next with the issue of whether the audit methodology employed by the Division was reasonably calculated to estimate the tax due from the seller, Wellington.

We reverse the determination of the Administrative Law Judge on this issue. However, we note that our review is limited to the audit methodology employed for the period September 1, 1983 through August 31, 1986, due to the Division's concession with respect to the earlier period.

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[10]"Finding of Fact 7(b) dealing with tax asserted for periods prior to 1983 should be deleted as no longer relevant, since the audit division concedes tax cannot be properly asserted against MNS for the earlier period" (Division's Exception).

Where, as here, the records of the taxpayer are insufficient or inadequate to permit an exact computation of the sales and use taxes due, the Division is authorized to estimate the tax liability on the basis of external indices (Tax Law § 1138[1]; see, Matter of Ristorante Puglia, Ltd. v. Chu, 102 AD2d 348, 478 NYS2d 91, 93; Matter of Surface Line Operators Fraternal Org. v Tully, 85 AD2d 858, 446 NYS2d 451, 452). The methodology selected must be reasonably calculated to reflect the taxes due (Matter of W. T. Grant Co. v. Joseph, 2 NY2d 196, 159 NYS2d 150, 157, cert denied 355 US 869; Matter of Ristorante Puglia, Ltd. v. Chu, supra) but exactness in the outcome of the audit method is not required (Matter of Markowitz v. State Tax Commn., 54 AD2d 1023, 388 NYS2d 176, 177, affd 44 NY2d 684, 405 NYS2d 454; Matter of Lefkowitz, Tax Appeals Tribunal, May 3, 1990). The burden rests with the taxpayer to show by clear and convincing evidence that the methodology was unreasonable or that the amount assessed was erroneous (Matter of Meskouris Bros. v. Chu, 139 AD2d 813, 526 NYS2d 679; Matter of Surface Line Operators Fraternal Org. v. Tully, supra).

In his determination, the Administrative Law Judge dismissed the assessments against petitioner because he did not understand how the information in the report was compiled.

The Administrative Law Judge wrote, in relevant part:

> "The audit cannot be accepted as valid. The critical element in this sales tax audit case is the amount of the markup (61.55%) applied to the purchases declared by the business in question . . . . That amount was repeatedly stated in the workpapers and at the hearing to be derived from a publication of Dun and Bradstreet. That publication has not been produced for introduction into evidence or even for inspection by petitioner and the administrative law judge. I cannot tell from the single page produced how the figures were computed or their limitations. In particular, in this case, I have no knowledge that 'other retail stores' as described by that publication is the proper category of that publication to cover the business here in question" (Determination, Conclusion of Law "A").

The above quoted phrase misinterprets the law. "The Audit Division is not responsible for demonstrating the propriety of the assessment, including the basis for its audit" (Matter of Blodnick v. New York State Tax Commn., 124 AD2d 437, 507 NYS2d 536, 538). In fact, "[c]onsiderable latitude is given an auditor's method of estimating sales under such

circumstances as exist in this case" (Matter of Grecian Sq. v. New York State Tax Commn., 119 AD2d 948, 501 NYS2d 219, 221). Petitioner bears the burden of proving the audit methodology was unreasonable (Matter of Surface Line Operators Fraternal Org. v. Tully, supra). However, the record must contain sufficient evidence to allow the trier of fact to determine whether the audit had a rational basis (Matter of Grecian Sq. v. New York State Tax Commn., supra, 501 NYS2d 219, 221; Matter of Fokos Lounge, Tax Appeals Tribunal, March 7, 1991; Matter of Fashana, Tax Appeals Tribunal, September 21, 1989).

The Division, at hearing, introduced the chart upon which the auditor based his mark-up percentage (Division's Exhibit "E-4").

First, we do not find under the circumstances herein that the auditor's mischaracterization of the source of the chart in any way impaired the ability of petitioner to meet the burden upon it, i.e., to prove that the Division's methodology was unreasonable.[11] Petitioner had full opportunity to examine the chart. Petitioner did not object to the chart. Petitioner did not ask one question concerning the chart at the hearing.

Second, we do not agree with the Administrative Law Judge's statement that the Division had the further obligation to understand and explain the compilation of the chart and how it specifically related to petitioner. As we stated in Matter of Bitable on Broadway (Tax Appeals Tribunal, January 23, 1992):

> "[t]he purpose of requiring the Division to identify the report utilized in this type of audit (see, Matter of Fokos Lounge, supra; Matter of Fashana, supra) is to provide a petitioner with access to the source of the chart and, thus, with the ability to introduce evidence challenging the soundness or applicability of the report. In other words, it ensures that a petitioner has the opportunity to sustain his burden of proof. In our view, to require that the Division explain the derivation of a report prepared by a third party would accomplish nothing except to introduce another level of questions as to whether the Division's description was accurate."

[11]In his workpapers and at hearing, the auditor indicated that the chart was from a Dun and Bradstreet publication. It turned out that it was from "The Almanac of Business and Industrial Financial Ratio," 1985 edition, by Leo Troy, Ph.D. and published by Prentice-Hall, Inc.

We conclude that the Administrative Law Judge erred in finding that the audit methodology was unreasonable based on the inability of the auditor to explain the compilation of the chart.

We deal next with the issue of whether there is statutory authority to hold petitioner liable for penalty and interest due from the seller. We conclude there is no such authority under the circumstances in this case.

In Matter of Velez v. Division of Taxation (supra), the court held that a bulk purchaser liable for the seller's taxes pursuant to section 1141(c) of the Tax Law could not be held liable for the penalty and interest assessed against the seller. Petitioner here is a bulk purchaser. We find Velez dispositive of the issue and conclude that penalty and interest cannot be properly asserted against petitioner.

We deal finally with the Division's assertion that the Administrative Law Judge decided the case on issues not raised by the parties and that in doing so exceeded his authority and put in question the fundamental fairness of the whole hearing process.

The Division's position is that it allowed the auditor to testify "as an accommodation to the Administrative Law Judge" (Division's brief, p. 14) and that, in the absence of pleadings by petitioner challenging the audit methodology, the Administrative Law Judge was precluded from considering the testimony and documentary evidence introduced at hearing by the Division.

Specifically, the Division asserts that:

> "[s]ince the Petitioner never raised the validity of the audit or the amount of tax asserted as issues in the petition, and never produced any evidence at hearing to show any error by the [Division], the ALJ could not properly reach those issues.
>
> "When an ALJ decides issues not in controversy, it deprives the parties of due process, and it is an abuse of discretion and expansion of the ALJ's authority beyond that contemplated by the enabling statute. Deciding cases based on issues not in dispute, also has the inevitable result of engendering otherwise unnecessary appeals to correct erroneous determinations and ultimately, draws into question the fundamental fairness of the whole hearing process in the Division of Tax Appeals" (Division's brief on exception, p. 18, emphasis added).

We cannot agree with this reasoning.

This Tribunal is an administrative agency of State government charged, as a matter of public policy, with "providing the public with a just system of resolving controversies with [the Division of Taxation] and to ensure that the elements of due process are present with regard to such resolution of controversies" (Tax Law § 2000). No doubt the Division is guided by the same principles in its efforts to resolve controversies with taxpayers and that it introduces testimony and evidence concerning the audit process in accord with these principles, not merely as an accommodation to the Administrative Law Judge.

We agree with the Division that responsive pleadings are an integral element in this just system and that it is incumbent on both parties to offer such pleadings. It is also quite clear, as we have pointed out in this decision, that petitioner did not challenge the audit methodology. However, that failure should not deprive the decision maker (either the Administrative Law Judge or this Tribunal) from considering the evidence in the record as the Administrative Law Judge did here. While the Administrative Law Judge erred in his interpretation of the law, it would have been a more egregious error if he had ignored the evidence in the record. In fact, the Division's argument would have precluded the Administrative Law Judge from raising Velez relative to the imposition of penalties against petitioner, penalties the Division itself concedes in its brief on exception that it cannot assert. Further, it would have prevented this Tribunal from raising Matter of Adamides v. Chu (134 AD2d 776, 521 NYS2d 826, 828, lv denied 71 NY2d 806, 530 NYS2d 109) relative to the validity of the deficiency asserted for the period 1979-1983, an assessment which the Division itself concedes on exception that it cannot properly assert. In both instances, the case law is clear, yet in the name of fairness the Division would preclude us from applying it unless pleaded by one or both of the parties.

Such a result certainly could not be the "just system" the legislation demands.

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 is modified;

3. The petition of MNS Cards & Gifts, Inc. d/b/a Hallmark Cards & Gifts is granted to the extent that the assessment for the period May 1, 1979 through August 31, 1983 as represented by notices S870727005Q and S870727006Q is cancelled; and

4. The Division of Taxation shall modify the notices of determination for the period September 1, 1983 through October 31, 1986 (S870727007Q and (S870727012Q) by deleting the interest and penalty asserted, but such notices are otherwise sustained.

DATED: Troy, New York
May 7, 1992

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

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

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