

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition :
of :
GIFTS BY GALLEGRO, INC. : DECISION
AND THOMAS PADAVONA, AS OFFICER : DTA No. 810018
: :
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, 1985 through November 30, 1988. :
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Petitioners Gifts By Gallego, Inc. and Thomas Padavona, as officer, 175-41 Liberty Avenue, Jamaica, New York 11433, filed an exception to the determination of the Administrative Law Judge issued on February 18, 1993. Petitioners appeared by David Feinblum, C.P.A. of Schwartz, Franzman, Suchman & Company. The Division of Taxation appeared by William F. Collins, Esq. (Patricia L. Brumbaugh, Esq. and John E. Matthews, Esq., of counsel).

Both petitioners and the Division of Taxation submitted letter briefs. Petitioners submitted a reply letter brief dated August 2, 1993 which began the six-month period to issue this decision.

Commissioner Koenig delivered the decision of the Tax Appeals Tribunal. Commissioner Dugan concurs.

ISSUE

Whether the Division of Taxation properly determined additional sales and use taxes due from petitioners for the period December 1, 1985 through November 30, 1988.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

On November 8, 1989, the Division of Taxation ("Division") issued to Gifts by Gallego,

Inc. ("Gifts") a Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period December 1, 1985 through November 30, 1988. Said notice stated a total tax due of \$66,365.82, penalty of \$18,604.77 and interest of \$22,098.30 for a total amount due of \$107,068.89. On the same date, a second Notice of Determination and Demand for Payment of Sales and Use Taxes Due was issued to Gifts for the period December 1, 1985 through November 30, 1988, setting forth penalty due in the sum of \$6,636.61. Both notices indicated that the tax assessed thereon had been estimated in accordance with the provisions of Tax Law § 1138(a)(1).

Also on November 8, 1989, two notices of determination and demands for payment of sales and use taxes due were issued to Thomas Padavona, as officer of Gifts by Gallego, Inc., for the same periods applicable to the corporation. The first notice indicated a total tax due of \$66,365.82, penalty of \$18,604.77 and interest of \$22,098.30, for a total amount due of \$107,068.89. The second notice set forth penalty due of \$6,636.61 for the same period. Once again there was an explanation on both notices indicating that the tax assessed had been estimated in accordance with the provisions of Tax Law § 1138(a)(1).

On or about October 19, 1988, the Division began an audit of the business of Gifts, a manufacturer of furniture made from PVC tubing which was cut and glued together and covered with material. The business was located at 175-41 Liberty Avenue, Jamaica, New York.

On October 20, 1988, the Division sent Gifts an appointment letter indicating that Gifts' sales and use tax returns for the period September 1, 1985 through August 31, 1988, had been scheduled for a field audit on November 22, 1988.

The letter went on to state that all books and records pertaining to Gifts' sales tax liability for the period under audit should be available on November 22, 1988, including "journals, ledgers, sales invoices, purchase invoices, cash register tapes, federal income tax returns and exemption certificates." The letter also stated that Gifts might be required to furnish additional records and/or information during the course of the audit.

Attached to said letter was a "records requested for sales tax audit" checklist, which requested records for the audit period September 1, 1985 to August 31, 1987. This checklist specifically called for Federal income tax returns for "the past two years," sales, purchase and expense invoices for the year 1987, and guest checks and register tapes for the year 1987. Item "11" on the checklist indicated that additional information might be required. Resale certificates supporting nontaxable sales also were specifically requested on this attached sheet.

An entry in the auditor's log, dated December 27, 1988, indicated that the audit period had been adjusted to the period December 1, 1985 through November 30, 1988. Apparently, a delay in the first appointment date of over one month prevented an audit of the period commencing September 1, 1985 and the audit period was extended one month as a balance. However, there was no evidence that a request for books and records was ever made, either written or oral, for the period September 1, 1988 through November 30, 1988.

The auditor made a survey of the business premises on November 1, 1988, the survey indicated a large warehouse which housed other businesses as well as Gifts. The businesses besides Gifts listed on the door included "World of Cellini", "Money Promotions, Inc.", and "Customize Cushions Corp.". The relationship between these companies and to petitioners was not disclosed.

The premises housed a manufacturing operation and a showroom area surrounded by offices.

An audit was finally performed at petitioners' accountant's office on December 27, 1988. The auditor was presented with a box of materials. Federal tax returns for the fiscal years ended April 30, 1985 and 1986 were produced but no return for 1987 was ever produced. Petitioners produced an accounts receivable worksheet for the period December 1985 through August 1987 and a worksheet containing purchases for the period December 1985 through May 1988. Petitioners also produced some purchase invoices for PVC material used in the production of furniture and some sales invoices issued to major shops selling retail to the public. Resale

certificates for these specific invoices were on file. It was generally found on audit that these particular items agreed with sales scheduled. However, when a comparison of the sales and purchases recorded was made to the Federal returns a large discrepancy was indicated. Sales reported as reflected on petitioners' worksheets indicated \$185,979.00 as opposed to the Federal income tax return which reported \$498,798.00 in sales. Purchases recorded as reflected by petitioners' worksheets indicated \$88,930.00 as compared to the Federal income tax returns which reported purchases of \$364,366.00. When petitioners' accountant was asked to explain the discrepancy, he did so in a letter dated December 21, 1989, which set forth the following:

"My records and those of my client indicate that the Total Sales amounts as reported on the Sales Tax Returns were in fact estimates. Estimates were used as a result of incomplete records being available at the time of filing. These estimates were based on cash receipts and therefore did not take into account either timing differences, or items that were not in fact sales. As my client's business operation consists of manufacturing and sale for resale of PVC furniture and therefore does not involve any taxable sales, the decision was made to file Sales Tax Returns based on the estimates rather than not filing or filing late. You, yourself, have mentioned to me that your visit to my client's place of business indicated that there were was [sic] no indication of any retail (taxable) sales operation taking place."

Based upon this information, the auditor decided to assess based upon petitioner's bank deposit information,¹ since bank deposits were the only item for which petitioner had proof (original source documentation). The Division deemed all deposits nontaxable sales. The auditor took the two available Federal tax returns and used the sales figures thereon as gross sales and subtracted the bank deposits as nontaxable sales yielding taxable sales figures. He divided the figure by two to get an average year and multiplied by three for the audit period. For the period December 1, 1985 through November 30, 1988, taxable sales were deemed to be \$804,435.00 yielding additional tax due of \$66,365.89. Penalty and interest were also assessed and omnibus penalty was assessed due to the fact that there was an omission of additional tax greater than 25% of audited tax due.

Petitioner's representative, Mr. David Feinblum, C.P.A., testified at hearing that he was

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The bank statements were in the name of Gifts by Gallego, Inc., Manufacturer's Hanover Trust Company Account No. 153 0613051 65.

unable to produce invoices of purchases or sales at the time of the audit and that there was confusion with regard to sales figures set forth on sales tax returns filed for the period in issue. Mr. Feinblum did not have records available at formal hearing, but was given an opportunity to submit documentation after the hearing to explain the large discrepancy between sales and purchases as recorded on petitioner's worksheets and those reflected on the Federal income tax returns for the years ended April 30, 1985 and 1986. Petitioner submitted partial sets of invoices for the fiscal year ended April 30, 1986 and for the period May 1, 1986 to November 30, 1988. It is noted that the sales invoices were not from Gifts By Gallego, Inc. but rather from an entity known as Cellini PVC located at 175-41 Liberty Avenue, Jamaica, New York, the same address listed for petitioner. Additionally, the more recent invoices note that Cellini PVC is a "subsidiary of Gifts By Gallego, Inc." However, no evidence was submitted to explain the relationship between the entities.

Other evidence submitted by petitioner post hearing included adding machine tapes which totalled the attached sales invoices for the fiscal year ended April 30, 1986. The totals were more than \$100,000.00 less than sales reported on the Federal income tax return for the same period. Similarly, the purchase invoices submitted by petitioner for the same period (indicating purchases by Cellini PVC, not petitioner) totalled \$302,855.67, while the Federal return for the same period reported \$348,938.00 for cost of goods sold.

There is no evidence in the record with regard to the corporate structure of Gifts By Gallego, Inc., or its relationship with any other corporation with which it might have had a sales or marketing relationship. There was no explanation as to how the goods were transferred to "subsidiary" corporations, if in fact that was the method by which Gifts marketed its product. Further, there was no evidence offered with regard to how other related corporations might have reported their sales, or whether separate bank accounts were utilized by those corporations. Additionally, no additional resale certificates were produced after hearing.

OPINION

In the determination below, the Administrative Law Judge held that because petitioners'

records were inadequate, the Division was authorized to estimate the sales and use tax liability of petitioners based on external indices. The Administrative Law Judge also noted that petitioners conceded the inadequacy of their records not only when they filed their returns, but on audit, at the hearing, and after the hearing.

The Administrative Law Judge also held that the Division was generous in giving full credit as nontaxable sales to petitioners' bank deposits (the only source documentation presented relating to petitioners' receipts) even though petitioners could not establish through the corporation's records that such deposits were nontaxable sales.

The Administrative Law Judge further held that: 1) since the documentation submitted after the hearing did not satisfactorily explain the discrepancy between the amount of sales allowed per deposits and the sales stated on petitioners' Federal income tax returns, the additional tax assessed by the Division was proper; 2) petitioners' poor recordkeeping practices left the Division no choice but to estimate the tax liability of petitioners; and 3) the Division's audit methodology was proper and reasonable.

Finally, the Administrative Law Judge cancelled the assessment for the quarter ending November 30, 1988 holding there was no request by the Division for books and records for that period, but in all other respects the Administrative Law Judge denied the petition and sustained the four notices of determination and demand for payment of sales and use taxes due dated November 8, 1989.

On exception, petitioners argue that "Cellini PVC" was a trademark used by petitioner Gifts by Gallego, Inc., petitioners and "Cellini PVC" were one and the same, and the auditor was advised of this fact.

Petitioners argue that they disagree with the auditor's calculation of sales alleging it did not take into account a decline in business operations, further arguing that in an attempt to supplement said decline, a new affiliated corporation, Sunrise Patio Furniture, Inc., was set up to sell petitioners' products at retail.

Petitioners further argue that: 1) the post-hearing invoices presented to the Administrative

Law Judge more accurately depict the true sales for the audit period; 2) constant cash flow problems existed; and 3) records indicate that in excess of \$200,000.00 in payments were made directly to suppliers and not to petitioners.

Petitioners' brief on exception included:

Exhibit "A" (a copy of a Cellini PVC check)

Exhibit "B" (a copy of a resale certificate)

Exhibit "C" (copies of various checks)

Petitioners request that the Administrative Law Judge's determination be reversed, modified or that the case be allowed to be reopened.

The Division argues that the Administrative Law Judge was correct in his finding that there is no proof in the record of any relationship between petitioner Gifts by Gallego, Inc. and Cellini PVC as well as his determination that the auditor used a reasonable method of calculating the total taxable sales of petitioners.

The Division further argues that: 1) the record does not establish that petitioners' business activity suffered a decline; 2) the Administrative Law Judge correctly determined that the data relied upon by the auditor was more reliable than the invoices submitted post-hearing by petitioners; 3) the auditor used a reasonable measure in determining unreported taxable sales; and 4) the exception of petitioners should be denied and the determination of the Administrative Law Judge should be affirmed.

The Division also argues that two exhibits, namely Exhibit "A" and Exhibit "C" which were attached to petitioners' brief should not be considered by this Tribunal as they were introduced into this proceeding for the first time on exception and cannot be introduced after the record has been closed.

Petitioners' brief in reply alleges that:

"[a]ll information submitted at the time of the filing of the brief in support of exception is evidence previously submitted to the auditor at the time of audit or evidence submitted to the Administrative Law Judge in response to his request at the time of hearing."

Petitioners' brief in reply also requests that the Tribunal apply the evidence submitted to

either reverse or modify the determination of the Administrative Law Judge.

We find no basis in the record before us for modifying the determination of the Administrative Law Judge in any respect. Therefore, we affirm the determination of the Administrative Law Judge for the reasons stated in said determination.

However, we must address petitioners' attempt to place before this Tribunal additional evidence in the form of copies of checks which are not part of the record below.

In calling the hearing to order, Administrative Law Judge Pinto stated:

"[i]n this file I only have the Petition and Answer. Anything you might have already submitted to the audit division prior to today or to the conference unit must be resubmitted if you wish for me to use it in reaching my determination in this matter" (Tr., p. 3).

In closing the hearing, and addressing petitioners' representative, the Administrative Law Judge stated:

"[o]nce I close this hearing today I will accept nothing further other than the documentation I have given you 30 days to present" (Tr., p. 41).

While petitioners argue that all the information submitted with their briefs is evidence previously submitted to the auditor or evidence submitted to the Administrative Law Judge in response to his request at the time of the hearing, a review of the record discloses that only Exhibit "B," the resale certificate, is in the record as part of the field audit report presented by the Division at the time of the hearing. No checks were submitted in evidence as part of the field audit report, the record before the Administrative Law Judge, or as part of petitioners' post-hearing submission authorized by the Administrative Law Judge.

We reject petitioners' attempt, at this late date, to introduce new evidence after the record has been closed. As we held in Matter of Schoonover (Tax Appeals Tribunal, August 15, 1991):

"[i]n order to maintain a fair and efficient hearing system, it is essential that the hearing process be both defined and final. If the parties are able to submit additional evidence after the record is closed, there is neither definition nor finality to the hearing. Further, the submission of evidence after the closing of the record denies the adversary the right to question the evidence on the record. For these reasons we must follow our policy of not allowing the submission of evidence after the closing of the record (see, Matter of Oggi Rest., Tax Appeals Tribunal, November 30, 1990; Matter of Morgan Guar. Trust Co. of N.Y., Tax Appeals Tribunal, May 10, 1990; Matter of International Ore & Fertilizer Corp., Tax Appeals Tribunal, March 1, 1990; Matter of Ronnie's Suburban Inn, Tax Appeals Tribunal, May 11, 1989; Matter of Modern Refractories Serv. Corp., Tax Appeals Tribunal,

December 15, 1988)" (Matter of Schoonover, supra).

As previously stated, we find no basis in the record before us for modifying the Administrative Law Judge's determination in any respect.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Gifts by Gallego, Inc. and Thomas Padavona, as officer, is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petition of Gifts by Gallego, Inc. and Thomas Padavona, as officer, is granted to the extent set forth in conclusion of law "B" of the Administrative Law Judge's determination and except as so granted, the petition is in all other respects denied; and
4. The Division of Taxation is directed to modify the four notices of determination and demand for payment of sales and use taxes due, dated November 8, 1989, issued against Gifts by Gallego, Inc. and Thomas Padavona, as officer, in accordance with conclusion of law "B" of the Administrative Law Judge's determination, but such notices are otherwise sustained.

DATED: Troy, New York
December 23, 1993

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

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