

NEW YORK STATE

DIVISION OF TAX APPEALS

In the Matter of the Petition :
of : DETERMINATION
TOP DRAWER CUSTOM CABINETRY CORP. : DTA NO. 825588
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 March 1, 2007 through August 31, 2010. :

Petitioner, Top Drawer Custom Cabinetry Corp., 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 March 1, 2007 through August 31, 2010.

Petitioner, by its representative, Arthur Richards, and the Division of Taxation, by Amanda Hiller, Esq. (Robert A. Maslyn, Esq., of counsel), waived a hearing and agreed to submit the matter for a determination based on documents and briefs to be submitted by August 25, 2014, which date commenced the six-month period for the issuance of this determination. After review of the evidence and arguments presented, Arthur S. Bray, Administrative Law Judge, renders the following determination.

ISSUE

Whether it was proper for the Division of Taxation to utilize a test period audit methodology following the execution of a test period audit agreement.

FINDINGS OF FACT

Petitioner, Top Drawer Custom Cabinetry Corp., and the Division of Taxation (Division) submitted a stipulation of facts, which has been accepted and incorporated herein. Additional findings of fact were also made.

1. During the period in issue, March 1, 2007 through August 31, 2010, petitioner operated a business that manufactured and installed cabinetry. In furtherance of its business, petitioner made purchases and sales of tangible personal property and services that were subject to tax under Articles 28 and 29 of the Tax Law.

2. In November 2010, the Division commenced a sales and use tax field audit of petitioner's books and records for the period in issue. On November 16, 2010, the Division mailed a letter to petitioner requesting an opportunity to review petitioner's sales and use tax books and records. A schedule of books and records to be produced was attached to the letter. At the time, petitioner was represented by David Biskup, CPA. A copy of the power of attorney form appointing Mr. Biskup as the representative was provided to the Division on November 29, 2010.

3. In the course of the audit, the Division concluded that the sales records were adequate to conduct an audit for the audit period. The sales records permitted the auditor to trace any transaction back to the original source or forward to the final total. The Division also concluded that there were adequate internal control procedures. For the same reasons, the Division also found that the expense purchase accounting records were in auditable condition.

4. On December 14, 2010, Zeliko Tomic, president of petitioner, executed a test period agreement in which petitioner consented to the Division's use of a test period method to

determine tax due on sales and expense purchases. The execution of the test period agreement occurred in the presence of petitioner's representative.

5. Under the topic of audit methodologies, the test period election form included a provision that stated:

“When my records are complete and available for the entire audit period, the Tax Department may not determine my tax based upon a test period audit without my consent. However, if I find that it may be practical to use the test period method audit, I may agree to use such method by completing this form.”

6. The test period election form also included a paragraph that was captioned “Test period election” that stated the following:

“The Tax Department representative has explained to me the various audit methods listed above.¹ If the auditor determines that my books and records are both complete and adequate, I agree the audit should be conducted using a **test period method audit**. It is understood that this agreement is contingent upon the adequacy of my records and pertains to the audit method to be used. It does not preclude my protest of the audit results on grounds such as the particular test period selected, the inclusion of certain transactions within the test, the taxability of certain transactions, or the method of projecting the results of the test period findings. The Commissioner of Taxation and Finance enters into this agreement on the assumption that my books and records, including computer files, are complete and adequate.”

7. Directly below this paragraph, the form contained boxes that had been checked in order to show that a test period audit method would be acceptable to the parties for the audit of sales and recurring expense purchases.

8. The Division conducted a test period audit of sales and expense purchases for the period June 1, 2009 through August 31, 2009. This period was selected as representative of the business activity. As a result of the test period audit, the Division determined that there were additional taxable sales of \$58,694.00 resulting in additional tax due of \$4,915.61. Utilizing a

¹ The reference to audit methods refers to a detailed method audit, a statistical sampling method audit or a test period audit.

test period methodology, the Division also determined that there were additional taxable expense purchases in the amount of \$51,764.00 and additional tax due on such purchases in the amount of \$4,335.21 for the period in issue. Also utilizing a test period methodology, the Division found that there were additional taxable material purchases in the amount of \$671,582.00 and additional tax due on such purchases in the amount of \$56,245.00. The Division reviewed petitioner's capital acquisitions in detail for the period in issue and determined that there were additional capital acquisitions during the audit period in the amount of \$23,300.00 leading to additional tax due in the amount of \$1,951.38.

9. By a series of consents to extend period of limitations, the date by which the Division could determine or assess tax for the period March 1, 2007 through May 31, 2009 was extended to June 20, 2012.

10. On October 14, 2011, petitioner's new representative, Arthur Richards, was afforded a conference with the auditor to discuss the audit findings. At the conference, Mr. Richards requested an adjustment based upon a sales invoice that was purportedly for a capital improvement. For the purpose of resolving the audit, the Division accepted the proposed adjustment. The adjustment reduced the amount of tax asserted to be due to \$67,447.20.²

11. At the conference, Mr. Richards also requested that the Division perform a detailed audit for the entire audit period. In response, Mr. Richards was told that this request was denied since petitioner had consented to the use of a test period methodology and the audit was completed.

² As originally proposed by the Division, the amount of the assessment was \$73,262.77.

12. On January 26, 2012, the Division issued to petitioner a Statement of Proposed Audit Change for Sales and Use Tax asserting that sales and use tax was due in the amount of \$67,447.20, plus interest, for a balance due of \$88,765.18.

13. On March 20, 2012, the Division issued a Notice of Determination (assessment number L-037402050) to petitioner assessing sales and use taxes for the period March 1, 2007 through August 31, 2010 in the amount of \$67,447.20, plus interest of \$21,608.46, less payments or credits of \$30,000.00, for a balance due of \$59,055.66.³

SUMMARY OF THE PARTIES' POSITIONS

14. The crux of petitioner's argument is that where, as here, there are adequate books and records available to conduct a detailed audit, the use of a test period audit must be by mutual consent and that, in this instance, a detailed audit was requested and should have been performed. Petitioner's representative is in agreement with the tax assessed for the test period and the tax assessed on capital acquisitions. However, he requests a refund of all other tax and interest paid.

15. In its brief, petitioner's representative states that he examined two other tax periods and found that one of the periods was consistent with the Division's test period audit and the use of the other period would have resulted in a reduction in the amount of tax due.

16. It is the Division's position that, by the execution of the test period agreement, petitioner waived its right to a detailed audit for the entire audit period. The Division further asserts that petitioner has the burden of proof, that petitioner waived its right to a detailed audit for the full audit period and that the test period audit was reasonable.

³ At the conclusion of the audit, petitioner remitted \$30,000.00 as part payment of the assessed liability.

CONCLUSIONS OF LAW

A. Tax Law § 1138(a)(1) provides, in relevant part, that if a sales tax return was not filed, “or if a return when filed is incorrect or insufficient, the amount of tax due shall be determined by the [Division of Taxation] from such information as may be available. If necessary, the tax may be estimated on the basis of external indices . . .” (Tax Law § 1138[a][1]).

B. In appropriate circumstances, the Division may utilize a test period audit methodology in order to determine the amount of tax due. In *Matter of Chartair v. State Tax Commn.* (65 AD2d 44, 46 [3rd Dept 1978]) the Court explained:

“Although there is statutory authority for the use of a ‘test period’ to determine the amount of tax due when a filed return is incorrect or insufficient (Tax Law § 1138, subd [a]), resort to this method of computing tax liability must be founded upon an insufficiency of record keeping which makes it virtually impossible to verify taxable sales receipts and conduct a complete audit [citations omitted]. However, if records are available from which the exact amount of tax can be determined, the estimate procedures adopted by the respondent become arbitrary and capricious and lack a rational basis [citation omitted]” (*Id.*, 411 NYS2d at 46).

C. As set forth above, petitioner contends that, despite the signed waiver, the Division was required to conduct an audit utilizing all of its books and records because the exact amount of tax could be determined from the records which were available. The Division contends that it was not required to comply with petitioner’s request for a detailed audit over the entire audit period because at the time the request was made, the waiver had been executed and the audit was conducted and completed. Petitioner submits that the Division’s assertion is erroneous because an assessment only becomes fixed through one of the following processes: (1) a signed consent, (2) passage of time, that is, 90 days after an assessment has been issued if there is no appeal, or (3) expiration of a waiver of the statute of limitations. Petitioner maintains that none of these conditions occurred here. In effect, petitioner claims that the consent to the use of a test period

was not binding. Petitioner submits that the request for a detailed audit over the entire audit period should have been granted and in support of its position points to *Matter of Wallach v. Tax Appeals Tribunal* (206 AD2d 696 [3d Dept 1994]) wherein the Court noted the validity of a test period audit method election but pointed out that “There was no claim that the corporation revoked its consent and insisted on a complete audit” (*Id.* at 698).

D. In this instance, the Division’s authority to utilize a test period audit method was not based upon Tax Law § 1138(a), but upon the written consent of the corporation (*see Matter of Wallach*). The audit method election form contains a complete disclosure of petitioner’s right to an audit based upon all of its records for the entire audit period. The form also put petitioner and its then representative on notice that a test period may not be utilized without petitioner’s consent. Through its president’s signature, petitioner acknowledged that if the auditor determined that petitioner had adequate records then a test period method audit should be used.

E. The question of what constitutes a valid and binding consent to the use of a test period has been addressed by the courts. In *Matter of James G. Kennedy & Company, Inc. v. Chu* (125 AD2d 773 [3d Dept 1986]) the taxpayer’s accountant, despite having available complete books and records, verbally agreed to the use of a test period. Following the completion of the audit, petitioner contended that the use of a test period was impermissible and the Court agreed. The Court first noted that a waiver requires the “intentional relinquishment of a known right” and that it must be clearly established and not inferred from equivocal acts or speech (*id., citing Matter of East 56th Plaza v. Abrams*, 91 AD2d 1129, 1130 [3rd Dept 1986]). The Court concluded that petitioner’s accountant’s verbal agreement to the use of a test period and acknowledgment that the test period selected was fair did not constitute an affirmative abandonment of the taxpayer’s right to an audit of the entire audit period. In reaching this

conclusion, the Court pointed out that petitioner's accountant told the auditor that, by not objecting, he did not intend to waive any defense or argument against the use of a test period audit. In contrast to the *Kennedy & Company* case, in *Matter of Sloan's Supermarket v. Chu* (140 AD2d 794 [3d Dept 1988]), the taxpayers executed a written consent to the use of a test period in lieu of a detailed examination. As a result, they were not in a position to argue that they were not aware of their right to a full audit if the necessary records were complete and accurate. In addition, at the hearing, one of that petitioner's officers acknowledged, with respect to the series of audits, that he had agreed to a test period on the same terms as set forth in the written consent. Accordingly, the Court concluded that there was a valid and knowledgeable consent to the use of a test period.

F. Here, petitioner's president, in the presence of its accountant, executed a form consenting to the use of a test period audit in lieu of a detailed audit for the entire audit period. This was a valid and knowledgeable consent and petitioner is bound by the choice that it made (*Matter of Sloan's Supermarket v. Chu; Matter of Wallach v. Tax Appeals Tribunal; Matter of Kyreos*, Tax Appeals Tribunal, August 6, 1998).

G. The petition of Top Drawer Custom Cabinetry Corp. is denied and the Notice of Determination, dated March 20, 2012, is sustained together with such penalty and interest as is lawfully due.

DATED: Albany, New York
February 5, 2015

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE