

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition :
of :
MOSES DYCKMAN : DECISION
D/B/A DYCKMAN'S :
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 September 1, 1981 through August 31, 1984. :
:

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on March 29, 1990 with respect to the petition of Moses Dyckman d/b/a Dyckman's, 73 West 47th Street, New York, New York 10036 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 September 1, 1981 through August 31, 1984 (File No. 805671). Petitioner appeared by Lawrence R. Cole, C.P.A. The Division of Taxation appeared by William F. Collins, Esq. (Gary Palmer, Esq., of counsel).

Both petitioner and the Division of Taxation filed briefs on exception. Oral argument, at the request of the Division of Taxation, was heard on November 14, 1990.

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

ISSUE

Whether the Division of Taxation properly requested and examined petitioner's books and records for the entire audit period.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for findings of fact "1(b)," "3(a)," "3(b)," and "6(b)" which have been modified. We have also made

additional findings of fact. The Administrative Law Judge's findings of fact, the modified findings of fact and the additional findings of fact are set forth below.

Petitioner, Moses Dyckman d/b/a Dyckman's, operates a jewelry store on West 47th Street in Manhattan, selling both at wholesale and retail. Petitioner rents space on its premises to eight or more other retail jewelers.

We modify finding of fact "1(b)" of the Administrative Law Judge's determination to read as follows:

Petitioner's gross sales for 1981, 1982 and 1983 were \$230,047.00, \$145,031.00 and \$109,448.00, respectively. Based on an examination of his Federal income tax returns, the Division determined that petitioner's average markup over cost for those years was 34.92%, 9% and 1.84%, respectively.¹

Petitioner's store manager testified that the average markup was approximately 10% to 20%, that no items were ever marked up as much as 50% and that expensive items were marked up the least.

In 1983, petitioner's store underwent extensive renovations, resulting in a drop in business revenue.

Most of petitioner's displayed merchandise was marked with a confidential code which reflected the cost of the item, while other items had the actual price marked on them. In either case, the salesman could negotiate with a customer to make a sale at the best price possible. Some items were marked with a price but not with a cost. On such items the cost was understood by the salesmen to be 50% of the manufacturer's list price. Petitioner sold these at

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The original finding of fact "1(b)" of the Administrative Law Judge's determination read as follows:

"Petitioner's gross sales for 1981, 1982 and 1983 were \$230,047.00, \$145,031.00 and \$109,448.00, respectively. His average markup over cost for those years was 34.92%, 9% and 1.84%, respectively."

We modify this finding of fact because the original finding of fact does not indicate the source or method for calculation of petitioner's markup.

up to 40% below list price. Gold items were sold by weight at a price depending on the current market value of gold. At times, this resulted in a loss from the actual cost of the item.

We modify finding of fact "3(a)" of the Administrative Law Judge's determination to read as follows:

Petitioner kept sales records and had his invoices available. Petitioner also had all purchase records. The purchase invoices could not be associated with specific items sold because some items were made up of several different pieces so that no one purchase invoice would provide its cost.²

We modify finding of fact "3(b)" of the Administrative Law Judge's determination to read as follows:

On December 17, 1986, the auditor called petitioner's representative and told him that she wanted to check nontaxable sales for the entire three-year period. This was over two years after the audit had commenced and after the second notice of determination had already been prepared (December 11, 1986). Petitioner refused to consent to this. The auditor claims that if petitioner had agreed to the test, she would have refrained from mailing out the second determination. The supplemental notice of determination was mailed the same day, December 17, 1986 (Tr., p. 60; Division's Exhibit I).³

The auditor checked the sales tax returns against Federal income tax returns and bank records. No unexplained differences were found.

The auditor attempted to determine petitioner's markup over cost based on the current sales price of displayed merchandise. For seven items, the auditor was able to determine both the sales price and cost resulting in an average markup of 12.3%. For four items, the sales price

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

"Petitioner kept sales records and had his invoices available. These, it is conceded by the Division of Taxation, were "facially" adequate. Petitioner also had all purchase records. The purchase invoices, however, could not always be associated with specific items sold because some items were made up of several different pieces so that no one purchase invoice would provide its cost."

We have deleted the sentence indicating the Division conceded that the records were "facially" adequate since it is not supported by the record.

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We have added the last sentence to the Administrative Law Judge's original finding of fact "3(b)" to more accurately reflect the record.

and the price code were known and recorded by the auditor, resulting in an average markup of 17.32%. For nine items checked by the auditor, the price was listed but no information about the cost was recorded. The total selling price of all items was \$1,720.50 and the items where the markup was computed comprised 52% of the total (\$890.50).

Consents extending the period of limitations were executed by petitioner on seven occasions. The last two consents extended the limitations period to September 20, 1986 and December 20, 1986.

A Notice of Determination and Demand for Payment of Sales and Use Taxes Due was issued on September 20, 1986 for sales and use taxes due of \$32,449.83, plus penalty at 25% of \$8,124.98 and interest of \$12,587.82, for a total amount due of \$53,212.63 for the period September 1, 1981 through August 31, 1984.

We modify finding of fact "6(b)" of the Administrative Law Judge's determination to read as follows:

A supplemental notice of determination was issued on December 17, 1986 (date typed on notice was December 20, 1986) for sales and use taxes due of \$44,312.51, plus penalty at 25% of \$11,078.15 and interest of \$26,836.67, for a total amount due of \$82,227.33 for the same period.⁴

Petitioner has not contested the imposition of the use tax in the amount of \$5,011.77 on purchases of fixed assets.

In conducting the audit, the auditor started with the amount of purchases as reported on Federal income tax returns for the audit period, prorating 1981 figures and projecting from 1983 figures for 1984. Such purchases amounted to \$478,919.00. (The purchase figure in

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The original finding of fact "6(b)" of the Administrative Law Judge's determination read as follows:

"A supplemental notice of determination was issued on December 20, 1986 for sales and use taxes due of \$44,312.51, plus penalty at 25% of \$11,078.15 and interest of \$26,836.67, for a total amount due of \$82,227.33 for the same period."

We modified this fact to more accurately reflect the record.

petitioner's books amounted to \$441,906.00.) She then applied a markup percentage of 97.86% derived from data compiled in a 1968 edition of "Expenses in Retail Business" published by the NCR Corporation. (The Division of Taxation has subsequently submitted copies of pages from a 1973 edition of the same publication which includes a table of figures from which a markup percentage of 78.57% can be inferred.) From the markup percentage of 97.86%, the auditor computed adjusted gross sales of \$947,589.13.

The auditor next examined records for the quarter ending November 30, 1983. She found reported gross sales of \$16,506.00 and wholesale sales, which were not included in reported sales, of \$5,176.50 for total gross sales of \$21,682.69. The taxable sales reported on the return were \$2,087.00. The nontaxable sales computed from the figures on the return were thus \$14,419.00. The auditor made a list of nontaxable sales (out-of-state sales) totalling \$14,013.00. Of this amount, \$6,833.00 was disallowed due to lack of proof of shipment to an out-of-state destination. The difference of \$7,180.00 was allowed. The allowable amount, when added to the wholesale sales of \$5,176.50, resulted in a total of allowable subtractions from gross sales of \$12,356.50. The \$7,180.00 of allowable out-of-state sales was 51.24% of the listed out-of-state sales and the disallowed \$6,833.00 was 48.76%. Since the nontaxable sales, as computed from the return for the quarter (\$14,419.00), were slightly higher than the listed sales (\$14,013.00), the auditor disallowed 48.76% of the tax return figure which resulted in \$7,030.80. The allowed portion of 51.24% resulted in an allowed amount of \$7,388.29 for the quarter.

To arrive at figures for the entire audit period, the auditor projected the quarter's figures on the basis of computed gross sales for the quarter. The allowed amount of \$7,388.29 was 34.08% of the calculated gross sales of \$21,682.69. The wholesale sales (all allowed) were 23.87% of that figure. These ratios, when applied to the audit period's calculated gross sales (based on purchases) of \$947,589.13, result in allowances for out-of-state sales and wholesale sales of \$322,938.37 and \$226,189.52, respectively. Taxable sales thus amount to \$398,461.22.

After subtracting the reported sales of \$65,269.00, this left additional taxable sales of \$333,192.22 and an additional tax due at 8¼% of \$27,488.36.

To prepare the assessment and presumably to calculate interest, the auditor computed the tax due by sales tax quarters using a margin of error of 510.49% computed by dividing the audited taxable sales by the reported taxable sales. With this computation the additional taxable sales for the audit period amounted to \$333,191.71 and the additional tax due to \$27,488.06. A use tax of \$5,011.77 was computed on purchases in three of the quarters. The total tax due was thus \$32,499.83.

The supplemental determination was based on the same markup percentage as used in the first determination. The allowable subtractions from gross sales were reduced, however, from \$549,127.89 to \$12,009.00. The allowed subtractions were for \$5,176.00 of wholesale sales in the quarter ending November 30, 1983 and \$6,833.00 for allowable nontaxable out-of-state sales for the same quarter. (This figure of \$6,833.00 should be \$7,180.00 and the total should be \$12,356.00 as noted separately in the auditor's workpapers.) All other claimed subtractions from gross sales were denied. This resulted in audited taxable sales of \$935,580.13. Audited taxable sales less reported taxable sales of \$65,269.00 resulted in additional taxable sales of \$870,311.13 which, when divided by reported sales of \$65,269.00, results in a 1333.42% error rate. (As noted by the auditor, to correct the mistake made in out-of-state sales, this should have been 1332.89%.) The taxable sales as thus computed amounted to \$870,309.90 and the additional tax due to \$71,800.57. No use tax was computed for this determination. The sales tax determined in the first notice, \$27,488.06 (but not the use tax which had been computed), was subtracted from this figure to arrive at the second determination of \$44,312.51.

We find the following additional facts:

On October 10, 1984, the auditor mailed to petitioner a letter confirming an appointment at petitioner's premises on November 8, 1984. The letter indicated that petitioner's New York sales tax returns for the period September 1, 1981 through August 31, 1984 had been selected for audit. The letter informed petitioner that "the conference is your opportunity to complete the audit with a minimal amount of time expended by you or your representative." The letter requested that petitioner bring certain records for specified portions of the audit period to

the conference. As relevant to exempt sales, the letter specifically requested:

"(2) Copies of your last 2 Sales Tax Returns and cancelled checks as proof of payment.

If your business has sales exempt from sales tax..resales, exempt organization sales, out of state sales, exempt sales, etc..please have documentation." (Division's Exhibit J, p. 23).

The November 4, 1984 appointment was cancelled by petitioner. A second appointment was set up for November 26, 1984, and was confirmed by the auditor with a letter identical to the first letter (Division's Exhibit J, p. 24).

OPINION

The only aspect of the audit at issue on this exception concerns the nontaxable, out-of-state sales made by petitioner (Division's brief on exception, p. 2). The Administrative Law Judge cancelled in its entirety the December 20, 1986 notice, which treated as taxable all of petitioner's out-of-state sales for periods other than the quarter ending November 30, 1983. The Administrative Law Judge determined that since the auditor had examined records for such sales only for the quarter ending November 30, 1983, that only that portion of the assessment could be sustained.

On exception, the Division of Taxation (hereinafter the "Division") asserts that the auditor requested books and records concerning out-of-state sales for the entire audit period; that petitioner failed to produce such records; that it was authorized to issue the supplemental notice of determination dated December 20, 1986; and that such notice should be sustained as it relates to out-of-state sales. The Division takes exception to those findings of fact made by the Administrative Law Judge that the Division conceded the adequacy of petitioner's books and records and that sufficient records of out-of-state sales were made available to the auditor for the entire audit period. Finally, the Division asserts that it properly determined that petitioner's books and records were inadequate because an evaluation of petitioner's accounting system by the auditor indicated a lack of sufficient internal control procedures.

The essence of petitioner's position on exception is that the Division did not make a timely and proper request for the books and records concerning out-of-state sales for the entire audit period. Stated differently, petitioner asserts that the supplemental notice was prepared and mailed before any request for books and records was made of petitioner.

We affirm the determination of 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), "from which the exact amount of tax can be determined" (Matter of Mohawk Airlines v. Tully, 75 AD2d 249, 429 NYS2d 759, 760).

The Division's actions concerning petitioner's out-of-state sales do not comply with these principles. The letters of appointment (Division's Exhibit J, pp. 23-24) indicate the audit was for the periods September 1, 1981 to August 31, 1984. The letters request records on out-of-state sales for only a portion of the audit period, i.e., the period covered by petitioner's last two

sales tax returns.⁵ In fact, the auditor examined only the records for out-of-state sales for the quarter ending November 30, 1983, and this was in connection with the first notice of determination issued on September 20, 1986. The record clearly indicates that the supplemental Notice of Determination, which treated all of petitioner's out-of-state sales as taxable other than those for the quarter ending November 30, 1983, was prepared on December 11, 1986. However, the auditor did not request books and records for out-of-state sales for the entire period of the audit until December 17, 1986, the same date she mailed the assessment (Tr., p. 60; Division's Exhibit I).

Under these circumstances, and the fact that the consent to extend the period of limitations expired on December 20, 1986, we conclude that the Division's request was not intended and did not provide petitioner with an adequate, meaningful opportunity to produce its books and records for audit.⁶ Such a request runs afoul of the principles underlying the decision in Christ Cella where a weak and casual request for books and records was held insufficient to justify a resort to an estimate audit (Matter of Christ Cella, Inc. v. State Tax Commn., supra).

⁵Conclusion of law B of the Administrative Law Judge's determination stated, in pertinent part:

"It is clear that petitioner made sufficient records available to the auditor for the entire audit period. The auditor, however, did not avail herself of these records and it was only after the initial notice of determination had been issued that there was any request made for out-of-state sales records. This request does not justify the auditor's disregard of petitioner's records nor her subsequent projection of the test period results over the entire audit period . . ."

This statement does not properly reflect the record. As we have indicated, the appointment letter did request records for out-of-state sales for that portion of the audit period covered by petitioner's last two sales tax returns.

⁶The facts here are in clear contrast to those in Matter of DACS Trucking Corp. (Tax Appeals Tribunal, March 21, 1991) where we sustained an assessment based on a test of the taxpayer's records where the Division first prepared a proposed assessment, then made a proper request for books and records which was declined by the taxpayer. The record in DACS clearly indicated that the assessment was tentative; that the Division was prepared to do a complete audit if the tentative assessment was not acceptable to the taxpayer; and that the taxpayer had adequate time (approximately three months) to consider the Division's offer to do a complete audit before the actual notice of determination was issued.

Accordingly, since there was not a proper request for the books and records concerning nontaxable out-of-state sales for other than the quarter ending November 30, 1983, the assessment for the period must be cancelled.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petition of Moses Dyckman d/b/a Dyckman's is granted to the extent indicated in conclusion of law "C" of the Administrative Law Judge's determination, but is otherwise denied; and
4. The Division of Taxation is directed to modify the Notice of Determination dated September 20, 1986 to include only the tax on the disallowed out-of-state sales for the quarter ending November 30, 1983 and the Notice of Determination dated December 20, 1986 is cancelled.

DATED: Troy, New York
April 25, 1991

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

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