STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
LUIS LIMA	:	DETERMINATION 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 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 March 1, 1998 through November 30, 2000.

A hearing was held before Timothy J. Alston, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on May 17, 2005 at 10:30 A.M., with all briefs to be submitted by September 16, 2005, which date commenced the six-month period for the issuance of this determination. Petitioner appeared by Leonard L. Fein, CPA. The Division of Taxation appeared by Christopher C. O'Brien, Esq. (Jennifer A. Murphy, Esq., of counsel).

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

1. 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.

2. 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.

3. 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.

4. 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.

5. 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.

6. 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 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.

[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.

7. 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.

8. 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.

9. 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.

10. 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).

11. 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

12. 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

13. 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

14. Petitioner's Schedule C's 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%

15. 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.

16. 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.

17. 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.

18. 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.

19. 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.

20. 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.

SUMMARY OF PETITIONER'S POSITION

21. Petitioner contends that the markup audit performed by the Division was not warranted because he maintained complete and accurate records. Petitioner asserts that the Division improperly disregarded his records in seeking to confirm petitioner's purchases with his suppliers. Petitioner contends that the disparity between purchases and reported taxable sales results from a buildup of inventory and that the apparent large buildup of 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.

22. Petitioner further contends that even if it was justified, the markup 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.

23. 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.

CONCLUSIONS OF LAW

A. The standard for reviewing a sales tax audit where external indices were employed was set forth in ***Matter of AGDN, Inc***. (Tax Appeals Tribunal, February 6, 1997), as follows:

> a vendor . . . is required to maintain complete, adequate and accurate books and records regarding its sales tax liability and, upon request, to

> make the same available for audit by the Division (***see***, Tax Law §§ 1138[a]; 1135; 1142[5]; ***see***, ***e.g.***, ***Matter of Mera Delicatessen***, Tax Appeals Tribunal, November 2, 1989). Specifically, such records required to be maintained 'shall include a true copy of each sales slip, invoice, receipt, statement or memorandum' (Tax Law § 1135). It is equally well established that where insufficient records are kept and it is not possible to conduct a complete audit, 'the amount of tax due shall be determined by the commissioner of taxation and finance from such information as may be available. If necessary, the tax may be estimated on the basis of external indices . . . ' (Tax Law § 1138[a]; ***see, Matter of Chartair, Inc. v. State Tax Commn.***, 65 AD2d 44, 411 NYS2d 41, 43). 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).

B. In this case, the records provided by petitioner on audit were internally consistent and thus appeared, upon initial review, to be complete and accurate. Letters from the Division to petitioner's suppliers to verify petitioner's purchase records indicated a significant discrepancy between petitioner's sales as reported and purchases as indicated by petitioner's suppliers. 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 Division's use of third-party information to verify petitioner's purchase records was proper (***see***, ***Matter of Roebling Liquors v. Commissioner of Taxation & Finance***, 284 AD2d 669, 728 NYS2d 509, 512, ***appeal dismissed*** 97 NY2d 637, 735 NYS2d 493, ***cert denied*** 537 US 816, 154 L Ed 2d 20). Indeed, "verification of books and records is an integral, accepted part of the audit process" (***Matter of Morano's Jewelers of Fifth Avenue, Inc.***, Tax Appeals Tribunal, January 2, 1992). Petitioner's contention that the Division improperly disregarded his records by requesting information from suppliers is thus rejected.

C. 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 (***see***, ***Matter of Roebling Liquors v. Commissioner of Taxation & Finance***, ***supra***). It was thus incumbent upon petitioner 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 markup audit was improper.

Petitioner asserted that the excess of purchases over reported sales resulted from a buildup of inventory. Neither petitioner nor any store employees testified at the hearing, however, to provide evidence of such an inventory buildup. Indeed, the only testimony presented on petitioner's behalf was that of petitioner's representative who has never been to the store and who has 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 (***see***, Finding of Fact "15"), 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 is properly accorded little evidentiary weight. Also undermining the document's credibility is 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 contended that his other businesses provided the source of funds for the inventory buildup. However, a review of petitioner's Federal income tax returns for the years 1998, 1999, and 2000 indicates that such other businesses generated only about $50,000.00 in net income over those three years (***see***, Finding of Fact "17"), far short of the approximately $500,000.00 necessary to fund the claimed inventory buildup (***see***, Findings of Fact "6" and "7"). 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. Moreover, this discussion of cash available to petitioner to finance his claimed inventory buildup assumes that all of such cash was used to purchase inventory for the liquor store, at best a doubtful proposition. This discussion 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). Additionally, 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. Finally, 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, petitioner has failed to prove that his records were complete and accurate during the audit period.

D. Given the unreliability of petitioner's records, the resort to an indirect audit method by the Division was justified (***see***, ***Matter of Roebling Liquors v. Commissioner of Taxation & Finance***, ***supra***). In fact, the use of a markup audit method to calculate taxable sales of a liquor store, in the face of inadequate records, has been consistently sustained (***see, Matter of Murphy***, Tax Appeals Tribunal, March 17, 1994; ***Matter of Robritt Liquor Store***, Tax Appeals Tribunal, December 27, 1991). Hence, the only issue remaining with respect to the assessment is whether petitioner has established that the amount of tax assessed as the result of application of such method was erroneous.

Petitioner has failed to establish any such errors. Petitioner complained that the markup was excessive, but offered no evidence of any specific errors in either of the markup tests. Petitioner 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 the store. Indeed, petitioner's employee assisted the auditor in listing the posted prices. Furthermore, it is 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. Petitioner did not, however, point to any specific items in either of the markup tests as being unrepresentative of his inventory.

E. The Division asserts penalties herein pursuant to Tax Law § 1145(a)(1)(i) and (vi). Section 1145(a)(1)(i) authorizes the imposition of penalty for the failure to file a return or to pay or pay over the sales and use taxes due within the time required. Tax Law § 1145(a)(1)(vi) authorizes the imposition of penalty upon a taxpayer for its 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. Reasonable cause includes any cause for delinquency which would appear to a person of ordinary prudence and intelligence as reasonable cause for the delay in filing a sales tax return and paying the tax imposed under Articles 28 and 29 of the Tax Law (***see***, 20 NYCRR 2392.1[d][5]; former 536.5[c][5]).

Petitioner has failed to establish reasonable cause or the absence of willful neglect in the present matter. Petitioner noted 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." This contention is effectively rebutted by the approximately $500,000.00 excess of purchases over reported sales for the audit period. Such a disparity clearly raises a question as to the accuracy of the store's sales tax returns. Petitioner also asserts that his frequent absence from the store does not indicate willful neglect. As to this claim, it should be noted that petitioner has not shown that the subject deficiency resulted from any acts or omissions of store employees. That is, as noted previously, petitioner claimed that the disparity between purchases and sales resulted from employee theft, but petitioner offered no proof of such claim. Nor has petitioner offered any evidence that his delegation of responsibility to his employees was reasonable. Moreover, whether or not petitioner's absence from the store is evidence of willful neglect, surely such absence does not support a finding of reasonable cause. Finally, the existence of a substantial discrepancy in this matter between the sales tax reported on the returns and the sales tax found to be due on audit supports the imposition of penalties (***see, Matter of S.H.B. Super Markets, Inc. v. Chu,*** 135 AD2d 1048, 522 NYS2d 985). Accordingly, penalties imposed herein are properly sustained.

F. The petition of Luis Lima is denied and the Notice of Determination dated February 7, 2003, is sustained.

DATED: Troy, New York
March 9, 2006

/s/ Timothy J. Alston
ADMINISTRATIVE LAW JUDGE