

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
TANGO BOUTIQUE, INC. AND	:	DECISION
ROSALIND COOK AND JUDITH LASHIN, AS OFFICERS	:	DTA No. 809674
	:	
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, 1985 through November 30, 1987.	:	

Petitioners Tango Boutique, Inc. and Rosalind Cook and Judith Lashin, as officers, 47 Glen Cove Road, Greenvale, New York 11548, filed an exception to the determination of the Administrative Law Judge issued on May 4, 1993. Petitioners appeared by DeGraff, Foy, Holt-Harris & Mealey, Esqs. (James H. Tully, Jr., Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Vera Johnson, Esq., of counsel).

Petitioners filed a brief in support of their exception, and a reply brief. The Division of Taxation filed a brief in opposition to the exception. Oral argument was held on November 10, 1993 and began the six-month period for the issuance of this decision.

The Tax Appeals Tribunal renders the following decision per curiam.

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 shown that their failure to comply with the Tax Law, if so determined, was due to reasonable cause and was not due to willful neglect.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for findings of fact "5" and "7" which have been modified. We have also made additional findings of fact. The

Administrative Law Judge's findings of fact, the modified findings of fact and the additional findings of fact are set forth below.

On July 5, 1989, the Division of Taxation ("Division") issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due spanning the period March 1, 1985 through November 30, 1987 to petitioner Tango Boutique, Inc. ("Tango") assessing sales and use tax due in the amount of \$271,997.28, plus penalty (Tax Law § 1145[a][1][i]) and interest. On the same date, the Division issued a notice of determination for the period June 1, 1985 through November 30, 1987 to Tango assessing a penalty of \$25,037.67 pursuant to Tax Law § 1145(a)(1)(vi). On the same date, the Division issued identical notices of determination and demands for payment of sales and use taxes due spanning the same periods and assessing the same amounts as above to petitioners Rosalind Cook and Judith Lashin, as officers. The notices indicated that they were personally liable as officers of Tango 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 Tango as described hereinafter.

On August 27, 1988, petitioner Tango, by Judith Lashin, executed a consent having the effect of extending the period of limitations for assessment of sales and use taxes for the period March 1, 1985 through November 30, 1985 to March 20, 1989. On January 30, 1989, petitioner Tango, by Judith Lashin, executed a consent having the effect of extending the period of limitations for assessment of sales and use taxes for the period March 1, 1985 through February 28, 1986 to June 20, 1989. Finally, on May 19, 1989, petitioner Tango, by Rosalind Cook, executed a consent having the effect of extending the period of limitations for assessment of sales and use taxes for the period March 1, 1985 through May 31, 1986 to September 20, 1989.

On January 11, 1988, the Division sent a letter to Tango advising that the corporation's sales tax returns were scheduled for field audit. The period under audit was stated in the letter to be from December 1, 1984 to the "present". The letter requested that all books and records

pertaining to the sales tax liability for the period under audit be made available. The books and records to be provided included journals, ledgers, sales invoices, purchase invoices, cash register tapes, exemption certificates and all sales tax records. Accompanying the appointment letter was a document entitled "Check List of Needed Records" which indicated the audit period to be December 1, 1984 to the "present". The documents requested included the following:

- General Ledger for audit period
- Cash Receipts Journal for audit period
- Cash Disbursements Journal for audit period
- Federal Income Tax Returns for audit period
- Sales Tax Returns and worksheets for audit period
- Sales invoices for audit period
- Expense purchase invoices for June - August 1987
- All fixed asset invoices for fixed assets acquired during the audit period
- Guest checks and cash register tapes for the audit period
- Proof of out-of-state shipments for audit period

Petitioners provided the auditor with a general ledger for the audit period, a cash receipts journal covering the period May 1987 through November 1987, a cash disbursements journal relating to the period July 1987 through November 1987, Federal income tax returns for years that had been filed during the audit period, sales tax returns and worksheets for the last two quarters of the audit period, sales invoices for the period September 1987 through November 1987 and some fixed asset invoices. Proof of nontaxable sales was not originally provided.

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

Tango is in the retail women's apparel business and is located in Roslyn, New York. During the period at issue, Rosalind Cook was the president of Tango and Judith Lashin was its vice-president. The business began operating on February 28, 1977. At the beginning of the audit period, the business was located in a converted barn of approximately 1,300 square feet. The business advertised itself as a "discounter" of women's name-brand clothing, attracting clients by underselling the larger department stores. Petitioners provided testimony at the hearing that Tango attracted out-of-state customers by advertising in national magazines which resulted in sales throughout the country. In addition, according to testimony, out-of-state sales were generated by Tango shipping merchandise to its New York customers with second homes in Florida. As many of petitioners' local customers spent time in Florida, petitioners opened a store there sometime in 1986.

However, the store was unsuccessful and closed within a year. The testimony further provided that merchandise that was shipped to customers both within and without New York State was handled by United Parcel Service ("UPS").

On March 1, 1987, the business's merchandise and records suffered substantial fire, smoke and water damage as a result of an electrical fire in the building. All of the business's records were destroyed. Following the fire, the business moved to a new, larger location in Roslyn, New York. Petitioners' sales and use tax returns show that the business was active during the quarters ended May 31, 1987 and August 31, 1987, the two quarters immediately following the fire. Tango reported taxable sales of \$332,528.00 for the quarter ending May 31, 1987, which was the third largest amount of taxable sales reported by Tango during the 11 quarters of the audit (Exhibit "J"). Tango reported taxable sales of \$162,176.00 for the quarter ending August 31, 1987 (Exhibit "J"). Purchases per Tango's books were determined by the auditor to be \$376,711.00 for the quarter ending May 31, 1987 and \$150,129.00 for the quarter ending August 31, 1987 (Exhibit "J"). The purchases determined for the quarter ending May 31, 1987 were the fourth largest during the audit period.¹

Petitioners employed a bookkeeper during the audit period. The bookkeeper would come into the store one or two days a week to maintain the records of the business. On the days the bookkeeper came into the store and the days she did not, the records were maintained in the same way. The sales slips from each day were attached to the daily cash register tape. The day's daily sales as shown on the cash register tape were recorded in the cash receipts journal. Following the daily bank deposit, the deposit slip would also be attached to the cash register tape and stored on a monthly basis in an envelope. The envelopes were placed in boxes and the boxes were stored in the business's attic. All of the records up to the date of the electrical fire were in the attic when the fire occurred, and they suffered extensive water damage. It is noted that the sales slips used by the sales people were not consecutively numbered nor was the information recorded on the slips sufficient to determine what item or items were being sold.

¹We modified the second paragraph of the Administrative Law Judge's finding of fact "5" by adding the last four sentences in response to petitioners' challenge to the Administrative Law Judge's finding that Tango's business was active during the quarters ending May 31, 1987 and August 31, 1987. The record reveals strong support for the Administrative Law Judge's finding and we modified the fact to specifically state the support.

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

The purchases from the business's books were totalled and adjusted for the Florida store purchases and the insurance loss. These adjusted purchases were marked up by 66.67%, a percentage derived from the Dun & Bradstreet Cost of Doing Business and an index entitled "Almanac of Business Ratios." This markup percentage was applied to adjusted purchases to determine audited gross sales. As no documentation of nontaxable sales was presented, audited gross sales were considered to be taxable sales from which reported taxable sales were subtracted to arrive at additional taxable sales. This amount was multiplied by the applicable tax rate to yield sales tax due of \$263,835.24. Petitioners were also assessed tax in the amount of \$8,162.04 on fixed asset purchases for a total amount of tax due of \$271,997.28.

Prior to the completion of the audit, petitioners provided the auditor with copies of UPS shipping documents for the last quarter of the audit period. These UPS shipping documents were obtained by petitioners from UPS and presented to the auditor sometime in October 1988. In an attempt to verify these records, two auditors reviewed summary documents of petitioners' shipments as maintained by UPS. The summary documents indicated the week of pickup, the number of pickups, and the number of packages included in each pickup. The auditor compared the number of packages claimed to have been shipped by petitioners with the number shown on the UPS records, and found that the UPS records verified only 250 of the 285 packages claimed by petitioners. In an effort to verify the out-of-state sales of the last quarter, the auditor mailed a questionnaire to 47 of the UPS customers asking the customers if they had purchased merchandise from Tango, the amount of the purchase and where it was delivered. The auditor received 16 responses indicating delivery of merchandise out of state, although 8 of the envelopes had New York State postmarks. Ten of the questionnaires were returned as undeliverable and no response was received from 21 of the questionnaires. No adjustment was originally made to claimed nontaxable sales for the last quarter because no information, such as the amount purchased, was received from the customers that could be related back to the original sales slips.²

On June 7, 1991, the Bureau of Conciliation and Mediation Services ("BCMS") issued a Conciliation Order revising the amount of tax, penalty and interest due. The revision was based upon a 13% disallowance of claimed nontaxable sales in the last quarter of the audit as computed

²We modified the second paragraph of the Administrative Law Judge's finding of fact "7" by changing the first word "Following" to "Prior to" at petitioners' request to reflect that the UPS shipping documents were supplied prior to the completion of the audit.

by the auditor and based upon the UPS documents. The recomputation for the last quarter reduced the notice of determination for the period March 1, 1985 through November 30, 1987 to tax due of \$260,697.92, plus applicable penalty and interest, and reduced the notice of determination for the period June 1, 1985 through November 30, 1987 for penalty assessed pursuant to Tax Law § 1145(a)(1)(vi) to \$24,483.48. The allowance percentage was not applied to the earlier quarters because petitioners did not present any documentation of nontaxable sales for such quarters.

For the 4 sales and use tax quarters prior to the audit period and the 12 quarters of the audit period, Tango late filed three quarters, late paid eight quarters and partially paid four quarters. The reason offered by petitioners for the failure to timely pay was that they were doing extensive buying for their new stores in Florida and Roslyn and did not have the money to pay the sales tax liability. Eventually, however, all sales tax liabilities were paid.

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

For the quarter ending November 30, 1987, Tango reported its taxable sales as 89% of its gross sales and its nontaxable sales as 11%. The averages for the other quarters of the audit were 55% taxable and 45% nontaxable.

Tango's bookkeeper testified that the nature of the business changed after the March 1987 fire and the business moved to a new location. This witness testified that the amount of nontaxable sales decreased after the move.

OPINION

The Administrative Law Judge concluded that Tango did not have adequate books and records and, therefore, that the Division had the right to use an estimate methodology. The Administrative Law Judge also concluded that the audit methodology had to be evaluated under all of the circumstances existing at the time of the audit and that the Division could not automatically rely on the presumption of section 1132(c) of the Tax Law that certain types of sales are taxable. Applying this analysis, the Administrative Law Judge determined that it was reasonable to disallow all nontaxable sales claimed by Tango for the period at issue (March 31,

1985 - August 31, 1987) because petitioners failed to provide any substantiation of these nontaxable sales during the audit or at the hearing. The Administrative Law Judge recognized that Tango's records were destroyed in a fire on March 1, 1987 but noted that petitioners were unable to provide any records for the two quarters ending after the fire (May 31, 1987 and August 31, 1987) even though Tango's sales tax returns indicated it was active during these quarters. Based on petitioners' failure to provide records for these two quarters, the Administrative Law Judge concluded that the Division's methodology was reasonable. The Administrative Law Judge also refused to abate the penalties imposed, finding that petitioners had not established reasonable cause for their failure to pay and that the Division's delay in filing its answer was not in itself a sufficient basis for waiving penalty.

On exception, petitioners argue that they provided overwhelming evidence of the out-of-state sales and that in the face of this evidence, the auditor's blanket disallowance of claimed nontaxable sales was not reasonable. Petitioners assert that the auditor's evaluation of the shipping records for the quarter ending November 30, 1987 indicated that their records are substantially accurate and that "[u]nder these circumstances, where most of the Petitioners' records were destroyed in the March 1 fire, the auditor's refusal to apply the results of the test period audit for the final quarter to the entire audit period is manifestly unreasonable" (Petitioners' brief on exception, p. 11). Petitioners argue that even if they had provided no records, there were other options available to the auditor to estimate nontaxable sales, for example, an observation test. Next, petitioners argue that the fire at their place of business constitutes reasonable cause for the abatement of penalties at least for the periods ending May 31, 1987 and August 31, 1987. Petitioners also argue that the destruction of their records made it impossible for them to completely overcome the assessment and that this constitutes a cause which indicates the absence of willful neglect within the meaning of 20 NYCRR 536.5. Finally, petitioners renew their request that the penalties be waived pursuant to 20 NYCRR 3000.4(a)(4) because the Division disregarded the time period for filing its answer.

In response, the Division argues that it properly disallowed all claimed nontaxable sales for the period at issue because petitioners failed to provide evidence of any nontaxable sales for this period. The Division asserts that the 13% disallowance ratio computed by the Bureau of Conciliation and Mediation Services for the quarter ending November 30, 1987 should not be extrapolated over the entire audit period because this period is not representative of the entire period and because this ratio was based upon UPS' records, not Tango's. Lastly, the Division argues that penalty should not be abated because petitioners had no records as to nontaxable sales after the fire, other than the records obtained from UPS, had a history of late filing and late paying of sales tax and admitted using the sales tax to pay other creditors.

We affirm the determination of the Administrative Law Judge.

We agree with the Administrative Law Judge that the issue is whether the audit methodology, which relied on the presumption of taxability, was reasonably calculated, taking into account all of the facts and circumstances existing at the time of the audit, to reflect the taxes due (Matter of Bernstein-on-Essex St., Tax Appeals Tribunal, December 3, 1992; Matter of House of Audio of Lynbrook, Tax Appeals Tribunal, January 2, 1992). We also agree with the Administrative Law Judge that under this test, the instant audit methodology was reasonable.

To establish that it made nontaxable sales by delivering merchandise to customers outside of New York State, petitioners presented the auditor only with general evidence that it made such sales. Petitioners did not produce evidence that any specific sale was, in fact, nontaxable. Thus, the instant case is very similar to Matter of Reference Library Guild (Tax Appeals Tribunal, August 4, 1988), where we upheld the disallowance of all claimed nontaxable sales.

Further, petitioners have not established that this audit, like that in Matter of Bernstein-on-Essex St. (supra), was 1) based on an assumption that the auditor knew to be incorrect, and 2) that the auditor failed to pursue available options for estimating the amount of nontaxable sales. Unlike the auditor in Bernstein on Essex St., the auditor in this case did not acknowledge that Tango made nontaxable sales and he expressed reasonable grounds for rejecting the UPS

records offered to him by petitioners to establish the nontaxable sales. Among the grounds articulated by the auditor were that the UPS records supplied by petitioners varied from those obtained directly by the auditor from UPS and that petitioners did not provide UPS records or any other documentation for the other quarters of the audit.

With respect to the availability of methods to estimate the nontaxable sales, we agree with the Division that the UPS shipping records produced by petitioners for the quarter ending November 30, 1987 do not provide a reasonable method for estimating nontaxable sales for the entire audit period. The most significant flaw with the use of these records is that petitioners have completely failed to explain why they could produce no records for the period from March 1, 1987 through August 31, 1987 (the period after the fire until the beginning of the last quarter of the audit period). Although petitioners claim that the business was inactive during this period, this contention is completely belied, as noted by the Administrative Law Judge, by Tango's sales tax returns for these quarters and their purchase records. The failure to adequately explain the lack of records for the period from March 1, 1987 through August 31, 1987 raises the possibility that petitioners selectively produced records that would produce a favorable audit result and renders these records unacceptable for the purpose of estimating nontaxable sales. The Division's decision not to rely on the records for the period ending November 30, 1987 to estimate the other quarters was also supported by the fact that the nontaxable ratio for this quarter, 11%, was significantly lower than the average nontaxable ratio, 45%, for the other quarters of the audit period.

In response to petitioners' suggestion that an observation test could have been performed, we note that according to petitioners' own witness the nature of the business and the amount of nontaxable sales had substantially changed by the time the audit took place.

Because petitioners have failed to prove in this proceeding either that any specific sales were nontaxable or that the audit methodology was unreasonable, we agree with the Administrative Law Judge that no further adjustments to the audit are warranted.

Turning to the question of the penalties imposed, petitioners have not established that the fire on the premises was the cause for the underpayment of tax at issue; therefore, this ground cannot constitute reasonable cause for petitioners' failure under 20 NYCRR 536.5(c)(2). Next, we find no basis in logic, the law or the regulations for petitioners' claim that their inability to disprove the assessment, due to circumstances beyond their control, clearly indicates the absence of willful neglect. Finally, we affirm the Administrative Law Judge's conclusion, for the reasons stated in the determination, that the Division's late filing of its answer does not warrant abatement of the penalties.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Tango Boutique, Inc. and Rosalind Cook and Judith Lashin, as officers, is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petition of Tango Boutique, Inc. and Rosalind Cook and Judith Lashin, as officers, is denied; and
4. The notices of determination dated July 5, 1989, as amended by the Bureau of Conciliation and Mediation Services' conciliation order and by the agreement of the parties, are sustained.

DATED: Troy, New York
April 28, 1994

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

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