

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition :
of :
AGDN, INC. :
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 September 1, 1986 :
through May 31, 1988. :

DECISION
DTA NOS. 813075
AND 813076

In the Matter of the Petition :
of :
ERIC GROSSMAN, :
OFFICER OF AGDN, INC. :
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 September 1, 1986 :
through May 31, 1988. :

Petitioners AGDN, Inc., P.O. Box 410, 425 Atlantic Avenue, Oceanside, New York 11572, and Eric Grossman, officer of AGDN, Inc., 1003 Lido Boulevard, Lido Beach, New York 11561, filed an exception to the determination of the Administrative Law Judge issued on May 28, 1996. Petitioners appeared by Kase & Druker (James O. Druker, Esq., of counsel). The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Brian J. McCann, Esq., of counsel).

Petitioners filed a brief on exception. The Division of Taxation filed a brief in opposition. Petitioners filed a reply brief. Petitioners' request for oral argument was denied.

Commissioner Jenkins delivered the decision of the Tax Appeals Tribunal. Commissioners DeWitt and Pinto concur.

ISSUES

- I. Whether the Division of Taxation properly utilized an external index to determine additional sales and use taxes due from AGDN, Inc.
- II. Whether petitioners' estimate of sales tax liability should be allowed in the alternative.

FINDINGS OF FACT

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

The Division of Taxation submitted with its brief 22 proposed findings of fact, all of which addressed the reliability of AGDN's books and records. Since it is conceded by petitioners that the Division was within its rights to resort to an external index to calculate petitioners' sales tax liability, due to the fact that petitioners' records were incomplete and insufficient to conduct a detailed audit, facts which address the reliability of records are deemed irrelevant to this matter.

Petitioners submitted 9 proposed findings of fact. Proposed finding 1 is deemed a misstatement of the facts and is rejected. Proposed findings 3, 7 and 8 are not established by the facts and, therefore, are not incorporated herein. Proposed findings 4, 5, 6 and 9 are rejected as conclusory in nature. The remaining fact is incorporated in the determination below.

The Division of Taxation ("Division") issued four notices of determination and demands for payment of sales and use taxes due for the period September 1, 1986 through May 31, 1988 dated March 20, 1990 following a field audit. Two notices were issued to AGDN, Inc. and Eric Grossman, as officer, each assessing tax due for the noted period in the amount of \$46,070.64, plus penalty and interest, for a total amount due of \$76,102.39. The other two notices assessed an additional "omnibus" penalty (Tax Law § 1145) for the same period in the amount of \$4,607.05 against each of the petitioners.

The reasonableness of the computation of sales and use tax as estimated by the use of an external index is the primary issue in this matter. The status of the personal liability of the individual petitioner as officer is not in question.

Petitioner AGDN, Inc. ("AGDN") is a New York corporation organized for the purpose of operating a plant nursery at 425 Atlantic Avenue, Oceanside, New York, at all relevant times during the audit period. It was incorporated in March 1986 and commenced operations the following month. AGDN's business consisted primarily of the sale of plants, shrubbery, seed and soils. The company did not sell lawnmowers, garden tools or equipment.

Eric Grossman, the sole owner of AGDN, had decided not to continue his college education. A nursery business renting space from his father's shopping center had closed in a time frame proximate to Eric's decision. Although Eric had no prior business experience, he decided to delve into the nursery business at the same location, having received a promise of financial backing from his father, Irving Grossman. Over approximately a three-year period, Irving allegedly loaned AGDN in excess of \$300,000.00, none of which has been repaid.

The assessments in this matter were issued after a field audit of AGDN's business operations. Several times prior to and during the field audit, the Division corresponded with the business for the purpose of requesting books and records. On February 5, 1988, the Division issued to AGDN an appointment letter indicating that AGDN's sales tax returns for the period March 1, 1986 through February 29, 1988 would be subject to a field examination and that petitioners were expected to produce all books and records pertaining to the sales tax liability of AGDN, including journals, ledgers, sales invoices, purchase invoices, cash register tapes, exemption certificates, Federal income tax returns and all other records pertaining to sales tax. Records requested were specified in an attached document. The correspondence was addressed to AGDNC Inc./ A Grossman Discount, P.O. Box 410 - 400 Atlantic Avenue, Oceanside, NY 11572. An appointment was scheduled for March 17, 1988. Throughout the initial stages of audit, numerous appointments were cancelled and rescheduled by petitioners.

The records available during audit included the Federal income tax returns, a cash receipts journal, a cash disbursements journal, some purchase invoices, a general ledger for the fiscal year ended March 31, 1988 and some monthly bank statements. Items which were not submitted included sales invoices, most purchase invoices, a general ledger for fiscal years ended March 31, 1987 and March 31, 1989, and landscape contracts.

A subpoena duces tecum dated August 1, 1988, was issued to petitioners requiring the company to produce all of AGDN's records for the period January 1, 1981 through May 31, 1988, including general ledgers, sales and purchase journals, sales and purchase invoices, exemption certificates, sales tax worksheets, Federal income tax returns and a description of the accounting system used.

Another appointment letter was issued to petitioners dated October 17, 1988 scheduling an appointment for November 16, 1988, requesting that petitioners have available all records referenced in the subpoena dated August 1, 1988.

On the basis of petitioners' failure to produce certain necessary documents, the Division made a determination that it could not conduct a detailed audit of AGDN on the documents provided. Petitioners conceded that since their records were only partially complete, the Division properly exercised its right to employ other methods of estimating sales. The parties dispute whether the Division's choice of an external index was a reasonable method of estimating AGDN's sales tax liability. Alternatively, petitioners offer a separate and distinct computation estimating liability on the basis of cost of sales.

Irving Grossman, Eric's father, testified on behalf of petitioners. He is neither an officer, shareholder, director nor employee of AGDN, though he obviously had extensive involvement with the business. The business occupied space in a shopping center owned by him at 425 Atlantic Avenue. He ordered merchandise and handled a substantial portion of the recordkeeping. He prepared the sales tax returns, and with the assistance of an accountant, the Federal income tax returns, for AGDN.

U.S. corporation short-form income tax returns (Form 1120-A) for the fiscal years ending May 31, 1987, May 31, 1988 and May 31, 1989 were submitted into evidence. One of the returns indicates that AGDN uses the cash basis method of accounting. No loans payable are shown on the earliest return. On the returns for years ended May 31, 1988 and May 31, 1989, the loans payable ranged from \$24,698.00 to \$322,723.00.

In January 1990, the auditors made a visit to AGDN's business premises for the purpose of conducting a mark-up test. The premises were closed and the gate locked. There is some discrepancy in the record as to whether AGDN in fact closed entirely for January, February and March of each year. Although there were some indications that the business was closed for at least some part of those months, the transcript of the sales tax returns indicates that sales were made during all months of the year.

Having determined that AGDN's records were insufficiently complete to conduct a detailed audit, the auditors determined that an external index based on AGDN's advertising expense would be used to estimate its sales activity. The entries in its cash disbursements register showed a monthly yellow page expense of \$356.50. The Division's section head of the sales tax unit involved in the audit established that although purchases, rent and utility expenses were considered as a means to estimate sales, the advertising expense was the only data the Division believed to be reliable after its review of the records.

Utilizing the Prentice-Hall Almanac of Business of Industrial Financial Ratios (1988 edition), the Division located data pertaining to the Retail Trade of Building Materials, Garden Supplies and Mobile Home Dealers. It showed businesses in these industries as having advertising expenses equal to 1.3% of gross sales. Thus, the Division divided the monthly advertising expense of \$356.50 by 1.3% to arrive at monthly gross sales of \$27,423.00. Since there were no claimed nontaxable sales, all were deemed taxable and the tax computed for the audit period, then defined as March 1, 1986 through May 31, 1988, totalled \$59,233.68. Subsequently, the earliest two quarters were handled by a Division of Tax Appeals Small Claims proceeding. Thus, the assessments as issued to petitioners were reduced by \$13,163.04

(\$6,581.52 x 2 quarters), to \$47,070.64. Furthermore, it was determined at hearing that petitioners had inadvertently not been given credit for \$968.00, the amount of sales tax paid by AGDN for the entire audit period.

The Prentice-Hall publication used to compute the estimated sales shows that the ratios referred to and used by the auditors were those of businesses reporting a business activity code of 5265, the same code used by petitioners on their corporate return for the fiscal period April 1, 1988 through March 31, 1989 to identify their business activity.

Petitioners continually claim that their offer of a computation of liability is more reasonable than the method to which the Division resorted. The following alternative estimate of taxable sales is offered by petitioners:

Start Inventory (9/1/86)	\$ 0
Plus merchandise purchases during the audit period	75,026
Less ending inventory (5/31/88)	55,662
Equals purchases available for sale (before breakage)	19,364
Less Breakage (33 1/3%)	6,455
Equals merchandise sold	12,909
Plus 50% markup	6,455
Equals gross sales	19,454
Less substantiated exempt sales	0
Equals taxable sales	19,464
Less reported taxable sales	12,100
Equals additional taxable sales	7,364

The beginning inventory is derived from a small claims proceeding where the presiding officer made the assumption that during the period in question in that matter (which immediately preceded September 1, 1986), all inventory on hand had been sold. Petitioners paid the tax computed on that basis, not being able to prove otherwise, and assert herein that the payment of tax twice could only be avoided by the use of a zero beginning inventory for the period commencing September 1, 1986.

The merchandise purchases shown are taken from AGDN's cash disbursements for the audit period. Checks drawn on Irving Grossman's personal account representing loans to AGDN comprise many of the early disbursements. AGDN eventually had a checking account and disbursements from such account were also presented as evidence.

The ending inventory amount was extracted from AGDN's corporate tax return for the fiscal year ending May 31, 1988. (The correct figure should have been \$56,023.00.)

An estimate of breakage, equal to 1/3 of the inventory of plants and trees, and a markup percentage was obtained through the the testimony of Irving Grossman, based on his experience in AGDN's business.

A total of reported taxable sales was available in the audit workpapers as transcribed from the returns as filed.

Throughout the hearing there was a significant amount of confusion about the date AGDN commenced business and its relationship, if any, to a nursery business in operation across the street from 425 Atlantic Avenue, at 400 Atlantic Avenue. The Division introduced as an exhibit a NYNEX Order for Directory Representation which bears an origination date of August 14, 1981, a service order date of September 15, 1986, a signature purportedly by the owner of A. Grossman's Discount Nursery Center dated July 12, 1987, and two date stamps: one on July 24, 1987 and the other on August 13, 1987. The customer name is A. Grossman's Discount Nursery Ctr., and the address as originally recorded on the form was 400 Atlantic Avenue, Oceanside. In a position marked "bill change only" the original address was changed to 425 Atlantic Avenue, Oceanside, New York.

The Division introduced into evidence the Nassau Consumer & Business Yellow Pages for 1984. Under the title listings of "Landscape Contractors" and "Nurserymen" was a business known as A. Discount Nursery & Garden Center, located at 400 Atlantic Avenue (opp. A & P) in Oceanside, with a telephone listing of 766-6663. There was no listing in such places bearing the Grossman name.

Also introduced into evidence were the 1985 Nassau Yellow Page listings for two companies; A. Discount Nursery & Garden Center and A. Grossman Discount Nursery Center. Both are shown as located at 400 Atlantic Avenue, Oceanside and bear the same telephone number, 766-6663. Both listings appeared under the heading "Landscape Contractors", and the latter also appears under the category of "Nurseryman".

Additionally submitted were the NYNEX Yellow Pages for Nassau printed for use during 1985-1986 and 1986-1987 years. In the 1985-1986 edition, under both headings, "Landscape Contractors" and "Nurserymen" appears A. Grossman's Discount Nursery Ctr. located at 400 Atlantic Avenue, Oceanside, with the same telephone as previously stated.

Although the Division conceded that AGDN as an entity was incorporated in March 1986, the relevance of the listings was to question the relationship, if any, of another nursery business which was in existence in the immediate vicinity with a very similar name, offering substantially similar goods and services and operated by other members of the Grossman family. Mr. Grossman's explanation for the address discrepancy is purely error on the part of the telephone company. He claims that the telephone number formerly belonged to his father-in-law's business across the street from AGDN (at 400 Atlantic Avenue), and was merely transferred to AGDN when Eric started in business, approximately 2 years after the death of his grandfather.

The cash disbursements records of AGDN were not complete, the categorization of the disbursements showed discrepancies and the purchase invoices submitted into evidence were manually altered to show a delivery address of 425 Atlantic Avenue, where the invoice originally bore the address of 400 Atlantic Avenue. No explanation was provided as to why a vendor would not have a correct address.

OPINION

In her determination, the Administrative Law Judge first reviewed the law governing the maintenance of books and records by New York vendors. As she pointed out, the Tax Law, regulations, and abundant case law developed in connection therewith leave it well settled that a vendor such as AGDN is required to maintain complete, adequate and accurate books and records regarding its sales tax liability and, upon request, to make the same available for audit by the Division (see, Tax Law §§ 1138[a]; 1135; 1142[5]; see, e.g., Matter of Mera Delicatessen, Tax Appeals Tribunal, November 2, 1989). Specifically, such records required to be maintained "shall include a true copy of each sales slip, invoice, receipt, statement or

memorandum" (Tax Law § 1135). It is equally well established that where insufficient records are kept and it is not possible to conduct a complete audit, "the amount of tax due shall be determined by the commissioner of taxation and finance from such information as may be available. If necessary, the tax may be estimated on the basis of external indices . . ." (Tax Law § 1138[a]; see, Matter of Chartair, Inc. v. State Tax Commn., 65 AD2d 44, 411 NYS2d 41, 43).

When estimating sales tax due, the Division need only adopt an audit method reasonably calculated to determine the amount of tax due (Matter of Grant Co. v. Joseph, 2 NY2d 196, 159 NYS2d 150, cert denied 355 US 869); exactness is not required (Matter of Meyer v. State Tax Commn., 61 AD2d 223, 402 NYS2d 74, lv denied 44 NY2d 645, 406 NYS2d 1025; Matter of Markowitz v. State Tax Commn., 54 AD2d 1023, 388 NYS2d 176, affd 44 NY2d 684, 405 NYS2d 454). The burden is then on the taxpayer to demonstrate, by clear and convincing evidence, that the audit method employed or the tax assessed was unreasonable (Matter of Meskouris Bros. v. Chu, 139 AD2d 813, 526 NYS2d 679; Matter of Surface Line Operators Fraternal Org. v. Tully, 85 AD2d 858, 446 NYS2d 451).

The Administrative Law Judge determined that in this case, despite repeated requests for records over an extended period of time, petitioners maintained and made available only limited books and records which, in their entirety, were not adequate for purposes of conducting an audit to determine the accuracy of AGDN's sales tax returns as filed. The daily sales records of petitioners were informal and AGDN's records as a whole were haphazard at best. The information as recorded was not verifiable in any manner and, as such, could not be relied upon to conduct a detailed audit. The purchase invoices were altered and what scarce register tapes were produced were not identifiable, and did not appear authentic. Petitioners conceded that their books were inadequate to conduct a detailed audit and that the Division was entitled to resort to an indirect method to determine AGDN's sales tax liability. Petitioners' challenge relates to the reasonableness of the method chosen by the Division.

The Administrative Law Judge recognized that indirect audit methodologies may not always result in an exact determination of liability. However, where a taxpayer's own failure to maintain adequate, accurate and complete books and records requires resort to such indirect audit techniques, exactness is not required of the Division in arriving at its determination, and the consequences of recordkeeping failures in this regard weigh heavily against the taxpayer (Matter of Meskouris Bros. v. Chu, supra). The Administrative Law Judge then concluded that although it is true that using a different calculation may provide a different, and arguably more accurate, picture of a taxpayer's business and, thus, its tax liability, the external index in this case was not unreasonable in selection or in application given this set of facts.

In attempting to show that the Division's method was unreasonable, petitioners pointed to the fact that the business category of "nurseries" was not included in the Prentice-Hall industry grouping title chosen by the Division for purpose of selecting the external index. However, AGDN's corporate tax return bears the same business code which precedes the title on the information chosen for use by the Division. In addition, common sense dictates that nurseries and garden supply businesses are sufficiently similar to be classified under the same industry grouping.

The point was raised in the case below as to whether the same index should be used for a start-up business as would be used with an existing and established operation. The Administrative Law Judge pointed out that the burden to establish that AGDN was truly a start-up operation was with petitioners and, since Irving Grossman was the only witness for AGDN to testify, his testimony was critical. The Administrative Law Judge concluded that the testimony of Irving Grossman was not sufficiently reliable to carry that burden. Numerous portions of the testimony are contradicted by information contained within the documents. Much of the testimony pertaining to any relationship to the nursery across the street, the NYNEX information and certain aspects of the business operations is confusing, evasive and not explained with the degree of clarity needed for us to deem the testimony reliable, especially with nothing more. For example, although Mr. Grossman attempted to explain his method of

loaning money to AGDN, by the payment of expenses for the business from his personal funds, the loans were not otherwise documented by a note payable to him, or any other agreement evidencing the same. Further, although Mr. Grossman wrote checks in the first fiscal period, the corporate tax return which corresponded thereto did not evidence a loan payable account on the balance sheet. The NYNEX and other yellow page information fostered much confusion, and the altered purchase invoices raise additional questions that remain unanswered.

The Administrative Law Judge found that petitioners' failed to produce evidence necessary to establish that AGDN was a "start-up" business. She, therefore, concluded that the index should not be used or altered to compensate for the nature of a new business. She went on to hold that petitioners have not met their obligation of proving, by clear and convincing evidence, that the result of the method used was unreasonably inaccurate or that the amount of the tax assessed is erroneous (Matter of Meskouris Bros. v. Chu, supra; Matter of Surface Line Operators Fraternal Org. v. Tully, supra). Accordingly, the calculation resulting from the use of an external index will not be disturbed in this case.

In the hearing below, petitioners attempted to prove that, in spite of a potentially acceptable method set forth by the Division, petitioners could provide a more accurate estimate by the use of, in part, AGDN's purchase records. The Administrative Law Judge found, however, that although the formula itself has merit, the dollar amounts, or the manner in which they are derived, for certain components, are seriously flawed for various reasons. First, petitioners attempted to begin with an opening inventory of \$0 based on the fact that petitioners had been engaged in a Small Claims proceeding which dealt with the quarter immediately preceding those in issue and tax was imposed on the entirety of such amount. There are two reasons a zero inventory cannot be adopted herein. The primary reason is that petitioners never established at this hearing that a zero beginning inventory is an accurate or reasonably estimated amount. In addition, petitioners' reliance on the Small Claims determination is improper. Tax Law § 2012, referencing the determinations issued by the small claims unit, states:

"such determinations of the small claims unit shall not be cited, shall not be considered as precedent nor be given any force or effect in any other proceeding conducted pursuant to the authority of the division [of Tax Appeals] or in any other judicial proceedings conducted in this state."

Accordingly, it would be improper to conclude that the findings of the presiding officer dictate the inventory amounts in this matter.

As the Administrative Law Judge noted, the amount arrived at by petitioners for merchandise purchases is extracted from a reconstructed cash disbursements journal which is deemed unreliable. There is no way to know whether all disbursements made by check were recorded in this source. Further, there is uncertainty regarding certain cash disbursements for purchases. A portion of the purchase invoices which would have provided further substantiation were altered or nonexistent. Accordingly, the reliability of purchases as a basis for the computation offered by petitioners is in serious doubt.

The percentages for breakage and mark-up were provided by the testimony of Irving Grossman. Given the unreliability of his testimony, without more, these percentages were properly rejected by the Administrative Law Judge.

On the issue of whether AGDN was closed for the first three months of each year, the Administrative Law Judge noted that, according to the corporate tax returns submitted into evidence, AGDN's method of accounting was on the cash basis method. Further, AGDN's sales tax returns indicated that sales were reported for all quarters of the audit period. Since sales are thus reported on the cash basis as the funds are received, the Administrative Law Judge determined that the business did not close for three months as alleged by petitioners. Thus, the evidence presented supports the use of the external index to determine income for all quarters.

We next address the issue of penalties. Tax Law § 1145(a)(1)(vi) imposes the omnibus penalty and states, in pertinent part, that:

"Any person required by this article to file a return, who omits from the total amount of state and local sales and compensating use taxes required to be shown on a return an amount which is in excess of twenty-five percent of the amount of such taxes required to be shown on the return shall be subject to a penalty equal to ten percent of the amount of such omission If the tax commission determines that

such omission was due to reasonable cause and not due to willful neglect, it shall remit all of such penalty."

Pursuant to the authority noted above, the omnibus penalty is imposed when it is determined that petitioners omitted an amount greater than 25% of the tax required to be shown on the sales tax return, unless petitioners carry the burden of proving that underreporting was due to reasonable cause and not willful neglect. The Administrative Law Judge concluded that petitioners have failed to meet such burden to establish reasonable cause.

Petitioners take exception to that portion of the Administrative Law Judges determination which held that: (1) the Division's audit method and results were reasonable; (2) that petitioners' cannot substitute their "estimate" of tax due for that determined by the Division; and (3) omnibus penalties were sustained. Petitioners argue that the fact that AGDN was closed the first three months of each year was not taken into account and petitioners' method of estimating tax was more accurate than the Division's estimate.

We affirm the determination of the Administrative Law Judge.

After reviewing the allegations of petitioners presented on exception, along with a review of the record before us, we would only add the following to the Administrative Law Judge's conclusion regarding petitioners' attempt to substitute their "estimate" for the Division's.

Petitioners cannot invalidate the Division's audit by offering their own "estimate" of tax liability as a substitute for the Division's (Matter of Albanese Ready Mix, Tax Appeals Tribunal, June 15, 1989; Matter of Sol Wahba, Inc. v. New York State Tax Commn., 127 AD2d 943, 512 NYS2d 542, 543). The applicable rule is that the petitioner has the burden to prove by clear and convincing evidence that the method of audit used or the amount of tax assessed was erroneous (Matter of Surface Line Operators Fraternal Org. v. Tully, *supra*). Petitioners cannot satisfy that burden of proof by failing or refusing to maintain adequate books and records and then offering as a substitute for the Division's audit their own "estimate" of tax due.

Therefore, we affirm the determination of the Administrative Law Judge for the reasons stated in the determination.

We reject petitioners' request to modify certain findings of fact and conclusions of law as the record supports those findings and conclusions reached by the Administrative Law Judge.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of AGDN, Inc. and Eric Grossman, as officer of AGDN, Inc., is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petitions of AGDN, Inc. and Eric Grossman, as officer of AGDN, Inc., are denied;

and

4. The four notices of determination and demands for payment of sales and use taxes due, dated March 20, 1990, as modified, are sustained.

DATED: Troy, New York
February 6, 1997

/s/Donald C. DeWitt
Donald C. DeWitt
President

/s/Carroll R. Jenkins
Carroll R. Jenkins
Commissioner

/s/Joseph W. Pinto, Jr.
Joseph W. Pinto, Jr.
Commissioner