

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :
of :
ERNEST WEINBERGER :
D/B/A A TOUCH OF SPIRIT : DETERMINATION
: DTA NO. 817553
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, 1993 through August 31, 1996.

Petitioner, Ernest Weinberger d/b/a/ A Touch of Spirit, 4720-16th Avenue, Brooklyn, New York 11204, 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, 1993 through August 31, 1996.

A small claims hearing was held before Arthur Johnson, Presiding Officer, at the offices of the Division of Tax Appeals, 5 Penn Plaza, New York, New York, on October 17, 2001 at 1:15 P.M. Petitioner appeared by Isaac Sternheim, CPA. The Division of Taxation appeared by Barbara G. Billet, Esq. (Leon Drucker).

ISSUE

Whether the Division of Taxation was in error for not giving an allowance for pilferage, theft and breakage when computing petitioner's taxable sales and, if so, what is a reasonable allowance.

FINDINGS OF FACT

1. Petitioner, Ernest Weinberger d/b/a A Touch of Spirit, operated a retail liquor store located at 4720 16th Avenue, Brooklyn, New York.

2. The Division of Taxation (“Division”) conducted a field audit of petitioner’s available books and records for the period September 1, 1993 through August 31, 1996. The Division found these records were inadequate to verify the accuracy of taxable sales reported on sales tax returns filed for the period under audit. Petitioner failed to retain cash register tapes or any other record of individual sales receipts. Purchase records were also incomplete. Due to the lack of records, it was necessary for the Division to determine petitioner’s sales on the basis of external indices. The Division chose to perform a third-party verification of purchases and a markup method of audit. The Division contacted petitioner’s suppliers and determined total merchandise purchases for the audit period of \$1,265,990.00. After making adjustments for beginning and ending inventory, the cost of merchandise sold was \$1,235,490.00. The Division verified that petitioner had nontaxable merchandise sold to exempt organizations of \$669,703.00, leaving purchases available for taxable sales of \$565,787.00. The Division conducted a markup test using quantities, cost and selling prices for the month of October 1998. The overall markup percentage of 27.45% was applied to purchases of \$565,787.00 to determine taxable sales of \$721,096 and taxes due of \$59,490.00. Petitioner paid taxes of \$49,445.00 with returns filed, resulting in additional taxes due of \$10,045.00.

3. On March 19, 1999, the Division issued a Notice of Determination to petitioner covering the period September 1, 1993 through August 31, 1996 for taxes due of \$10,045.00, plus interest of \$6,270.00 and penalty of \$3,078.71, for a total amount due of \$19,394.63.

4. Petitioner had a prior audit for the period June 1, 1988 through May 31, 1991. This audit also necessitated the use of external indices to estimate sales because of inadequate records and resulted in additional taxes due.

SUMMARY OF THE PARTIES POSITION

5. Petitioner did not dispute the audit methodology; however, he argued that the Division did not give any consideration to inventory losses from pilferage, theft or breakage. Petitioner maintained that such allowance should be seven percent. Petitioner relied on ***Matter of Shop Rite Wines and Liquors, Inc.*** (Tax Appeals Tribunal, February 21, 1991) wherein the Tribunal granted a seven percent allowance for pilferage, theft and breakage instead of a two percent allowance used by the Division in its audit calculations. The Tribunal concluded that there was no rational basis for the use of a two percent figure by the Division and that petitioner's testimony and the submission of an article from the Beverage Media, an industry magazine, substantiated that the two percent allowance was too low a percentage. The magazine article was from the June 1988 volume and stated that the nationwide loss in package stores due to theft alone was seven percent of inventory.

Petitioner argued further that a seven percent allowance for pilferage and theft was justified because it was a one-person operation that had no security devices to deter theft. The inventory was accessible to costumers with some inventory placed on the sidewalk.

Petitioner maintained that a recalculation of taxable sales after adjusting inventory by seven percent to allow for pilferage and theft discloses an insignificant variance with reported taxable sales.

6. The Division argued that the facts in the above cited case are completely different from this case. In ***Matter of Shop Rite Wines and Liquors (supra)***, the store was located in a high

crime area of East Harlem and petitioner presented both testimony and documentary evidence to prove the seven percent allowance for pilferage and theft. In this case, the store was located in an upscale, low crime area of Borough Park. The neighborhood was populated with religious people and the buildings nearby the store were synagogues and schools. The Division also argued that petitioners offered no proof that it suffered inventory losses through pilferage and theft.

The Division's auditor testified that in his audit experience of more than 20 years, he never saw allowances for pilferage and theft of seven percent. The typical allowance used by his office was one-half of one percent but each case has to be evaluated individually. In this case, the auditor believed that no allowance was warranted because of the location of the store and the character of the people who lived in the neighborhood.

CONCLUSIONS OF LAW

A. Petitioner did not produce sales invoices, cash register tapes or any other records that would serve as a verifiable record of taxable sales. Under such circumstances, the Division properly estimated petitioner's sales on the basis of external indices (Tax Law § 1138[a][1]; ***Matter of Licata v. Chu***, 64 NY2d 873, 487 NYS2d 552).

The audit methodology utilized by the Division to estimate sales must be reasonably calculated to reflect taxes due (***Matter of Markowitz v. State Tax Commission***, 54 AD2d 1023, 388 NYS2d 176, ***affd*** 44 NY2d 684, 405 NYS2d 454).

B. A test period and markup method of audit has been determined to be a method reasonably designed to estimate taxes due (***Matter of Pizza Works, Inc.***, Tax Appeals Tribunal, March 21, 1991). Since the method was reasonable, petitioner has the burden 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 Commn.*, 127 AD2d 943, 512 NYS2d 542).

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 Bros. v. Chu*, 139 AD2d 813, 526 NYS2d 679).

C. Petitioner did not present any testimony or documentary evidence to show that losses to inventory from pilferage and theft amounted to seven percent of inventory. Petitioner relied totally on a decision of the Tax Appeals Tribunal that involved a liquor store in a high crime area as opposed to a low crime area and the claimed allowance was supported by testimony and other evidence. Petitioner, however, has established that some adjustment for pilferage, theft and breakage was reasonable. Accordingly, I believe that it is fair and equitable (Tax Law § 2012) to adjust inventory by three percent to allow for pilferage, theft and breakage.

Petitioner has also established that its underreporting of taxable sales was not due to willful neglect and therefore, the penalties imposed by the Division are canceled.

D. The petition of Ernest Weinberger d/b/a A Touch of Spirit is granted to the extent indicated in Conclusion of Law "C" and the Division of Taxation is hereby directed to modify the Notice of Determination issued March 19, 1999 consistent with the determination rendered herein. The petition is in all other respects denied.

DATED: Troy, New York
January 17, 2002

/s/ Arthur Johnson
PRESIDING OFFICER