

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
GIACOMO BRANCATO	:	DECISION
D/B/A J & F FENCE & IRON WORKS CO.	:	DTA NOS. 801024/ 801477
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 May 31, 1983.	:	

Petitioner, Giacomo Brancato d/b/a J & F Fence & Iron Works Co., 112-17 159th Street, Jamaica, New York 11433 and the Division of Taxation filed exceptions to the determination of the Administrative Law Judge issued on February 11, 1988 with respect to petitioner's 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 May 31, 1983 (File Nos. 801024 and 801477). Petitioner appeared by Peter J. Arico. The Division of Taxation appeared by William F. Collins, Esq. (Lawrence A. Newman, Esq., of counsel).

Neither the petitioner nor the Division requested oral argument or submitted a brief.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUE

- I. Whether the Division properly conducted an audit of petitioner.
- II. Whether a 10% allowance for waste and theft of purchases was appropriate.
- III. If such an allowance for waste and theft is appropriate, whether the allowance should be applied to net purchases.

FINDINGS OF FACT

We find the facts as stated in the Administrative Law Judge's determination and such facts are incorporated herein by this reference except that finding of fact "2(a)" is modified as set forth below.

During the periods at issue, petitioner, Giacomo Brancato d/b/a J & F Fence & Iron Works Co., operated as a construction contractor, specializing in fences, gates, railings and other such products. Petitioner also sold materials over the counter, both wholesale and retail. Petitioner's business was affiliated with Vincent Brancato Fence & Iron Co., operated by Vincent Brancato. Vincent Brancato is Giacomo Brancato's father.

A sales tax audit of petitioner's books and records was conducted by the Queens District Office:

We modify finding of fact "2(a)" to read as follows:

- (a) Records available for audit consisted of sales tax returns, Federal and State income tax returns, depreciation schedules, cash receipts journal, sales invoices, check disbursements journal, purchase invoices, cancelled checks, monthly bank statements, resale certificates, exempt organization certificates, capital improvement certificates and customers' exempt purchase certificates. There was no sales book, no purchases book, no job cost book, no inventory control records, no sales tax return worksheets, no Federal income tax worksheets and some sales invoices were missing.

Gross sales per books were found to be \$38,513.00 greater than gross sales reported. Gross sales per Federal income tax returns were greater than gross sales per books by \$57,857.00 in 1980 and \$10,570.00 in 1981. These differences were pointed out to petitioner but no explanation for the differences was given.

Review of sales invoices for the period December 1979 through August 1980 showed that \$3,830.00 in customer payments had been omitted. A bartered sale of \$2,946.00 had also been omitted.

In view of these findings, petitioner's books and records were deemed to be inadequate.

Gross sales were computed from purchases. Petitioner at first had stated that approximately 20% of capital improvement sales would represent materials. This percentage was used in preparation of a proposed audit adjustment, but was later increased to 33.33% and agreed upon by petitioner at a conference. The reason for the change was to take into consideration the fact that the markup on over-the-counter sales would be lower than that on capital improvement sales. Purchases of materials as per the books for the audit period amounted to \$278,162.00. Adding bartered purchases of materials of \$2,946.00 increased this figure to \$281,108.00 in audited materials purchased, which, divided by 33.33% resulted in gross sales of \$843,408.00. At a conference it was agreed that subcontract purchases represented 66.67% of a sale. This was based on the audit of Vincent Brancato Fence & Iron Co. Subcontract purchases on the books amounted to \$32,446.00 and rentals amounted to \$1,099.00 for a total of \$33,545.00 which, divided by 66.67%, resulted in \$50,315.00 in gross sales. Total audited gross sales were determined to be \$893,723.00 (\$843,408.00 plus \$50,315.00).

Taxable sales per books were \$1,023.00 greater than taxable sales reported.

A test of audited nontaxable sales was made for the nine-month period December 1, 1979 through August 31, 1980, as these periods appeared to represent normal business activity and would correspond to test periods used in the Vincent Brancato Fence & Iron Co. audit. An error percentage of 19.30% was found and applied to \$774,843.00 of audited sales on which no tax had been paid, resulting in \$149,546.00 in additional taxable sales (figures rounded on a quarterly basis). The audited and tested nontaxable sales figures were increased from the book figures to reflect the increase in sales per the audit method.

Total additional taxable sales were \$150,569.00 which resulted in \$12,161.95 in additional tax due.

Purchases per books agreed with purchases per Federal income tax returns. Purchases of materials were tested for the thirteen-month period December 1, 1979 through December 31, 1980, and it was found that no tax had been paid on any materials purchased and that 98.24% of the materials account represented materials, while the balance represented supplies. Accordingly,

materials purchased per books of \$278,162.00 were multiplied by 98.24% resulting in \$273,266.00 in materials. An additional \$2,946.00 in materials was added for a bartered purchase and audited materials purchased for the audit period were found to be \$276,212.00. A percentage of capital improvement sales was computed to be 40.81% from the cash receipts book for the nine-month period December 1, 1979 through August 31, 1980. This percentage was applied to \$276,212.00 in audited materials purchased for the audit period resulting in \$112,722.00 in audited materials purchases subject to use tax. Petitioner was given credit for \$74,726.00 of purchases reported as subject to use tax. Total additional purchases subject to use tax were \$37,996.00 resulting in \$3,078.96 in additional use tax on purchases.

Total additional taxes were calculated as \$15,240.91 (\$12,161.95 plus \$3,078.96).

Petitioner executed the following consents extending the period of limitation for assessment of sales and use taxes:

(a) Consent dated March 14, 1983, extending the period of limitation for the taxable period December 1, 1979 through May 31, 1980 to September 30, 1983.

(b) Consent dated August 22, 1983, extending the period of limitation for the taxable period December 1, 1979 through August 31, 1980 to December 20, 1983.

(c) Consent dated February 24, 1984, extending the period of limitation for the taxable period December 1, 1980 through February 28, 1981 to June 20, 1984.

On December 20, 1983 the Division issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due to petitioner for the period December 1, 1979 through November 30, 1980 in the amount of \$21,683.16 in tax, \$5,420.79 in penalty and \$9,619.40 in interest, for a total due of \$36,723.35. This assessment was subsequently reduced to \$4,784.32 in tax and \$3,874.89 in penalty and interest for a total due of \$8,659.21 by Notice of Assessment Review dated August 22, 1984.

On June 15, 1984 the Division issued a second Notice of Determination and Demand for Payment of Sales and Use Taxes Due to petitioner for the period December 1, 1980 through May 31, 1983 in the amount of \$10,456.59 in tax, \$2,604.43 in penalty and \$3,644.29 in interest, for a total of \$16,705.31.

The Division had originally issued a proposed audit adjustment to petitioner in the amount of \$62,724.34 in tax. This amount was reduced to \$22,343.80 in tax after additional documentation and information was presented by petitioner. Additional tax was eventually reduced to the total of \$15,240.91.

Petitioner did not keep a job cost book because he did not believe it was necessary in his type of business. Materials (e.g., steel) were purchased by the carload and used as needed. Petitioner believed an analysis of cost for each job would be impractical from a bookkeeping aspect. Moreover, no general ledger was kept by petitioner because the business was small. Petitioner used a cash receipts ledger.

Not all material purchased by petitioner was consumed in manufacturing products. Because of the nature of the business, odd lengths of steel usually would remain from each job. This material was hauled to a scrap dealer. Other material was stolen from petitioner's premises. Waste and theft amounted to 10% of all material purchased.

During the audit and, in fact, at the hearing, petitioner maintained that books and records were adequate and available and requested a complete audit of all items.

In addition to the facts found by the Administrative Law Judge, we find the following facts.

The Division requested some of petitioner's books and records for the entire initial audit period, i.e., December 1, 1979 through August 31, 1982, and others for only a part of the period.

The general ledger, cash receipts journal, cash disbursement journal, fixed asset invoices, resale, exempt and capital improvement certificates and bank statements and cancelled checks were requested for the entire initial period. However, Federal income tax returns were requested only for 1980 and 1981, sales tax returns were requested only for the quarter ended August 31, 1982 and purchase invoices, sales invoices and expense invoices were requested only for the period December 1, 1979 through December 31, 1980.

Sales invoices were examined only for the nine month period of December 1, 1979 through August 31, 1980. The auditor assumed that because some sales invoices were missing during this nine month test period that sales invoices would be missing throughout the audit period.

OPINION

The Administrative Law Judge determined that the petitioner's records were incomplete and that it was proper for the Division to select a method reasonably calculated to reflect the petitioner's sales and use tax liability. The Administrative Law Judge also applied a 10% allowance for waste and theft.

Petitioner asserts that the findings of fact and conclusion of law indicating incomplete and insufficient books and records is unfounded, that petitioner had complete books and records and, accordingly, that the audit method employed was incorrect because a detailed audit of the books and records should have been conducted. Petitioner also asserts that the audit was conducted improperly because the petitioner was not informed of an alternative audit method and did not consent to such a method. Lastly, the petitioner asserts that the 10% allowance for waste and theft should apply to net purchases.

The Division of Taxation's exception pertains solely to the 10% allowance. It asserts that this allowance should be eliminated.

We deal first with the adequacy of the Division's audit procedure. The case law elaborates the manner in which the Division may conduct an audit and the conditions under which it may resort to external indices as a method of computing sales tax liability.

The decision in Chartair, Inc. v. State Tax Commn. (65 AD2d 44) makes it clear that resort to external indices as a method of computing sales tax liability must be founded on a determination of the insufficiency of the taxpayer's record keeping which makes it virtually impossible to verify sales receipts and conduct an audit. There must be an actual request for the taxpayer's books and records (Matter of Christ Cella, Inc. v. State Tax Commn., 102 AD2d 352) for the entire period of the assessment (Matter of Adamides v. Chu, 134 AD2d 776, lv to appeal denied 71 NY2d 806) and the Division must make a thorough examination of such records (Matter of King Crab Restaurant, Inc.

v. Chu, 134 AD2d 51 [3d Dept. 1987]) before proceeding to external indices to determine the taxpayer's sales tax liability. The issue is whether the request for records and subsequent examination meets these standards.

We conclude that in this case, these standards must be applied separately to the two components of this audit - the use tax and the sales tax portions.

With respect to the sales tax portion, it is uncontroverted that the auditor requested only sales invoices for the period December 1, 1979 through December 31, 1980 and then examined only the invoices for the nine month period of December 1, 1979 through August 31, 1980. The decision that it was not necessary to perform a detailed audit of sales invoices for the entire audit period to determine nontaxable sales was based on the fact that a few sales invoices were missing from the nine month test period. In our view, this auditor did not make a sufficient request and examination of the petitioner's records with respect to sales to support his determination that the sales records for the entire period of December 1, 1979 through May 31, 1983 were inadequate. Therefore, it is impossible to determine the sufficiency of the sales records and the use of the test period/markup audit was improper (Matter of King Crab Restaurant, Inc. v. Chu, *supra*). Accordingly, audited nontaxable sales (finding of fact "2[g]" of the Administrative Law Judge's determination) must be reduced to \$33,933 to reflect only those nontaxable sales determined pursuant to the detailed audit of the nine month test period (Exhibit G, schedule 36A).

With respect to the use tax portion of the assessment, the auditor found no job cost book, inventory control records or similar records for the entire audit period, December 1, 1979 through August 31, 1982. Without such records, the auditor had no means to determine whether petitioner sold or consumed, in capital improvements, the property he purchased. Accordingly, we conclude that the auditor properly determined that petitioner's records were unreliable (Matter of Korba v. State Tax Commn., 84 AD2d 655) to determine use tax and properly resorted to the test period and estimate techniques to assess use tax for the entire initial audit period of December 1, 1979 through August 31, 1982.

The Notice of Determination issued on June 15, 1984 also covered the period ending November 30, 1982, although no request or examination of records for this quarter was made. In the face of petitioner's assertion that he has adequate books and records, this automatic expansion of the audit results to the quarter ending November 30, 1982 must be annulled (Matter of Adamides v. Chu, supra).

We deal next with the Division's assertion on exception that the Administrative Law Judge's determination to allow 10% of purchases for waste and theft is improper.

The Administrative Law Judge's determination was based on direct testimony by petitioner and a post-hearing submission allowed by the Administrative Law Judge involving a recomputation of petitioner's tax liability. That recomputation was the subject of written analysis (post-hearing) by the Division which was submitted to the Administrative Law Judge as part of the record. After reviewing these documents we agree with the determination of the Administrative Law Judge allowing 10% of gross purchases as waste.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of petitioner, Giacomo Brancato D/B/A J & F Fence & Iron Works Co., is granted to the extent that additional taxable sales are reduced to \$34,956 (finding of fact "2h" of the Administrative Law Judge's determination), consisting of \$33,933 of audited nontaxable sales (finding of fact "2g" of the Administrative Law Judge's determination) and \$1,023 taxable sales per books (finding of fact "2f" of the Administrative Law Judge's determination) and to the extent that the assessment for the quarter ending November 30, 1982 is cancelled, but except as so granted is in all other respects denied;

2. The determination of the Administrative Law Judge is modified to the extent indicated in paragraph "1" above but except as so modified is in all other respects affirmed; and

3. The petition of Giacomo Brancato D/B/A J & F Fence & Iron Works Co. is granted to the extent indicated in paragraph "1" above and in conclusion of law "D" of the Administrative Law Judge's determination but except as so granted is in all other respects denied.

Dated: Albany, New York
November 10, 1988

/s/John P. Dugan
John P. Dugan
President

/s/Francis R. Koenig
Francis R. Koenig
Commissioner