

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition	:	
of	:	
ANTONIO MARTINEZ & PERCIO LOPEZ	:	DECISION
D/B/A KENYA HAND MADE CIGARS	:	
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, 1977	:	
through August 31, 1980.	:	

Petitioners, Antonio Martinez and Percio Lopez, d/b/a Kenya Hand Made Cigars, 171 West 29th Street, New York, New York 10001, 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, 1977 through August 31, 1980 (File No. 39481).

A hearing was commenced before James Hoefer, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York on July 23, 1985 at 1:15 P.M. and continued to conclusion before the same Hearing Officer at the same location on December 5, 1985 at 1:15 P.M. Petitioner appeared by David E. Tilzer, C.P.A. The Audit Division appeared by John P. Dugan, Esq. (Irwin A. Levy, Esq. of counsel).

ISSUE

Whether the Audit Division properly estimated the sales tax liability of the seller in a bulk sales transaction based upon an audit of the books and records of the purchaser/petitioner.

FINDINGS OF FACT

1. On February 1, 1979, petitioners Antonio Martinez and Percio Lopez purchased, for the total sum of \$3,000.00, a business located at 171 West 29th

Street, New York, New York. On March 5, 1979, Mr. Martinez and Mr. Lopez filed, in the New York County Clerk's Office, a Business Certificate for Partners certifying that "... they are conducting or transacting business as members of a partnership under the name or designation of Kenya Hand Made Cigars at 171 West 29th Street, City of New York...". Petitioners' business activities consisted of the manufacture of hand made cigars and the wholesale and retail sale of said hand made cigars.

2. Petitioners owned and operated the business from the date of purchase, February 1, 1979 through the end of the audit period in question. One Miguelina Guzman owned and operated the business prior to its sale to petitioners. Petitioners did not notify the Audit Division, as required by section 1145(c) of the Tax Law, of the price, terms and conditions of their purchase of said business.

3. In the early part of 1981 the Audit Division commenced a field audit of petitioners' books and records. Said books and records consisted of a cash receipts journal and check disbursements journal. Petitioners did not maintain sales invoices, cash register tapes or any other verifiable records of taxable sales. Petitioners estimated the taxable sales reported on the sales and use tax returns filed with the Audit Division.

4. Since petitioners' books and records were inadequate, the Audit Division resorted to the use of a one day observation test to determine the accuracy of reported taxable sales. Based on the one day observation test, the Audit Division computed, pursuant to the following table, quarterly taxable sales of \$16,224.00:

Total cash in register at 3:00 P.M.	\$260.00	
Less: cash in register at opening	<u>90.00</u>	
Sales for 6 hours (9 - 3)	170.00	
Sales for 8 hours (170/6 x 8)	227.00	
Full days per week	<u>x 5</u>	
Sales Monday through Friday		\$ 1,135.00
Sales for Saturday ($\frac{1}{2}$ day or $\frac{1}{2}$ of \$227.00)		<u>113.00</u>
Total sales per week		\$ 1,248.00
Weeks per quarter		<u>x 13</u>
Total sales per quarter		\$16,224.00

5. Based on its observation test, the Audit Division, on September 18, 1981, issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due to Antonio Martinez and Persio (sic) Lopez, d/b/a Kenya Hand Made Cigars. Said notice, which encompassed the period March 1, 1977 through August 31, 1980, determined tax due of \$17,286.88, plus simple interest of \$3,925.50, for a total amount due of \$21,212.38.

6. On March 10, 1980, petitioners executed a consent agreeing that the amount of sales and use taxes due for the taxable period March 1, 1977 through November 30, 1979 could be determined at any time on or before March 20, 1981. On January 14, 1981, petitioners executed a second consent, for the same taxable period, extending the period of limitations for assessment to any time on or before September 20, 1981. Both consents were executed by Kenya Hand Made Cigars although it had not owned or operated the business for the first 22 months (March 1, 1977 through January 31, 1979) out of the 42 month audit period. No consents extending the period of limitations were executed by Miguelina Guzman, the prior owner of the business.

7. During the course of its examination the Audit Division did not ascertain whether petitioners operated their business in a manner similar to the prior owner. The Audit Division did not examine the prior owner's books and records and therefore it is not known whether said prior owner maintained adequate books and records. No assessment was issued by the Audit Division

against the previous owner for the period prior to the sale of the business to petitioners.

8. At the hearing held on December 5, 1985, petitioners' representative and the Audit Division agreed in principal to recompute the assessment using a method developed at a pre-hearing conference concerning a subsequent assessment issued against petitioners. The method agreed upon was to (i) take the number of pounds of outside leaf material purchased pursuant to petitioners' books and multiply it by 25% to account for unrecorded purchases; (ii) multiply the adjusted pounds of outside leaf material by 140 (the number of cigars made per pound of outside leaf material) to determine the total number of cigars sold; (iii) multiply the total number of cigars sold by 55 percent¹ to determine the number of cigars sold at retail (balance of 45 percent were sales made at wholesale); and (iv) multiply the number of cigars sold at retail by a 55¢ selling price² to determine audited taxable sales. During the period February 1, 1979 through August 31, 1980, petitioners' books revealed purchases of outside leaf material of some 550 pounds.

CONCLUSIONS OF LAW

A. That absent adequate books and records it is proper, pursuant to Tax Law §1138(a)(1), for the Audit Division to rely upon external indices to verify

1 Although petitioners' representative agreed to the method used to recompute the sales tax liability he argued that 70 percent to 90 percent of sales were sales for resale. No evidence was presented to support this assertion.

2 Petitioners' representative also argued that the 55¢ selling price determined at the pre-hearing conference represented a selling price for later periods and that it should be reduced to 50¢ for these earlier periods. Again, no evidence was presented to support this argument.

taxable sales as reported on returns. Petitioners' books and records were admittedly inadequate and therefore the use of external indices was warranted. However, petitioners herein only owned and operated the business as of February 1, 1979. Prior to that date, the business was owned and operated by one Miguelina Guzman, a person unrelated to petitioners. Since the Audit Division did not examine the books and records of Miguelina Guzman it is not known whether said books and records were adequate or inadequate. Inasmuch as it has not been established that Miguelina Guzman's books and records were inadequate, the Audit Division cannot use external indices to determine if any tax is due from Ms. Guzman during the period of her ownership of the business (Matter of Chartair, Inc. v. State Tax Commission, 65 A.D. 2d 44). Accordingly, there is no basis for the assessment of any sales taxes due for the period prior to the petitioners' purchase of the business (February 1, 1979).

B. That additional sales tax due for the period February 1, 1979 through August 31, 1980 is to be recomputed pursuant to the method set forth in Finding of Fact "8", supra. Said method results in additional taxable sales of \$25,416.00 and a tax due of \$2,033.28.

C. That the petition of Antonio Martinez and Percio Lopez, d/b/a Kenya Hand Made Cigars is granted to the extent indicated in Conclusions of Law "A" and "B", supra; that the Audit Division is directed to modify the Notice dated

September 18, 1981 accordingly; and that, except as so granted, the petition is in all other respects denied.

DATED: Albany, New York

STATE TAX COMMISSION

APR 28 1986.

Rodriguez W. Allen
PRESIDENT

Francis R. Koenig
COMMISSIONER

Mark J. [Signature]
COMMISSIONER