STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
DARMAN BUILDING SUPPLY CORPORATION	:	DECISION DTA NO. 822058
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, 2001 through February 29, 2004.	:	

Petitioner, Darman Building Supply Corporation, filed an exception to the determination of the Administrative Law Judge issued on April 29, 2010. Petitioner appeared by Everett Hopkins, Esq. The Division of Taxation appeared by Mark Volk, Esq. (Osborne K. Jack, Esq., of counsel).

Petitioner filed a brief in support of its exception. The Division of Taxation filed a letter brief in lieu of a formal brief in opposition. Petitioner did not file a reply brief. Petitioner's request for oral argument was withdrawn.

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

ISSUE

Whether the audit methodology was reasonably calculated to determine the amount of sales and use taxes due.

FINDINGS OF FACT

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

forth below.

Petitioner, Darman Building Supply Corporation (Darman), was a supplier of building materials to contractors.

On February 24, 2004, the Division of Taxation (Division) sent an appointment letter to Darman stating that its sales and use tax records had been scheduled for a field audit for the period March 1, 2001 through February 29, 2004. The letter stated that "[a]ll books and records pertaining to the sales and use tax liability, for the audit period, must be available on the appointment date." A schedule of books and records to be produced was attached to the letter.

On June 28, 2004, an audit was conducted at petitioner's representative's office. Initially, the only information provided was a general ledger for the period April 1, 2001 through March 31, 2004, the income tax returns for these periods and a series of exempt sales forms. The Division was not presented with any invoices or a description of the jobs that were performed.

In the course of the audit, the Division ascertained that it could not reconcile the gross sales per the books with the gross sales reported on the federal income tax returns. For the fiscal year ended March 31, 2002, sales per the general ledger were $5,034,637.00, while the sales reported on the income tax returns for the year were $8,671,687.00. Although asked, no explanation was offered by petitioner as to why the general ledger figure was so much lower than the income tax figure. From April 2002 through March 2004, the differences in the sales figures were not considered significant. Therefore, the sales amounts reported in the general ledger were used. For each fiscal year, the highest sales figures were used.

The Division gave petitioner the following list of those documents that it wished to examine on the next audit appointment: sales invoices with exemption certificates for

nontaxable sales for the quarter ending August 31, 2003; materials purchase invoices for the quarter ending August 31, 2003; expense purchase invoices for repair and maintenance including auto repair, office expenses, warehouse cost and miscellaneous expenses for the quarter ending August 31, 2003; the invoice for a motor vehicle purchased September 30, 2002; and sales journals for the fiscal year ending March 31, 2002.

On August 4, 2004, the audit was reassigned to a new auditor, who scheduled an audit appointment at the office of Darman's accountant. In a letter dated August 19, 2004, the new auditor requested that petitioner provide the records requested by the previous auditor. Written requests for these records were also made on February 7, 2005, April 21, 2005, November 29, 2005, February 24, 2006, March 13, 2006 and June 29, 2006.

On December 23, 2004, the auditor met with petitioner's accountant and reviewed the general ledger for the period April 1, 2001 through March 31, 2004. However, the items requested in the letter of August 19, 2004 were not provided. The auditor and the accountant then discussed the audit procedure, the documents that were still required and Darman's protest rights. Another appointment was scheduled.

After encountering difficulty in scheduling a subsequent audit appointment, the auditor advised petitioner's representative that unless additional documentation was produced, he would issue a statement of proposed audit change based upon the information that was available.

On May 23, 2005, an appointment was held at the accountant's office. During this meeting, petitioner's accountant presented a series of contractor exempt purchase certificates. No other records, such as sales invoices or contracts, which would have provided a description of the job that was performed, were presented. Consequently, the auditor concluded that the

certificates did not substantiate the exempt sales.

On May 24, 2005, the Division issued a Statement of Proposed Audit Change for Sales and Use Tax asserting a deficiency of sales and use taxes in the amount of $2,098,491.43 plus penalties and interest. The statement was based on information that was available at that time, which consisted of a general ledger for the period April 1, 2001 to March 31, 2004, the income tax returns for those periods and a series of exempt sales forms. Invoices or a description of the job that was performed were not available. The asserted deficiency was calculated by disallowing all of the exempt sales that were reported on Darman's sales and use tax returns because no documentation was presented to substantiate the exemptions. In addition, the Division concluded that there was one fixed asset transaction, which the Division determined was taxable and which resulted in additional taxes due of $657.77.

On June 21, 2005, the Division received the Statement of Proposed Audit Change from petitioner's accountant with an explanation that petitioner needed additional time to produce invoices and tax exemption certificates. The Division replied that petitioner could have approximately 30 more days to provide documentation, and thereafter, the audit would be closed as a disagreed case. Following a series of unsuccessful attempts by the Division and petitioner's accountant to contact each other, the parties agreed to meet on November 7, 2005 at the office of petitioner's accountant.

On November 7, 2005, the auditor went to the office of the taxpayer's accountant and reviewed additional documentation including sales invoices for the period June 1, 2003 through August 31, 2003, sales transaction details by account for the same period of time and contractor exempt purchase certificates. At the end of the meeting, they agreed to schedule another

appointment on December 29, 2005.

On November 29, 2005, the auditor sent a letter, which again listed the items required and confirmed the appointment in December. At the December meeting, the auditor was advised that petitioner did not have any additional records. Upon returning to his office, the auditor prepared a Test Period Audit Method Election form and cover letter and mailed them to Darman and Darman's accountant.

On March 10, 2006, a meeting was held at the Division's Queens District Office. During the meeting, petitioner's accountant, at that time, signed the test period election form with regard to sales.

The assessment that followed was based on the following review of four discrete areas: sales, disallowed exempt sales, expenses and fixed assets.

(a). In order to determine the amount of tax due on petitioner's sales, petitioner's accountant provided a document titled Transaction Detail by Account. The document set forth a list of each customer and the amount of the sale to that customer for the period June 1, 2003 through August 31, 2003. Next to each transaction, petitioner's accountant made a notation showing whether the sale was taxable or exempt. The Division noted that according to the schedule, there were taxable sales of $882,552.00, while petitioner reported taxable sales of $495,519.00 during the same period of time. The Division subtracted the reported taxable sales of $495,519.00 from the taxable sales per the schedule of $882,552.00, determining that there were additional taxable sales during the test period of $387,033.00. The Division then divided the additional taxable sales by the reported taxable sales to calculate an error rate of 78.1066 percent. The error rate was multiplied by the reported taxable sales for each quarter during the

audit period to find the additional taxable sales for each quarter. The additional taxable sales were, in turn, multiplied by the tax rate in effect during that particular quarter, to calculate the amount of additional tax due. The sum of the additional tax due for each sales tax quarter during the audit period was $483,219.25.

(b). The Division also computed an error rate based upon the exempt sales that were not substantiated. Since sales were made in New York City and Suffolk County, which had different sales tax rates, different calculations were performed for each location. With respect to the sales in New York City, the Division disallowed claimed exempt sales in the amount of $98,808.72. The total amount of exempt sales, $2,035,805.50, was divided by the amount of disallowed exempt sales to calculate an error rate of 4.8535 percent. The error rate was then applied to the audited exempt sales during the audit period, determining additional taxable sales of $1,010,369.00 and additional tax due of $84,639.44.

For Suffolk County, the disallowed exempt sales were $18,118.98. This amount was divided by the amount of exempt sales during the test period of $2,035,805.50, resulting in an error rate of 0.89 percent. The Division multiplied the error rate by the amount of reported exempt sales during the audit period resulting in disallowed exempt sales of $185,274.00.

The total amount of tax due arising from disallowed exempt sales was $100,512.15.

(c). According to petitioner's general ledger, the total of all expenses for the sales tax quarter June 1, 2003 through August 31, 2003 was $119,560.00. The expenses included such items as an automobile lease, building maintenance, equipment rental, office repairs, supplies, utilities and an expense for the warehouse. The auditor had previously requested expense invoices for the period. However, none were provided. The Division also determined that the

expense purchase records did not allow the Division to trace any transactions back to the original source or forward to the final total. Since no invoices were presented, the Division projected the expenses throughout the audit period and then multiplied the expenses, broken down by the applicable sales tax quarter, by an error rate of 100 percent. The product was then multiplied by the sales tax rate in effect for the quarter in issue, which resulted in tax due of $10,005.08.

(d). In regard to fixed assets, the Division assessed sales and use tax in the amount of $657.77 on petitioner's purchase of a motor vehicle because petitioner was unable to produce an invoice to substantiate that it had paid tax on this purchase. The Division did not review any registration material in determining whether to assess tax.

On the basis of the forgoing audit findings, the Division issued a Notice of Determination to petitioner assessing sales and use tax in the amount of $594,394.25 plus penalty and interest for a balance due of $1,270,513.38. Both statutory and omnibus penalties were assessed pursuant to Tax Law § 1145(a)(1)(i) and (vi) because the additional tax due was more than 25 percent of the audited tax due.

In order to determine the amount of tax due, it was the practice of petitioner's principal, Mr. Green, to examine all of the deposits for a sales tax quarter and determine which ones were taxable. He calculated the tax due on the total amount of taxable receipts. Mr. Green based his conclusion of whether a job was taxable on his intimate knowledge of the business and of the jobs performed.

At the hearing, petitioner presented the testimony of Mr. Jeffrey Terry, an accountant who was retained by petitioner after the period in issue. Mr. Terry reviewed the audit findings and prepared the following analysis:

(a). Mr. Terry maintained that the Division's calculation of tax due on additional taxable sales was erroneous because petitioner believes that it mistakenly classified two transactions as taxable sales when they were exempt: Almar GA Atl Term 03102 for $31,356.83 and Aspro Solco JC Penny for $890.71.[1] Mr. Terry subtracted the total of the two sales from the original taxable sales amount of $882,552.00 to calculate revised taxable sales for the test period of $850,304.00. Mr. Terry further reduced the amount by the taxable sales collected during the test period of $196,136.00 and by the amount of taxable sales collected in subsequent periods of $609,426.00.[2] As a result of these calculations, Mr. Terry found that there were additional taxable sales during the test period of $44,743.00. Mr. Terry's computations resulted in a revised error rate of 5.5542 percent and a finding that the amount of additional tax due on sales was $34,362.21.

(b). Relying upon five exemption certificates and the understanding that two other customers were exempt from sales tax, Mr. Terry recalculated the error rate on disallowed exempt sales in New York City from 4.85 percent to .44 percent. The proposed revised error rate calculated by Mr. Terry resulted in tax due in the amount of $9,798.00. With respect to disallowed exempt sales in Suffolk County, Mr. Terry found that there was one sale to a police organization in Suffolk County. Petitioner treated this sale as exempt. According to Mr. Terry,

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[1] Mr. Terry's conclusion that these sales were not taxable was based solely on the memory and representation of petitioner's principal. Mr. Terry did not review the actual invoices or supporting documentation.

[2] Mr. Terry maintained that reliance upon the transactions detail report was misplaced because petitioner reported sales tax when payment was received not when the sales took place. A review of the transaction detail report led Mr. Terry to the conclusion that some of the sales within the test period were actually received by petitioner after the test period. Mr. Terry did not perform a reconciliation to determine if the tax was actually collected and remitted to New York. Nor did he perform a test to ascertain if the procedure described by petitioner's principal was actually followed.

this reduced the error rate and the amount of tax due to zero.

(c). Mr. Terry also recalculated the amount of tax due on petitioner's expenses over the test period. Mr. Terry submits that tax should not have been assessed on the motor vehicle lease because a well-established company, such as Ford, would have charged sales tax. Mr. Terry supported this argument with proof that the registration on this vehicle was due for renewal.

According to Mr. Terry, it would not have been possible to register the vehicle unless sales tax was paid. A second category of expense that was challenged by Mr. Terry was characterized as payments to the owner. Mr. Terry maintained that no tax was due because these payments were repayments of loans to the owner for specific expense items. The third category was utilities. Mr. Terry submitted that the utilities would have charged sales tax and therefore sales tax was already paid on the utilities. Mr. Terry's analysis resulted in disallowed expenses of $2,966.90. The disallowed expenses were divided by the expenses tested of $7,339.90 resulting in an error rate of 40.4215 percent and tax due of $4,044.33. Prior to making these calculations, Mr. Terry did not review the lease from Ford, the utility bills or any supporting documentation regarding payments to the owner.

(d). With respect to fixed assets, Mr. Terry concluded that no tax was due. As explained in petitioner's brief, petitioner maintains that a responsible company would have charged sales tax.

On the basis of Mr. Terry's calculations, petitioner believes that the revised amount of tax due is $48,204.65.

In its brief, the Division agreed to reduce the amount of additional tax due from disallowed exempt sales in New York City from $84,639.44 to $9,798.00, which is the amount proposed by

petitioner. The Division also agreed to reduce the amount of tax assessed on the basis of disallowed exempt sales in Suffolk County from $15,872.71 to zero. On the basis of the forgoing, the amount of tax asserted to be due is revised from $594,394.25 to $503,680.82. Except for the concession regarding the amount of disallowed exempt sales, the Division argues that petitioner has not presented sufficient evidence warranting any additional adjustments and that, as adjusted, the notice should be sustained.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge upheld the Notice of Determination issued on November 13, 2006, modified as indicated in the finding of fact above, wherein the Division agreed to reduce the amount of additional tax assessed for unreported sales from $594,394.25 to $503,680.82 due to the allowance of certain exempt sales.

The Administrative Law Judge affirmed the balance of the tax assessed on sales on the basis that petitioner had consented to an estimated audit by signing an audit method election form agreeing to the use of the test period audit, citing ***Matter of James Kennedy & Co. v. Chu,*** 125 AD2d 773, [1986].

The Administrative Law Judge dismissed petitioner's argument that the Division's use of a test period method was erroneous, in that when there was a difference between the sales indicated on the general ledger and those reported on the federal return, the auditor chose the amount resulting in the most taxes due. The Administrative Law Judge rejected this argument by quoting this Tribunal in ***Matter of AGDN, Inc.***, (Tax Appeals Tribunal, February 6, 1997):

> 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).

Although the audit method election was not used with respect to expenses, the Administrative Law Judge found that the inadequacy of petitioner's records warranted the use of an indirect audit method. The Administrative Law Judge stated that, "[t]he absence of the records contravenes Tax Law § 1135(a)(1), which directs persons required to collect sales tax to maintain records sufficient to verify all transactions, in a manner suitable to determine the correct amount of tax due. The records required to be maintained 'include a true copy of each sales slip, invoice, receipt, statement or memorandum.'"

The Administrative Law Judge further rejected petitioner's objection to the auditor's allegation that the utility bills could have been for a private home, citing Tax Law § 1132(c)(1), which provides for the presumption that all sales are subject to tax and places the burden of proof on petitioner (***Matter of Meskouris Bros. v. Chu***, 139 AD2d 813 [1988]).

The Administrative Law Judge also rejected petitioner's argument that it would collect and remit the sales tax when it received the last amount from its customer and that there were instances when gross sales were reported but never, in fact, collected. The Administrative Law Judge noted that 20 NYCRR 532.1(a)(2) states that where a vendor makes a sale for which payment is not received at the time of delivery, such sale must be reported on the return covering the period in which the sale is made. Thus, if the sale is a taxable sale, the full amount of the tax must be remitted with the return whether or not any money was collected at the time of sale.

The Administrative Law Judge also rejected petitioner's claim that payments in round

numbers to the owner from the firm were not payment for expenses but were rather returns of loans, finding that petitioner failed to meet its burden of proof to support this argument.

ARGUMENTS ON EXCEPTION

On exception, petitioner argues that the Administrative Law Judge failed to acknowledge that the Division's sample test period was arbitrary and capricious and that it was arbitrary to use the federal income tax returns for some periods, and for other periods, petitioner's general ledger; that it was arbitrary to assess taxes on a registered motor vehicle when such would not have been registered unless taxes had been paid; that it was also arbitrary to assess taxes on utilities without establishing whether the premises were commercial or residential; and arbitrary to assume that checks made out to the principal were subject to sales tax. Petitioner further argues that it was arbitrary to claim that no sales taxes were paid on the lease of a vehicle from Ford Motor Company when such company would not lease a vehicle without charging proper sales taxes.

The Division argues in support of the Administrative Law Judge's determination that petitioner voluntarily consented to a test period audit by signing a test period method election and that once a taxpayer consents to the use of a test period audit with full knowledge of the right to insist upon a detailed audit, a taxpayer cannot claim that a complete audit was required without first rescinding the agreement, which was never done.

Further, the Division points out that it would have been permitted to use a test period audit even without petitioner's consent since the Division had previously made numerous unsuccessful requests for books and records.

In regard to the use of the amounts listed on the federal returns as well as petitioner's ledger, the Division states that petitioner provided no explanation for the discrepancies and no

reason why a lower amount was more accurate.

In regard to other objections, the Division states that the burden of proof was on petitioner and that petitioner had not produced sales documents to indicate taxes paid.

OPINION

We affirm the determination of the Administrative Law Judge.

This Tribunal has often stated the standard for reviewing a sales tax audit where external indices were employed. As we set forth in ***Matter of Your Own Choice*** (**supra**):

> To determine the adequacy of a taxpayer's records, the Division must first request ***(Matter of Christ Cella, Inc. v. State Tax Commn.***, [102 AD2d 352, 477 NYS2d 858]) and thoroughly examine (***Matter of King Crab Rest. v. Chu***, 134 AD2d 51, 522 NYS2d 978) the taxpayer's books and records for the entire period of the proposed assessment (***Matter of Adamides v. Chu***, 134 AD2d 776, 521 NYS2d 826, ***lv denied*** 71 NY2d 806, 530 NYS2d 109). The purpose of the examination is to determine, through verification drawn independently from within these records (***Matter of Giordano v. State Tax Commn.***, 145 AD2d 726, 535 NYS2d 255; ***Matter of Urban Liqs. v. State Tax Commn.***, 90 AD2d 576, 456 NYS2d 138; ***Matter of Meyer v. State Tax Commn.***, 61 AD2d 223, 402 NYS2d 74, ***lv denied*** 44 NY2d 645, 406 NYS2d 1025; ***see also***, ***Matter of Hennekens v. State Tax Commn.***, 114 AD2d 599, 494 NYS2d 208), that they are, in fact, so insufficient that it is "virtually impossible [for the Division of Taxation] to verify taxable sales receipts and conduct a complete audit" (***Matter of Chartair, Inc. v. State Tax Commn.***, 65 AD2d 44, 411 NYS2d 41, 43; ***Matter of Christ Cella, Inc. v. State Tax Commn.***, ***supra***), "from which the exact amount of tax due can be determined" (***Matter of Mohawk Airlines v. Tully***, 75 AD2d 249, 429 NYS2d 759, 760).
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> Where the Division follows this procedure, thereby demonstrating that the records are incomplete or inaccurate, the Division may resort to external indices to estimate tax (***Matter of Urban Liqs. v. State Tax Commn., supra***). The estimate methodology utilized must be reasonably calculated to reflect taxes due (***Matter of W.T. Grant Co. v. Joseph***, 2 NY2d 196, 159 NYS2d 150, ***cert denied*** 355 US 869, 2 L Ed 2d 75), but exactness in the outcome of the audit method is not required (***Matter of Markowitz v. State Tax Commn.***, 54 AD2d 1023, 388 NYS2d 176, ***affd*** 44 NY2d 684, 405 NYS2d 454; ***Matter of Cinelli***, Tax Appeals Tribunal, September 14, 1989). The taxpayer bears the burden of proving with clear and convincing evidence that the assessment is erroneous (***Matter of Scarpulla v. State Tax Commn.***, 120 AD2d 842, 502 NYS2d 113) or that the

> audit methodology is unreasonable (***Matter of Surface Line Operators Fraternal Org. v. Tully***, 85 AD2d 858, 446 NYS2d 451; ***Matter of Cousins Serv. Station***, Tax Appeals Tribunal, August 11, 1988). In addition, "[c]onsiderable latitude is given an auditor's method of estimating sales under such circumstances as exist in [each] case" (***Matter of Grecian Sq. v. New York State Tax Commn.***, 119 AD2d 948, 501 NYS2d 219, 221).

Petitioner voluntarily consented to the test period audit. As the Administrative Law Judge points out, the Division would have been permitted to use the test period audit even without petitioner's consent since the Division had previously made numerous unsuccessful requests for its books and records.

Further, in determining gross sales, the Division cannot be faulted for using the amounts from petitioner's federal income tax returns for the period April 1, 2001 through March 31, 2002, which were substantially higher than the gross sales in its general ledger, i.e., $8,671,687.00 compared to $5,034,637.00. Petitioner provided no explanation for this discrepancy. Therefore, for the period April 1, 2001 through March 31, 2002, the Division was justified in using the higher figure, and using the figures from the general ledger for the other periods.

Regarding petitioner's arguments on the sales tax due on its vehicle transactions, we note that petitioner bears a heavy burden to overcome an assessment. Tax Law § 1132© requires that a taxpayer keep records sufficient to verify all transactions. Such proof is required to overcome the presumption of correctness that attaches to a properly issued notice (***see e.g. Matter of Tavolacci v. State Tax Commn.***, 77 AD2d 759 [1980]). Herein, petitioner contends that sales tax due must have been paid because Ford Motor Company would have paid the tax and New York State would not register a vehicle if the taxes were not paid. These arguments remain unpersuasive because they are not evidence of sufficient records, such as "a true copy of each

sales slip, invoice, receipt, statement or memorandum," showing that sales tax was actually paid (Tax Law § 1132[c]). Similarly, petitioner's contention that the checks paid to the principal by the company must have represented the repayment of loans rather than the purchase of products subject to sales tax, simply based upon the fact that the checks were in even amounts, is equally unimpressive. Accordingly, we reject petitioner's argument on this point, as well. Here, petitioner failed to provide sufficient documentation to meet its burden of proof.

With regard to petitioner's challenge to the audited utility tax rate, although the auditor should have visited the premises, petitioner bears the burden of proof on this matter and has failed to adduce sufficient evidence to overcome the presumption of correctness.

We reject petitioner's argument that it was not in a position to pay sales tax based on billing because it would collect and remit its sales tax when it received the amount from the customer and that there were instances wherein gross sales were reported but were never in fact collected. The regulations at 20 NYCRR 532.1[a][2] require that when a vendor makes a sale for which payment is not received at the time of delivery, such sale must be reported on the return covering the period in which the sale is made. If the sale is a taxable sale, the full amount of tax must be remitted with the return, whether or not any money was collected at the time of the sale. As such, petitioner's argument is wholly unpersuasive.

We have considered petitioner's remaining arguments and find them to be without merit.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Darman Building Supply Corporation is denied;

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

3. The petition of Darman Building Supply Corporation is granted to the extent indicated

in conclusion of law "L" of the Administrative Law Judge's determination, but in all other respects is denied; and

4. The Notice of Determination as modified in accordance with paragraph "3" above is sustained.

DATED:Troy, New York
September 15, 2011

/s/ James H. Tully, Jr.
James H. Tully, Jr.
President

/s/ Charles H. Nesbitt
Charles H. Nesbitt
Commissioner