STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petitions	:	
of	:	
M & B APPLIANCE, INC. AND MAN M. MUNJAL AND INDER S. BINDRA, AS OFFICERS	:	DECISION DTA Nos. 801653, 802764, 802765, and 802766
for Revision of Determinations 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, 1983.	:	

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on August 17, 1990 with respect to the petitions of M & B Appliance, Inc. and Man M. Munjal and Inder S. Bindra, as officers, 83-15 Broadway, Elmhurst, New York 11373 for revision of determinations 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, 1983. Petitioners appeared by John R. Serpico, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Anne W. Murphy, Esq. of counsel).

Both parties filed briefs on exception. Oral argument, at the request of the Division of Taxation, was heard on October 10, 1991.

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

ISSUES

I. Whether petitioners satisfied their burden of showing that certain sales were sales for resale, sales to exempt organizations and export sales and, therefore, not subject to tax.

II. Whether the Division of Taxation properly requested and examined books and records for the extended audit period.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for finding of fact "10(c)" which has been modified. The Administrative Law Judge's findings of fact and the modified finding of fact are set forth below.

On September 20, 1984, the Division of Taxation (hereinafter the "Division") issued identical notices of determination and demands forpayment of sales and use taxes due for the period December 1, 1979 through August 31, 1981 to petitioners, M & B Appliances, Inc. ("M & B"), Inder S. Bindra and Man M. Munjal, assessing sales tax due in the amount of $332,274.56 plus a civil fraud penalty in the amount of $166,137.28 plus interest. The notices issued to Mr. Munjal and Mr. Bindra explained that each was personally liable as an officer of M & B for taxes determined to be due from the corporation. On August 27, 1985, the Division issued to petitioners notices of determination and demands for payment of sales and use taxes due for the period September 1, 1981 through August 31, 1983, assessing sales tax due in the amount of $779,052.35, plus penalty and interest. Again, Mr. Munjal and Mr. Bindra were assessed as officers of M & B.

On October 7, 1985, the Division issued to petitioners notices of assessment review, revising the notices issued on September 20, 1984 by reducing the tax due to $296,094.32 and substituting a penalty of $74,023.58 in lieu of the previously asserted civil fraud penalty.

Petitioner M & B, by one of its officers or appointed representatives, executed a series of five consents having the effect of extending the period of limitation on assessment for the period December 1, 1979 through August 31, 1981 to any time on or before September 20, 1984. According to the field audit narrative, an assessment was issued on September 20, 1984 because a waiver of the period of limitation could not be obtained for a later date. Likewise, the civil fraud penalty was imposed "to protect the Department's possible claim." Subsequently, M & B executed three more consents, extending the assessment period for the period December 1, 1979 through August 31, 1982 to September 20, 1985.

The notices of determination under consideration were issued as a result of a field audit of M & B's business operations. By letter dated September 8, 1982, the Division scheduled an audit

appointment for October 8, 1982. The period under audit was December 1, 1979 through August 31, 1982. The letter stated: "All books and records pertaining to your Sales Tax liability for the period under audit should be available. This would include journals, ledgers, Sales invoices, purchase invoices, cash register tapes, exemption certificates and all Sales Tax records. Additional information may be required during the course of the audit."

The records made available for audit were sales tax returns and related worksheets, Federal and State income tax returns and related worksheets, depreciation schedules, a cash receipts journal, sales invoices for two test periods selected by the auditor, a check disbursements journal, a general ledger, monthly bank statements, resale certificates, exempt organization certificates and bills of lading. The auditor deemed the records to be in fair condition.

On the day of the first audit appointment, the auditor reviewed the general ledger and cash receipts journal. The auditor selected two test periods, September 1, 1981 through November 30, 1981 and June 1, 1982 through August 31, 1982, and asked M & B to provide sales invoices of nontaxable sales for these periods at the next appointment. According to the auditor, the purpose of requesting invoices for the six-month period was to "test" the sufficiency of the books and records. From this point on, the audit concerned itself only with the two test periods. All further references to the audit in this determination should be understood to apply to the test periods unless otherwise indicated.

At the second appointment, M & B provided the requested invoices. After review, the auditor determined that M & B's books and records were inadequate to verify reported taxable sales for the entire audit period. Several factors indicated the inadequacy of the books and records. Most of the sales invoices were not prenumbered, and none of them could be traced to the cash receipts journal. According to the auditor, petitioners' reported taxable sales were 12 and one-half percent of its reported gross sales. The auditor stated that he was told by petitioners' accountant that taxable sales were consistently estimated as a percentage of gross sales.[1]

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[1]M & B filed sales tax returns showing taxable sales to be 11.5739 percent of gross sales for each sales tax quarter in the period December 1, 1979 through November 30, 1981. For the period December 1, 1981 through February 28, 1982, petitioner reported taxable sales which were 11.55 percent of gross sales, and for the period

M & B's gross sales for the test periods as shown in its books were compared to bank statements and sales tax returns and no differences were found. Sales as shown in M & B's general ledger reconciled with M & B's gross receipts as reported on its Federal income tax returns.

Petitioners' sales invoices were grouped into five categories labeled: trucking, UPS, shipping, exempt, and wholesale sales. Sales in these categories were claimed by M & B to be nontaxable sales. The auditor visited the premises of M & B and questioned Mr. Munjal regarding M & B's records of taxable sales. He was told that retail sales made in the store were written up on an invoice and provided to the bookkeeper who totaled the invoices on a daily basis and entered the amount in a sales book. The auditor requested copies of sales invoices showing taxable sales at this time and several times thereafter, but he was never provided with them. M & B did not use a cash register capable of producing a register tape.

The auditor attempted to verify the nontaxable status of sales in each of the categories as stated above.

The month of August 1982 was used as a test period for sales shipped by UPS and by truck. The auditor was able to reconcile invoices in these categories amounting to $610,756.28 with UPS records and trucking company receipts. Sales of $18,254.91 were found to have been delivered within New York State and were reclassified by the auditor as taxable sales.

Sales categorized by M & B as "shipping" were in actuality sales for export. The auditor attempted to match individual items shown on M & B sales invoices with the same items on corresponding bills of lading used for shipment.[2] The bills of lading were those of airlines and sea carriers and were prepared by M & B's customers who were shipping goods overseas. Oftentimes, the bill of lading would simply read "household goods" or would indicate that an

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March 1, 1983 through May 31, 1983, petitioner reported taxable sales which were 5.92 percent of gross sales.

[2]The audit report states: "Taxpayer's invoices were the bills of lading." Later, however, it states: "if the description on the bill of lading was 'One Used Refrigerator' and a refrigerator was listed on the invoice, then the refrigerator was allowed." These statements appear to be irreconcilable. Based on all the evidence in the record, it was concluded that the auditor worked from two sets of documents, sales invoices and bills of lading.

item was "used". The auditor contacted the shippers and verified that the crates had actually been shipped overseas. The auditor treated as nontaxable sales all items which he was able to match with a comparable item on the bill of lading. M & B's sales invoices in the export category totaled $184,434.50. The auditor was unable to trace to a bill of lading sales totaling $139,127.50; therefore, this amount was deemed additional taxable sales for the test period.

We modify finding of fact "10(c)" of the Administrative Law Judge's determination to read as follows:

> Invoices from claimed exempt sales totaled $53,692.10. The auditor reviewed approximately 60 sales invoices claimed to represent sales to tax exempt organizations or individuals (diplomats, etc.). The auditor deemed an exempt sale to be substantiated only if a fully completed invoice was accompanied by a fully completed exemption certificate. In some instances, an exemption certificate was attached to an invoice, but the invoice had no name and address on it. For example, an invoice dated November 19, 1981 showed sales of $279.00. There was no name on the invoice. Attached to the invoice was an exemption certificate which identified the exempt organization as the American Merchant Marine Library with an identification number provided. The auditor treated this and similar transactions as taxable sales. In other instances, it appeared that an exemption number was added after other parts of the exemption certificate were completed. These were treated as taxable sales. In one instance, M & B made two sales during the test period to an organization with the same name, with different addresses, but obtained only one certificate. In this case, the auditor treated as exempt only the sale shown on the invoice having an attached certificate. Thus, a sale made on October 14, 1981 to the Freedom Church of Revelation, 87-21 57 Avenue, Elmhurst was deemed nontaxable, since an exemption certificate was affixed to the invoice. A sale made on November 15, 1981 in the amount of $674.00 to the Freedom Church of Revelation, 135-17 222 Street, Laurelton was deemed taxable because an exemption certificate was not provided. Total claimed exempt sales deemed taxable by the auditor amounted to $26,813.85.[3]

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[3]The original finding of fact "10(c)" of the Administrative Law Judge's determination read as follows:

> "Invoices from claimed exempt sales totaled $53,692.10. The auditor reviewed approximately 60 sales invoices claimed to represent sales to tax exempt organizations or individuals (diplomats, etc.). The auditor deemed an exempt sale to be substantiated only if a fully completed invoice was accompanied by a fully completed exemption certificate. In some instances, an exemption certificate was attached to an invoice, but the invoice had no name and address on it. For example, an invoice dated November 19, 1981 showed sales of $279.00. There was no name on the invoice. Attached to the invoice was an

The auditor next listed all of the invoices which M & B claimed to be nontaxable by virtue of being sales for resale. The total amount of these invoices was $3,203,168.14. Resale certificates provided by M & B were correlated with invoices initially substantiating nontaxable sales of $617,489.43. The auditor then compiled from the invoices a list of 211 vendors for whom M & B had not provided a resale certificate or had provided an incomplete certificate. M & B was asked to provide completed certificates for each of these vendors. In the meanwhile, the auditor attempted to match the resale certificates already provided against the Division's computer files. He found that some of the authorization numbers were nonexistent or had been deactivated.

Approximately four months after the request was made, petitioners provided the auditor with completed resale certificates. The auditor suspected the authenticity of these certificates because much of the information on the forms was completed in the handwriting of one or two individuals. Also, the information shown on the certificates was identical to the information the auditor provided on the list of requested certificates. That is, if the auditor provided a complete name and address (which he copied from M & B sales invoices), the certificate had a complete name and address; if the auditor provided a name and no address, the certificate was completed with a name but without an address.

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exemption certificate which identified the exempt organization as the American Merchant Marine Library with an identification number provided. The auditor treated this and similar transactions as taxable sales. In other instances, it appeared that an exemption number was added after other parts of the exemption certificate were completed. These were treated as taxable sales. In some cases, M & B made several sales during the test period to the same organization or individual but obtained only one certificate. In these cases, the auditor treated as exempt only sales shown on invoices having an attached certificate. For instance, a sale made on November 15, 1981 in the amount of $674.00 to the Freedom Church of Revelation was deemed taxable because an exemption certificate was not provided. A sale made on October 14, 1981 to the same organization was deemed nontaxable, since an exemption certificate was affixed to the invoice. Total claimed exempt sales deemed taxable by the auditor amounted to $26,813.85."

We modified this fact based on our review of the Division's Exhibits "H," "I" and "J," the audit workpapers concerning exempt sales, which indicate only one instance of a sale to the organization with the same name. However, as noted, these organizations had different addresses and only one provided an exempt sales certificate.

The auditor sent a verification letter to a random sample of the vendors for whom a resale certificate had been requested. Addresses were obtained from telephone books, the Division's computer files and the M & B sales invoices. In its entirety, the letter reads:

> "Dear Sirs:
>
> It is imperative that this office obtain information from you regarding purchases made by you from:
>
> M & B Appliance, Inc.
> 83-15 Broadway
> Elmhurst, N.Y. 11373
>
> for the period of Sept., Oct., & Nov., 1981, and June, July, & August, 1982.
>
> Kindly review your files to supply us with the dollar volume, by month if possible, for the months requested.
>
> The receipt of this information in a diligent and accurate manner will negate the possibility of a field visit or use of a subpoena to verify this information.
>
> Kindly supply this information by [date changed depending on date of letter].
>
> If you have any questions, please feel free to call."

Some of these letters were returned to the Division stamped "Forwarding Order Expired". This caused the auditor to further question the authenticity of some of the resale certificates received from M & B, since it appeared that M & B had contacted vendors when the Division could not. Because of this, the Division decided to try to verify all sales invoices by contacting the vendor shown on the invoice. Eventually, letters requesting information regarding purchases made from M & B were sent to all of M & B's vendors. In addition, the auditor personally contacted some vendors and attempted to obtain from each a written statement indicating whether or not the resale certificate provided by M & B was authentic.[4] A review of the

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[4]The auditor asked vendors to complete and sign the following statement:

> "__[John Doe]__ of __[John Doe Company]__ has examined the attached resale certificate (ST-120). I have reviewed it with all partners, officers or employees to whom the certificate could have been presented for completion.
>
> To the best of my knowledge, the attached certificate __[was]

responses received indicates that of the 53 vendors contacted, 21 unequivocally denied executing the resale certificate and 7 unequivocally admitted signing the resale certificate. Others could not be located (e.g., the business was closed, moved to another location, was a private residence) or gave equivocal responses (e.g., the signature "might be" that of a departed employee) or denied executing the certificate but refused to sign a statement. In addition, some vendors who denied executing the resale certificate reported purchasing merchandise for resale, in some cases in significant amounts. For example, Mike Broody Camera denied executing the resale certificate but admitted purchasing merchandise from M & B during the test period in the amount of $63,827.00.

The auditor substantiated $880,367.25 in sales for resale from a total of $3,203,168.14 claimed.

Vendors responding to the verification letter reported $615,824.46 in purchases from M & B. M & B invoices to these vendors amounted to $1,638,818.89. Typically, the vendor responses consisted of handwritten notations placed on the bottom of the letter. Some of the responses were uninformative. For example, one vendor simply replied that it was out of business and its records were in cold storage. The auditor deemed to be substantiated nontaxable sales only the amounts reported by the vendors, except in those cases where the vendor reported purchasing more than the amount shown on M & B's invoices. In those cases, the auditor treated as substantiated only the lesser amount shown on the invoice. In this way, the auditor substantiated total nontaxable sales for the test period of $589,373.67.

The Division issued notices of determination on September 20, 1984, calculating tax due of $332,274.56 on the basis of information available up to this point in time, primarily verifications received from M & B's customers, with no further adjustments. The auditor's handwritten notes for September 19, 1984 state: "Computed allowable exempt sales percentage. Computed disallowed taxable sales for the period 12/1/79-8/31/81." The auditor's calculations

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[was not] completed and signed by a partner, officer or employer [sic] of [John Doe Company]."

for the period December 1, 1979 through August 31, 1981 are not in the record and the factors which made up those calculations are not known with certainty. The audit continued from this point.

In its cash receipts journal, M & B listed all checks received in payment for purchases and the name of the person or entity drafting the check. The auditor reviewed this journal and identified all vendors who had not responded to the verification letter who had made payments by check to M & B. M & B invoices made out to the vendors so identified amounted to $405,893.93. Check payments from this group of vendors amounted to $86,796.00. The latter amount was deemed to be substantiated nontaxable sales. This amounted to 33.069 percent of the amount shown on the invoices.

At the beginning of the audit, M & B had provided some resale certificates. Initially, the auditor correlated the certificates with invoices to substantiate nontaxable sales of $617,489.43. The auditor now determined that only 33.069 percent, or $204,197.58, of these should be allowed as nontaxable sales.

The auditor added all substantiated nontaxable sales: $589,373.67 as verified by vendors purchasing from M & B; $86,796.00 in additional payments by check as verified through M & B's cash receipts journal; and $204,197.58, representing a percentage of those sales for which resale certificates were originally provided. This resulted in substantiated sales for resale of $880,367.25. This amount was added to substantiated nontaxable sales in the other categories of sales yielding total substantiated nontaxable sales for the test period of $1,545,054.00. Reported nontaxable sales for the same period were $4,105,105.00. The auditor then calculated an error rate of 62.36 percent. The error rate was applied to reported nontaxable sales for the period December 1, 1979 through August 31, 1981 to calculate additional taxable sales of $3,701,179.00 with a tax due on this amount of $296,094.32, and a notice of assessment review was issued for that period. The Division decided to update the audit period by including the period September 1, 1982 through August 31, 1983. Therefore, the auditor then applied the error

rate to reported nontaxable sales for the period September 1, 1981 through August 31, 1983 to calculate additional taxable sales of $9,685,483.00 with a tax due on this amount of $799,052.35.

During the course of the audit, there were several contacts between the Division and petitioners. Petitioners questioned the accuracy of the information received by the Division from M & B's customers. M & B's overall claim was that the customers were only reporting purchases made by check, which were verifiable by the Division, and were not reporting purchases made in cash. The Division analyzed records maintained by M & B to weigh this contention. The Division was told that M & B deposited all checks it received in a State Bank of India account while currency was deposited in an account with the European American Bank (EAB). A comparison of deposits in these two accounts showed that 71.11 percent of total receipts were deposited in the State Bank of India Account (the account used for checks) while 28.89 percent of total receipts were deposited in the EAB account (used for currency). From this, the auditor concluded that less than one-third of M & B's sales were paid in cash, with the remainder being paid by check. This undermined M & B's argument that its customers tended to pay in cash and had understated cash purchases when reporting to the Division.

To exemplify its claim that vendors were not accurately reporting purchases, M & B's representative pointed to four customer accounts which showed significant differences between cash purchases and purchases by check.

Customer	Sales Per Invoices	Sales Per Customers	Payments By Check
Ing Stereo Mall	$ 10,398	$ 7,440	$ 850
Mike Brody Camera	87,829	63,827	3,087
Rafik Appliance	146,420	70,440	51,114
Ulster Electronics	36,268	10,941	6,768

Since the figures showed that each of the four customers had reported to the Division a substantial amount of cash purchases, the Division concluded that M & B's records did not support its argument that vendors were only reporting purchases made by check.

During the audit period, M & B's annual gross receipts per its Federal income tax returns increased from $2,814,144.00 for the fiscal year ended June 30, 1980 to $8,030,486.00 for the

fiscal year ended June 30, 1982. According to M & B, this large increase in the volume of its sales resulted from a change in the way it did business. M & B began doing business as a candy store in 1974. It evolved into a retail appliance and luggage store, selling merchandise for export, mainly to European and Indian nationals (see, Matter of M & B Appliances, State Tax Commission, April 25, 1984 [TSB-H-87(220)S]). By 1982, M & B had developed a large wholesale business. It was the authorized distributor for products manufactured by SONY, Panasonic, Samsonite and others. It also continued operating a retail store.

During the audit period, M & B employed approximately seven people, two of whom were delivery persons. M & B operated its wholesale business on a cash and carry basis. The delivery person not only delivered merchandise but also collected payment for merchandise delivered. These payments consisted of cash, or currency, checks drawn on the retail vendor's bank account and third-party checks, usually checks received by the vendor from its own customers and used to pay M & B. It was M & B's practice to list in its cash receipts journal, the name of the drawer of every check it received, the date the check was received and the amount of the check. The M & B delivery person receiving the check initialed it. This enabled M & B to trace any third-party checks returned for insufficient funds to the vendor who gave it to
M & B in payment. M & B could then collect the amount of the check from the vendor.
M & B did not extend lines of credit to its customers. It did accept postdated checks which were not deposited until several days after the date of the sale. In some cases, M & B would deposit a check although its customer had informed M & B that funds in the customer's account were insufficient to cover the amount of the check. When the check was returned, M & B would return to the customer to collect the payment in cash. At other times, M & B held checks for several days knowing the customer had insufficient funds to cover the check. The check served as a form of collateral and would be returned to the customer upon receiving payment in cash. These business practices explain the large number of checks listed in M & B's cash receipts journal and the large amount of the deposits in the State Bank of India account used for checks.

In maintaining its own books and records, M & B did not segregate its sales receipts into taxable and nontaxable categories. M & B's accountant testified that neither M & B's sales invoices nor its cash receipts journal identified its retail sales or separated retail and wholesale sales. M & B's accountant estimated M & B's reported taxable sales, using a methodology taught to him by the prior accountant.

Mr. Munjal explained how M & B had obtained the requested resale certificates. Two or three salesmen had completed the portion of the certificates that asks for the seller's and purchaser's name and address. They then personally contacted the vendors, asking them to sign the certificates and provide an authorization number.

Petitioners pointed to approximately 40 vendor responses to demonstrate that the vendor responses were an unreliable basis for assessing tax.

The response from vendor number 27[5] indicates that the vendor's name is B & B Refining located at 63-61 99th Street, Rego Park, while the auditor's workpapers show vendor number 27 to be B & B Custom Institute located at 62-60 99th Street, Rego Park.

Several vendors for whom M & B provided resale certificates reported that they had made no purchases from M & B (vendor numbers 67, 178, 238 and 321). It is petitioners' position that the resale certificates are valid and would not have been given to M & B if the vendor had not purchased from M & B.[6]

Vendor number 69 admitted making purchases of $4,987.00 during the period ended August 31, 1982 but claimed that the signature on the resale certificate was not his. M & B invoices showed purchases by this vendor in the amount of $7,409.00. The auditor treated as substantiated purchases in the amount of $4,987.00.

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[5]The response number refers to a control number assigned to each vendor by the auditor. It allowed the auditor to cross-reference M & B sales invoices, resale certificates, responses to the verification letter and statements by the vendors regarding the authenticity of the resale certificates.

[6]Three of the vendors in question each denied that it had executed the resale certificate provided to the Division by M & B.

Vendor number 79 indicated that its goods were purchased from M & B on consignment, and only $1,893.00 worth of goods were actually kept by the vendor and paid for. M & B's invoices showed purchases of $12,546.00 by this vendor. Apparently, it is petitioners' position that the full amount of goods transferred on consignment to vendor number 79 should have been treated as sales for resale.

Vendor number 83 stated that it had no records of ever purchasing any goods from M & B. Petitioners note that the auditor's workpapers show nontaxable purchases by vendor number 83 in the amount of $20,611.00 and that the vendor submitted a valid resale certificate. Vendor number 83 was among that first group of vendors for whom M & B provided certificates at the outset of the audit. The auditor's workpapers referred to by petitioners contain information taken from M & B's records. The information regarding vendor number 83 was not verified by the vendor; therefore, the auditor treated all sales allegedly made to vendor number 83 as taxable. Petitioners made similar arguments regarding vendor numbers 112 and 235.

Vendor number 183 reported purchasing approximately $104,000.00 worth of goods from M & B. M & B invoices showed purchases of $105,031.65. The auditor treated only $104,000.00 as substantiated sales for resale.

The verification letter from vendor number 161 has penciled notations on it consisting of a series of numbers. Petitioners argue that the penciled notations serve to verify a higher amount of nontaxable sales than the amount treated as nontaxable by the auditor. The penciled notations appear to be those of the auditor; the sum of those numbers is equal to the amount shown on the M & B invoices. The vendor reported purchasing a smaller amount than that shown on M & B invoices, and the auditor treated as substantiated nontaxable sales only the amount verified by the vendor.

In several instances, the vendor reported having made purchases from M & B within several days or weeks of the test periods (vendor numbers 201 and 263). The auditor disregarded these purchases. Petitioners argue that these purchases should have been considered in determining nontaxable sales by M & B.

Petitioners claim that the auditor's practice of combining the invoices of vendors operating with the same name out of several locations worked to M & B's detriment. They use as an example vendor numbers 250 and 256. The response from vendor number 256, located on 37th Avenue in Woodside, New York, indicated purchases of $8,285.00. A letter to vendor 250, operating under the same name on Division Street, was not responded to. The auditor's notations indicate some uncertainty regarding the proper allocation of the amounts shown on M & B's invoices to the two vendors. In the end, the auditor treated $8,285.00 as substantiated nontaxable sales. Apparently, there were one or more sales invoices totaling $1,480.00 written to either vendor 250 or 256 which the auditor did not treat as nontaxable. Petitioners pointed out similar problems with regard to vendor numbers 233, 268, and 272.

The failure of a vendor to respond completely to the Division's verification letter worked to M & B's detriment. Vendor number 151 replied in a manner which was unresponsive to the Division's letter and indicated that the vendor did not fully understand the Division's request. An employee of vendor number 182 called the Division stating that "the boss" was away from the business and offering to respond to the letter within four weeks. A reply was never received. Vendor number 197 replied: "Sales made to this firm have been minimal and are not recorded separately as this firm is not a regular customer. As such, it is not practical to research our records for the periods in question as it would involve finding a couple of transactions among thousands." M & B invoices show purchases by vendor number 197 of $20,254.00 during the test periods. Vendor number nine replied: "ACO is out of business due to lack of business. Our records are in cold storage." M & B invoices show purchases by vendor number nine of $5,580.00 during the test periods. In each of these instances, the auditor treated M & B's records as unsubstantiated.

OPINION

The Division issued two notices of determination to petitioners: the first on September 20, 1984 for the period December 1, 1979 through August 31, 1981, and the second on August 27, 1985 for the period September 1, 1981 through August 31, 1983.

The Administrative Law Judge determined that the Division made a proper request for petitioners' books and records for the period December 1, 1979 through August 31, 1982 but not for the period September 1, 1982 through August 31, 1983. On this basis, the Administrative Law Judge cancelled that portion of the assessment relating to the period September 1, 1982 through August 31, 1983.

The remainder of the Administrative Law Judge's determination addressed only the period December 1, 1979 through August 31, 1982, the "original audit period."[7]

The Administrative Law Judge determined that the Division's examination of petitioners' records for the original audit period was sufficient and that based on the record as a whole the Division reasonably concluded that petitioners' books and records were insufficient to support a complete audit. Specifically, the Administrative Law Judge pointed to the fact that petitioners' general ledger and cash receipts journal did not segregate taxable and nontaxable sales; that upon request petitioners failed to produce records of taxable sales; that the auditor was told by petitioners' representatives that their taxable sales were estimated as a percentage of gross sales; that petitioners' sales invoices did not state the tax due on those sales which petitioners considered to be retail sales; and that petitioners admitted at hearing that they kept no independently verifiable record of their taxable sales as required by sections 1132(c) and 1135(a) of the Tax Law.

Based on these facts, the Administrative Law Judge concluded that the Division was justified in resorting to a test period audit to determine petitioners' taxable sales for the entire period.

The Administrative Law Judge concluded, however, that petitioners proved by clear and convincing evidence that the notice issued on September 20, 1984 for the periods December 1, 1979 through August 31, 1981 lacked a rational basis. The Administrative Law Judge determined that the notice was issued before the audit was completed in order to avoid the

[7]The original audit was, thus, covered by two notices: the September 20, 1984 notice for the period December 1, 1979 through August 31, 1981, and the August 27, 1985 notice for the period September 1, 1981 through August 31, 1982.

expiration of the statute of limitations and that there was nothing in the record to indicate how the auditor calculated petitioners' taxable sales. Relying on Matter of Hair & Nails (State Tax Commn., November 7, 1985) and Matter of Miley (State Tax Commn., October 30, 1985), the Administrative Law Judge cancelled the notice.

The Administrative Law Judge then dealt with substantive aspects of the Division's audit methodology concerning petitioners' alleged sales for resale, sales to exempt organizations and export sales and, on the basis of this analysis, cancelled the assessment for the period September 1, 1981 through August 31, 1982, the portion of the "original audit period" covered by the August 27, 1985 notice.

The Administrative Law Judge determined that petitioners overcame the presumption of taxability by providing resale certificates to the Division as provided for in Tax Law § 1132(c) and the Division's own regulations (20 NYCRR 532.4[c][2]). In essence, the Administrative Law Judge found that the Division had no basis to disregard the resale certificates originally provided by petitioners (i.e., $617,489.43). Further, the Administrative Law Judge determined that the method used by the Division to verify the authenticity of the other resale certificates provided by petitioners yielded inconclusive results at best, and was, as petitioners asserted, inherently unreliable. In particular, the fact that petitioners' vendors were not required to explain how they arrived at the figures in their responses or to describe their recordkeeping systems, coupled with the fact that the auditor did not examine the books and records of the vendors contacted by the Division, meant that the Division could not have known whether the figures they reported were accurate. In the view of the Administrative Law Judge, the Division effectively ignored what the Administrative Law Judge termed "facially valid" resale certificates and proceeded on the theory that all sales which could not be verified were, in fact, taxable sales, a methodology which the Administrative Law Judge found was inconsistent with Tax Law § 1132 and 20 NYCRR 532.4(c)(2), the sections setting forth the criteria for a vendor to overcome the presumption of taxability through the use of resale certificates. Based on this

analysis, the Administrative Law Judge concluded that petitioners met the section 1132(c) standards for all of the resale certificates it provided to the Division.

The Administrative Law Judge determined that petitioners substantiated certain sales to exempt organizations by providing exemption forms and certificates for each of the purchasers to whom the sales were made. The Administrative Law Judge rejected the Division's approach of deeming an exempt sale to be substantiated only if a fully completed invoice was accompanied by a fully completed exemption certificate. The Administrative Law Judge, relying on Matter of Rac Corp. v. Gallman (39 AD2d 57, 331 NYS2d 945), determined that the adequacy of the certificates proffered by petitioners should be judged on substance and form, and not on form alone, as the Administrative Law Judge believed the Division had done.

Finally, the Administrative Law Judge dealt with what petitioners categorized as "shipping" sales which in actuality were sales for export. The Administrative Law Judge rejected the Division's approach of treating as substantiated only those sales for which the Division was able to match sales invoices with the same items on bills of lading used for shipment. The Administrative Law Judge pointed out that the bills of lading were prepared by the purchaser, not petitioners. The Administrative Law Judge determined that petitioners prepared the sales invoices, which were adequate to verify the sales, and maintained the bills of lading as evidence that the merchandise shown on the sales invoices was exported. "There is no evidence to suggest that there was any fraud involved here . . . . Under these circumstances, petitioners carried their burden of proof to show that [their sales for export] were not delivered in New York State" (Determination, conclusion of law "H").

The Division asserts that the record clearly shows that the Division adequately apprised petitioners of the extension of the audit period to quarters up to and including the period ending August 31, 1983, both orally by the auditor and in writing by letter dated January 10, 1984, and that petitioners consented to and participated in the extended audit (Exhibits "F" and "G"). As a result, the Division asserts that the notice for the first period was properly issued.

The Division asserts that its conduct of the audit was proper and reasonable under the circumstances of the case. Specifically, and as the Administrative Law Judge determined, the Division asserts that it made a proper request of petitioners for their books and records; that it made a proper examination of such books and records to determine their adequacy for the conduct of a full audit; that it properly determined that such books and records were not adequate for a full audit; and that it was justified in resorting to a test period review of petitioners' books and records to determine taxable sales.

The Division asserts that petitioners did not overcome the presumption of taxability of the disputed transactions because they did not establish that, at the time of the transactions, they had received and retained properly completed resale certificates as required by statute and regulation. The Division asserts that, under the facts and circumstances, it was within its authority to verify the authenticity of the resale certificates provided by petitioners. In this regard, the Division points out that, upon initial request, petitioners were able to provide only a limited number of resale certificates for their resale transactions and that when petitioners finally did submit certificates, many were incomplete on their face and were acknowledged to have been prepared by petitioners' employees well after the date of the asserted transactions. In short, the Division seriously questions the authenticity of the resale certificates. The Division asserts that the method chosen for verification, i.e., contacting petitioners' customers, was proper and reasonable and that the Division's determination to exempt only those sales where it was established that the sales were sales for resale was proper.

The Division also asserts that the Administrative Law Judge erred in concluding that the Division arbitrarily disallowed certain of petitioners' sales denoted as exempt and export. The Division asserts that its action was proper in that it was based on the failure of petitioners to provide supporting documentation for such sales.

On exception, petitioners argue, as they did at hearing, that the Division should be required to submit the audit history of the petitioners. Petitioners assert that such history would show that petitioners are wholesalers, not retailers; that the Division intended to produce a substantial

deficiency in comparison to past audit results; and that it could do so only by choosing the methodology used here. Petitioners assert that the methodology has no credibility whatsoever and that:

> "[t]here may be abuses in the collection, reporting and paying of sales tax. However, it occurs at the retail level, not the wholesale level. The degree of the alleged margin of error would result in the proposition that Petitioner produced false invoices and would warrant a charge of criminal fraud, if believed. Taxes are burdensome to all, but we as taxpayers bear the necessity to pay. It is difficult for businesses to comply with all the regulations to perfection as is being required of this Petitioner" (petitioners' brief on exception, p. 2).

Petitioners assert that the determination of the Administrative Law Judge is correct.

We modify the determination of the Administrative Law Judge.

We deal first with the issue of whether the Administrative Law Judge properly cancelled that portion of the assessment for the period September 1, 1982 through August 31, 1983, on the basis that the Division failed to make a proper request for records for that period.

We agree with the Administrative Law Judge.

The law is clear that, "[t]he honest and conscientious taxpayer who maintains comprehensive records as required has a right to expect that they will be used in any audit to determine his ultimate tax liability" (Matter of Chartair, Inc. v. State Tax Commn., 65 AD2d 44, 411 NYS2d 41, 43).

To determine the adequacy of a taxpayer's records, the Division must first request (Matter of Christ Cella, Inc. v. State Tax Commn., 102 AD2d 352, 477 NYS2d 858, 859) and thoroughly examine (Matter of King Crab Rest. v. Chu, 134 AD2d 51, 522 NYS2d 978, 979-80) the taxpayer's books and records for the entire period of the proposed assessment (Matter of Adamides v. Chu, 134 AD2d 776, 521 NYS2d 826, 828, lv denied 71 NY2d 806, 530 NYS2d 109). The purpose of the examination is to determine, through verification drawn independently from within these records (Matter of Giordano v. State Tax Commn., 145 AD2d 726, 535 NYS2d 255, 256-57; Matter of Urban Liqs. v. State Tax Commn., 90 AD2d 576, 456 NYS2d 138, 139; Matter of Meyer v. State Tax Commn., 61 AD2d 223, 402 NYS2d 74, 76, lv denied 44

NY2d 645, 406 NYS2d 1025; see also, Matter of Hennekens v. State Tax Commn., 114 AD2d 599, 494 NYS2d 208, 209), that they are, in fact, so insufficient that it is "virtually impossible [for the Division of Taxation] to verify taxable sales receipts and conduct a complete audit" (Matter of Chartair, Inc. v. State Tax Commn., supra, 411 NYS2d 41, 43; Matter of Christ Cella, Inc. v. State Tax Commn., supra), "from which the exact amount of tax due can be determined" (Matter of Mohawk Airlines v. Tully, 75 AD2d 249, 429 NYS2d 759, 760).

Where the Division follows this procedure, thereby demonstrating that the records are incomplete or inaccurate, the Division may resort to external indices to estimate tax (Matter of Urban Liqs. v. State Tax Commn., supra). Here, the original audit period was December 1, 1979 through August 31, 1982. The audit appointment letter was a clear and unequivocal request for all books and records for that period. There was no request for records for any other period and clearly no examination of any such records. The fact that petitioners were made aware that the audit period had been extended does not function as a request for books and records for the extended audit period (see, Matter of Top Shelf Deli, Tax Appeals Tribunal, February 6, 1992).

We deal next with the issue of whether the Administrative Law Judge properly determined that the notice dated September 20, 1984 lacked a rational basis and was issued to avoid the expiration of the statute of limitations.

We disagree with the Administrative Law Judge.

The law is clear that a notice of determination of additional tax due issued by the Division must have a rational basis and cannot be issued solely to extend the statute of limitations (see, Matter of Brown v. New York State Tax Commn., 199 Misc 349, 99 NYS2d 73). In Brown, all of the allegations in the petitioner's complaint were deemed admitted, and the court assumed, as alleged in the complaint, that the Tax Commission had no basis whatsoever for its estimate of the petitioner's taxable income except for the return filed by him which he alleged correctly reflected his income (Matter of Brown v. New York State Tax Commn., supra, 99 NYS2d 73, 77). The record in this case is markedly different from that in Brown and indicates that the September 20, 1984 notice had a rational basis for its assertion of a tax deficiency. The audit was commenced

in September 1982. Approximately 300 hours were spent on the audit from the time of its commencement through the September 20, 1984 notice (see, Exhibit "G"). In that period, all available records were thoroughly examined by the Division, a determination was made that the records were inadequate, test periods were completed and computation of nontaxable sales was completed, i.e., UPS $592,501.00; export $45,307.00; exempt organizations $26,878.00; and sales for resale $569.093.00 for a total of $1,232,148.00. The assessment was based on this work (Division's Exhibit "H", auditor's worksheets, pp. 148-150). In our opinion, the notice had a rational basis.

We next consider the Administrative Law Judge's determination as it deals with sales for resales, sales to exempt organizations, and export sales.

The Tax Law imposes sales tax on receipts from all "retail sales" of tangible personal property, unless exempt or excluded from tax by provision of law (Tax Law § 1105[a]). The tax is a transaction tax imposed at the time the transaction occurs and is imposed if the delivery of goods is made or possession is transferred from the vendor to the purchaser in New York State (see, Matter of David Hazan, Inc. v. Tax Appeals Tribunal, 152 AD2d 765, 543 NYS2d 545, affd 75 NY2d 989, 557 NYS2d 306; Matter of Continental Arms Corp. v. State Tax Commn., 130 AD2d 929, 516 NYS2d 338, revd on other grounds 72 NY2d 976, 534 NYS2d 362). So-called "sales for resale" are excluded from the definition of "retail sales" and are not taxable (Tax Law § 1101[b][4]). Sales to specific exempt organizations are exempt from tax (Tax Law § 1116).

For the purpose of the proper administration of the sales tax and to prevent evasion of the tax, the law presumes that all receipts from the retail sale of tangible personal property are subject to tax until the contrary is established. The burden of proving that any receipt is not taxable is upon the person required to collect tax or the customer (Tax Law § 1132[c]).

During the period at issue, a sale was deemed a retail sale and, thus, taxable:

> "unless (1) a vendor shall have taken from the purchaser a certificate in such form as the tax commission may prescribe, signed by the purchaser and setting forth his name and address and, except as otherwise provided by regulation of the tax commission, the number of his registration certificate, together with such other information as said commission may require, to the effect that the

> property . . . was purchased for resale . . . or (2) the purchaser prior to taking delivery, furnishes to the vendor: any affidavit, statement or additional evidence, documentary or otherwise, which the tax commission may require demonstrating that the purchaser is an exempt organization described in section eleven hundred sixteen" (former Tax Law § 1132[c], emphasis added).

For the period in issue, the Division's regulations provided that, in order to prove that a sale was exempt from tax because it was made for resale or the purchaser was an exempt organization, the vendor, "at the time of sale," was required to obtain a properly completed exemption certificate from the purchaser and retain the certificate in his files. Such certificate satisfied the vendor's burden of proof (former 20 NYCRR 532.4[b][2]). However, the vendor was not relieved of the burden of proof when no exemption certificate or an improper certificate was furnished, or when the vendor had actual knowledge that a certificate furnished was false or fraudulent.

A certificate was considered to be properly completed when it contained the (i) date prepared, (ii) name and address of the purchaser, (iii) name and address of the vendor, (iv) identification number of the purchaser as shown on the certificate of authority or exempt organization number as shown on the exempt organization certificate, (v) signature of the purchaser or the purchaser's authorized representative, and (vi) any other information required to be completed on the particular form (former 20 NYCRR 532.4[c][2]).

The Division's regulations, in effect for the period at issue here, provided for the use of a "blanket resale certificate," stating that such a certificate:

> "may be filed with the vendor by a purchaser to cover additional purchases of the same general type of property or service. Each vendor accepting a resale certificate must, for verification purposes, maintain a method of associating a sale made for resale with the resale certificate on file" (former 20 NYCRR 532.4[4][d][4]).

The Division's regulations made no provision for a "blanket certificate" for other exempt sales.

We modify the determination of the Administrative Law Judge as it relates to petitioners' sales for resale.

We deal first with the verification process used by the Division with regard to the 211 vendors for which petitioners provided invoices but did not provide a resale certificate or provided an incomplete certificate.

Clearly, as the Administrative Law Judge acknowledged, the Division had the authority to treat, as taxable, those sales for which a valid resale certificate was not provided. In short, the Division could have elected to treat as taxable all of the sales to the 211 vendors. Instead, the Division provided petitioners with the opportunity to provide resale certificates after the fact, i.e., after the transaction. When those certificates were provided, it was within the Division's authority to seek to verify the authenticity of those certificates. We are persuaded that this verification process was an integral part of the audit and was prudent and proper under the circumstances.

The Division has broad powers "to prescribe methods for determining the amount of receipts . . . and for determining which of them are taxable and which are nontaxable" (Tax Law § 1142[4]). In Matter of Morano's Jewelers of Fifth Ave. (Tax Appeals Tribunal, January 2, 1992), this Tribunal held that:

> "Verification of books and records is an integral, accepted part of the audit process (see, Matter of Giordano v. State Tax Commn., 145 AD2d 726, 535 NYS2d 255 . . . [the former State Tax Commission was not required to accept the total accuracy of the records produced by petitioner since they were self-serving and not subject to independent verification]). In Matter of On the Rox Liqs., Ltd. v. State Tax Commn. (124 AD2d 402, 507 NYS2d 503, 505), the court rejected the claim that the retention of an exempt organization certificate file which did not reflect specific sales to specific exempt organizations was adequate proof. The court stated, 'to state the proposition is to refute it. Carried to its logical conclusion, this course of reasoning justifies the patently unacceptable consequence of exempt sales, without providing any documentation whatsoever to verify those sales'" (Matter of Morano's Jeweler's of Fifth Ave., supra, emphasis in original).

Contrary to the determination of the Administrative Law Judge, the calculation made by the Division is clear in the record. The auditor used the following methodology:

1 - Responses to the verification letter totalled $615,824.46 versus $1,638,818.89 claimed by petitioners as nontaxable sales for resale. The auditor deemed as substantiated

nontaxable sales only the amounts reported by the vendors, except in those cases where the vendor reported purchasing more than the amount shown on petitioners' invoice, in which case the auditor allowed the invoice amount. In this way, the auditor allowed $589,373.67.

2 - The auditor reviewed the cash receipts journal and identified all vendors who had not responded to the verification letter and who had made payments by check to petitioners. Invoices for these vendors amounted to $405,893.93. Check payments amounted to $86,796.00. This was the amount the auditor allowed as substantiated nontaxable sales.

The total sales allowed from these two calculations, i.e., $676,169.67 ($589,373.67 + $86,796.00), amounted to an allowance rate of 33.069 percent of the invoice amount $2,044,713.76 ($1,638,819.89 + $405,893.93).

We deal next with the application of the allowance ratio (33.069 percent) derived from the verification process to the $617,489.43 of resale certificates originally provided by petitioners with the result that $204,197.52 of such sales were treated as nontaxable. We agree with the Administrative Law Judge that application of the error rate to these certificates was improper since there is nothing in the record to indicate why the resale certificates originally provided by petitioners, i.e., with respect to the $617,489.43 in sales, were insufficient nor is there anything to lead us to conclude that petitioners did not accept the certificates in good faith (see, Matter of Saf-Tee Plumbing v. Tully, 77 AD2d 1, 432 NYS2d 409). Accordingly, we find no basis in the record for rejection of the total amount of these certificates and the application of an error ratio thereto.

We deal next with petitioners' sales to exempt organizations. We reverse the determination of the Administrative Law Judge. Petitioners here have not substantiated the fact that all the sales at issue were, in fact, made to exempt organizations. The rule is well stated in Matter of On the Rox Liqs., Ltd. v. State Tax Commn. (supra, 507 NYS2d 503, 505, lv denied 69 NY2d 603, 512 NYS2d 1026) that:

> "To demonstrate the sales at issue are nontaxable, petitioner must not only show that the purchaser is an exempt organization, but also proffer adequate documentation confirming the existence and accuracy of the allegedly exempt sale. Although petitioner

> maintains a file of facially valid exempt organization certificates, as respondent tellingly observed in its decision, petitioner's 'recordkeeping left no means whereby sales reported as exempt could be tied to or compared with those exemption certificates * * * Without any means of identifying individual exempt sales, there was no way to determine, on audit, if all such sales were made to exempt organizations or to individuals properly buying on behalf of exempt organization'" (Matter of On the Rox Liqs., Ltd. v. State Tax Commn., supra).

Our review of the record in this matter, in particular the Division's Exhibits "H," "I" and "J" (the audit workpapers concerning sales to exempt organizations), leads us to conclude that the Division correctly disallowed those sales where the sales invoice indicated no named purchaser and was attached to an exemption certificate which indicated the name of an exempt organization, and those sales where it appeared that an exemption number was added after other parts of the exemption certificate were completed. Further, our review of the audit workpapers fails to show, as the Administrative Law Judge determined, that the Division required individual, completed, exemption certificates on multiple sales to the same organization. As our modification to finding of fact "10(c)" shows, the audit workpapers indicate that the October 14, 1987 sale to the Freedom Church of Revelation, 87-21 57 Avenue, Elmhurst had an exemption certificate on file with the sales invoice and was properly treated as nontaxable. The Division correctly disallowed the November 15, 1987 sale to the Freedom Church of Revelation, 137-17 222 Street, Laurelton since there was no exemption certificate on file with the sale invoice and the church had a different address from that in the earlier sale.

We deal next with petitioners' export sales. The Administrative Law Judge determined that petitioners "established the existence and the amount of claimed export sales" and that in the absence of evidence of fraud petitioners proved that the sales were not delivered in New York State (Determination, conclusion of law "F"). We disagree. Petitioners, through their invoices, have shown that sales occurred; however, they have not met their burden of proving that actual delivery of the merchandise involved in such sales did not take place in New York State (Matter of Continental Arms Corp. v. State Tax Commn., supra; Matter of David Hazan, Inc. v. Tax Appeals Tribunal, supra).

The auditor was unable to match individual items shown on petitioners' invoices with the same items on corresponding bills of lading used for shipment. This made it impossible to determine that actual delivery of the goods did not take place in New York. The fact that the bills of lading were those of airlines and sea carriers and were prepared by petitioners' customers who were shipping goods overseas does not mitigate the burden on petitioners to show that actual delivery did not take place in New York State. The situation here is fundamentally the same as in Continental Arms (delivery of goods by the seller's agent to the customer at the airport where they were placed in the customer's luggage, which was taken to the airline counter, checked in and placed on a conveyor belt for transit to the airplane, indicates that the actual delivery took place in this State) and Hazan (the fact that the customers did not open the packaged goods until after the airplane had left the United States does not constitute proof that actual delivery did not take place in this State).

We agree with the Division that the inability to trace the specific items to a bill of lading makes it impossible to determine that actual delivery of the goods did not take place in New York State. Under the circumstances, the Division correctly treated as nontaxable sales all items which it was unable to match with a comparable item on a bill of lading.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is granted to the extent that the notices of determination issued on September 20, 1984 and August 27, 1985 are sustained, except that the assessment for the period September 1, 1982 through August 31, 1983 is cancelled and that the assessment will be decreased by allowing petitioners $617,489.43 in sales for resale;

2. The determination of the Administrative Law Judge is modified to the extent indicated in paragraph "1" above, but is otherwise sustained;

3. The petitions of M & B Appliance, Inc. and Man M. Munjal and Inder S. Bindra, as Officers are granted to the extent indicated in paragraph "1" above, but are otherwise denied; and

4. The Division of Taxation shall modify the notices of determination dated September 20, 1984 and August 27, 1985 in accordance with paragraph "1" above, but such notices are otherwise sustained.

DATED: Troy, New York
April 9, 1992

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

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

/s/Maria T. Jones
Maria T. Jones
Commissioner