STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition of BORRELLI'S GIFT SHOP, INC. 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 December 1, 1974 through November 30, 1978.	DECISION

Petitioner, Borrelli's Gift Shop, Inc., c/o Vincent Borrelli, 2212 Throop Avenue, Bronx, New York 10469, 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 December 1, 1974 through November 30, 1978 (File No. 28445).

A small claims hearing was held before Judy M. Clark, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on April 29, 1982 at 9:15 A.M. and continued to conclusion on September 12, 1983 at 1:15 P.M., with all briefs to be submitted by October 12, 1983. Petitioner appeared by F. Dane Buck, Jr., Esq. The Audit Division appeared by John P. Dugan, Esq. (Kevin A. Cahill, Esq., of counsel).

ISSUES

I. Whether all sales and purchase records were available at the time of audit precluding the Audit Division from reviewing only a test period of sales to determine petitioner's markup and determining tax due therefrom for the entire audit period.

II. Whether the Audit Division's findings as a result of the test period review accurately reflected the sales made by petitioner for the entire audit period.

III. Whether penalties and interest imposed pursuant to section 1145 of the Tax Law in excess of the minimum statutory rate should be cancelled.

FINDINGS OF FACT

1. On September 3, 1979, the Audit Division issued two notices of determination and demand for payment of sales and use taxes due against Borrelli's Gift Shop, Inc. covering the period December 1, 1974 through November 30, 1978. The Notices were issued as a result of a field audit and asserted total additional tax due of $15,534.14, plus penalty and interest of $8,063.04, for a total due of $23,597.18.

2. Petitioner executed two consents to extend the period of limitation for the issuance of an assessment. The period was extended to September 20, 1979.

3. Petitioner operated a gift shop at 610 East 187th Street, Bronx, New York, selling retail merchandise such as home decorations and small furniture. Petitioner ceased its business operation on June 15, 1979.

4. On audit, the Audit Division compared gross sales reported on sales and use tax returns filed with sales recorded in petitioner's books and records and Federal Corporation Income Tax Returns filed. As of the date of audit, petitioner had filed only the 1975 and 1976 Federal returns. For the years 1975 and 1976, the Audit Division found that the gross sales were $72,280.00 higher on the Federal returns filed than reported on the sales tax returns. The Audit Division determined an error rate in reporting gross sales of 24.4 percent and applied this rate to the gross sales reported on sales and use tax returns filed for the entire audit period. The Audit Division determined that petitioner underreported gross sales by $164,000.00 on sales and use tax returns filed.

The Audit Division then performed a markup test on October 19, 1978 in order to verify these gross sales based on purchases made. The Audit Division reviewed 31 sales invoices from the period October 1 through October 17, 1978. These sales invoices were numerically sequenced from a sales book maintained and provided by petitioner for the purpose of such test. The actual purchase invoice was reviewed to determine the cost of each item sold, including any freight charges paid. Based on this review, the Audit Division determined that petitioner's markup on the items sold was 70.2 percent.

Petitioner's purchases on the Federal tax returns filed were also higher than those recorded on its books for the years 1974 and 1975 by $5,213.40 or 2.2 percent. The Audit Division therefore increased petitioner's purchases recorded in its books for the period December 1, 1974 through May 31, 1978 by 2.2 percent, applied the markup of 70.2 percent thereon, and determined gross sales as well as taxable sales of $723,151.14 for this period. Petitioner reported taxable sales of $562,088.00 on sales and use tax returns filed. Additional taxable sales of $161,063.14 were determined, an increase of 28.7 percent over those reported. The Audit Division updated its audit findings to include the period June 1, 1978 through November 30, 1978 and determined additional taxable sales of $190,457.96 and tax due thereon of $15,236.66. The balance of tax determined due ($297.48) was due to petitioner's unsubstantiation of deliveries made to jurisdictions other than New York City. The Audit Division thereby determined the total sales tax deficiency for the period December 1, 1974 through November 30, 1978 of $15,534.14.

5. During the interim of the first hearing and the continuation, petitioner submitted copies of its U.S. Corporation Income Tax Returns filed for the years 1977 and 1978. These were prepared by petitioner's new accountant from the

worksheets of petitioner's prior representative. Based on this submission, the Audit Division adjusted the purchases marked up on audit based on the actual purchases reported on the Federal returns for the audit period, made an adjustment for inventory not sold and further allowed 2 percent for pilferage and broken merchandise. This reduced the additional sales tax determined on audit based on a markup of purchases at 70.2 percent to $13,169.60 from $15,236.66 for the entire audit period.[1]

The Audit Division upheld its position on the imposition of penalty and interest in that petitioner had been audited previously and additional taxes were determined due. The Audit Division maintained that petitioner's recordkeeping procedures should have been corrected as a result of the first audit.

6. Petitioner contended that all books and records were available at the time of audit; therefore, the test period of sales reviewed by the Audit Division was not necessitated by lack of sales or purchase records. No substantial evidence was submitted to show the existence of those records at the time of audit or thereafter.

Further, petitioner contended that the period of the sales review was not indicative of its overall business operation in that the period of sales review occurred during its peak selling period where markups were the highest. Petitioner testified that its peak selling period occurred from September to December and May and June. During the balance of the calendar year, sales were in progress to eliminate out-of-date merchandise and to make room for the next season's stock.

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1 No adjustment was made in the $297.48 tax due for jurisdictional errors.

Petitioner also testified that the store always deducted at least 20 percent off the marked selling price of items as a purchasing incentive to its customers.

Petitioner did not charge sales tax to its customers but rather absorbed the tax out of its profits when filing its sales tax returns. Petitioner contended that if sales tax were separately stated to its customers, it would have been at a competitive disadvantage in the neighborhood.

7. The Audit Division's worksheets disclose that petitioner did in fact advertise reduction sales during its off-season selling period. During the Audit Division's first contact at the petitioner's place of business during August, 1978, sales were advertised at 20 to 40 percent off regular selling prices.

No evidence was submitted by petitioner to show the effect of such sales on the Audit Division's findings. Petitioner's purchases and sales, as recorded on its books and records, however, disclosed an overall markup on purchases of 65 percent for the period December, 1974 through May, 1978.

8. Petitioner argued that all its sales and use tax returns were timely filed for the period under review. Petitioner therefore sought reduction of penalty and interest in excess of the minimum statutory rate. Petitioner contended it relied on the services of its prior accountant for the preparation of its sales and use tax returns. Testimony had been given that the principals entered sales figures in the books and the accountant totaled the sales figures when returns were needed to be filed. Cash register tapes were discarded once the sales were recorded.

Petitioner's present accountant totaled sales recorded in petitioner's books and records and divided the total sales by 108 percent to determine taxable sales and sales tax due.

CONCLUSIONS OF LAW

A. That section 1138(a) of the Tax Law provides that if a return when filed is incorrect or insufficient, the amount of tax due shall be determined from such information as may be available. That petitioner's own records disclosed the inadequacy of the sales tax returns as filed.

That the Audit Division used the information available at the time of audit to determine gross sales and verify those gross sales by use of a markup of purchases method of audit. When additional information was provided, to wit, the Federal tax returns for the years 1977 and 1978, adjustments were made to purchases marked up on audit to conform with the purchases actually sold.

That the Supreme Court in Holland v. United States, 348 U.S. 121, 132; 99 L.ed 150, 162 (1954), in discussing the use of an indirect audit method even when adequate books and records were available, held "the Government must be free to use all legal evidence available to it in determining whether the story told by the taxpayer's books accurately reflects his financial history".

That the use of a markup of purchases method of audit to verify gross sales receipts was proper. The petitioner has not shown that all source documents were available for audit in order to determine the exact amount of its sales and to support its books and records. (Chartair, Inc. v. State Tax Commission, 65 A.D.2d 44, 411 N.Y.S.2d 41 (1978)).

B. That in determining the markup on petitioner's purchases, the Audit Division used the actual selling prices of the goods sold during the period reviewed. Any discounts petitioner may have given were therefore accounted for. The Audit Division failed to consider, however, that sales occurred during other selling periods. That the markup on purchases used to determine petitioner's sales is hereby reduced to 65 percent pursuant to Finding of Fact "7".

C. That 20 NYCRR 536.1 provides for the remission of penalties and interest exceeding the minimum interest set by statute when reasonable cause is shown for failure to pay over tax. Reasonable cause was not shown in the instant case. There is no statutory authority requiring a reduction on the grounds that a taxpayer relied in good faith on legal counsel or other representative. (C. H. Heist Corp. v. State Tax Commission, 66 A.D.2d 499, 414 N.Y.S.2d 751 (1979)).

D. That the petition of Borrelli's Gift Shop, Inc. is granted to the extent indicated in Conclusion of Law "B" above; that the Audit Division is directed to further modify the Notices of Determination and Demand for Payment of Sales and Use Taxes Due issued on September 3, 1979 and revised pursuant to Finding of Fact "5"; and that, except as so granted, the petition is in all other respects denied.

DATED: Albany, New York

JUN 01 1984

STATE TAX COMMISSION

Roderick G. W. Chu

PRESIDENT

Francis R. Koenig

COMMISSIONER

Walter J. Carroll

COMMISSIONER