STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition

of

CLARKE AND O'SULLIVAN WINES & LIQUORS

for Redetermination of a Deficiency or for Refund of Unincorporated Business Tax under Article 23 of the Tax Law for the Year 1980.

In the Matter of the Petition

of

CORNELIUS O'SULLIVAN AND MARIE O'SULLIVAN (DECEASED)

for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Years 1979, 1980 and 1981.

In the Matter of the Petition

of

MICHAEL J. CLARKE

for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Years 1979, 1980 and 1981.

DECISION

Petitioner, Clarke and O'Sullivan Wines & Liquors, 30 Henry Street, Orangeburg, New York 10962, filed a petition for redetermination of a deficiency or for refund of unincorporated business tax under Article 23 of the Tax Law for the year 1980 (File No. 52158).

Petitioners, Cornelius O'Sullivan and Marie O'Sullivan (deceased), 22 Quake Lane, Pearl River, New York 10965, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the years 1979, 1980 and 1981 (File Nos. 52155 and 52156).

Petitioner, Michael J. Clarke, 30 Henry Street, Orangeburg, New York 10962, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the years 1979, 1980 and 1981 (File No. 52157).

A consolidated 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 November 22, 1985 at 9:15 A.M., with all briefs to be submitted by January 22, 1986. Petitioners appeared by Murray L. Korn, C.P.A. The Audit Division appeared by John P. Dugan, Esq. (Herbert Kamrass, Esq., of counsel).

ISSUE

Whether it was proper for the Audit Division to increase petitioners' reported net income based upon the results of a sales tax audit.

FINDINGS OF FACT

1. Clarke and O'Sullivan Wines & Liquors was a partnership engaged in the retail sale of wine and liquor. Cornelius O'Sullivan and Michael J. Clarke were its only partners and each partner shared equally in the partnership's profits and/or losses. The partnership was formed on or about January 23, 1979 and the business was sold on June 4, 1981.

2. Sometime in 1981, the Audit Division, through the sales tax audit section of its White Plains District Office, conducted a field audit of the partnership to determine if the proper amount of sales tax was collected and remitted. The sales tax audit was conducted using a purchase markup analysis. A wine markup of 47 percent and a liquor markup of 23 percent was computed by

the sales tax auditor by comparing purchases for the month of April, 1983 to selling prices from the month of July, 1983.

3. Petitioners disagreed with the markups determined by the sales tax auditor on the basis that he used selling prices from a period after the business had been sold. The sales tax auditor, apparently recognizing that some distortion may have occurred by using selling prices from a period when petitioners were not the owners of the liquor store, reduced the wine markup to 40 percent and the liquor markup to 17 percent. These revised markups were not determined as the result of any comparison of purchases to selling prices and were apparently markups which the sales tax auditor believed were applicable to petitioners' business.

4. Using the revised wine markup of 40 percent and revised liquor markup of 17 percent, the sales tax auditor computed additional sales tax due of $1,539.56 in the following manner:

Wine purchases	$ 87,618.00	
Add 40% markup	35,047.00	
Wine sales		$122,665.00
Liquor purchases	$225,304.00	
Add 17% markup	38,302.00	
Liquor sales		263,606.00
Audited gross sales		$386,271.00
Less nontaxable sales		33,598.00
Audited taxable sales		$352,673.00
Less reported taxable sales		314,184.00
Additional taxable sales		$ 38,489.00
Tax rate		.04
Sales tax due		$ 1,539.56

5. Petitioners disagreed with the computation of additional sales tax due and pursued a resolution of the matter with the Audit Division. Although in disagreement with the computation of sales tax due, petitioners ultimately agreed to the assessment for the following reasons:

i) the business had been sold and a substantial sum of money from said sale was being held in escrow pending the outcome of the sales tax audit;

ii) the amount of tax due was relatively small and the payment of professional fees to contest the audit findings would have equalled or exceeded the alleged tax due; and

iii) the individual who had purchased the liquor store from petitioners was himself trying to sell the business and the proposed sale could not be completed until petitioners resolved the sales tax audit matter. Petitioner were being pressured to settle the sales tax audit matter so that the liquor store could once again be sold.

6. Neither petitioners nor their representative were informed at any point in the course of the sales tax audit that the results would or might be employed to determine personal income and unincorporated business tax deficiencie

7. After petitioners consented to the results of the sales tax audit, said results were forwarded to the income tax audit section in the White Plains District Office. An income tax field audit was subsequently commenced and the income tax auditor assigned to the case chose 1980 as a sample year to audit. The income tax auditor intended to reconstruct petitioners' income using the cash availability analysis method. The partnership and Michael J. Clarke maintained records sufficient to perform a cash availability analysis, however, Cornelius O'Sullivan was missing bank statements and the income tax auditor determined that, without these records, an accurate cash availability analysis could not be performed with respect to Mr. O'Sullivan. The auditor further determined that a cash availability analysis had to be performed with respect to all three petitioners in order to be accurate and, since this was not

possible, he decided to utilize the results produced by the sales tax purchase markup analysis.

8. In order to make the sales tax audit adjustments applicable for personal income and unincorporated business tax purposes, the income tax auditor made the following determinations:

(i) that the increase in gross sales of $36,721.00 ($386,271.00 audited gross sales less $349,550.00 reported gross sales) determined pursuant to the sales tax purchase markup analysis resulted in additional net income for personal income and unincorporated business tax purposes of $36,721.00; and

(ii) that since the sales tax audit encompassed the period December 1, 1978 through May 31, 1981, the additional income of $36,721.00 was apportioned to the calendar years 1978[1], 1979[1], 1980 and 1981 in the sums of $417.00, $11,755.00, $17,026.00 and $7,523.00, respectively.

9.(a) On February 15, 1984, the Audit Division issued a Statement of Unincorporated Business Tax Audit Changes to the partnership which increased partnership income by $11,755.00, $17,026.00 and $7,523.00 for 1979, 1980 and 1981, respectively. Based on the aforementioned Statement, the Audit Division, on April 11, 1984, issued a Notice of Deficiency to the partnership for the year 1980 asserting additional unincorporated business tax due of $257.25, plus interest of $92.66, for a total allegedly due of $349.91. No tax was asserted

---

1 For unincorporated business tax purposes, the years 1978 and 1979 are not at issue as the statute of limitations for assessment had expired before completion of the income tax audit.

due for the year 1981 since the unincorporated business tax rate for said year was zero percent.

(b) On March 30, 1984, the Audit Division issued a Statement of Personal Income Tax Audit Changes to Cornelius O'Sullivan for the years 1979, 1980 and 1981 increasing reported income by $5,878.00, $8,513.00 and $3,761.00, respectively. The increases were based on petitioner's distributive share (50%) of the adjustments made to the partnership's income for these same years. On March 30, 1984, the Audit Division issued a Notice of Deficiency to Cornelius O'Sullivan for the years 1980 and 1981 proposing additional New York State personal income tax due of $1,343.36, plus interest of $408.99, for a total allegedly due of $1,752.35. A second Notice of Deficiency, also dated March 30, 1984, was issued to Cornelius O'Sullivan and Marie O'Sullivan[2] (deceased) for the year 1979[3] proposing additional New York State personal income tax due of $357.56, plus interest of $159.24, for a total allegedly due of $516.80.

(c) On February 15, 1984, the Audit Division issued a Statement of Personal Income Tax Audit Changes to Michael J. Clarke for the years 1979, 1980 and 1981. On said Statement the Audit Division proposed, ~~inter alia~~[4], to increase reported income by $5,877.00 for 1979, $8,513.00 for 1980 and $3,762.00

2 Marie O'Sullivan (deceased) is involved in this proceeding solely as the result of having filed a joint income tax return with Cornelius O'Sullivan.

3 The Audit Division determined that for personal income tax purposes the statute of limitations for assessment had not expired for the year 1979 since there existed a 25 percent omission of income [Tax Law §683(d)(1)].

4 Petitioner Michael J. Clarke contests only those adjustments which stem from the sales tax audit findings and concedes the accuracy of all other

for 1981. Said increases were based on petitioner's distributive share (50%) of the adjustments made to the partnership's income for these same years. On March **30,** 1984, the Audit Division issued a Notice of Deficiency to Michael **J.** Clarke for the years 1979[5], 1980 and 1981 proposing additional New **York** State personal income tax due of $2,002.72, plus interest of $677.73, for a total allegedly due of $2,680.45.

10. The partnership maintained a complete double entry set of books and used the accrual method of accounting. Petitioners' representative maintained that the partnership had complete books and records, including all cash register tapes and sales invoices, and that he "...agreed to a markup percentage (audit) because we couldn't get any place with the examiner'' and that "...in order to get on with the examination we agreed to a markup percentage (audit)."

CONCLUSIONS OF LAW

A. That it is proper to use a purchase markup analysis to reconstruct a taxpayer's net income for personal income and unincorporated business tax purposes (Matter of William T. Kelly, State Tax Comm., December 31, 1984). However, in the instant matter, the Audit Division's use of a purchase markup analysis is inappropriate, as the revised markup percentages utilized in the sales tax audit were essentially estimated percentages and were not computed by actually determining the difference between costs and selling prices. The use of these estimated figures does not vitiate the sales tax assessment to which petitioners agreed. However, since petitioners were not made aware of and clearly did not accede to their use for personal income and unincorporated business tax purposes, said estimated figures, standing alone, do not constitute a proper foundation for the assertion of personal income and unincorporated business tax deficiencies (Matter of Golden Coach, Inc., State Tax Comm., November 7, 1985).

B. That the petitions of Clarke and O'Sullivan Wines & Liquors and Cornelius O'Sullivan and Marie O'Sullivan (deceased) are granted and the notices of deficiency dated April 11, 1984 and March 30, 1984 are cancelled in their entirety.

C. That petition of Michael J. Clarke is granted to the extent that any increases based upon the sales tax audit results are to be deleted from the computation of his personal income tax liability and except as so granted, the petition is in all other respects denied.

DATED: Albany, New York

JUL 03 1986

STATE TAX COMMISSION

PRESIDENT

COMMISSIONER

COMMISSIONER