

STATE OF NEW YORK  
STATE TAX COMMISSION

---

In the Matter of the Petition :  
of :  
HENRY STREET LIQUORS, INC. : DECISION  
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, 1977 :  
through August 31, 1981. :

---

Petitioner, Henry Street Liquors, Inc., 129 Henry Street, Hempstead, New York 11550, 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, 1977 through August 31, 1981 (File No. 41019).

A hearing was held before Sandra F. Heck, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on March 17, 1986 at 1:15 P.M. Petitioner appeared by Turetzky, Sternheim Co. (Isaac Sternheim, C.P.A.). The Audit Division appeared by John P. Dugan, Esq. (Anne W. Murphy, Esq., of counsel).

ISSUES

I. Whether the Audit Division properly disallowed certain sales by petitioner claimed as nontaxable, by determining that petitioner had accepted properly completed resale certificates in bad faith.

II. Whether the Audit Division properly asserted a fraud penalty on the assessment herein.

FINDINGS OF FACT

1. On August 20, 1982, the Audit Division issued to petitioner, Henry Street Liquors, Inc., two notices of determination and demands for payment of

sales and use taxes due. Both notices were for the period December 1, 1977 through August 31, 1981 and asserted base taxes due in the amounts of \$97,246.05 and \$2,305.45, together with interest in the amounts of \$27,638.86 and \$289.89, for total amounts due of \$124,884.91 and \$2,595.34. The total amount due under both assessments was \$127,480.25. Petitioner executed consents extending the period of limitation for assessment of sales and use taxes for the period December 1, 1977 through August 31, 1980 to August 20, 1982.

2. On March 27, 1985, the Audit Division issued to petitioner two notices of determination and demands for payment of sales and use taxes due for the period December 1, 1977 through August 31, 1981, which notices asserted fraud penalties in the amounts of \$48,622.98 and \$1,152.72, together with interest in the amount of \$5,386.65 on the first notice, for total amounts due of \$54,009.63 and \$1,152.72. The total amount due under both assessments was \$55,162.35.

3. At a prehearing conference held on March 5, 1984, the amount of tax due on the assessments described in Finding of Fact "1" hereof was reduced by \$6,806.52, resulting in a total amount of tax due of \$92,744.98 plus penalty and interest.

4. Petitioner is a high volume liquor store which reported \$8,211,694.00 of gross sales during the audit period. Nontaxable sales to exempt organizations and sales for resale were claimed in the amount of \$4,726,546.00, of which \$2,247,000.00 were determined to be sales for resale. The Audit Division allowed all of the sales to exempt organizations, but disallowed 58.3 percent of the sales for resale (\$1,310,001.00).

5. At the commencement of the audit in October 1980, it was established that petitioner's records were unavailable for the years 1978 and 1979 due to a fire at petitioner's premises in September 1979. With the consent of petitioner's

representative, the sales for resale were examined for a one-month test period, May 1980.

6. Of the sales for resale for May 1980, there were twenty different customers. The petitioner kept a copy of the sales invoice for each sale for resale and produced a resale certificate for each of the twenty customers. The sales invoice identified the customer's name and, in all or most cases, indicated the customer's address. The sales invoice did not specify the type and unit price of liquor or wine sold, but instead indicated the gross quantity (i.e., number of cases) of liquor or wine sold and the total price. On most invoices, the customer's vendor identification number also appeared. All of the resale certificates produced by petitioner were either properly completed or contained minor errors of a type commonly disregarded by the Audit Division.

7. From the sales invoices and resale certificates retained by petitioner for May 1980, the auditor transcribed the customer name, amount of sale, and the vendor identification number for each sale for resale claimed by petitioner. The auditor was suspicious of the validity of the resale certificates because some of the vendor identification numbers started with the prefix NY6, a series which the auditor believed had not been utilized in assigning the numbers.

8. The auditor checked the transcribed identification numbers against the Department of Taxation and Finance's (hereinafter the "Department") master vendor record. The check revealed that of the 20 numbers, 19 had never been assigned to any taxpayer by the Department. The only identification number which was valid was for CRS Color Lab, a vendor not involved in the liquor business. The other 19 customers were all bars or private clubs. The auditor determined that 3 of the 20 customers were registered vendors with the Department,

but that their actual identification numbers were different from the ones indicated on the resale certificates retained by petitioner.

9. At the time the resale certificates were originally accepted by petitioner, it was not possible for petitioner to verify the validity of the identification numbers with the Department.

10. The auditor then requested that petitioner obtain statements from each of the 20 customers, on the customers' own letterheads, which stated how much liquor the customers had purchased from petitioner for the period March, April and May 1980. Petitioner supplied 16 statements on a form created by petitioner which form contained blanks for the name and address of the customer, the dollar amount of purchases, and the name of the person signing the statement.

11. The president of petitioner corporation explained that the reason why the statements were not provided on the customers' letterheads was that the customers operate in a poor area, are not the most sophisticated people, and most of them do not have letterheads. The petitioner did try to obtain business cards to attach to resale certificates whenever possible.

12. The auditor attempted to verify the information contained on the statements by calling the customers on the telephone or visiting the customers' premises and, without identifying himself, asking for the person who signed the statement. In each case where the auditor was able to contact the business named on the statement, he was informed that the person who signed the statement was not affiliated with the business.

13. Petitioner claimed that most of the customers contacted by the auditor ceased doing business with petitioner because they did not want to be contacted by the Department.

14. A review of the information contained in the 16 statements revealed the following discrepancies:

- a) Scorpio Eagle Lounge - Statement listed address as 156 West Graham Avenue, Hempstead and was signed by Mattie Rae. In the Coles Directory (a directory which cross-references names, addresses, and telephone numbers), the address was for Wray Lodge, Inc., Mattie Wray, President, identification number 11-2293155. The State Liquor Authority records listed Scorpio Eagle Lounge at 162 West Graham Avenue, Hempstead.
- b) Gladys's Den - Statement listed address as 186 West Graham Avenue, Hempstead, New York, and was signed by Gladys Healy. The State Liquor Authority Records listed the address of Gladys's Den as 198 West Graham Avenue in Hempstead. In the Department's master vendor file, the operator of Gladys's Den was listed as Gladys Lynch.
- c) Streak Disco Co., Inc. - Statement listed address as 70 Main Street, Hempstead. The Coles Directory had no listing for 70 Main Street.

15. After being unable to verify the statements with the customers who supposedly submitted them, the Audit Division disallowed the nontaxable sales and offered a statement of proposed audit adjustment. The statement of proposed audit adjustment was disagreed with by petitioner. The Audit Division then decided to expand the test to include the months of January through April of 1980 and March through May of 1981. The petitioner's representative agreed to the expanded test period.

16. In the expanded test period, sales for resale were claimed to have been made to 14 additional vendors not listed in the previous test period. None of these additional 14 vendors were registered under the identification number listed on the resale certificate.

17. The auditor then sent a form (DO-1641[4/77]), which the Department uses to verify purchases, to any of the 34 customers who had not been previously contacted by the auditor. The form letter asked the customers to state their purchases from petitioner for a specified time period. The auditor sent 21 letters and received 9 responses. Two of the responses indicated that the customers did make purchases and indicated the amounts of purchases. One of the two affirmative responses also submitted delivery tickets showing delivery by petitioner of the product. Petitioner's records, however, did not indicate that sales had been made for the amounts on the delivery tickets. The remaining 7 responses indicated that they had made no purchases from petitioner.

18. To arrive at the percentage of disallowed sales for resale the auditor based his calculations only on the nine customers who responded to his direct request for information (see, Finding of Fact "17" hereof). The auditor first totalled the purchases for the entire test period (January through May 1980, and March through May 1981) from the two customers who said they had made purchases from petitioner (\$43,465.50). The auditor then totalled the purchases over the same period of the seven customers who claimed that they did not make any purchases from petitioner (\$60,769.59). By making a ratio of the disallowed sales for resale (\$60,769.59) to the total sales for resale for the nine customers, a 58.3 disallowance percentage was developed. The auditor then applied the 58.3 disallowance percentage to sales for resale for the entire audit period (\$2,247,000.00) to arrive at \$1,310,001.00 in disallowed sales for resale.

CONCLUSIONS OF LAW

A. That section 1101(b)(4) of the Tax Law defines a "retail sale" to include a "sale of tangible personal property to any person for any purpose, other than (A) for resale...".

B. That section 1132(c) of the Tax Law, in effect during the audit period, provided, in pertinent part, as follows:

"Unless...a vendor shall have taken from the purchaser a certificate in such form as the tax commission may prescribe, signed by the purchaser and setting forth his name and address and, except as otherwise provided by regulation of the tax commission, the number of his registration certificate, together with such other information as said commission may require, to the effect that the property or service was purchased for resale..., the sale shall be deemed a taxable sale at retail. Where such a certificate or statement has been furnished to the vendor, the burden of proving that the receipt, amusement charge or rent is not taxable hereunder shall be solely upon the customer. The vendor shall not be required to collect tax from purchasers who furnish a certificate of resale or an exempt organization statement in proper form."

C. That 20 NYCRR 532.4(b)(3) provides that:

"[w]hen the vendor is furnished with a properly completed exemption certificate, the burden of proving a transaction is not taxable shall be solely upon the customer."

Subparagraph (b)(4) of the same section provides that:

"[t]he vendor shall not be relieved of the burden of proof when no exemption certificate or an improper certificate has been furnished him, or when the vendor has actual knowledge that a certificate furnished is false or fraudulent."

D. That the courts have held that where a resale certificate is accepted in good faith and the vendor has no actual knowledge that a certificate is false or fraudulent, the vendor is under no duty to investigate or police its customers (see, American Cyanamid & Chemical Corp. v. Joseph, 308 N.Y. 259 [1955]; RAC Corporation v. Gallman, 39 A.D.2d 57 [1972]). The Court of Appeals in American Cyanamid, supra, stated in dicta that a vendor could not relieve

itself of the obligation to collect sales tax if it accepts a resale certificate fraudulently or in bad faith.

E. That none of the 34 resale certificates examined bore valid identification numbers; many sales invoices did not indicate specific quantities sold; supporting documentation subsequently furnished by petitioner was inaccurate, at best; and customer replies to the auditor's inquiry regarding purchases from petitioner conflicted with petitioner's records. Taking all these facts together, it must be concluded that petitioner accepted the certificates with knowledge they were false and/or fraudulent.

F. That the imposition of a fraud penalty requires clear and convincing evidence of every element of fraud, including willful, knowledgeable and intentional wrongful acts or omissions constituting false representation and resulting in deliberate nonpayment or underpayment of tax. (Matter of Walter Shutt and Gertrude Shutt, State Tax Comm., June 4, 1982.) The Audit Division's case does not rise to the necessary quantum of proof. There nonetheless emerges a pattern of conduct by petitioner such as to warrant the imposition of penalties pursuant to Tax Law section 1145(a)(1).

G. That the petition of Henry Street Liquors, Inc. is granted to the extent indicated in Conclusion of Law "F"; the Audit Division is directed to modify the notices of determination and demands for payment of sales and use taxes due issued on August 20, 1982 and March 27, 1985 in accordance with Finding "3" and Conclusion "F"; and except as so granted, the petition is in all other respects denied.

DATED: Albany, New York

STATE TAX COMMISSION

NOV 12 1986

  
PRESIDENT

  
COMMISSIONER

  
COMMISSIONER