

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
SIDNEY WALLACH, OFFICER OF WALLACH SONS OF EASTCHESTER, INC.	:	DECISION
	:	DTA NO. 807943
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 December 1, 1982	:	
through May 31, 1987.	:	

Petitioner Sidney Wallach, Officer of Wallach Sons of Eastchester, Inc., 360 Hungry Harbor Road, Valley Stream, New York 11581 filed an exception to the determination of the Administrative Law Judge issued on May 4, 1992 with respect to his petition 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 December 1, 1982 through May 31, 1987. Petitioner appeared by Nemiroff, Cosmas, Titus & Colchamiro, C.P.A.'s (Peter Cosmas, C.P.A.). The Division of Taxation appeared by William F. Collins, Esq. (Michael B. Infantino, Esq., of counsel).

Petitioner filed a brief on exception. The Division of Taxation filed a letter in lieu of a brief. Petitioner's 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 Division of Taxation properly subjected to tax certain of the corporate petitioner's claimed nontaxable sales.

II. Whether petitioner has established any basis warranting reduction or abatement of penalty.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

Petitioner Wallach Sons of Eastchester, Inc. ("Wallach Sons") operates a retail jewelry store located in Scarsdale, New York. The business operates out of a street-level location in a shopping strip (not a mall), and has been engaged in business continuously since 1916. Petitioner Sidney Wallach is the president of Wallach Sons of Eastchester, Inc.

On or about July 30, 1985, the Division of Taxation (hereinafter the "Division") commenced an audit of the business of Wallach Sons of Eastchester, Inc. On August 19, 1985, the Division mailed an audit appointment letter advising Wallach Sons that an initial audit appointment was scheduled for September 23, 1985 and that all books and records should be available for review. Audit activity, including review of records and meetings between petitioners' representative and the auditor, ensued. Ultimately, on April 27, 1988, Wallach Sons, by its duly authorized representative, executed an audit method election form pertaining to the audit period December 1, 1982 through May 31, 1987. Pursuant to this election, it was agreed that in lieu of a detailed audit of all records for the entire audit period, a detailed audit of a representative portion of the audit period would be made by the Division. The parties agreed that the audit would pertain to Wallach Sons' sales and recurring expense purchases and, more specifically, that Wallach Sons' claimed nontaxable sales for the test period May 1, 1984 through May 31, 1985 (some 13 months) would be examined in detail.

For the noted test period, Wallach Sons reported nontaxable sales in the amount of \$685,403.75. The majority of such sales were claimed to be nontaxable on the basis of having involved shipments of merchandise to purchaser/recipients in locations outside of New York State. The auditor requested documentation substantiating the nontaxability of such sales, including shipping documents such as postal receipts, United Parcel Service shipment books and/or the like. The record is not entirely clear as to what specific substantiation was furnished

in response, except that for at least six months of the test period petitioners were unable to furnish any shipping documents or delivery receipts. After review, the auditor disallowed as unsubstantiated \$446,304.75 of claimed nontaxable sales, resulting in a disallowance rate of 65.12%. The auditor applied this rate to claimed nontaxable sales of \$2,000,032.00 for the entire audit period, resulting in total disallowed claimed nontaxable sales of \$1,302,421.00. In turn, tax was computed thereon in the amount of \$76,629.83.

The results of this test of nontaxable sales were presented to petitioners' representative, in response to which petitioners' representative requested that the Division select another time period and conduct an additional test. According to the audit report offered in evidence, petitioners' representative indicated that "[Wallach Sons] was keeping better records" after the time of the first test, thereby alleging that a second test would present a more accurate portrayal of nontaxable sales (i.e., allow for the presentation of better substantiation thereof).

The Division agreed to conduct a second test and the parties agreed to the period June 1, 1986 through May 31, 1987 for such test. For this period, Wallach Sons claimed nontaxable sales of \$243,642.25. After review of documentation presented, the auditor disallowed as unsubstantiated some \$22,001.25 of such claimed nontaxable sales, resulting in a disallowance rate of 9.03%. As with the first test, a lack of shipping documents caused the disallowance of claimed nontaxable sales.¹

After completing the second test, the auditor combined the results of the two tests to arrive at a "weighted" disallowance percentage. Such disallowance percentage was computed by comparing total disallowed nontaxable sales for both test periods (\$468,306.00) to total claimed nontaxable sales for both test periods (\$929,046.00), resulting in a combined disallowance rate of 50.41%. In turn, the auditor applied such weighted disallowance percentage to claimed nontaxable sales for the entire audit period, resulting in disallowed nontaxable sales of \$1,008,215.00 and tax due thereon in the amount of \$57,972.38.

¹The auditor who conducted the first test was no longer employed by the Division when the second test was agreed to, and thus another auditor was assigned the case and conducted the second test.

In addition to the foregoing, the audit encompassed a review of petitioners' recurring expense purchases. Such audit review resulted in the calculation of a use tax liability on such expense purchases in the amount of \$1,740.59 for the audit period.

On November 25, 1988, the Division issued to Wallach Sons two notices of determination and demands for payment of sales and use taxes due, spanning together the period December 1, 1982 through May 31, 1987 and assessing tax due in the aggregate amount of \$59,712.97, plus penalty and interest. On the same date, identical notices of determination were issued to petitioner Sidney Wallach, as an officer of Wallach Sons responsible to collect and remit taxes on behalf of the corporate petitioner. Six validated consents had been executed on behalf of Wallach Sons, pursuant to which sales and use taxes for the period December 1, 1982 through August 31, 1985 could be assessed at any time on or before December 20, 1988.

At the commencement of proceedings herein, petitioners admitted liability for the use tax portion of the assessment (\$1,740.59). In addition, petitioner Sidney Wallach agreed and admitted that he was a person responsible to collect and remit taxes on behalf of Wallach Sons pursuant to Tax Law §§ 1131(1) and 1133(a). Hence, the only items at issue herein involve the disallowance of claimed nontaxable sales, and the related issue of whether penalty was properly assessed under the facts in this matter.

Petitioners presented the testimony of their representative herein, who was also petitioners' representative during the audit, as well as the testimony of petitioner Sidney Wallach. In sum of the testimony, Wallach Sons' usual method of delivery out of state involved U.S. Postal Service shipments. Some 90 to 95% of such out-of-state shipments involved insured, registered mail, return receipt requested. The balance of Wallach Sons' out-of-state shipping was by United Parcel Service or by overnight mail. These shipping methods had been used for years prior to, during and after the audit period herein. Specifically, shipments were logged by Wallach Sons in U.S. Postal Service books, with the return receipts placed in such books when received back by Wallach Sons. Return receipt shipping was used because of the need to verify that the items shipped (jewelry) were, in fact, received.

The audit report's narrative section indicates that after performance of the first test by the Division, and review thereof by petitioners' representative, "[i]t was agreed that a second test of nontaxable sales would be done and a weighted average of both tests would be used to arrive at a disallowed non-taxable percentage." According to the report and to the auditor's testimony, petitioners' representative's reason for requesting a second test was that Wallach Sons' "recordkeeping was greatly improved after the original test period." By contrast, petitioners' representative testified to his belief that the results of the second test only (the 9.03% disallowance rate) would be applied to claimed nontaxable sales for the entire audit period. Petitioners' representative indicated that he raised with the auditor and the auditor's team leader (audit supervisor) the possibility of sending verification letters to Wallach Sons' customers in support of claimed nontaxable sales. He indicated that this procedure was rejected by the Division's auditor and team leader because a second test was to be performed. Petitioners' representative alleged that he did not go forward with the verifications because he believed the results of the second test would be applied to the entire audit period, as described.

Petitioners allege the main problem in substantiating claimed nontaxable (out-of-state) sales for the initial test period resulted from petitioners' inability to locate records, specifically U.S. Postal Service shipping books, for at least a portion of the first test period. Petitioners believe that the records were either misplaced or lost during a storewide renovation which occurred between April 1985 and June 1985, or were destroyed subsequently in a fire occurring on January 21, 1986 in the back area of the store. Petitioners described the renovation as being a "wall-to-wall" renovation, including the construction of a second story for office space. Wallach Sons' records were kept in the basement of the store. During the renovation, the entire store contents were moved into the basement (the basement was not renovated as part of the overall store renovation). The fire occurred in the back "work area" of the store where inventory cards, inventory and, allegedly, records were kept. Petitioners' post-hearing documentary submission included photographs of the fire area, as well as an insurance report and related litigation documents. According to the report, the fire caused "heavy fire damage to

workshop bench area and adjacent door and walls. Heavy smoke damage to jewelry and both adjacent exposure stores" Photographs showing the fire damage do not, however, as claimed clearly or otherwise show any "burnt records."

Petitioners' representative attempted to obtain duplicate shipping or delivery records from the Post Office. However, he was advised that such records were not kept for more than two years and were not available.

Petitioners submitted in evidence a copy of the confirmation letter their representative prepared (but did not send) together with an invoice for the particular customer named on the letter. The invoice indicates a customer address of Bronx, New York, but a shipping/delivery address of Montpelier, Vermont. The verification letter, addressed to the customer's Bronx, New York location, requests certification that the invoice items were shipped directly to the customer's Montpelier, Vermont address.

Petitioners' representative pointed out that different auditors conducted the two tests, and that there was also a change of team leaders (audit supervisors) during the course of the audit. Petitioners' representative testified that the new supervisor allegedly was willing to apply the disallowance percentage from the second test to the total amount of claimed nontaxable sales for the entire audit period. The auditor who conducted the second test testified to no recollection of such an agreement or statement, but rather that the Division agreed to do a second test because of petitioners' representative's allegation that Wallach Sons' recordkeeping was greatly improved after the time of the first test.

The Division points out that for the first nine quarterly periods covered by the subject audit, approximately 52% of Wallach Sons' gross sales were claimed as nontaxable sales. In turn, for the second nine quarterly periods covered by the audit, approximately 17% of Wallach Sons' gross sales were claimed as nontaxable sales. When questioned about this decrease in claimed nontaxable sales, neither Sidney Wallach nor petitioners' representative could offer an explanation, except the statement that shipping to Florida and the south increased during the summer months due to vacationing families having their purchases shipped to their out-of-state

homes.

Sales and use tax returns filed by Wallach Sons (as transcribed and included in the audit report) reveal the following as to the percentage of nontaxable sales claimed for each of the quarterly periods included in the audit:

<u>Period Ended</u>	<u>Percentage of Gross Sales Claimed To Be Nontaxable Sales</u>
2/28/83	33
5/31/83	46
8/31/83	49
11/30/83	61
2/28/84	56
5/31/84	64
8/31/84	55
11/30/84	47
2/28/85	47
5/31/85	22
8/31/85	21
11/30/85	19
2/28/86	21
5/31/86	13
8/31/86	16
11/30/86	12
2/28/87	16
5/31/87	15

OPINION

The Administrative Law Judge determined that petitioner² did not substantiate that all but 9.03% of his claimed nontaxable sales should be accepted and allowed as nontaxable. The Administrative Law Judge found that the decrease in nontaxable sales commencing halfway through the audit period supports a conclusion that petitioner simply maintained better records for the latter periods in the audit. The Administrative Law Judge further found that the record does not support a finding that the decrease in taxable sales was due to the fact that more nontaxable sales were made in summer months. Thus, the Administrative Law Judge found that the Division's use of both test periods to arrive at a weighted disallowance percentage was reasonable.

2

As only petitioner Sidney Wallach, Officer of Wallach Sons of Eastchester, Inc., filed an exception, all references to petitioner hereinafter are to Sidney Wallach, Officer of Wallach Sons of Eastchester, Inc.

In addition, the Administrative Law Judge determined that petitioner had ample time between the issuance of the notices of determination and the start of the hearing to send verification letters to his out-of-state customers in an attempt to substantiate claimed nontaxable sales.

Finally, the Administrative Law Judge found that petitioner did not establish how his records in substantiation of claimed nontaxable sales were lost. Therefore, the Administrative Law Judge sustained the penalties assessed.

On exception, petitioner continues to argue that it was agreed to by the parties that the second test would be used to determine the disallowance rate for the entire audit period. Petitioner maintains that the result of the second test of his records, the 9.03% disallowance rate, provides a far more accurate result than does the result of combining the two tests, the 50.41% weighted disallowance rate. Petitioner further maintains that a second test was agreed to because the records for the first period were either destroyed during a fire or during the renovation period. Petitioner also argues that because the records were destroyed, through no fault of petitioner, penalty should be abated.

In response, the Division states that petitioner has failed to prove that all but 9.03% of his claimed nontaxable sales should be accepted and allowed as nontaxable. The Division further states that petitioner failed to sustain his burden to prove that the penalty imposed should be abated. Therefore, the Division requests that the Administrative Law Judge's determination be affirmed and the notice of exception be denied.

After reviewing the allegations presented to us on exception and the record before us, we find no basis for modifying the Administrative Law Judge's determination in any respect. The Administrative Law Judge adequately and correctly addressed the same allegations presented on exception to this Tribunal. Therefore, we affirm the determination of the Administrative Law Judge for the reasons stated in said determination.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Sidney Wallach, Officer of Wallach Sons of Eastchester, Inc. is denied;
 2. The determination of the Administrative Law Judge is affirmed;
 3. The petition of Sidney Wallach, Officer of Wallach Sons of Eastchester, Inc. is denied;
- and
4. The notices of determination and demand for payment of sales and use taxes due, dated November 25, 1988, are 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