

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition

of

SAM 6 RAJ APPLIANCE DISCOUNT CENTER, INC.

DETERMINATION

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, 1978
through November 30, 1981.

Petitioner, Sam & Raj Appliance Discount Center, Inc., 37-08 74th Street, Jackson Heights, New York 11373, 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, 1978 through November 30, 1981 (File No. 45834).

A hearing was commenced before Brian L. Friedman, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on August 6, 1986 at 9:15 A.M. and continued to conclusion on November 18, 1986 at 9:15 A.M. Petitioner appeared by Seymour Finder, CPA. The Audit Division appeared by John P. Dugan, Esq. (Michael Gitter, Esq., of counsel).

ISSUES

I. Whether the Audit Division properly disallowed certain sales which petitioner claims to have been exempt from sales tax by virtue of the fact that said sales were made to diplomatic personnel or officers of permanent missions to the United Nations.

11. Whether the Audit Division properly determined that petitioner's bank deposits, which indicated gross sales receipts exceeding reported gross sales, were unreported sales subject to sales tax.

FINDINGS OF FACT

1. In November of 1981, the Audit Division commenced a field audit of Sam & Raj Appliance Discount Center, Inc. (hereinafter "petitioner"). On November 16, 1981 and on December 10, 1982, petitioner's president, S. K. Kapadia, executed consents which extended the period of limitation for assessment of sales and use taxes for the period December 1, 1978 through February 28, 1980 to December 20, 1982 and June 20, 1983, respectively.

2. On March 30, 1982, petitioner's president and Farouk R. Nematalla of the Audit Division executed Form AU-377.12, Audit Method Election, on which they elected to utilize a representative test period audit method to determine any sales or use tax liability.

3. Pursuant to this audit, the Audit Division issued to petitioner, on June 20, 1983, a Notice of Determination and Demand for Payment of Sales and Use Taxes Due in the amount of \$400,100.70, plus penalty and interest, for a total amount due of \$633,857.65 for the period December 1, 1978 through November 30, 1981.

4. Prior to commencement of the audit, a letter was sent to petitioner which advised that all books and records pertaining to its sales tax liability for the audit period should be available. Among the records specifically requested were journals, ledgers, sales invoices, purchase invoices, cash register tapes and exemption certificates. The auditor initially examined petitioner's records pertaining to nontaxable sales and, based upon said examination, determined that petitioner's records were adequate and sufficient to warrant an audit method utilizing all records within the audit period. Pursuant to this determination, Form AU-377.12, described above, was executed by the parties. However, upon a subsequent examination of petitioner's records

pertaining to taxable sales, the auditor was not provided with cash register tapes and found that sales invoices for the period were neither dated nor pre-numbered.

5. Petitioner provided the auditor with a Federal corporation income tax return only for the taxable year July 1, 1979 through June 30, 1980. A bank deposit analysis was performed for this period by comparing cash receipts with the amounts reported on the Federal return and on the State sales tax returns. A substantial discrepancy between cash received and sales reported was found. The original amount of tax assessed pursuant to the Notice of Determination and Demand for Payment of Sales and Use Taxes Due issued June 20, 1983 was based upon the percentage of the difference between cash received and sales reported for the year, projected over the entire audit period.

6. (a) Subsequent to the issuance of the notice of determination and demand, the Audit Division revised its original assessment pursuant to the utilization of a different test period audit method. Sales invoices totalling \$305,277.19 for the month of June 1981 were examined. The auditor disallowed claimed nontaxable sales in the amount of \$28,284.50 and thereupon applied a margin of error of 9.27 percent ($\$28,284.50 / \$305,277.19$). For the period at issue, petitioner claimed nontaxable sales of \$6,954,898.00. The auditor applied the error percentage of 9.27 percent and, therefore, disallowed claimed nontaxable sales of \$644,718.96. This disallowed amount, taxed at the applicable sales tax rate, resulted in tax due for the period in the amount of \$51,726.08.

(b) The auditor also performed a test period audit analysis with respect to cash receipts as compared with gross sales reported for the sales tax quarter ending November 30, 1981. Gross sales pursuant to cash receipts were \$1,016,876.67. Gross sales per sales tax returns for the quarter were

\$803,031.00, thereby resulting in a difference of \$213,845.67. The auditor allowed as deposits not representing sales certain transfers, deposits of sales tax, returned checks, etc., but disallowed the amount of \$36,717.00 which petitioner claimed to have been loans received from certain individuals. A margin of error of 17.17 percent ($\$36,717.00/\$213,845.67$) was determined. This error percentage was applied to the difference between cash receipts and gross sales per returns for each of the quarters at issue to determine the amount of cash receipts which, according to this test period analysis, should have been subject to tax. By applying the appropriate sales tax rate, the auditor determined additional tax due, pursuant to this analysis, in the amount of \$25,995.78.

(c) The auditor combined the amounts of additional tax due pursuant to each of the test period analyses performed hereinabove and, therefore, determined total sales tax due for the period at issue in the amount of \$77,721.86, plus penalty and interest.

7. (a) As indicated in Finding of Fact "6(a)", supra, the auditor, in his test period analysis of claimed exempt sales, disallowed claimed nontaxable sales in the amount of \$28,284.50. At the hearing, petitioner produced a sworn statement from the president of Columbia Appliances & Travels, along with a completed Resale Certificate and copies of invoices, which indicated that Columbia purchased items totalling \$7,228.20 during the test period (June 1981) and that said purchases were made for purposes of resale. Accordingly, the amount of \$7,228.20 is allowed as a nontaxable sale.

(b) The Audit Division improperly disallowed \$308.37 of a claimed sale to Aegean Gifts, Inc. in the amount of \$653.62. The Audit Division allowed \$345.25 which represented a purchase made on January 12, 1981. A sales

invoice in the amount of \$653.62 dated June 5, 1981 and a completed Resale Certificate were produced by petitioner. The full amount of the claimed sale (\$653.62) should have been allowed as an exempt sale.

(c) Subsequent to the hearing held herein, the Audit Division, by letter dated December 26, 1986 from its representative, Michael Gitter, Associate Attorney, conceded that 92.3 percent of certain sales which petitioner claimed to have been tax exempt as sales to diplomatic personnel were, in fact, sales to such personnel. The purchases and amounts of sales at issue were as follows:

Mohammed Siddigi	\$ 477.33	
Hilda Montenegro	1,071.69	
Supoj Hotewaphervanidnder	627.00	
Syed A. Ahmed	944.07	
Mrs. Nongluck Narymit	950.47	
Mercedes Buenaventura	561.75	
Carlo Miguelli	704.00	
Mary Shahtaheri	1,415.20	
Ariya Chensavasdijai	632.21	
Gloria Herman	1,489.30	
Jong Won Lee	764.90	
Salua Lahlou	875.70	
	<u>\$10,513.62</u>	Total

A sale to Mimi Kyes was disallowed since the DTF-10 card number used in the purchase was issued to the wife of the Ambassador from Sri Lanka and was cancelled on May 28, 1981, a time which was prior to the test period.

(d) For the test period (June 1981), the following sales, claimed by petitioner to have been exempt from the imposition of sales tax, were properly disallowed by the Audit Division and were, therefore, subject to tax for the reasons set forth herein:

(1) \$571.11 to Shirley Flores - disallowed because purchaser responded to the Audit Division's third-party verification by stating that she did not purchase anything from petitioner during the period at issue;

(iii) \$1,681.00 to Soliman Abdel Mutalib - disallowed because the customer copy of a charge slip for a purchase in the amount of \$200.00 was dated June 1, 1980, a period which is not within the test period;

(iii) \$1,641.27 to Tara Shah - disallowed because purchaser's designee, Lanna Trading & Shipping, Ltd., took possession of goods in New York and, as such, purchaser was deemed to have taken delivery within the State;

(iv) \$961.30 to Vallee Chunhaswadikul - disallowed for the same reason as that set forth in (iii) herein;

(v) \$1,412.00 to Dr. T. Venkataswamy - disallowed \$809.00 and allowed \$603.00 which was confirmed by the purchaser pursuant to the Audit Division's third-party verification;

(vi) \$266.00 to Sona Appliances, Inc. - disallowed pursuant to a letter from the purchaser claiming that the resale certificate was not signed by a member of the company; and

(vii) \$2,533.55 to Bargain Line - disallowed because goods were not delivered out of state and the purchaser failed to obtain an out-of-state resale permit.

(e) By virtue of the findings herein, the total amount of sales disallowed as exempt sales is reduced from \$28,284.50 to \$10,234.31 (\$28,284.50 - \$7,228.20 - \$308.37 - \$10,513.62 = \$10,234.31). Accordingly, the error percentage is reduced from 9.27 percent to 3.35 percent (\$10,234.31/\$305,277.19). Applying the revised error percentage to claimed nontaxable sales for each of the sales tax quarters at issue and taxing the resulting amounts at the applicable rate for each quarter results in a reduction of tax due, pursuant to this test

period analysis, from \$51,726.08, as originally determined by the auditor, to the sum of \$18,692.84.

8. (a) During the month of October 1981, Henry Coleman loaned petitioner the sum of \$10,000.00 as evidenced by copies of a withdrawal from his savings account and of a bank draft to petitioner dated October 17, 1981.

(b) Petitioner withdrew the sum of \$8,350.35 on October 1, 1981 which was used to secure a sight draft in order that **Raj** Sari Palace, Inc. could purchase merchandise from Singapore. On October 14, 1981, **Raj** Sari Palace, Inc. issued two checks totalling \$8,335.35 as repayment. No proof of payment of the remaining \$15.00 was presented.

(c) At the hearing held herein, the Audit Division conceded that a Dreyfus Liquid Assets, Inc. check from Sharad Dalal drawn October 29, 1981 in the amount of \$3,000.00 and made payable to petitioner was returned for lack of joint signatures and, as such, should not have been held by the Audit Division to have been part of the original sum of \$36,717.35 representing unsubstantiated loans since this \$3,000.00 was not received by petitioner.

(d) Petitioner contends that it received loans during the test period as follows:

The Fashion Game	\$ 5,000.00
Raj Gandhi	2,382.00
Dinu Patel	1,000.00
Indira & Kusum Patel	3,000.00
Nitin Vora	4,000.00
	<u>\$15,382.00</u>

Such contentions are not supported by credible testimony or evidence which would substantiate that the above amounts were loans.

(e) By virtue of the findings herein, the error percentage originally computed by the Audit Division with respect to the test period cash receipts analysis must be reduced from 17.17 percent (\$36,717.00/\$213,845.67) to 7.19

percent ($\$36,717.00 - \$10,000.00 - \$8,335.35 - \$3,000.00 = \$15,381.65$;
 $\$15,381.65 / \$213,845.67 = .0719$). Applying the revised error percentage to the difference between cash receipts and gross sales per returns for each of the sales tax quarters at issue and thereupon applying the proper sales tax rate to the **sums** obtained therefrom results in additional tax due, pursuant to this analysis, in the amount of \$10,885.82.

9. As indicated in Finding of Fact "6(c)", the auditor combined the amounts of additional tax due pursuant to each of the test period analyses performed and determined additional tax due in the amount of \$77,721.86. Pursuant to Findings of Fact "7" and "8", the amount of additional sales tax due for the period at issue is reduced from \$77,721.86 to \$29,578.66, plus applicable penalty and interest.

CONCLUSIONS OF LAW

A. That section 1138(a)(1) of the Tax Law provides, in part, that if a return required to be filed is incorrect or insufficient, the Tax Commission shall determine the amount of tax due on the basis of such information as may be available. This section further provides that, if necessary, the tax may be estimated on the basis of external indices.

B. That it **is** well settled that where a taxpayer does not maintain and make available such records, including source documents, as will allow the establishment of an audit trail and enable verification of the accuracy of returns filed, the Audit Division may resort to indirect audit methodology in carrying out its audit function. However, in determining the amount of a sales tax assessment, it is the duty of the Audit Division to select a method "reasonably calculated to reflect the taxes due" (Hatter of Grant Co. v. Joseph, 2 NY2d 196, 206; Matter of Meyer v. State Tax Commn., 61 AD2d 223, 227. 1v denied 44

NY2d 645). In turn, when the Audit Division employs such a method, it becomes incumbent upon the petitioner to establish error (Matter of Meyer v. State Tax Commn., supra).

C. That while petitioner did maintain books and records, said books and records were insufficient for verification of taxable sales since sales invoices were not sequentially numbered and cash register tapes were not made available. Accordingly, the Audit Division was entitled **to employ, and did obtain from** petitioner consent to such employment, of a test period audit analysis of sales claimed to be exempt from the imposition of sales tax and of an analysis of cash receipts.

D. That if the audit method was reasonable, the burden then rests upon the taxpayer to demonstrate by clear and convincing evidence that the method of audit or the amount of tax assessed was erroneous (Matter of Surface Line Operators Fraternal Organization v. Tully, 85 AD2d 858). Petitioner does not contend that the audit methods employed were erroneous, but merely asserts that the Audit Division erred with respect to its determinations with respect to specific sales claimed by petitioner to be exempt from tax and to certain amounts received by petitioner which it claims represented loans rather than sales.

E. That, as indicated in Finding of Fact "9", supra, petitioner has met its burden of proof with respect to certain transactions and the Audit Division has conceded the nontaxability of some of these transactions, with the result that additional tax due is reduced from \$77,721.86, as determined by the Audit Division subsequent to the issuance of the Notice of Determination and Demand for Payment of Sales and Use Taxes Due, to \$29,578.66, plus applicable penalty and interest. With respect to the additional transactions which petitioner

contends represent exempt sales and loans from third parties, petitioner has not met its burden of proving, by clear and convincing evidence, that the Audit Division erred in its categorization of said transactions as sales subject to tax and/or sums received as payment for goods or services.

F. That the petition of Sam & Raj Appliance Discount Center, Inc. is granted only to the extent indicated in Conclusion of Law "E"; that the Audit Division is directed to modify the Notice of Determination and Demand for Payment of Sales and Use Taxes Due issued June 20, **1983** accordingly; and that, except as so granted, the petition is in all other respects denied.

DATED: Albany, New York

SEP 03 1987


ADMINISTRATIVE LAW JUDGE