

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition :
of :
R & J AUTOMOTIVE, INC. :
for Redetermination of a Deficiency or for :
Refund of Corporation Franchise Tax under :
Article 9-A of the Tax Law for the Fiscal :
Years Ended September 30, 1980 through :
September 30, 1982. :

In the Matter of the Petition :
of :
R & J AUTOMOTIVE, INC. :
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, 1980 :
through November 30, 1982. :

DECISION

In the Matter of the Petition :
of :
JOHN (DEC'D) AND MARGARET EIFLER :
for Redetermination of a Deficiency or for :
Refund of Personal Income Tax under Article 22 :
of the Tax Law for the Years 1980, 1981 and :
1982. :

In the Matter of the Petition :
of :
RAYMOND AND DOLORES EIFLER :
for Redetermination of a Deficiency or for :
Refund of Personal Income Tax under Article 22 :
of the Tax Law for the Years 1980, 1981 and :
1982. :

Petitioner R & J Automotive, Inc., c/o Bowes & Chestara, 251 River Street, P.O. Box 214, Troy, New York 12181, filed an exception to the determination of the Administrative Law Judge issued on August 19, 1988 with respect to its petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the fiscal years ended September 30, 1980 through September 30, 1982 (File No. 801058).

Petitioner R & J Automotive, Inc., c/o Bowes & Chestara, 251 River Street, Box 214, Troy, New York 12181, filed an exception to the determination of the Administrative Law Judge issued on August 19, 1988 with respect to its 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, 1980 through November 30, 1982 (File No 801060).

Petitioners John (dec'd) and Margaret Eifler, 6044 Sparling Road, Saugerties, New York 12477, filed an exception to the determination of the Administrative Law Judge issued on August 19, 1988 with respect to their petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the years 1980, 1981 and 1982 (File No. 801061).

Petitioners Raymond & Dolores Eifler, 6279 Old Route 32, Saugerties, New York 12477, filed an exception to the determination of the Administrative Law Judge issued on August 19, 1988 with respect to their petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the years 1980, 1981 and 1982 (File No. 801093).

Petitioners appeared by Bowes & Chestara, Esqs. (John D. Chestara, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Arnold M. Glass, Esq., of counsel).

Petitioners submitted a brief on exception. The Division submitted a letter in lieu of a brief.

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

ISSUE

Whether the Division utilized impermissible audit methodologies in either its initial audit, or its subsequent re-examination, of petitioner R & J Automotive, Inc.'s corporation franchise tax reports for each of the three fiscal years in question.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge and such facts are repeated below.

During the period at issue herein, petitioner R & J Automotive, Inc. ("R & J") operated a gasoline service station located in Kingston, New York. R & J's only shareholders were John Eifler (since deceased) and Raymond Eifler, each of whom owned 50 percent of R & J's issued and outstanding common stock. R & J filed its corporation franchise tax reports based on a fiscal year ending September 30. For Federal purposes, R & J filed Form 1120 (U.S. Corporation Income Tax Return) for its fiscal years ended September 30, 1980 and 1981, and Form 1120S (as an electing Small Business Corporation) for its fiscal year ended September 30, 1982. For New York State purposes, R & J paid the then-minimum New York State corporation franchise tax amount (per statute) of \$250.00 for each of the fiscal years in question. There is no evidence that R & J was an electing Small Business Corporation for New York State purposes for any such fiscal years.

In or about October of 1981, the Division advised R & J, by letter, that a corporation franchise tax audit of R & J's business operations would be conducted for the fiscal years ended September 30, 1980 through September 30, 1982. Follow-up telephone calls by the auditor resulted in information alleging that R & J's books and records were in Florida with R & J's accountant, one Butch Cooper. Over the period of the next two years (10/81 - 10/83), a series of appointments to conduct the audit were made resulting in some meetings between the auditor and John Eifler. However, during this period of time very few books and records were

made available to the auditor and despite repeated efforts, the auditor never received a complete set of books and records for any one of the three fiscal years in question. While some records were made available, it is undisputed that R & J's records were not in an auditable form, being described by petitioners' own successor accountant as "in a shambles".

In the face of this lack of complete and auditable records, the auditor determined to calculate R & J's corporate receipts from gasoline sales and from repair sales by resort to markup audit methodologies. The auditor made a comparison of the selling price per gallon (pump price) for R & J's gasoline versus its delivery invoice cost for gasoline on the date of May 20, 1982. This comparison, which excluded excise taxes and sales taxes from the selling (pump) price, resulted in a profit amount of 15.6 cents per gallon. This profit amount per gallon was applied to the amount of gallonage purchased by R & J for the fiscal year ended September 30, 1980, per information obtained from R & J's supplier (Getty Oil Company), to arrive at R & J's receipts from the sale of gasoline for such year.

Review of R & J's corporate franchise tax report and available records for the fiscal year ended September 30, 1980 revealed that 80.15 percent of R & J's purchases represented gasoline purchases, with 19.03 percent representing parts purchases. The dollar amount of parts purchased (per the report) was marked up 66.7 percent (to account for parts sales) plus an additional 70.26 percent (to account for labor services), with such markup amounts based on Division office experience and utilized because R & J's records from which a direct markup could have been calculated were not available at such time.

The auditor totalled gasoline sales receipts, as computed above, plus parts and service sales receipts as computed above, and compared such total to sales as reported per R & J's Federal and New York State corporate tax returns, revealing that receipts per the returns were reported as less than receipts as computed per the noted audit results. For the fiscal years ended September 30, 1981 and September 30, 1982, the auditor reviewed R & J's corporate franchise tax reports in line with the finding from 1980 that 80.15 percent of R & J's reported purchases represented purchases of gasoline with the balance representing purchases of parts.

Accordingly, 80.15 percent of R & J's purchases were deemed to have been gasoline purchases (at cost), which purchases were marked up by the per gallon profit percentage previously described to arrive at receipts from gasoline sales for each of the fiscal years ended September 30, 1981 and September 30, 1982 (said markup being 15.6 cents per gallon). The remaining portion of purchases (19.03% thereof) was deemed to represent parts purchases and also was marked up at the previously noted parts and labor percentages. Accordingly, after comparison of R & J's receipts per audit to receipts per its corporate returns, an understatement of receipts by R & J was determined to have occurred in each of the fiscal years in question, in the respective amounts of \$63,916.82 (f/y/e 9/30/80), \$74,942.68 (f/y/e 9/30/81) and \$41,555.94 (f/y/e 9/30/82).

On March 28, 1984, the Division issued to petitioner R & J a Statement of Audit Adjustment and a Notice of Deficiency for each of the fiscal years in question. These statements and notices indicate that they are based on the aforementioned field audit results, and assert a corporation franchise tax deficiency for each of the three fiscal years in the respective amounts of \$5,931.98, \$6,391.19 and \$3,988.25. In addition, for each of the years in question a fraud penalty was imposed against R & J pursuant to Tax Law § 1085(f).

The auditor also gave each of the individual petitioners (the Eiflers) a cost of living sheet to complete.¹ Upon review of the completed cost of living sheets, the auditor determined that the figures reported thereon by each of the individual petitioners were unrealistically low. The auditor concluded that the individual petitioners could not "possibly" have existed upon the amount of monies (sources of income) reflected thereon. Accordingly, the auditor utilized a Department of Social Services chart showing cost of living figures for upstate rural areas in making a determination as to the amount of income such petitioners would have needed to meet their costs of living. In turn, the difference (shortfall) between such amounts per the

¹There is no evidence that either Margaret Eifler or Dolores Eifler were employed by or involved in the operation or ownership of R & J during the period in question. It appears their names are included in these proceedings as the result of having filed joint personal income tax returns with their respective spouses, John Eifler and Raymond Eifler.

Social Services chart and the amounts reported as income on each of the individual petitioner's income tax returns for the years 1980, 1981 and 1982, was deemed to have been made up by distributions from R & J to each of the individual petitioners. More specifically, the auditor calculated constructive dividends for the years 1980 and 1981 (available as the result of the corporate excess receipts determined upon audit) sufficient to remove the shortfall found for the individual petitioners, and included such amounts as additional taxable income to each individual petitioner. For 1982, the auditor determined the corporation to have been an electing small business corporation for Federal purposes and thus to have distributed all available excess corporate receipts per audit through to the individual petitioners. This distribution for 1982 was also to close the shortfall as determined, and was treated as a constructive dividend for corporation franchise tax purposes since R & J had not elected treatment as a small business corporation for New York State purposes.

On January 27, 1984, the Division issued a Statement of Personal Income Tax Audit Changes to John and Margaret Eifler. This statement indicated a recalculation of such petitioners' personal income tax liability for each of the years 1980, 1981 and 1982 based upon the distributions of R & J's audited additional receipts as described above. For the respective years in issue the amounts distributed were \$17,911.70 (1980), \$21,122.17 (1981) and \$20,777.97 (1982). This calculation resulted in additional personal income taxes asserted against petitioners John and Margaret Eifler for each of the years in question in the respective amounts of \$1,391.73 (1980), \$1,729.10 (1981) and \$1,567.78 (1982). These latter amounts were asserted against petitioners John and Margaret Eifler via the issuance of a Notice of Deficiency on March 26, 1984, which Notice of Deficiency also included the assertion of a fraud penalty against such petitioners pursuant to Tax Law § 685(e).

On January 27, 1984 a similar Statement of Personal Income Tax Audit Changes was issued to petitioners Raymond and Dolores Eifler indicating corporate distributions for each of the respective years in issue in the amounts of \$18,102.49 (1980), \$20,389.40 (1981) and \$20,777.97 (1982). These additional distributions resulted in the calculation of additional

personal income taxes against such petitioners in the respective amounts of \$1,304.29 (1980), \$1,607.87 (1981) and \$1,877.67 (1982). These latter amounts were asserted against petitioners Raymond and Dolores Eifler via a Notice of Deficiency dated March 26, 1984, which notice also included the assertion of a fraud penalty against such petitioners pursuant to Tax Law § 685(e).

Petitions to contest the aforementioned corporate and individual personal income tax deficiencies were filed on behalf of the respective petitioners on April 18, 1984. Each of these petitions was essentially identical in format, asserting generally that the results of the audit were flawed in that such results were based on estimates and improper audit methodologies.

In addition to the foregoing, the auditor also determined that the additional corporate receipts for each of the years in question, as derived from sales of gasoline and of parts and services, were properly subject to sales tax. Accordingly, the auditor computed additional sales tax due for the period December 1, 1980 through November 30, 1982. By a Notice of Determination and Demand for Payment of Sales and Use Taxes Due dated January 13, 1984, the Division assessed against petitioner R & J a sales tax deficiency in the amount of \$6,834.48, plus a fraud penalty pursuant to Tax Law § 1145 (former [a][2]). At hearing, a mailing log and other information was submitted in evidence establishing that such notice was, in fact, mailed on January 13, 1984.

With respect to the Notice of Determination and Demand for Payment of Sales and Use Taxes Due, the only petition protesting the same is a petition bearing a Tax Appeals Bureau indate stamp of May 1, 1984. At hearing, petitioners' counsel stated that this petition bearing the May 1, 1984 indate stamp had been hand delivered by petitioners' counsel to the (former) Tax Appeals Bureau on May 1, 1984, and was a copy of a petition which was signed, dated and mailed on February 17, 1984 by the offices of Bradley & Co. More specifically, this petition was originally prepared by one Joseph Bradley, an accountant retained by petitioners sometime in late 1983 during the course of the ongoing audit herein.

Joseph Bradley testified at hearing that he prepared the petition, signed and dated it on February 17, 1984, and that his secretary mailed the petition via ordinary mail from the Troy, New York Post Office located near Mr. Bradley's office. Mr. Bradley did not specify the address to which the petition was allegedly mailed, indicating that it was mailed to the "Tax Department". On the first and third hearing dates, Mr. Bradley testified to the existence of a diary in which he routinely records all mailings from his office, as well as the time constraints, specifically with respect to tax notices, within which documents are to be mailed. A period of time was allowed subsequent to the final hearing date, in addition to the period of time passing between the first and third hearing dates, within which to produce a copy of relevant sections of the diary or the diary itself. At no time, however, was this diary or any segment thereof produced. The Division indicated that it has no record of any petition being received to contest the sales tax Notice of Determination and Demand, thus maintaining that said Notice finally and irrevocably fixed and assessed the tax and that petitioner R & J is without recourse to address the merits of the sales tax assessment.

Subsequent to petitioners' retention of Mr. Bradley as their accountant, and subsequent to the issuance of the notices at issue herein, Mr. Bradley obtained from petitioner John Eifler (at R & J's location in Kingston) approximately five boxes purporting to contain all available business records of R & J. A prehearing conference was held in this matter at which conference petitioners alleged that such records could be organized in an auditable form. In turn, the Division agreed to re-evaluate the prior audit work and notices resulting therefrom. Mr. Bradley and his employees performed an accountant's compilation² of the records received from R & J's Kingston location, specifically for the fiscal year ended September 30, 1980. This fiscal year was agreed to between petitioners and the Division as the year of reconstruction.

Mr. Bradley and two of his employees (including a "junior accountant" and a secretary) devoted approximately 40 to 50 hours in reviewing the records of R & J, including records of

²An accountant's compilation is defined as "presenting in the form of financial statements information that is the representation of management (owners) without undertaking to express any assurance on the statements." (Taylor and Glezen, Auditing: Integrated Concepts and Procedures, at 852 [3rd ed 1985].)

check disbursements, cash disbursements, monthly bank statements and purchase and sales invoices. Mr. Bradley's employees expended approximately 30 hours compiling information concerning cash receipts and cash disbursements, payroll information and bank reconciliations, from which resulting workpapers Mr. Bradley compiled a general ledger, a balance sheet, a trial balance, and a profit and loss statement for R & J. As described by Mr. Bradley's testimony, "I tied them [sales] back into [R & J's] books of original entry [from] their daily sales sheets. If there were other sales, I have no way of knowing." In this context Mr. Bradley noted that he, or his staff, reviewed all sales invoices in the boxes of records, but noted that he did not know if he had invoices for all sales. It was noted that some sales invoices were numbered while others were not, and that some sales and purchases were made in cash. Mr. Bradley testified "I don't know if they are or aren't complete. All I know [is] the records here I feel are the records of the business."

The ultimate result of Mr. Bradley's compilation was the presentation, for each of the respective fiscal years, of net income numbers nearly identical to those reflected on R & J's corporate franchise tax reports as filed. More specifically, for the years 1980 and 1981, R & J's franchise tax reports indicated losses in the approximate amounts of \$2,000.00 and \$8,000.00, and for 1982 a profit in the amount of approximately \$800.00. By contrast, Mr. Bradley's compilation results revealed a net loss for 1980 in an amount of approximately \$2,000.00, a net loss for 1981 of approximately \$9,000.00 and a net profit for 1982 of approximately \$500.00. Further, by contrast, the audit results determined additional receipts (net profit) of approximately \$64,000.00 for 1980, nearly \$75,000.00 for 1981 and approximately \$41,000.00 for 1982.

As agreed to at the prehearing conference, the Division dispatched two auditors to perform a re-evaluation of R & J's franchise tax audit results. The auditors spent approximately two to three hours at Mr. Bradley's office and, assertedly, approximately 12½ hours in total on the re-audit (including evaluation of documents and information transcribed at or taken from Mr. Bradley's office). In essence, the auditors determined R & J's gasoline sales receipts to

have been approximately correct as reported. However, the auditors' review of approximately 200 purchase invoices concerning parts purchases, and approximately 225 invoices representing customer repair sales resulted in a liability based upon additional audited receipts, hereinafter described.

The auditors reviewed the noted invoices for parts purchases and determined a markup based upon a comparison of part cost per invoice as opposed to the manufacturer's suggested selling price for such part. The auditors indicated their belief, based on experience, that many service stations sell parts at higher than the manufacturer's suggested selling prices. However, the auditors nonetheless based their markup on manufacturer's suggested selling prices, calculating such markup on parts to be 44.08 percent, to which, after review of approximately 225 sales invoices, a labor markup of 55.20 percent was added. With respect to tires and batteries, based on audit experience as well as the above-noted invoice review, the auditors determined and allowed a lower markup of 15 percent.

The resulting total markup on parts and labor was utilized in comparison to R & J's corporate returns as the basis for determining R & J's receipts on re-audit. More specifically, the marked up amount of receipts including parts and labor for the fiscal year ended September 30, 1980 was compared to the corporate tax report for such fiscal year. This comparison revealed an understatement of receipts, calculated as an error rate, of 12.9164 percent. This error rate was applied to R & J's corporate franchise tax reported receipts for each of the fiscal years in question to arrive at additional receipts per re-audit. These additional receipts were less in amount than those found initially upon audit, and were calculated in the amounts of \$37,731.51 (1980), \$34,805.05 (1981) and \$29,777.55 (1982).

Accordingly, the Division conceded to the propriety of reductions to the original notices of deficiency for corporation franchise tax, recalculating such tax deficiencies for R & J's 1980, 1981 and 1982 fiscal years in the respective amounts of \$3,338.04, \$2,402.42 and \$2,835.41. Thus, the asserted deficiency in corporation franchise tax was reduced to a total of \$8,575.87 for the three fiscal years in question, plus the aforementioned fraud penalty. In turn, the

Division conceded that the personal income tax deficiencies issued against John and Margaret Eifler and Raymond and Dolores Eifler, as based upon the corporate audit results, should also be reduced. More specifically, for 1980 and 1981, the Division distributed a portion of the excess corporate receipts per audit to each of the individual petitioners as constructive dividends.³ For 1982, since R & J was an electing small business corporation (for Federal purposes) the entire amount of excess corporate receipts was distributed equally to each of the individual petitioners. With respect to John and Margaret Eifler, distributions for each of the years were, respectively, \$12,911.00 (1980), \$16,122.17 (1981) and \$14,888.77 (1982). In turn, such (reduced) distributions resulted in a reduction of additional personal income tax asserted for each of the years to the amounts of \$811.25 (1980), \$1,087.00 (1981) and \$1,050.40 (1982), thus totalling \$2,948.65 plus the noted fraud penalty. With respect to Raymond and Dolores Eifler, the additional distributions were in the respective amounts of \$13,102.48 (1980), \$15,389.40 (1981) and \$14,888.78 (1982), thus resulting in a reduction in the asserted amounts of personal income tax to the respective amounts of \$753.22 (1980), \$991.44 (1981) and \$1,005.41 (1982), totalling \$2,750.07, plus the noted fraud penalty.

The Division did not specifically recompute the assessed deficiency of sales and use taxes or reduce the original assessment per the Notice of Determination and Demand, taking the position that since a timely petition to contest the sales tax assessment was not filed, said notice became finally and irrevocably fixed and the Division of Tax Appeals is without jurisdiction to review or reduce the amount thereof or pass upon the appropriateness of the fraud penalty.

With respect to the fraud penalty included on each of the notices, the Division asserted the same based upon allegations of lack of cooperation at the time of the initial audit, upon the substantial amount of underreporting determined upon audit, and upon the condition of the

³The "shortfall" previously determined for each of the individual petitioners (difference between reported income per returns and estimated cost of living needs per Social Services chart was reduced by \$5,000.00 in each year. The resulting amount was attributed to each of the individual petitioners as additional taxable income (constructive dividends) from the excess corporate receipts.

records as maintained by petitioners. At the first hearing date, the Division's representative requested, in the alternative, that should the fraud penalties be held not supportable under the facts, the Division would assert the lesser statutory penalties for negligence under Tax Law §§ 1085(b) (corporate) and 685(b) (personal income tax). No such alternative request was presented with respect to the sales tax assessment, presumably in keeping with the position that the petition of this assessment was not timely filed.

Petitioners (the Eiflers) did not provide testimony at any of the hearing dates.

OPINION

The Administrative Law Judge concluded that petitioner R & J Automotive, Inc. had not timely petitioned the sales tax Notice of Determination and that the Division of Tax Appeals was without jurisdiction to reach the merits of this assessment. With respect to the corporation franchise and income tax deficiencies, the Administrative Law Judge sustained the amount of tax assessed, as reduced pursuant to the post-conference re-examination conducted by the Division of Taxation, on the grounds that the audit methodology employed had a rational basis and that petitioners had not proved the assessment to be erroneous. The Administrative Law Judge found that the Division had failed to sustain its burden to prove the fraud penalties asserted, but concluded that the Division had properly requested the alternative imposition of the negligence penalties pursuant to Tax Law §§ 1085(b) and 685(b) and sustained its burden of proof with respect to these penalties.

On exception petitioners challenge only the conclusion of the Administrative Law Judge that the audit methodology employed to determine R & J's income for corporate franchise tax purposes was proper. Petitioners assert that the Division agreed to perform a re-audit of R & J and that no such re-audit was in fact performed. Petitioners contend that they offered a complete set of R & J's books and records upon re-audit which were not properly taken into account. Relying on Matter of King Crab Restaurant, Inc. v. Chu (134 AD2d 51, 522 NYS2d 978), petitioners argue that the Division was not authorized to resort to external indices to estimate tax until it made an investigation of the records offered sufficient to determine that the

records were inadequate. Petitioners claim that a sufficient investigation of the records was not made on the "re-audit." Further, petitioners claim that a full audit of their complete set of books and records would reveal that they in fact do not have any tax due and owing for the years in question.

In response the Division argues that petitioners' records were insufficient such that resort to estimation procedures was permissible. Further, the Division asserts that it never agreed to perform a re-audit. Instead, the Division claims that it agreed only to "further review" the case at hand after a conference between petitioners and the Division was held. Alternatively, the Division contends that if it is determined that a re-audit rather than mere "further review" was agreed to, then the Division properly estimated petitioners' liability on re-audit as the records presented on re-audit were insufficient as well.

We affirm the determination of the Administrative Law Judge.

The only issue before us is the appropriateness of the methodology used by the Division to determine R & J's corporate income. The facts indicate that the records of R & J were in an abysmal state during the initial attempt by the Division to examine the records. Since the condition of the records that were made available rendered them almost completely useless for audit purposes, the initial auditor resorted to an indirect auditing method, i.e., a reconstruction of income by a mark-up of purchases to determine R & J's corporate income. Following the determination of tax due based on the estimated income, a conference was held between the Division of Taxation and the petitioners. The record indicates that at the conference the Division agreed to re-evaluate the prior audit, largely due to the fact that R & J's records were in a much more useful state than upon the initial examination. It is the extent, manner and effect of this re-evaluation that is the basis of petitioners' exception.

We agree with the Administrative Law Judge that the Division was authorized to use an indirect auditing method, the mark-up of purchases, to determine R & J's income, both on the initial audit and upon the re-evaluation. Both the Division and petitioners have erroneously argued that the audit methodology required here is that applicable to sales and use tax audits.

In a sales and use tax audit, resort to external indices as a method of computing sales tax liability must be founded upon a determination of the insufficiency of the taxpayer's record keeping which makes it virtually impossible to verify sales receipts and conduct a complete audit (Chartair, Inc. v. State Tax Commn., 65 AD2d 44, 411 NYS2d 41). This standard, requiring demonstrably inadequate records before an indirect auditing technique may be used, has been explicitly rejected in audits of income for personal income, non-resident earnings and unincorporated business taxes (Matter of Giuliano v. Chu, 135 AD2d 89, 521 NYS2d 883; Matter of Hennekens v. State Tax Commn., 114 AD2d 599, 494 NYS2d 208). The distinction between an income tax audit and a sales tax audit centers on the type of tax being imposed (Hennekens v. State Tax Commn., supra). While sales tax audits seek recovery of taxes imposed directly upon verifiable receipts as evidenced by books and records which are required to be maintained (Matter of Licata v. Chu, 64 NY2d 873, 874, 487 NYS2d 552) audits involving the imposition of tax on income concern the receipt of income which cannot easily be verified by reference to books and records (Matter of Hennekens v. State Tax Commn., supra). The standard articulated by the courts of New York concerning audits of income is that indirect auditing methods are proper where the taxpayer's income is not accurately reflected in his books and records (see, Matter of Giuliano v. Chu, supra; Matter of Hennekens v. State Tax Commn., supra; Matter of Checho v. State Tax Commn., 111 AD2d 470, 488 NYS2d 859).

The New York State reconstruction of income cases have their genesis in the Federal law and cases. In particular, the case of Holland v. United States (348 U.S. 121) is recognized as the cornerstone of the law concerning reconstruction procedures. In Holland the Court recognized that reconstruction methods in income tax cases serve two primary purposes. First, they serve as a means of testing the accuracy of the books and records that have been presented. Second, they are cogent evidence of the amount of income which has been unreported. Further, Holland gave rise to the well settled principle that the fact that books and records appear to be adequate on their face does not preclude the use of reconstruction methods (see, Schwarzkopf v. Commr., 246 F2d 731, citing, Holland v. United States, supra,

at 131-132). We believe that the application of such principles to the circumstances before us, to determine income for corporate franchise tax purposes, supports the audit methodology utilized by the Division.

The facts indicate that at the re-examination by the Division the petitioners presented a set of records and an accompanying summary which petitioners claim were accurate and complete. However, such accuracy and completeness is not guaranteed by the fact that the records appear to be adequate on the surface (Jacobs v. United States, 126 F Supp 154). When facts are present which give rise to doubt as to the accuracy of the records as properly reflecting income, the records should be verified by one of the methods of reconstructing income (Jacobs v. United States, supra; Holland v. United States, supra).

Here the Division was presented with facts that placed the completeness and accuracy of petitioners' records in doubt. As the Administrative Law Judge pointed out in his decision: petitioners' business was conducted in part in cash, petitioners advanced no proof that sales invoices were retained for each repair sale, and the invoices that were maintained were not sequentially numbered. Additionally, petitioners presented no evidence as to their actual markup over cost during the audit period. Such facts indicate the inaccuracy and incompleteness of the records that were offered (see, Jacobs v. United States, supra; Meyers v. United States, 134 F Supp 520).

As a result, we conclude that petitioners have failed to satisfy their burden of proving by clear and convincing evidence that both the method used to arrive at the assessment and the assessment itself are erroneous (see, Tax Law § 689[e]; Matter of Giuliano v. Chu, supra). Accordingly, we sustain the imposition of the corporation franchise and income tax assessments.

Since we have concluded that the auditing techniques employed on the re-evaluation of petitioners' records satisfies the applicable standard for an audit of income, we need not address the issue of whether the Division of Taxation in fact agreed to perform a re-audit of petitioners' records.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the petitioners, R & J Automotive, Inc., John (Deceased) and Margaret Eifler and Raymond and Dolores Eifler is denied;
2. The Determination of the Administrative Law Judge is affirmed;
3. The petitions of R & J Automotive, Inc., John (Deceased) and Margaret Eifler and Raymond and Dolores Eifler are granted to the extent indicated in finding of fact "22" and conclusions of law "E", "F" and "J" of the Administrative Law Judge's determination, but are in all other respects denied; and
4. The Division of Taxation is directed to modify the notices of deficiency accordingly, but such notices are otherwise sustained and the Notice of Determination is sustained.

DATED: Troy, New York
June 15, 1989

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

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