

STATE OF NEW YORK
DIVISION OF TAX APPEALS

In the Matter of the Petition :
of :
REFERENCE LIBRARY GUILD, INC. : DETERMINATION
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, 1981 :
through November 30, 1983. :

Petitioner, Reference Library Guild, Inc., 2267 East 12th Street, Brooklyn New York 11229, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 1981 through November 30, 1983 (File No. 801766).

A hearing was held before Robert F. Mulligan, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on September 21, 1987 at 10:45 A.M., with all briefs to be submitted by November 23, 1987. Petitioner appeared by Lester H. Winick, president. The Audit Division appeared by William F. Collins, Esq. (Gary Palmer, Esq. of counsel).

ISSUE

Whether the Audit Division properly disallowed sales claimed to have been made outside of New York State and thus not subject to sales tax.

FINDINGS OF FACT

1. Petitioner, Reference Library Guild, Inc., was selected for audit because of a Federal computer tape match program conducted by the Department of Taxation and Finance which found that gross sales reported by petitioner on its sales tax returns were substantially less than gross sales shown on its Federal income tax returns.
2. The audit was commenced by the Brooklyn District Office in July 1984.
 - (a) Gross receipts reported by petitioner on its Federal income tax returns for the fiscal

year ending September 30, 1982 were \$629,780.79. Gross sales reported on petitioner's sales tax returns for the comparable periods were \$41,332.00. The discrepancy translated into an error percentage of 1,423.71 percent.

(b) Gross sales reported by petitioner on its sales tax returns were the same as taxable sales reported by petitioner on said returns.

(c) The auditor was advised by petitioner's president, Lester H. Winick, that the operation of business ceased in September 1983, due to his illness. Mr. Winick claimed that the gross sales not shown on the return were nontaxable out-of-state sales. The auditor determined that petitioner had inadequate books and records and the error percentage of 1,423.71 percent was applied to taxable sales reported by petitioner of \$94,230.00 to arrive at additional taxable sales of \$1,341,564.00 and audited taxable sales of \$1,435,794.00.

(d) Tax due for the audit period was found to be \$118,453.01. After deducting tax paid of \$7,774.27, additional tax due was determined to be \$110,678.74.

3. On December 20, 1984 the Audit Division issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due to petitioner in the amount of \$110,678.74 in tax, \$26,038.25 in penalty, and \$30,630.35 in interest, for a total of \$167,347.34. (The field audit report indicates that an officer assessment was also issued on that date, but it is not in the record of this proceeding.)

4. Petitioner was incorporated in New York on October 18, 1966 and began business operations in New York on October 1, 1972. Lester H. Winick was the sole shareholder and officer of the corporation.

5. During the period at issue, the business was operated on a part-time basis by Mr. Winick. Its place of business was in his apartment in Brooklyn.

6. The corporation sold multi-volume reference sets. The following is a representative list of items sold and the prices at which they were offered:

<u>ITEM</u>	<u>PRICE</u>
Medical and Health Encyclopedia (22 vols.)	\$199.90
Illustrated World Encyclopedia (15 vols.)	139.90
Journal of Negro History (56 vols.)	599.90
Religious Encyclopedia (20 vols.)	199.90
Afro American Life and History (10 vols.)	199.90

7. All of petitioner's sales were generated from public transit advertising on buses and subway cars in large United States cities. A potential customer would detach a postcard from one of petitioner's displays and mail it to petitioner's post office box in Brooklyn, New York. Petitioner would then forward the inquiry to one of its independent contractor salesman located in the area where the prospect resided. If the sale was consummated, the customer usually signed an installment sale contract agreeing to pay for the books over a period of time.

8. Petitioner did not factor its accounts receivable, but retained the installment sales contracts and borrowed against them.

9. Petitioner's sales increased steadily over the years, but in 1983 Mr. Winick suffered a heart attack and stroke and was unable to work for about six months.

10. While Mr. Winick was unable to work, the business could not meet its obligations and the corporation was forced into an assignment for the benefit of creditors. Petitioner's creditors removed almost all of petitioner's books and records. Much material was discarded by employees or agents of the creditors.

11. At the hearing, petitioner produced a large quantity of postcard inquiries each with an office memorandum slip attached. These inquiries had been characterized by petitioner as "no good leads" (inquiries which did not result in sales) and dated from the latter part of 1983. A cursory examination of the several thousand inquiries reveals that the cards were completed and mailed by residents of the following metropolitan areas:

Atlanta	Memphis	Norfolk
Baltimore	Milwaukee	Philadelphia
Boston	Nashville	Pittsburgh
Chicago	New Orleans	St. Louis
Dallas	New York	Washington

This material had been shown to the auditor by petitioner at a conference, in an attempt to prove out-of-state sales.

12. Petitioner purchased display space on the basis of a certain number of buses and/or subway cars in a particular city for one month at a time. Petitioner's advertising expense, as reported on its Federal income tax returns, was \$49,812.29 for the fiscal year ending September 30, 1981 and \$86,134.30 for the fiscal year ending September 30, 1982.

13. At the hearing, the administrative law judge directed petitioner's president to contact petitioner's former advertising agencies and obtain breakdowns of its advertising expenditures for the various cities during the period at issue. The advertising agencies, Winston Network, Inc., New York Subways Advertising Co., Inc. and Aladdin Advertising Service, reported that they no longer had that information, but confirmed that they had placed transit advertising for petitioner

in Boston, Philadelphia, Baltimore, Washington, Norfolk, Richmond, Chicago, Atlanta, Charlotte and Miami during the period at issue.

14. Petitioner was able to establish by documentary evidence that the following advertising invoices from Winston Network, Inc. were paid during the period at issue:

<u>Date</u>	<u>Number of Displays</u>	<u>Location</u>	<u>Cost</u>
6/15/82	240	Philadelphia Bus & Subway	\$1,020.00
9/9/82	450	Philadelphia Bus & Subway	1,912.50
9/9/82	350	Baltimore	1,487.50
10/1/82	900	Washington Bus	2,478.60
11/9/82	450	Philadelphia Bus & Subway	1,912.50
11/9/82	350	Baltimore	1,487.50
1/1/83	900	Washington Bus	4,833.10
	(Included 1 mo. past due)		
2/1/83	450	Philadelphia Bus & Subway	1,816.45
2/1/83	350	Baltimore	1,412.70

The above represents a portion, not all, of petitioner's out-of-state advertising expense during said period.

CONCLUSIONS OF LAW

A. That Tax Law § 1138(a)(1) provides, in pertinent part, as follows:

"If a return required by this article is not filed, or if a return when filed is incorrect or insufficient, the amount of tax due shall be determined by the tax commission from such information as may be available. If necessary, the tax may be estimated on the basis of external indices, such as stock on hand, purchases, rental paid, number of rooms, location, scale of rents or charges, comparable rents or charges, type of accommodations and service, number of employees or other factors."

B. That where a taxpayer's records are incomplete or insufficient, the Audit Division may select a method reasonably calculated to reflect the sales and use taxes due and the burden then rests upon the taxpayer to demonstrate by clear and convincing evidence that the method of audit or amount of tax assessed was erroneous

(Surface Line Operators Fraternal Organization, Inc. v. Tully, 85 AD2d 850).

C. That since most of petitioner's records had been removed by its creditors, complete books and records were not available for audit. Consequently, it was proper for the Audit

Division to estimate petitioner's sales pursuant to Tax Law § 1138(a)(1).

D. That the Audit Division did not select a method reasonably calculated to reflect petitioner's sales and use taxes due. It is obvious that a very substantial portion of petitioner's business activities was conducted outside of New York State and it would follow that a similarly substantial portion of petitioner's sales was made outside of New York State and thus nontaxable. At the time of the audit, it may have been possible for the Audit Division to reconstruct petitioner's New York sales by apportioning advertising expenditures or through the use of other third party information which may have been available at that time. Instead of attempting to reconstruct New York sales, however, the Audit Division disallowed all out-of-state sales and held all sales as taxable to New York State. While petitioner admits that it mistakenly failed to show gross sales attributable to all states on its return, it maintains that all New York sales were in fact reported. In view of the credible testimony of petitioner's president, Lester H. Winick, the partial records produced by petitioner, the explained unavailability of other records, and in the absence of a proper audit showing otherwise, the tax paid by petitioner is deemed to be correct.

E. That the petition of Reference Library Guild, Inc., is granted and the Notice of Determination and Demand for Payment of Sales and Use Taxes Due dated December 20, 1984 is cancelled.

DATED: Albany, New York
December 23, 1987

ADMINISTRATIVE LAW JUDGE