

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition

of

LUNG KEE CO., 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, 1979
through August 31, 1982.

Petitioner, Lung Kee Co., Inc., 22 Bowery, New York, New York 10013, 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. 49400).

A hearing was held before Brian L. Friedman, Hearing Officer, at the
offices of the State Tax Commission, Two World Trade Center, New York, New
York, on May 1, 1986 at 1:15 P.M., with all briefs to be submitted by September 4,
1986. Petitioner appeared by Murray Appleman, Esq. The Audit Division appeared
by John P. Dugan, Esq. (Kevin A. Cahill, **Esq.**, of counsel).

ISSUES

I. Whether the audit procedures and tests used by the Audit Division in
an examination of petitioner's available books and records were proper and
whether, **as a** result thereof, the Audit Division correctly determined that
petitioner had additional taxable sales for the period at issue.

II. Whether, if additional tax **is** due, petitioner has established reasonable
cause for underreporting and underpayment of tax, thus warranting cancellation
or reduction of penalties assessed.

FINDINGS OF FACT

1. For the period at issue, Lung Kee Co., Inc. (hereinafter "petitioner") operated a Chinese grocery store at 22 Bowery, New York, New York.

2. On November 4, 1983, as the result of an audit, the Audit Division issued to petitioner a Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period December 1, 1979 through August 31, 1982 in the amount of \$38,822.42, plus penalty of \$9,203.75 and interest of \$11,117.94, for a total amount due of \$59,144.11. Of the total tax of \$38,822.42 assessed pursuant to this notice, \$38,756.74 was assessed on petitioner's sales and \$65.68 was assessed on expense purchases made by petitioner. At the hearing held herein, the Audit Division conceded that the tax assessed on expense purchases should be reduced from \$65.68 to \$26.53 for the period at issue.

3. On February 15 and April 7, 1983, petitioner executed consents extending the period of limitation for assessment of sales and use taxes for the period at issue to December 20, 1983.

4. The Audit Division requested that petitioner provide all books and records pertaining to its sales tax liability, including journals, ledgers, sales invoices, purchase invoices, cash register tapes, exemption certificates and all sales tax records. On audit, petitioner made available sales tax returns and related worksheets, Federal and State income tax returns, cash receipts journal, check disbursements journal, purchase invoices and a general ledger. Cash register tapes or receipts were not provided to the Audit Division.

5. With the aid of an interpreter, the auditor spoke with Mr. Chiu Yuen, President of Lung Kee Co., Inc. The auditor discussed the use of a test period audit with Mr. Chiu Yuen, who did not object to this audit method. The auditor thereupon requested all purchase invoices for the months of January and June of

1982 since, based upon his experience in conducting audits of similar businesses, the months of January and July were most representative. Petitioner did not record soda purchases in its records **so** the results of third party verification requests were used to determine soda purchases. Petitioner's purchases, excluding soda, were then broken down into categories. The percentage of taxable items in each category were found to be as follows:

General	-----	5.59%
Beer	-----	6.66%
Candy	-----	2.835
Tobacco	-----	3.87%
		<hr/>
		18.95% Total Taxable
		81.05% Nontaxable

6. A markup test was performed for items in each of the categories, including soda, using costs and selling prices in effect at the time of the audit. Current purchase invoices were used in the markup test due to the fact that petitioner did not have sales receipts or purchase records for various items purchased and sold in 1981 and 1982. By comparing the selling price against the cost to petitioner, the following markup percentages were obtained:

General	-----	29.29%
Beer	-----	19.81%
Candy	-----	15.89%
Tobacco	-----	25.73%
Soda	-----	13.17%

The auditor then applied the above markup percentages **to** the purchases to determine audited taxable sales. Petitioner's reported taxable sales were subtracted from audited taxable sales to arrive at additional taxable sales. Sales tax due **on** the additional taxable sales was determined to be \$38,756.74.

7. For the period at issue, petitioner's gross sales were properly reported on its Federal income tax returns. For the first sales tax quarter of the period at issue, petitioner had estimated its taxable sales at 1.3 percent

of its gross sales and, for the remaining sales tax quarters of the audit period, petitioner reported 2.6 percent of its gross sales as taxable sales.

8. The Audit Division imposed penalty on the tax deficiency based upon the fact that petitioner had previously been audited and, for the period at issue, had estimated its taxable sales by reporting 1.3 percent of its gross sales as taxable sales. The Audit Division contends that even though the State Tax Commission issued a decision sustaining the assessment for this prior period, petitioner had not corrected the reporting method which resulted in the assessment.

9. Petitioner contends that section 1135 of the Tax Law does not provide for specific record keeping requirements and that, for the period at issue, no regulations had been promulgated which clearly set forth standards upon which a determination could be made as to whether or not a taxpayer had maintained adequate records. Petitioner maintains that the absence of register tapes should not have resulted in a determination by the Audit Division that its books and records were inadequate and that the Audit Division should not have estimated tax due on the basis of external indices.

CONCLUSIONS OF LAW

A. That section 1135 of the Tax Law, in effect for the period at issue, provided, in pertinent part, as follows:

"Every person required to collect tax shall keep records of every sale, and of all amounts paid, charged or due thereon of the tax payable thereon, in such form as the tax commission may by regulation require. Such records shall include a true copy of each sales slip, invoice, receipt, statement or memorandum upon which subdivision (a) of section eleven hundred thirty-two requires that the tax be stated separately."

B. That petitioner failed to keep records of taxable sales or sales tax collected as specifically required by section 1135 of the Tax Law. The Appellate Division, Third Department, in Goldner v. State Tax Commission, 70 AD2d 978, stated:

"While petitioner did maintain certain records such as sales journals and ledgers, this information could not be verified because petitioner did not retain cash register tapes or guest checks prior to notice of the audit. This failure to keep cash register tapes was a clear violation of section 1135 of the Tax Law."

C. That where the taxpayer's own failure to maintain proper records prevents exactness in determination of sales tax liability, exactness is not required (Markowitz v. State Tax Commission, 54 A.D.2d 1023, aff'd 44 NY2d 684).

Because of petitioner's inadequate record keeping, the Audit Division's use of a test period and markup audit as a basis for determining petitioner's liability was proper in accordance with section 1138(a) of the Tax Law (Chartair, Inc. v. State Tax Commission, 65 AD2d 44; Matter of Sakran v. State Tax Commission, 73 AD2d 989).

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 has failed to sustain this burden of showing error.

E. That section 1145(a)(1) of the Tax Law provides that penalties which have been assessed shall be remitted if the taxpayer establishes that the failure to comply was due to reasonable cause and was not due to willful neglect. Additionally, 20 NYCRR 536.1(b) provides, in pertinent part, that "[i]n determining whether reasonable cause exists..., the taxpayer's previous

compliance record may be taken into account." Petitioner's utilization **of** an estimation of its sales tax liability by reporting a percentage **of** its gross sales as sales subject to tax was previously rejected by the State Tax Commission (Matter of Lung Kee Co., Inc., State Tax Commission, March 13, 1981). Petitioner has introduced no evidence to indicate that, subsequent to the issuance of the aforesaid decision, it took steps to correct its record keeping or reporting methods nor has petitioner introduced any evidence to show that its failure to pay over the proper amount **of** tax was due to reasonable cause and not due to willful neglect. Cancellation or reduction of penalties assessed is, therefore, not warranted.

F. That the petition **of** Lung Kee Co., Inc. is granted only **to** the extent indicated in Finding of Fact "2"; that the Audit Division is directed to modify the Notice **of** Determination and Demand for Payment of Sales and Use Taxes Due issued November 4, 1983 accordingly; and that, except as **so** granted, the petition is in all other respects denied.

DATED: Albany, New York

STATE TAX COMMISSION

JAN 30 1987

PRESIDENT


COMMISSIONER


COMMISSIONER

I abstain.

Roderick W. Chen