STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
A & J AUTO REPAIR CORPORATION AND ARISMENDI BLANCO AS OFFICER	:	DETERMINATION
		DTA NO. 807021
for Revision of Determinations or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period March 1, 1984 through February 28, 1987.	:	

Petitioners, A & J Auto Repair Corporation and Arismendi Blanco, as officer, c/o Michael Yastrab, C.P.A., 330 Seventh Avenue, New York, New York 10001, filed a petition for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1984 through February 28, 1987.

A hearing was held before Thomas C. Sacca, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on January 15, 1991 at 9:15 A.M., with additional documentation submitted by the Division of Taxation on March 15, 1991. Petitioner A & J Auto Repair Corporation appeared by Michael Yastrab, C.P.A. The Division of Taxation appeared by William F. Collins, Esq. (Kevin A. Cahill, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation made an adequate request for petitioners' books and records.

II. Whether the sales tax field audit conducted by the Division of Taxation utilized an audit method reasonably calculated to reflect the taxes due.

III. Whether petitioners proved that the result of the audit method used was unreasonably inaccurate or that the amount of tax assessed was erroneous.

IV. Whether petitioners presented sufficient evidence to establish certain sales as sales for

resale.

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

FINDINGS OF FACT

On October 9, 1987, the Division of Taxation issued two notices of determination and demands for payment of sales and use taxes due to petitioner A & J Auto Repair Corporation ("A & J") for the period March 1, 1984 through February 28, 1987 which assessed a sales tax liability of $268,661.96, plus penalties (Tax Law § 1145[a][1][i], [vi]) and interest. On the same date, the Division of Taxation issued two additional notices of determination and demands for payment of sales and use taxes due spanning the same period and assessing the same amounts as above to petitioner Arismendi Blanco, as officer of A & J. The notices indicated that he was personally liable as an officer of A & J for taxes determined to be due from the corporation. The notices were based upon the results of a field audit of the business operations of A & J as described hereinafter.

On February 19, 1987, the Division sent a letter to A & J advising that the corporation's sales tax returns for the period March 1, 1984 through February 28, 1987 were scheduled for field audit. The letter requested that all books and records pertaining to the sales tax liability for the period under audit be made available. The letter further stated that the books and records provided should include journals, ledgers, sales invoices, purchase invoices, cash register tapes, exemption certificates and all sales tax records. Accompanying the letter was a document entitled "Required Records for Sales Tax Audit" which requested the corporation's general ledger, cash receipts journal, cash disbursements journal, Federal income tax returns for the last three years, sales tax returns and cancelled checks for the quarters of the audit period, all fixed asset invoices for fixed assets acquired during the audit period, resale, exempt and capital improvement certificates supporting nontaxable sales, the last New York State income tax withholding check, the last Employer's Quarterly Report of Wages Paid to Each Employee (Form WRS-2) and the last New York State General Business Corporation Franchise Tax

Return (Form CT-3).

On April 2, 1987, the auditor met with petitioners' accountant to review the books and records of the business operation. A & J was in the business of automobile repairs, specifically automobile body repairs. Its president was Arismendi Blanco. The corporation had ceased doing business on March 2, 1987.

The auditor was provided with the corporation's Federal income tax returns for the fiscal years ended February 28, 1985 and February 28, 1986, a resale certificate and the corporation's bank statements. No other records were provided at this meeting. The Federal income tax returns showed the corporation's gross income for the fiscal years ended February 28, 1985 and February 28, 1986 to be $200,947.00 and $235,880.00, respectively. The bank statements indicated that the corporation had two accounts: a payroll account with deposits totalling approximately $265,000.00 during the audit period and a general business account with deposits totalling approximately $655,000.00 during the audit period. The auditor testified that there were no transfers between the two accounts. The resale certificate, dated March 20, 1984, listed Winfield Auto Body ("Winfield") as the purchaser, bore the signature of the vice-president of Winfield and contained Winfield's certificate of authority identification number. The certificate stated that it was a blanket certificate for the purchase of tangible personal property for resale. During the course of the meeting, the auditor presented the accountant with a list of additional documentation needed for the sales tax audit. Included on the list were sales invoices to Winfield during the audit period, cancelled checks from Winfield to A & J during the audit period, a statement from Winfield that the checks represent all sales from A & J during the audit period and supplier invoices for supply expenses of $45,209.00 for the fiscal year ended February 28, 1986. The auditor and the accountant scheduled a second appointment for May 12, 1987.

On May 4, 1987, A & J executed a consent which extended the period of limitations for assessment of sales and use taxes for the period March 1, 1984 through August 31, 1984 to December 20, 1987. The consent was signed by petitioner Arismendi Blanco, as president.

On June 12, 1987, following extensions requested by petitioners' accountant, the auditor reviewed, at the accountant's office, the expense invoices for the fiscal year ended February 28, 1986. During this meeting, the accountant advised the auditor that A & J did not maintain sales invoices because all of its work was done for Winfield. The accountant was also not able to provide Winfield's cancelled checks to A & J during the audit period. Additionally, the auditor requested, but was not provided with, A & J's Federal income tax return for the fiscal year ended February 28, 1987 and A & J's expense invoices for the fiscal years ended February 28, 1985 and February 28, 1987. The accountant was able to provide two letters from Winfield which stated that:

(a) A & J performed some sublet work for Winfield and that Winfield collected the sales tax from its customers and remitted it to New York State.

(b) Winfield paid A & J $200,612.00 during the period March 1, 1984 through February 28, 1985 and $202,562.00 during the period March 1, 1985 through February 28, 1986.

During the audit period, A & J filed New York State and local sales and use tax returns which indicated zero gross sales, zero taxable sales, zero purchases subject to use tax and zero tax due. The returns were signed by Arismendi Blanco, as president.

Given the limited availability of records as described above and the lack of source documentation detailing the sales activities of A & J, including its gross sales, its customers, or the amounts and contents of individual transactions, the auditor concluded that A & J had inadequate books and records for purposes of conducting a detailed audit and therefore determined to resort to indirect audit methodologies. More specifically, the auditor selected an audit method utilizing a rent factor obtained from the 1985 edition of the Almanac of Business and Industrial Financial Ratios.

The Almanac of Business and Industrial Financial Ratios ("Almanac"), which was used by the auditor in estimating the sales at issue, was introduced into evidence. The Almanac contains financial information relating to 311 different industries, which are subdivided by asset

size. For each industry, the Almanac provides the total number of returns filed in each subdivision, selected financial factors, selected financial ratios, and selected operating factors as a percent of net sales, including rent paid on business property. The ratio used in the audit was calculated based upon an analysis of information contained in 30,247 tax returns filed with the Internal Revenue Service for the accounting period July 1980 through June 1981. The business category selected by the auditor was "automobile repair, services, garages", and the asset category used was "under $100,000.00".

In computing the additional taxable sales for the audit period, the auditor utilized the rent paid by the business for the fiscal years ended February 28, 1985 and February 28, 1986 as shown on A & J's Federal income tax returns, and for the fiscal year ended February 28, 1987 he used the total of rent paid as shown on cancelled checks. The amounts, as shown on the business's Federal income tax returns and cancelled checks, were as follows:

Fiscal Year Ended	Amount
February 28, 1985	$42,000.00
February 28, 1986	48,000.00
February 28, 1987	52,000.00

The Federal income tax return for the fiscal year ended February 28, 1987 was requested, but not provided, to the auditor. Total rent for each year was divided by the Almanac rent factor of 4.4% to arrive at audited sales for each fiscal year. The auditor totalled the yearly audited sales to arrive at additional taxable sales of $3,227,272.00 and additional tax due of $266,249.94 for the audit period.

In addition, the auditor reviewed the invoices relating to recurring expenses for the fiscal year ended February 28, 1986, the only year for which purchase invoices were provided by petitioners. Based upon his review, the auditor determined a margin of error between purchases on which tax was not paid and total purchases. This error rate was applied to the supply expense as shown on the Federal income tax returns for the fiscal years ended February 28, 1985 and February 28, 1986. To determine additional tax due on expense purchases for the fiscal year ended February 28, 1987, for which no Federal income tax return was provided, the

auditor applied the margin of error to the supply expense amount for the fiscal year ended February 28, 1986 plus 12%, which was the percentage increase between the first two years of the audit period. As a result, additional tax due of $2,412.00 on expense purchases was determined for the audit period.

The individual who prepared A & J's sales tax returns was a public accountant working for petitioner's representative as an independent contractor. The representative's knowledge of the business operation of A & J was based upon conversations with petitioner Arismendi Blanco and the public accountant.

The representative testified that Arismendi Blanco owned and operated a wholesale automobile repair business with one customer, Winfield Auto Body Corporation. A & J's business was located on the premises of Winfield and, according to the representative, the rent was paid to a company owned by the owners of Winfield. The representative further testified that the rent, which was paid weekly, was actually a fee which allowed the corporation to do subcontract work for Winfield. Due to this subcontractual arrangement, it was the opinion of the representative that sales invoices were not required to be maintained by A & J.

According to the representative, petitioners made an error in completing the sales tax returns showing gross sales to be zero. The representative had not reviewed these returns at the time they were filed because it was his opinion that no sales or use tax was due. Finally, the representative testified that the money in the payroll account was transferred from the general business account and, therefore, the bank statements are consistent with the Federal income tax returns which show gross sales for the first two years of the audit period of approximately $200,000.00.

During the course of the hearing, two corporate powers of attorney appointing Mr. Yastrab, C.P.A., to represent A & J Auto Repair Corporation in proceedings involving sales tax for the period March 1, 1984 through February 28, 1987 were introduced into the record of this matter. The powers are dated April 20, 1987 and August 1, 1989 and are signed by Arismendi Blanco, as president. A power of attorney appointing Mr. Yastrab to represent

Mr. Blanco at these proceedings was not provided to the Division of Tax Appeals nor introduced into the record of this hearing. Although Mr. Yastrab was provided with a month's time following the hearing to file an individual power of attorney, no such document was filed. In addition, Mr. Blanco did not appear at the hearing. On both the Request for a Conciliation Conference form and the Petition form, Mr. Blanco's address appears care of Mr. Yastrab's office address. The notice of hearing advising Mr. Blanco of this hearing was mailed care of Mr. Yastrab's office.

CONCLUSIONS OF LAW

A. The notice of hearing was properly mailed to petitioner Arismendi Blanco at the address as shown on both the Request for a Conciliation Conference and the Petition. A power of attorney in which Mr. Blanco appointed Mr. Yastrab to appear in this matter was not submitted into evidence. Mr. Blanco did not appear at the scheduled hearing. Therefore, as neither petitioner nor a duly authorized representative appeared, Arismendi Blanco is held to be in default pursuant to 20 NYCRR 3000.10(b)(2).

B. Tax Law §§ 1135 and 1142.5 provide that a taxpayer is under a duty to maintain complete, adequate and accurate records of its sales and to make the same available for audit upon request. These records must be kept in a manner suitable to determine the correct amount of tax due and must be available for the Division's inspection upon request (Taw Law § 1135[d]; 20 NYCRR 533.2[a][2]). The regulations provide that among the sales records required to be maintained are:

> "sales slip, invoice, receipt, contract, statement or other memorandum of sale,...cash register tape and other original sales document" (20 NYCRR 533.2[b][1]).

Tax Law § 1138(a) further provides that where adequate records are not maintained or made available, the Division of Taxation is entitled to resort to indirect methodologies, including external indices, in conducting audits and determining the accuracy of a taxpayer's returns as filed.

C. The Division of Taxation's resort to external indices as a method of computing sales

tax liability must be founded upon a determination of the insufficiency of the taxpayer's recordkeeping which makes it virtually impossible to verify sales receipts and conduct an audit (Chartair, Inc. v. State Tax Commission, 65 AD2d 44, 411 NYS2d 41). In such circumstances, the Division of Taxation must select a method of audit reasonably calculated to reflect tax due (Matter of Grecian Square v. State Tax Commission, 119 AD2d 948, 501 NYS2d 542), and the burden is on petitioner to establish by clear and convincing evidence that both the method used to arrive at the tax assessment and the assessment itself are erroneous (Matter of Sol Wahba, Inc. v. State Tax Commission, 127 AD2d 943, 512 NYS2d 542).

To determine the adequacy of a taxpayer's books and records, the Division of Taxation must first actually request the books and records (Matter of Christ Cella, Inc. v. State Tax Commission, 102 AD2d 352, 477 NYS2d 858) for the entire period of the proposed assessment (Matter of Adamides v. Chu, 134 AD2d 776, 521 NYS2d 826, lv denied 71 NY2d 806), and must make a thorough examination of such records (Matter of King Crab Restaurant, Inc. v. Chu, 134 AD2d 51, 522 NYS2d 978), before proceeding to external indices to determine the taxpayer's sales tax liability.

D. The Division of Taxation made several written and oral requests for petitioner's books and records, but was not provided with most of the documents requested. It is undisputed that the business's sales records were inadequate, given the lack of a cash receipts journal, a general ledger, sales invoices and the incorrect information contained on the sales tax returns. Furthermore, petitioner conceded that, except for the expense invoices and bank statements, no other records were maintained. Under these circumstances, the use of an indirect audit method was appropriate (Matter of Licata v. Chu, 64 NY2d 873, 487 NYS2d 552; Matter of Vebol Edibles, Inc. v. State of New York Tax Appeals Tribunal, 162 AD2d 765, 557 NYS2d 678, lv denied 77 NY2d 803). Thus, the only remaining issues with regard to the audit are whether the particular methods employed, and the results thereof, were irrational or erroneous.

E. When a taxpayer's records are inadequate, the Division of Taxation must select an audit method reasonably calculated to reflect the sales and use taxes due (Matter of Grant v.

Joseph, 2 NY2d 196, cert denied, 355 US 869; Tax Law § 1138[a][1]). It is recognized that "the Audit Division is not responsible for demonstrating the propriety of the assessment, including the basis of its audit" (Matter of Blodnick v. State Tax Commission, 124 AD2d 437, 507 NYS2d 536, 538) and that "considerable latitude is given to an auditor in estimating sales under these circumstances" (Matter of Grecian Square, Inc. v. State Tax Commission, supra). It is only necessary that sufficient evidence be produced to demonstrate that a rational basis existed for the auditor's calculations (Matter of Grecian Square, Inc. v. State Tax Commission, supra; Matter of Willy Savino d/b/a Willy's Service Station, Tax Appeals Tribunal, September 22, 1988). The burden is then placed upon petitioner to show 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, 139 AD2d 813, 526 NYS2d 679, 681).

F. Tax Law § 1138(a)(1) expressly states that a rent factor may form the basis for determining tax due. In Matter of A & J Gifts Shop v. Chu (145 AD2d 877, 536 NYS2d 209, lv denied 74 NY2d 603), the Appellate Division determined that an estimate of sales equal to ten times the taxpayer's rent was reasonably calculated to reflect the taxes due:

> "The external index used was developed based upon a special flea market program carried out by the Department. Initially, sales were calculated based upon a Dun & Bradstreet report which found rent to generally be 4% of the cost of doing business. Accordingly, sales were calculated to be 20 times the rent. This gross sales figure was adjusted downward to 10 times the rent on the basis of the Tax Commission's experience with the flea market program and audits of similar vendors in the industry" (id.).

In addition, the Tax Appeals Tribunal has upheld the Division's use of an industry index from a Dun and Bradstreet Cost of Doing Business Survey where, as here, the taxpayer's records were clearly inadequate (see, Matter of Atlantic House Yemen Restaurant, Inc., Tax Appeals Tribunal, July 11, 1991).

G. In the matter at hand, the auditor employed a rent factor that was obtained from the Almanac of Business and Industrial Financial Ratios. The auditor's use of the rent factor, as detailed in Finding of Fact "9", supra, provided a rational basis for the calculation of sales tax due. It is noted that the Division used a rent factor based upon a large representative sample

(30,247) of returns filed with the Internal Revenue Service. The operating ratio was derived to provide a guide as to the average amount spent by corporations for rental expenses. In addition, the category used, "automobile repair, services, garages", best describes the type of business operation conducted by petitioner. Therefore, the method used by the auditor was reasonably calculated to reflect the taxes due (see, Matter of A & J Gifts Shop v. Chu, supra; Matter of Atlantic House Yemen Restaurant, Inc., supra; Tax Law § 1138[a][1]).

H. Petitioner has the burden to establish by clear and convincing evidence that the audit method was erroneous and/or the result of the audit was unreasonably inaccurate (Matter of Sol Wahba, Inc. v. State Tax Commission, supra; Matter of Surface Line Operators Fraternal Organization, Inc. v. Tully, 85 AD2d 858, 446 NYS2d 451). Concerning the audit method employed, petitioner asserted that the results thereof were incorrect in light of A & J's method of doing business. However, it was incumbent upon petitioner to establish through credible evidence or supporting documentation that the results of the audit were unreasonable. The allegations and testimony of petitioner's representative, without more, are insufficient to warrant an adjustment to the method of audit employed (Matter of Vebol Edibles, Inc. v. State of New York Tax Appeals Tribunal, supra; Matter of Mera Delicatessen, Inc., Tax Appeals Tribunal, November 2, 1989).

Furthermore, where a taxpayer's own failure to maintain adequate, accurate and complete books and records requires resort to 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 Brothers, Inc. v. Chu, supra). Petitioner cannot now claim that the indirect audit method employed by the Division does not accurately reflect the business activity of the corporation where the corporation failed to maintain the books and records which the Division could have used to establish the corporation's business activities and sales tax liability.

I. Tax Law § 1105(a) imposes a sales tax on the receipts from every retail sale of tangible personal property except as otherwise provided in Article 28 of the Tax Law. Tax Law

§ 1101(b)(4)(i)(A) defines a retail sale as a sale of tangible personal property to any person for any purpose, other than "for resale as such or as a physical component part of tangible personal property." There is a statutory presumption that all receipts for property or services are subject to tax and the burden to prove otherwise rests with the taxpayer (Tax Law § 1132[c]; see, Matter of Savemart, Inc. v. State Tax Commission, 105 AD2d 1001, 482 NYS2d 150, 152, lv denied 65 NY2d 604).

J. The documentation submitted by petitioner is insufficient to establish that petitioner's sales were sales for resale. The resale certificate was a blanket certificate for the sale of tangible personal property, and therefore does not apply to the services performed by petitioner for Winfield. The letter from Winfield states the total amount claimed to be paid by Winfield to petitioner during two of the three years of the audit, but does not break down these amounts between tangible personal property and services provided. Most importantly, petitioner has failed to introduce any source documentation which would establish both the total sales of petitioner and the sales to Winfield, as well as a detailed analysis of the sales to Winfield, such as a breakdown between the tangible personal property and services sold for each of the transactions involved. Therefore, there is no way to determine A & J's total sales, its sales to Winfield and the nature and content of the transactions with Winfield. Inasmuch as petitioner has failed to establish that the corporation's sales constituted sales for resale, no adjustments to the tax assessed are warranted (see, Matter of Savemart, Inc. v. State Tax Commission, supra; Matter of RAC Corp. v. Gallman, 39 AD2d 57, 331 NYS2d 945). It is noted that the testimony of A & J's accountant as to how the business was conducted and that all sales were sales for resale to Winfield is insufficient to establish that the estimated audit was unreasonable (see, Matter of Atlantic House Yemen Restaurant, Inc., supra).

K. Petitioner has not presented any evidence warranting a remission of the penalties. Such penalties may only be remitted if the failure to pay was due to reasonable cause and not due to willful neglect (Tax Law § 1145[a][1][iii], [vi]). In view of the magnitude of the deficiency and the failure to maintain proper records, petitioner has not satisfied this burden

(see, Matter of Echo Bay Yacht Club, Tax Appeals Tribunal, December 28, 1990).

L. The petition of A & J Auto Repair Corporation is denied and the notices of determination and demands for payment of sales and use taxes due, dated October 9, 1987, are sustained.

DATED: Troy, New York
9/19/91

ADMINISTRATIVE LAW JUDGE