STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
LUIS LIMA	:	DECISION DTA NO. 820076
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 March 1, 1998 through November 30, 2000.	: :	

Petitioner Luis Lima, 117 Smith Street, Brooklyn, New York 11217, filed an exception to the determination of the Administrative Law Judge issued on March 9, 2006. Petitioner appeared by Leonard L. Fein, CPA. The Division of Taxation appeared by Mark F. Volk, Esq. (Jennifer A. Murphy, Esq., of counsel).

Petitioner filed a brief in support of his exception and the Division of Taxation filed a brief in opposition. Petitioner filed a reply brief. Oral argument, at petitioner's request, was heard on November 6, 2006 in New York, New York.

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

ISSUES

I. Whether the Division of Taxation properly determined additional sales tax due from Luis Lima.

II. Whether petitioner has established any facts or circumstances warranting the abatement of penalties imposed pursuant to Tax Law § 1145(a)(1)(i) and (vi).

FINDINGS OF FACT

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

Petitioner, Luis Lima, owned and operated as a sole proprietorship a liquor store known as Sterling Wines & Liquors located at 117 Smith Street, Brooklyn, New York. The store is located in a mixed residential and commercial area in downtown Brooklyn and is not far from courthouses, a subway station, retail stores and apartment buildings. The store was open from 10:00 A.M. to 10:00 P.M. Monday through Thursday and from 10:00 A.M. to 11:00 P.M. on Friday and Saturday. Petitioner was generally not present in the store during the day. During that time, petitioner's employees ran the store. Petitioner usually came to the store at about 5:00 P.M. The store also sold Lotto tickets. The store had a cash register and had two aisles displaying wines and liquors on each side.

On January 17, 2001, the Division of Taxation ("Division") sent a letter to petitioner scheduling an appointment for March 29, 2001 on which to commence a sales and use tax field audit of Sterling Wine & Liquors for the period March 1, 1998 through November 30, 2000. The Division's letter requested that all of the business's books and records for the audit period be available for review. Among the records specifically requested were the general ledger, cash receipts journal, cash disbursements journal, Federal income tax returns, purchase invoices, sales invoices, guest checks, cash register tapes, bank statements, financial statements and day books.

In response to the Division's request, petitioner produced his Federal income tax returns for the years 1998, 1999 and 2000; cash register tapes for the entire audit period; day books for the entire audit period; bank statements for the entire audit period and purchase invoices.

Petitioner also provided a cash disbursements journal for 2000 and a general ledger for 2000, which indicated $464,402.00 in wine and liquor purchases.

Upon initial review, petitioner's records appeared complete and accurate. Petitioner's books reconciled with taxable sales as reported. Individual transactions could be traced back to the original source or forward to a final total. Bank deposits were not in substantial agreement with the books and records because such deposits included Lotto sales and rent receipts from petitioner's rental properties.[1] There were minor differences in gross sales or gross receipts as reported on petitioner's sales tax returns, day books, and Federal income tax returns.

The Division sent letters to petitioner's wine and liquor suppliers to verify petitioner's purchases for the audit period. The identity of the suppliers was determined from a review of petitioner's purchase invoices for the months of October and November 2001. In response to the Division's request, the suppliers provided the dollar amount of sales made to petitioner for each month of the audit period. In total, the supplier information revealed purchases by petitioner of $1,046,541.00 for the audit period. Additionally, the Division's subsequent review of petitioner's cash disbursements journal for the period January 1, 2000 through November 30, 2000 showed $49,413.00 in purchases from other suppliers that were not part of the Division's original survey.

Petitioner reported a total of $635,885.00 in taxable sales for the audit period.[2] Given this excess of purchases over reported sales, the Division determined that petitioner's books and

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[1] Petitioner's Federal income tax returns show that petitioner owned six rental properties in Brooklyn during the years at issue. Petitioner's returns also show that he owned a laundromat in Brooklyn during the years in question.

[2] Petitioner reported no nontaxable sales during the audit period.

records were inaccurate and unreliable for the purpose of verifying petitioner's taxable sales and therefore determined to estimate petitioner's sales tax liability using a purchase markup method.

First, the Division calculated petitioner's audited purchases by taking total purchases from the information obtained from petitioner's suppliers and increasing that amount by an error rate of 12.82 percent. Audited purchases thus totaled $1,180,708.00. The error rate was determined by dividing the $49,413.00 in purchases for the period January 1, 2000 through November 30, 2000 from suppliers that were not a part of the Division's survey by the amount of purchases shown by the supplier survey for the same period. After making a one percent allowance for pilferage and breakage, the Division determined that petitioner had $1,168,900.00 in merchandise available for sale during the audit period.

Next, the Division conducted two tests to determine petitioner's markup on the wine and liquor sold in the store. For the first test the cost of the items was determined by a detailed review of purchase invoices for the month of November 2001. The auditor then visited the store on December 26, 2001 to record the selling prices as posted in the store of all items available for sale. This date was chosen by petitioner. An employee at the store assisted the auditor in the recording and listing of selling prices. This first test yielded a markup of 69.8 percent. At petitioner's request, a second markup test was conducted. For this test the cost of items sold was determined by a detailed review of purchase invoices for October and November 2001. On February 4, 2002 the auditor again visited the store to record the selling prices of all items available for sale. Again, an employee at the store assisted the auditor in the listing of selling prices. This second test revealed a markup of 60.8 percent. The Division then averaged the results of the two tests to reach a markup of 65.3 percent for the audit period.

The Division then applied the markup of 65.3 percent to the merchandise available for sale of $1,168,900.00 to reach audited taxable sales of $1,932,192.00. After subtraction of taxable sales reported, such calculations result in additional taxable sales of $1,296,307.00 for the audit period with additional tax due thereon of $106,945.00.

On February 7, 2003, the Division issued to petitioner a Notice of Determination which asserted $106,945.00 in additional sales and use tax due, plus penalty and interest, for the period March 1, 1998 through November 30, 2000. The notice asserted penalties pursuant to Tax Law § 1145(a)(1)(i) and (vi).

Petitioner's Federal Schedule C's for the liquor store for the years 1998, 1999 and 2000 reported the following inventory amounts and, by implication, inventory increases:

Year	Beginning Inventory	Ending Inventory	Amount of Increase
1998	$215,235.00	$263,160.00	$47,925.00
1999	$263,160.00	$279,980.00	$16,820.00
2000	$279,980.00	$568,000.00	$288,020.00

Petitioner's returns reported purchases for the years 1998, 1999 and 2000 as follows:

1998	1999	2000
$187,420.00	$185,215.00	$464,402.00

The vendors surveyed by the Division on audit indicate annual purchases by petitioner as follows:

1998 (Mar.-Dec.)	1999	2000 (Jan.- Nov.)
$315,642.00	$345,467.00	$385,432.00

Petitioner's Schedule Cs for the liquor store reported the following gross receipts, cost of goods sold, gross profit and, by implication, markup percentages for the years 1998, 1999 and 2000:

Year	Gross Receipts	Cost of Goods Sold	Gross Profit	Mark-up Percentage
1998	$236,302.00	$139,495.00	$96,802.00	69.4%
1999	$241,187.00	$168,395.00	$72,795.00	43.2%
2000	$243,156.00	$176,382.00	$66,774.00	37.9%

During the audit, petitioner provided the Division with a December 2000 inventory list. Petitioner, Luis Lima, purportedly personally compiled this list, which claims to show an inventory of $625,951.00 as of December 31, 2000.

Although the liquor store had employees throughout the audit period, the schedule C's for 1999 and 2000 contain no deduction for wages. The 1998 return does list a deduction for wages.

According to petitioner's Federal income tax returns, his rental real estate generated an aggregate loss of $27,457.00 for the years 1998, 1999 and 2000. Petitioner's returns for the same years reveal total net profit from his laundromat business of $35,458.00. Petitioner's returns also reveal income from lottery sales totaling $42,103.00 for the years 1999 and 2000.

Petitioner's Federal income tax returns indicate that petitioner claimed a total of $190,740.00 in depreciation with respect to his rental properties for the years 1998, 1999 and 2000.

Petitioner filed joint Federal income tax returns with his wife in 1998, 1999 and 2000. Petitioner listed three children and a parent as dependents on his returns.

Petitioner did not personally appear at the hearing and did not testify. Petitioner's representative did testify at hearing, but conceded that he has never visited the liquor store.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge noted the standard for reviewing a sales tax audit where external indices were employed. The Administrative Law Judge observed that the records provided by petitioner on audit initially appeared internally consistent, complete and accurate. However, letters from the Division to petitioner's suppliers to verify petitioner's purchase records indicated a significant discrepancy between petitioner's reported sales and petitioner's purchases based on his suppliers' information. Based upon this discrepancy, the Division deemed petitioner's records to be inaccurate and unreliable and, therefore, resorted to a mark-up audit methodology.

The Administrative Law Judge found that the Division's use of third-party information to verify petitioner's purchase records was proper. The Administrative Law Judge pointed out that verification of books and records is an integral, accepted part of the audit process, and rejected petitioner's contention that the Division improperly disregarded his records by requesting information from suppliers.

The Administrative Law Judge found that the discrepancy between the third-party purchase information and petitioner's reported taxable sales was sufficient to show the inaccuracy and unreliability of petitioner's records and justified the Division's use of an indirect or estimated audit methodology. It was petitioner's burden to establish the reason for the difference between the supplier information and his sales tax returns and thereby establish that the Division's use of a mark-up audit was improper.

Petitioner claimed that the excess of purchases over reported sales resulted from a buildup of inventory. The Administrative Law Judge observed, however, that neither petitioner nor any of his employees testified at hearing to provide evidence of such an inventory buildup. The Administrative Law Judge noted that the only testimony presented on petitioner's behalf was that of his representative, a man who had never been to the store and who had no direct knowledge that the excess of purchases over reported sales resulted from an inventory buildup. As to the inventory list provided by petitioner to the Division on audit, the Administrative Law Judge found that absent testimony from the individual who prepared the document (petitioner) regarding how and when it was prepared, and without an opportunity to assess petitioner's credibility, the inventory list could be accorded little evidentiary weight. The Administrative Law Judge noted that the document's credibility was further undermined by the unexplained difference between the $625,951.00 in inventory indicated therein and the $568,000.00 ending inventory as listed on petitioner's 2000 schedule C. Also weighing against petitioner's claim of an inventory buildup is the apparent lack of a source or sources of funds for such buildup. Petitioner argued that his other businesses provided the source of funds for the inventory buildup. The Administrative Law Judge pointed out, however, that a review of petitioner's Federal income tax returns for the years 1998, 1999, and 2000 showed that such other businesses generated only about $50,000.00 in net income over those three years, far short of the approximately $500,000.00 necessary to fund the claimed inventory buildup. Even if one were to consider depreciation claimed on petitioner's rental properties as cash available to petitioner, the total cash available to petitioner to fund the inventory buildup remains about $250,000.00 short of the necessary amount. The Administrative Law Judge observed that this discussion of cash available to petitioner to finance his claimed inventory buildup also assumed that all of such cash was used to purchase inventory for the liquor store. The Administrative Law Judge found this an unlikely proposition, since it makes no allowance for household or personal expenses for petitioner, his wife, three children or dependent parent.

Also lacking in the record, assuming petitioner's sales and income tax returns are accurate, is any rationale as to why petitioner would seek to maintain an inventory ($568,000.00) equal to nearly three years' worth of sales ($635,885.00). Further, the Administrative Law Judge noted, petitioner offered no evidence to show that any part of the apparent buildup was the result of timing differences; that is, that inventory purchased in a prior year was paid for in 2000. Petitioner claimed that he received letters from his suppliers for nonpayment, but offered no such letters in evidence to support that claim. Finally, the Administrative Law Judge observed, petitioner offered no evidence to support his claim that some portion of the excess of purchases over sales resulted from theft. Having failed to establish any explanation for the excess of purchases over sales, the Administrative Law Judge found that petitioner failed to carry his burden to prove that his records were complete and accurate during the audit period.

Given the unreliability of petitioner's records, the Administrative Law Judge found that the Division's resort to an indirect audit method was justified (***see, Matter of Murphy***, Tax Appeals Tribunal, March 17, 1994; ***Matter of Robritt Liq. Store***, Tax Appeals Tribunal, December 27, 1991). Thus, the only issue remaining for the Administrative Law Judge with respect to the assessment was whether petitioner had established that the amount of tax assessed as the result of application of such method was erroneous.

The Administrative Law Judge found that petitioner failed to establish any such errors. Petitioner argued that the markup was excessive, but offered no evidence to show it. Petitioner also offered no evidence to support his claim that the Division used discounted cost amounts as opposed to petitioner's actual cost amounts. The record shows that the cost of the items in the markup was determined by a detailed review of purchase invoices for the months of October and November 2001, and selling prices used in the markup were taken from the prices as posted in petitioner's store. Indeed, petitioner's employee assisted the auditor in listing the posted prices. Furthermore, the Administrative Law Judge observed that the markup of 65.3 percent, which was used by Division in its deficiency calculations, falls within the markup of 69.4 percent which is indicated by petitioner's 1998 income tax return. Petitioner also contended that the inventory at the time of the markup test was unrepresentative because it contained holiday items. Again, petitioner did not offer evidence to support this claim.

The Division asserted penalties pursuant to Tax Law § 1145(a)(1)(i) and (vi), respectively, for failure to file a return or to pay or pay over the sales and use taxes due within the time required and petitioner's omission from the total amount of sales and use taxes required to be shown on a return an amount which is in excess of 25 percent of the amount of such taxes required to be shown on the return. Such penalties may be abated, pursuant to Tax Law § 1145(a)(1)(iii) and (vi), when the taxpayer establishes that such omission was due to reasonable cause and not due to willful neglect.

The Administrative Law Judge found that petitioner failed to establish reasonable cause or the absence of willful neglect in the present matter. Petitioner argued that he reported all sales as indicated by the cash register tapes and contended that he had no reason to question anything as being awry. The Administrative Law Judge rejected this contention in light of petitioner's approximately $500,000.00 of excess purchases over reported sales for the audit period. This disparity, the Administrative Law Judge observed, clearly draws into question the accuracy of the store's sales tax returns. Petitioner also urged that his frequent absence from the store did not indicate willful neglect, but this claim was not supported by any evidence that the subject deficiency was caused by acts or omissions of his employees. Nor did petitioner offer any evidence that his delegation of responsibility to his employees was reasonable. The Administrative Law Judge concluded that petitioner's absences from the store did not support a finding of reasonable cause. The Administrative Law Judge found that the substantial discrepancy between the sales tax reported on the returns and the sales tax found to be due on audit supported the imposition of penalties (***see, Matter of S.H.B. Super Markets v. Chu***, 135 AD2d 1048, 522 NYS2d 985).

ARGUMENTS ON EXCEPTION

Petitioner argues on exception, as he did below, that the mark-up audit performed by the Division was not warranted because he maintained complete and accurate records, and that the Division improperly resorted to an indirect audit method. Petitioner claims that the Division improperly disregarded his records in seeking to confirm petitioner's purchases with his suppliers. Petitioner contends that the disparity between his purchases and reported taxable sales resulted from an inventory buildup and that the large buildup in inventory reflected on the 2000 Federal Schedule C results from timing differences, i.e., inventory purchased in a prior year was paid for in 2000.

Petitioner further contends that even if it was justified, the mark-up audit was substantially wrong because the Division used improper cost amounts. That is, petitioner asserts that the Division used discounted cost amounts for retailers who pay within 10 days as opposed to petitioner's actual costs. Petitioner also asserts that the markup was flawed because it was performed on holiday items which have a higher markup. Finally, petitioner asserts that, since he was often not present at the store, the allowance for pilferage should have been greater.

Petitioner asserts that penalties imposed herein should be canceled. Petitioner notes that he maintained records as required under the Tax Law and reported and paid sales tax consistent with the amounts shown on his cash register tapes. Petitioner asserts that his frequent absence from the business did not constitute willful neglect and that he properly and reasonably delegated responsibility to his employees.

OPINION

Petitioner, through his representative Mr. Fein, claims that his books and records are accurate, even though his inventory purchases exceeded reported sales by a substantial amount. The store's ending inventory in 1999 was $279,000.00. The store's ending inventory at the end of 2000 was $568,000.00.[3] The Division asked for source documentation to show how the liquor store's cash flow could support this growth in the store's inventory. Instead of source documents, the Division was provided with a list prepared by petitioner (Exhibit "10"). Other than this list, petitioner did not testify or put in documentation to show how the store's sales could support these inventory purchases. Instead, Mr. Fein argued that there are many reasons

[3]Petitioner's representative argued that petitioner's records should be deemed adequate so long as petitioner's cash register tapes tie into his bank accounts. Since petitioner commingled funds from his other businesses into the store's bank account, they do not, in fact, tie into petitioner's daybooks (Hearing Tr., p. 37). Based on Mr. Fein's own premise, petitioner's books and records would still be held insufficient for audit.

why purchases could exceed sales, e.g., theft. However, no evidence of theft was offered in evidence. In fact, Mr. Fein admitted he had no idea of whether any theft of inventory had taken place. At audit, petitioner's gross sales were reconciled to his Federal income tax returns and sales tax returns. Petitioner's actual gross sales were found not to be in substantial agreement with the sales reported on petitioner's State and Federal returns, but petitioner's evidence does not explain this. Petitioner argued that the auditor used an improper mark-up percentage when conducting the audit, but again, offered no source documents to show an error in the audit method or results. Mr. Fein was allowed to testify on petitioner's behalf, but on cross examination he admitted that he had never been to the liquor store and only knew what petitioner told him. Given the fact that Mr. Fein admitted he had never been to petitioner's store, had no personal first hand knowledge of its day-to-day operations, and admitted that he only knew what petitioner told him, his testimony was not legally competent and can be given no weight.

In order to arrive at a reasonable estimate of sales, a mark-up percentage needs to be applied to cost of goods sold. Cost of goods sold is equal to opening inventory plus purchases minus closing inventory. Accordingly, cost of goods sold will equal purchases only if opening and closing inventory are the same. An increase in closing inventory will result in a reduction of cost of goods sold and thus estimated sales. Also, if an actual inventory is taken only annually and the sales tax audit periods do not conform to petitioner's accounting year, further imprecision in the estimate may result. While plausible explanations of differences between a taxpayer's reported sales and the Division's estimates could be based on these theories, there is no evidence in the record that would support them in the present case.

Finally, petitioner argued that penalties should be abated, but again, evidence in the record does not support his argument. As we have stated in other cases, the arguments of petitioner ' s representative are not a substitute for evidence (***Matter of Hero***, Tax Appeals Tribunal, September 11, 2003). Petitioner's arguments here were neither compelling nor supported by credible evidence. Accordingly, we affirm the determination of the Administrative Law Judge for the reasons stated therein.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Luis Lima is denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petition of Luis Lima is denied; and

4. The Notice of Determination dated February 7, 2003 is sustained.

DATED: Troy, New York
April 19, 2007

/s/ Charles H. Nesbitt
Charles H. Nesbitt
President

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

/s/ Robert J. McDermott
Robert J. McDermott
Commissioner