

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition
of
DATA ACCESS SYSTEMS, 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, 1979
through August 31, 1982.

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DECISION

Petitioner, Data Access Systems, Inc., 156-15 Northern Boulevard, Flushing, New York 11354, 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, 1979 through August 31, 1982 (File No. 43226).

A hearing was held before James Hoefer, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on September 9, 1985 at 1:15 P.M. Petitioner appeared by Seymour Finder, C.P.A. The Audit Division appeared by John P. Dugan, Esq. (Joseph Pinto, Esq., of counsel).

ISSUE

Whether the Audit Division properly determined petitioner's sales and use tax liability.

FINDINGS OF FACT

1. On March 15, 1983, as the result of a field audit, the Audit Division issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due against petitioner, Data Access Systems, Inc., in the amount of \$2,658.63, plus interest of \$521.71, for a total due of \$3,180.34 for the period December 1, 1979 through August 31, 1982.

2. Petitioner engages in software consulting work. Petitioner's business involves assisting clients in solving problems which occur in their computer systems. As a favor to its clients, petitioner sells some hardware, consisting mainly of used computer peripherals and accessories such as printers and disk drives. Petitioner has a small number of clients and, over the course of the audit period, it dealt with nine or ten customers according to the sales invoices supplied to the Audit Division.

3. On audit, the auditor determined that petitioner's books and records were inadequate to conduct a complete audit because petitioner maintained no general ledger, purchase journal or sales journal. Additionally, petitioner's sales invoices, which were numbered by petitioner rather than preprinted, appeared to be incomplete. There were approximately 125 invoices missing, including one consecutive group of 90. The auditor, therefore, performed a purchase markup audit. Based on petitioner's cash disbursements journal, the auditor found total hardware purchases and subtracted an ending inventory for September 30, 1981 of \$15,000.00 to arrive at cost of hardware purchases sold of \$48,625.00. He then applied a markup of 25 percent, which was less than the industry average of 42 percent, to account for the fact that petitioner sold used hardware. Petitioner also had maintenance service performed on its computers totalling \$2,894.00. The auditor included this amount in petitioner's taxable sales which totalled \$63,675.00. Petitioner had reported taxable sales of \$31,327.00. The difference between audited sales and reported sales represented additional taxable sales which the auditor divided by reported sales to arrive at an error rate of 103.26 percent. He applied the error rate to the sales reported over the audit period and then applied the appropriate sales tax

rate to obtain additional sales tax due. The auditor also found recurring purchases subject to use tax of \$45.44.

4. Petitioner concedes that it owes use tax of \$45.44 on purchases and \$232.88 use tax on computer maintenance, but argues that the \$2,894.00 paid for the maintenance should not have been factored in with taxable sales to determine the error rate because the maintenance was not a taxable sale, but a purchase subject to use tax. Petitioner also argues that use of a \$15,000.00 ending inventory was inaccurate because it was not based on an actual inventory but was estimated by petitioner's former accountant for income tax purposes without checking petitioner's hardware on hand. Petitioner submitted an actual inventory taken as of September 30, 1982 which indicated that the ending inventory was \$30,000.00.

5. Petitioner also maintains that its invoices were complete and that the missing numbers were created intentionally so that petitioner's clients would not realize that it had such a limited clientele. Petitioner also submitted a sales invoice indicating that a \$3,486.20 sale was returned as defective. However, in using a purchase markup based on cost of goods sold, such a refund would have no impact on the calculation. Petitioner also objected to use of a 25 percent markup arguing that all its sales were either at cost or at a very low markup. No evidence was presented substantiating this claim or indicating what markup petitioner might have used.

CONCLUSIONS OF LAW

A. That section 1135 of the Tax Law, in effect during the period in issue, requires every person required to collect sales tax to keep records of every sale and of the tax payable thereon. "Such records shall include a true copy of each sales slip, invoice, receipt, statement or memorandum...".

Section 1138(a) provides that if a sales tax return "is not filed, or if a return when filed is incorrect or insufficient, the amount of tax due shall be determined by the tax commission from such information as may be available. If necessary, the tax may be estimated on the basis of external indices..."

"When records are not provided or are incomplete and insufficient, it is [the Tax Commission's] duty to select a method reasonably calculated to reflect the taxes due. The burden then rests upon the taxpayer to demonstrate...that the method of audit or the amount of the tax assessed was erroneous" (Surface Line Operators Fraternal Organization, Inc. v. Tully, 85 A.D.2d 858).

B. That inasmuch as petitioner did not maintain records of every sale in accordance with section 1135 of the Tax Law, the auditor was justified in conducting a purchase markup audit. Petitioner's argument that gaps were intentionally left in its invoice numbering system does not satisfactorily explain why 90 consecutive invoices were missing while most of the remainder were present and in order. Moreover, petitioner had at least nine or ten regular clients during the audit period rather than the one or two to which the testimony alluded. Thus, there would have been no need to make the clients believe petitioner had no more than one or two other customers.

C. That petitioner has not met its burden of proving that the 25 percent markup was incorrect. The markup was lower than the industry average and petitioner offered no proof other than allegations to refute the percentage. Petitioner, however, has shown that an ending inventory of \$30,000.00 should have been used in computing the cost of hardware purchases sold. Additionally, the \$2,894.00 in taxable maintenance charges constituted a taxable purchase by petitioner and should not have been added to taxable sales prior to determining petitioner's error rate for computing additional taxable sales. Thus, petitioner's

sales and use tax liability is reduced to \$1,138.75, plus interest, determined as follows:

Hardware purchases	\$63,625.00
Less ending inventory	30,000.00
Hardware purchases sold	33,625.00
Markup 25 percent	8,406.00
Hardware sales	42,031.00
Less sales reported	31,327.00
Additional taxable sales	\$10,704.00

$$\text{Error rate } \frac{\$10,704.00}{\$31,327.00} = .34 = 34 \text{ percent}$$

<u>Reported Sales</u>	<u>Error Rate</u>	<u>Additional Sales</u>	<u>Tax Rate</u>	<u>Tax</u>
\$21,506.00	x.34	\$7,312.00	8.00%	\$584.96
9,821.00	x.34	3,339.00	8.25%	275.47
				<u>\$860.43</u>

Sales tax due	\$ 860.43
Use tax on maintenance	232.88
Use tax on purchases	45.44
	<u>\$1,138.75</u>

D. That the petition of Data Access Systems, Inc. is granted to the extent indicated in Conclusion of Law "C"; that the Audit Division is directed to modify the Notice of Determination and Demand for Payment of Sales and Use Taxes Due issued March 15, 1983, accordingly; and that, except as so granted, the petition is in all other respects denied.

DATED: Albany, New York

STATE TAX COMMISSION

FEB 18 1986

Richard A. Clem
PRESIDENT

Francis R. Koening
COMMISSIONER

Mark J. Ouellet
COMMISSIONER