

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
MOUNTAIN STAR COMPANY, INC.	:	DECISION
for Redetermination of a Deficiency or for Refund of	:	DTA NOs. 820630,
Corporation Franchise Tax under Article 9-A of the Tax	:	820631, AND 820632
Law for the Period June 1, 1998 through May 31, 2002.	:	

In the Matter of the Petition	:	
of	:	
MOUNTAIN STAR COMPANY, INC.	:	
for Revision of a Determination or for Refund of Sales	:	
and Use Taxes under Articles 28 and 29 of the Tax Law	:	
for the Period September 1, 1999 through May 31, 2002.	:	

In the Matter of the Petition	:	
of	:	
MOUNTAIN STAR COMPANY, INC.	:	
for Revision of a Determination or for Refund of Tax	:	
on Cigarettes and Tobacco Products under Article 20	:	
of the Tax Law for the Period September 1, 1999	:	
through May 31, 2002.	:	

Petitioner, Mountain Star Company, Inc., and the Division of Taxation, filed exceptions to the determination of the Administrative Law Judge issued on January 18, 2007. Petitioner appeared by Peter J. Murphy, CPA. The Division of Taxation appeared by Daniel Smirlock, Esq. (Jennifer A. Murphy, Esq., of counsel).

Petitioner and the Division of Taxation each filed briefs in support of their exception, briefs in opposition and reply briefs. Oral argument, at the request of both parties, was heard on September 17, 2007 in New York, New York.

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

ISSUES

I. Whether the audit method employed by the Division of Taxation was reasonable or whether petitioner has shown error in either the audit method or result.

II. Whether the Division of Taxation properly determined additional corporation franchise tax due.

III. Whether the Division of Taxation properly determined additional tax due on cigarettes and tobacco products.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for findings of fact "4," "5," and "6" which have been modified. The Administrative Law Judge's findings of fact and the modified findings of fact are set forth below.

Petitioner, Mountain Star Company, Inc., is a retailer of tobacco products, tobacco accessories, cigarettes, candy, gift items, drug store products, flashlights, lighters, batteries, soda, newspapers and magazines. The size of the business operation is approximately 4,000 square feet, with approximately 2,500 square feet being used directly in the retail business. Petitioner dedicated space at the rear of the store for tobacco products and has installed humidifiers to keep the products fresh. Behind the tobacco shop, petitioner has an office and two storage rooms. Petitioner provides parking at both the front and rear of the store and customers may enter the

premises from either location. The business is located at 412 Hillside Avenue, New Hyde Park, New York, and is open seven days a week from 7:30 A.M. to 9:30 P.M.

Mr. Yung K. Myung is president and a 50% shareholder of petitioner. His wife, Maryann Myung, holds the other 50% of the stock of the corporation.

On April 23, 2002, the Division issued to petitioner a letter indicating that a sales and use tax audit of petitioner's books and records for the period March 1, 1999 through February 28, 2002 was scheduled for May 15, 2002. The letter requested that all books and records pertaining to petitioner's sales and use tax liability for the period under audit were to be made available on the appointment date. These records were to include financial statements, accountant's work papers, journals, ledgers, sales invoices, purchase invoices, cash register tapes, exemption certificates, Federal income tax returns, New York State income tax returns, documentation to substantiate all business expenses deducted, sales and use tax returns, cigarette and tobacco tax returns and Federal and New York State personal income tax returns for all officers and owners of the business and all business checking account bank statements with checks written.

During the audit period, petitioner reported gross and taxable sales based on cash register tapes. At the end of each day petitioner would print a daily summary report and prepare a schedule based on the cash register tape totals. The schedule summarized the daily sales for each sales tax quarter and petitioner would then report sales revenue on the sales and use tax returns based upon the summary schedule.

We modify finding of fact "4" of the Administrative Law Judge's determination to read as follows:

The Division introduced in evidence an affidavit dated December 20, 2005 of its principal auditor, Saeed Siddiqui, to which are attached his log of work on the audit and other work papers. The affidavit states, "Jeet Jaikissoon, whose title

is Tax Auditor I, assisted me in all aspects of this audit.” The affidavit also includes the following statements:

7. Records that were requested but not provided include detailed cash register tapes describing what was sold per each transaction and guest checks.
8. Petitioner was able to produce such documents as purchase invoices, schedules supporting pre-paid sales tax, MT-203 returns and cash register tapes that only consisted of daily totals by department.
9. The cash register tapes did not detail each and every individual sales transaction. Not only were they not adequate source sales documentation, these summarized tapes had inconsistencies. On a test period check (3/1/01 – 5/31/01) there was an ending meter reading (NRGT) for March 8, 2001 lower than the beginning meter reading for that day and there were many void transactions on the summarized daily cash register tapes which could not be verified due to the non-availability of detailed daily cash register tapes.
10. After reviewing the documents provided, petitioner’s sales records were deemed inadequate because petitioner’s source documentation was deemed unreliable and inadequate. Records were also deemed inadequate when a review of from [sic] a third party supplier showed purchases exceeded sales.

The Audit Report attached to the affidavit as Exhibit B includes the following statement:

Taxpayer couldn’t provide the detailed cash register tapes showing each and every individual transaction and he had no explanations of the various adjustments reflected on the summarized tapes.

Petitioner’s petition contradicts the foregoing statements as follows:

As part of its business . . . taxpayer maintains books and records to support the amounts appearing on the Sales Tax returns filed. Such records include originals of daily cash register tapes, and daily summaries of sales, which are then summarized and used to enter the total sales on the Sales Tax returns. . . . All of these records were made available to the NYS Sales Tax auditors in the course of their audit. (Underscoring added.)

The Division’s lead auditor on the case, Saeed Siddiqui, apparently left the employ of the Division in December 2005 and did not testify at the hearing. Instead, Jeet Jaikissoon, a more junior auditor who assisted Mr. Siddiqui, testified

as to the audit methodology and explained Mr. Siddiqui's affidavit and the accompanying audit report.¹

We modify finding of fact "5" of the Administrative Law Judge's determination to read as follows:

Soo J. Chin testified on behalf of petitioner that she is the daughter of Mr. Myung and worked from time to time in the store. She provided a detailed description of the operation of the cash register and explained the entries on samples of the cash register tapes which were introduced as petitioner's Exhibit 3. That exhibit consists of a copy of a tape on which each entry is marked with the date and time, the nature of the merchandise sold (*e.g.*, "packs," "carton," "candy," "cigar"), the purchase price, the amount of tax applicable to the transaction, the payment presented by the customer, and the amount of change returned to the customer. There are about one hundred entries on the sample tape beginning with an entry numbered 4077 at 2:00 pm on December 24, 1999 and ending with an entry numbered 4181 at 3:39 pm on December 24, 1999. She testified about her conversations with Mr. Siddiqui, including the following:

Q. Have you ever met Mr. Siddiqui?

A. Have I ever talked to Mr. Siddiqui?

Q. Yes.

A. In the past?

Q. Yes.

A. He was at the store during the summer, and I was there visiting my parents because I don't see them that often, and he was there. He was questioning certain items, and I explained everything to him, and he seemed fine with that at the time.

Q. What did you explain to him?

A. He was asking me about certain items were being voided and stuff like that, and he was asking me why and what it meant. I said, "Void encompasses refunds in case the customer does not have money." Say he bought a piece of candy 55 cents, I'm going to charge 55 cents, he looks in his pocket, he does not have his wallet, so what happens, I void out the transaction as if it doesn't exist.

¹ We have modified finding of fact "4" to more fully reflect the record.

The same with refunds. A lady came by, bought a card yesterday, she decided she got a better card somewhere else, so she's going to return it to me, and I void that transaction. All mistakes, refunds and exchanges, it goes under void, it's like it never happened. I got my merchandise back, the customer got their money back. It's easier that way.

Q. Was he aware that there were these kinds of tapes?

A. Yes, I told him and showed him everything. He actually came up to the register and watched me punch out certain items with customers there, and I showed him how the number popped up and everything, and he was very satisfied (Tr., pp. 84, 85).

On cross examination the Division questioned Ms. Chin about the cash register tapes as follows:

Q. Do you know where these cash register tapes are kept in the business?

A. Where the tapes –

Q. Are stored.

A. The old ones?

Q. Yes.

A. It goes by month. My father collects them per month, puts them in a rubber band, as you can see over there, and he puts it away.

Q. Is there a file cabinet where they are kept?

A. He puts it in a box.

Q. On a shelf?

A. Yes (Tr., pp. 88, 89).

Following the testimony of Ms. Chin, Mr. Myung testified at length about his bookkeeping practices, including his preparation of daily books based on the detailed daily cash register tapes (Tr., pp. 91-105).

He also testified about his payment practices with respect to suppliers. Finally, Young Choi, the certified public accountant who prepared sales tax returns and

personal and corporate tax returns testified about how the returns for the audit period were prepared (Tr., pp. 105-109).²

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

The Division performed an analysis of purchases and reported taxable sales for the period December 1999 through May 2001, which revealed that purchases were consistently higher than reported sales. The auditor requested that Center Candy, Inc., a supplier of petitioner, provide the amount of sales to petitioner on a monthly basis. These purchases were compared to reported taxable sales and revealed that the amount of purchases was more than the reported sales for the entire audit period. The Division determined that petitioner's books and records were inaccurate and unreliable for the purpose of verifying petitioner's taxable sales and therefore determined to estimate petitioner's sales tax liability using a purchase markup method. The auditor chose the test periods of December 1, 1999 through February 29, 2000 and March 3, 2001 through May 31, 2001. Petitioner's representative agreed with the auditor that these periods were representative of the business operation for the entire audit period.³

The third-party verification received from Center Candy, Inc. agreed with the purchases submitted by petitioner to the auditor for both test periods. This third-party information was therefore used for the entire audit period to determine audited purchases. The tobacco purchases used were based upon the purchases reported on petitioner's MT-203 tax returns.

The auditor added to the purchases of Candy Center, Inc., as indicated on the third-party information, the tobacco purchases from other suppliers as indicated on the MT-203 returns, which list tobacco suppliers and purchases separately. For the entire audit period, reported sales of \$1,743,076.00 were less than total audited purchases of \$2,539,578.32.

A review of the summary cash register tapes revealed that petitioner also sold nontobacco items such as soda, candy, magazines, newspapers and greeting cards. The auditor computed a

² We have modified finding of fact "5" to more fully reflect the record.

³ We have modified finding of fact "6" to more fully reflect the record.

percentage of 3.18% representing the ratio of miscellaneous sales to total sales for the test period. Audited purchases from Center Candy, Inc. and other tobacco suppliers was multiplied by 3.18% to arrive at total audited purchases for the audit period. A markup was then applied to purchases.

A 16.35% markup was determined based upon a weighted average markup of the actual markups determined for cigarettes (10.88%) and tobacco (100%) using information from petitioner's own internal records and a 40% agreed upon markup for candy. This 16.35% markup was applied to audited purchases of cigarettes, tobacco and candy to arrive at audited sales for these items. A 50% markup was applied to the miscellaneous sales to determine audited sales. The 50% markup was based on audit experience.

The auditor computed under reported taxable sales by subtracting reported taxable sales from total audited taxable sales. Total under reported taxable sales were divided by reported taxable sales to determine an error rate for computing audited taxable sales for each of the three years under audit. The applicable error rate was applied to the sales tax reported by quarter to arrive at additional taxable sales and additional sales tax due for each quarter. Total additional audited taxable sales for the audit period was \$988,579.49.

On June 20, 2003, the Division issued to petitioner a Notice of Determination assessing sales and use tax due of \$84,029.27, plus penalty and interest, for the period March 1, 1999 through May 31, 2002.

The auditor reviewed the schedules supporting gross receipts as reported on petitioner's U.S. corporation income tax returns, Form 1120. The purchases as reported on the forms 1120 were not consistent with the purchase information obtained during the sales and use tax audit. The Division resorted to the markup audit to determine petitioner's corporation franchise tax liability. Sales as determined on the sales tax audit were deemed gross receipts. Petitioner's

purchases were recomputed by adding purchases per the third-party information obtained from Center Candy, Inc. to purchases from other sources as determined from petitioner's tobacco tax returns. Purchases of other products were determined to be 3.49% of cigarette and tobacco purchases. Beginning inventory per the Federal forms 1120 was added to purchases and then ending inventory per the Federal forms 1120 was subtracted to compute the costs of goods sold. Based upon these computations, it was determined that petitioner owed additional corporation franchise tax and MTA surcharge tax. As a result, the Division issued to petitioner, on June 26, 2003, two notices of deficiency assessing corporation franchise tax of \$33,717.00 and general business corporation MTA surcharge of \$6,210.00, for the period June 1, 1998 through May 31, 2002.

The auditor reviewed petitioner's purchases for the two test periods (December 1, 1999 through February 29, 2000 and March 1, 2001 through May 31, 2001), which revealed actual purchases of cigarette and tobacco products of \$23,470.89, while petitioner had reported purchases of \$22,397.00 for the test periods. The difference of \$1,073.89 was comprised of purchases from SAG Imports, Inc. in the amount of \$919.89 and from CAO International, Inc. in the amount of \$154.00 during the month of May 2001. Purchase invoices from SAG Imports, Inc., dated May 25 and 30, 2001 indicated the amount of the purchases. An error rate of 4.79% was computed and then multiplied by the purchases of tobacco as reported on petitioner's distributor of tobacco products tax returns for the audit period to determine audited tobacco purchases. Tobacco purchases reported were subtracted from audited tobacco purchases to arrive at additional tobacco purchases for the audit period.

The auditor also determined that petitioner had overstated its prepaid sales tax on cigarette and tobacco purchases for the two test periods. The error rate computed was applied to the tax-

paid purchases claimed on petitioner's tobacco tax returns to arrive at total cigarette and tobacco products on which no sales tax had been paid.

As a result of the additional tobacco purchases and nonpayment of tax on purchases, the Division issued to petitioner a Notice of Determination, dated June 23, 2003, assessing tax on cigarettes and tobacco products for the period September 1, 1999 through July 31, 2002 of \$2,933.51, plus penalty and interest.

On May 15, 2002, petitioner executed a Consent Extending Period of Limitation for Assessment of Corporation Franchise Tax under Article 9-A of the Tax Law for the taxable period June 1, 1998 through May 31, 1999 to August 15, 2003. On October 16, 2002, petitioner executed a Consent Extending Period of Limitation for Assessment of Cigarette and Tobacco Tax under Article 20 of the Tax Law for the taxable period September 1, 1999 through May 31, 2000 to June 30, 2003. On December 4, 2002, petitioner executed a Consent Extending Period of Limitation for Assessment of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the taxable period September 1, 1999 through August 31, 2000 to September 20, 2003.

In a letter dated May 23, 2006, SAG Imports, Inc. stated that petitioner's last purchase of cigars occurred on August 8, 1999. The letter further indicated that petitioner did make purchases after that date, but SAG Imports, Inc. received the shipments back, and credited petitioner's account. Mr. Myung testified that the items were returned because SAG Imports, Inc. refused to agree to the payment arrangement requested by petitioner. Two invoices from CAO International, Inc., dated October 16, 2001 and December 30, 2002, indicated that the supplier credited petitioner's account a total of \$1,299.35. Mr. Myung testified that petitioner was credited with \$154.00 in purchases made during May 2001 because the goods delivered from CAO International, Inc. were damaged and returned to the supplier.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge found that in response to the Division's request for petitioner's books and records, petitioner provided only purchase invoices, schedules supporting prepaid sales taxes, tax returns and summary cash register tapes, but did not provide detailed source documentation such as detailed cash register receipts or guest checks. Moreover, the Administrative Law Judge accepted the auditor's analysis of purchases and reported sales as revealing purchases to be consistently higher than purchases. Based on this alleged discrepancy and the lack of source documentation, the Administrative Law Judge determined that the Division properly concluded that petitioner's records were incomplete and inaccurate and reasonably used a mark-up estimation method based in part on information from petitioner's suppliers to determine petitioner's sales for the audit period. He found, however, that the Division had failed to request petitioner's books and records for the period March 1, 2002 through May 31, 2002 and accordingly cancelled the assessments of sales and use tax and corporation franchise tax for this period. He also cancelled the assessment of tax on tobacco products to the extent of \$1,073.89 based on credit for purchases returned to the supplier.

With respect to the imposition of penalties, the Administrative Law Judge found that petitioner did not establish that its failure to pay the correct amount of tax was due to reasonable cause and accordingly determined that the penalties imposed by the Division should not be abated.

ARGUMENTS ON EXCEPTION

Petitioner argues in support of its exception that it maintained adequate books and records and made available to the auditor detailed cash register tapes and that the Division accordingly was not justified in using an estimation procedure in determining petitioner's tax liability.

Moreover, petitioner asserts that an excess of purchases over sales has no significance because it fails to take into account opening and closing inventories and may be explained by a build-up of inventories during the audit period. In addition, some of the purchased stock was sent to another store under common ownership.

The Division argues that the Administrative Law Judge correctly determined that petitioner's records were inadequate and that it was justified in applying an estimation method in determining petitioner's liability for sales and use taxes, franchise taxes and cigarette taxes. The Division also takes exception to the Administrative Law Judge's conclusion that the Division must determine that a taxpayer's records are inadequate before using estimates to determine franchise tax due.

OPINION

The standard for reviewing a sales tax audit where external indices were employed is as follows: The Division must first request and thoroughly examine the taxpayer's books and records for the entire period of the proposed assessment. The purpose of the examination is to determine, through verification drawn independently from within these records, whether they are in fact so insufficient that it is virtually impossible for the Division to verify taxable sales receipts and conduct a complete audit from which the exact amount of tax due can be determined. Where the Division follows this procedure, and thereby demonstrates that the records are incomplete or inaccurate, the Division may resort to external indices to estimate tax. The estimate methodology utilized must be reasonably calculated to reflect taxes due, but exactness in the outcome of the audit method is not required. The taxpayer bears the burden of proving with clear and convincing evidence that the assessment is erroneous or that the audit methodology is unreasonable. In addition, considerable latitude is given an auditor's method of

estimating sales under such circumstances as exist in each case. (*see, Matter of Your Own Choice*, Tax Appeals Tribunal, February 20, 2003).

There is a substantial conflict in the factual evidence presented at the hearing on the issue of the adequacy of petitioner's records. The Division introduced the affidavit of its lead auditor, Mr. Siddiqui, which included the assertion that petitioner's source documents, namely detailed cash register tapes, were not made available to him. The affidavit also states that Mr. Siddiqui was assisted by Mr. Jaikissoon "in all aspects of the audit." This statement was contradicted by the testimony of Mr. Jaikissoon, the only witness presented at the hearing by the Division, who testified that his only direct role was the review of certain purchase invoices and not the source documents presented by petitioner (*see*, Hearing Tr., pp. 26-27). The remainder of Mr. Jaikissoon's testimony consists almost entirely of explanations of various computation schedules attached to Mr. Siddiqui's audit report and is accordingly of little probative value on the issue of whether petitioner maintained and made available to the auditor detailed source documents from which its tax liability could be determined.

At the hearing, petitioner presented three witnesses. Ms. Chin, who worked in petitioner's shop from time to time, testified in considerable detail about her conversations with Mr. Siddiqui during the audit on the subject of the transactional cash register tapes. She was able to explain how the tapes provided several types of information about each transaction. Her testimony contained corroborative details explaining cancelled or no-sale entries on the tapes supporting the assertion that no transactions would have been made that were not rung up. Mr. Myung, the owner of petitioner and Ms. Chin's father, testified with respect to the bookkeeping practices by which the detailed source information was summarized in a day book and also testified that he paid for all inventory by company check. Finally, Mr. Choi, petitioner's certified public

accountant, provided information about the conduct of petitioner's business and the preparation of its tax returns. None of this testimony was seriously challenged on cross examination. The testimony of petitioner's witnesses is consistent and credible and leaves the reader with the impression of an enterprise in which an effort was made to comply with the record-keeping required by the tax law. If the Administrative Law Judge found that the demeanor of the witnesses or other factors detracted from their credibility, he has failed to say so. Checking thousands of small transactions involving a pack of cigarettes or a candy bar is doubtless a task of grinding tedium. It cannot be avoided, however, by an arbitrary assertion that adequate books and records were unavailable. Nevertheless, there was no testimony or other evidence that detailed cash register tapes for the entire audit period were actually presented to the auditor.

Even if petitioner maintained detailed source documents and otherwise had internally consistent records, it was appropriate for the auditor to test the accuracy of those records by obtaining information from other sources. Thus, in *Roebling Liqs. v. Commissioner of Taxation and Fin.*, 284 AD2d 669 (2001), the court held that the Division was justified in relying on purchase data from wholesalers in determining that the taxpayer's apparently complete records were inadequate. Here, purchase information received from petitioner's suppliers consistently showed purchases in excess of sales and in excess of purchases reflected on petitioner's Federal income tax returns.

There are various circumstances that might explain an excess of purchases over sales. For example, inventory accounting is generally applied on an annual basis; while sales taxes are reported on a quarterly basis. As a result, inventories may be built up or drawn down during a quarter in a way that is not symmetrical with the annual calculations. Also, a business may be slow to adjust its purchases to reflect a slowing velocity of turnover resulting from changes in the

business cycle. In this case, petitioner asserts that the excess of purchases over sales can be explained by increases in closing inventory. However, the auditor's calculations set forth in Schedule C-G to his audit report (Division's Exhibit "J") are tied into petitioner's years ending May 31 and the closing inventory amounts on petitioner's Federal income tax returns on IRS Form 1120 for each of the years ending in 2000, 2001, and 2002. Petitioner observes that the total reported cost of goods sold for those three years was \$1,861,325.00 and reported sales for the period were \$1,963,236.00, indicating that sales exceeded cost of goods sold—a more appropriate comparison than purchases (*see*, Petitioner's brief in support, pp. 7-8). What petitioner fails to note, however, is that when the additional audited purchases are added, the cost of goods sold for the period rises to \$2,571,424.89—an amount substantially exceeding reported sales (*see*, Division's Exhibit J, Schedule C-G). We are unable to find in the record an explanation for these differences. Accordingly, we think the auditor was justified in concluding that petitioner's books and records were inadequate and that an estimation method should be applied to determine petitioner's tax liability.

The Division took exception to the Administrative Law Judge's cancellation of petitioner's franchise tax liability of the period March 1, 2002 to May 31, 2002. The Division argues that the rigorous rules of the *Chartair* case (65 AD2d 44 [1978]), including the requirement that the Division make specific requests for the taxpayer's records, do not apply to franchise tax audits citing *Hennekens v. State Tax Commn.*, 114 AD2d 599 (1985), and *Matter of R & J Automotive*, Tax Appeals Tribunal, June 15, 1989.

The distinction relied on by the Division was articulated by the Tribunal in *Matter of Rujak Trucking Corp.*, Tax Appeals Tribunal, April 1, 1993, as follows:

In determining petitioner's franchise tax for the years at issue, the Division calculated New York gross earnings by multiplying petitioner's gross earnings by the percentage of miles driven in New York, which was ascertained by examining petitioner's mileage records for the fourth quarter of 1987. These mileage reports were used in the Division's test period audit of highway use tax. In asserting that the Division's method of assessment lacked a rational basis, petitioner urges us to apply the standard used to determine when a sales tax assessment may be estimated. This standard prohibits the use of a test period audit unless the taxpayer's records are inadequate to permit a complete audit (Matter of Chartair, Inc. v. State Tax Commn., 65 AD2d 44 [1978]; Matter of Mohawk Airlines v. Tully, 75 AD2d 249 [1980]). Tax Law § 1138(a)(1), which provides the statutory foundation for this standard, states that the Division shall determine the amount of tax due "from such information as may be available [and] [i]f necessary, the tax may be estimated on the basis of external indices" (emphasis added). This statutory language has been characterized as conferring upon a taxpayer the right to have his sales tax liability determined from the records which the taxpayer is required by law to maintain (Matter of Chartair, Inc. v. State Tax Commn., *supra*, 411 NYS2d 41, 43 [1978]; *see*, Tax Law §§ 1131[1], 1135; 20 NYCRR 533.2).

In urging that a similar standard be applied in the franchise tax area, petitioner argues that because the Division had no evidence that its records would not accurately reflect income, the Division's failure to examine these records renders the assessment invalid. A necessary corollary of this argument is that when complete records exist, the Division must perform a complete examination of these records to determine the amount of franchise tax due, even where the taxpayer has failed to file a return. However, this argument ignores the critical distinction between section 1138(a)(1) and its franchise tax counterpart, section 1081(a). Section 1081(a) provides that if a taxpayer required to file a franchise tax return fails to do so, "the [Division] is authorized to estimate the taxpayer's New York tax liability from any information in its possession" (emphasis added). Unlike section 1138(a)(1), section 1081(a) contains no preconditions to the Division's use of estimate techniques. In our view, if the Legislature's intention was to require a complete examination of a non-filing corporation's records before estimation techniques are permitted, it would have stated this intention within section 1081(a).

Similarly, in *Matter of R & J Automotive*, Tax Appeals Tribunal, June 15, 1989, we sustained a franchise tax deficiency and held that the audit standards required in sales and use tax cases was inapplicable, stating as follows:

Both the Division and petitioners have erroneously argued that the audit methodology required here is that applicable to sales and use tax audits. In a sales and use tax audit, resort to external indices as a method of computing sales tax liability must be founded upon a determination of the insufficiency of the taxpayer's record keeping which makes it virtually impossible to verify sales receipts and conduct a complete audit (Chartair, Inc. v. State Tax Commn., 65 AD2d 44 [1978]). This standard, requiring demonstrably inadequate records before an indirect auditing technique may be used, has been explicitly rejected in audits of income for personal income, non-resident earnings and unincorporated business taxes (Matter of Giuliano v. Chu, 135 AD2d 893 [1987]; Matter of Hennekens v. State Tax Commn., 114 AD2d 599 [1985]). The distinction between an income tax audit and a sales tax audit centers on the type of tax being imposed (Hennekens v. State Tax Commn., *supra*). While sales tax audits seek recovery of taxes imposed directly upon verifiable receipts as evidenced by books and records which are required to be maintained (Matter of Licata v. Chu, 64 NY2d 873, 874 [1985]) audits involving the imposition of tax on income concern the receipt of income which cannot easily be verified by reference to books and records (Matter of Hennekens v. State Tax Commn., *supra*).

Petitioner's response to this assertion by the Division is that since the additional franchise tax liability is based on the figures that the Division developed during the course of the sales tax audit, the law governing sales tax audits, as articulated in *Chartair*, should apply (*see*, Petitioner's Reply Brief, p. 17). We think that the law is clear that the Division is not required to meet the standards of *Chartair* and similar cases in asserting a deficiency of franchise tax and thus was justified in determining petitioner's income for the period March 1, 2002 to May 31, 2002 based on an estimation technique. We accordingly reverse the determination of the Administrative Law Judge to sustain the imposition of the franchise tax for that period.

Accordingly, it is ORDERED, ADJUDGED, and DECREED that:

1. The exception of Mountain Star Company, Inc. is denied;
2. The exception of the Division of Taxation is granted;

3. The determination of the Administrative Law Judge is reversed in accordance with paragraph "2" above, but is otherwise affirmed;

4. The petitions of Mountain Star Company, Inc. are granted to the extent indicated in conclusions of law "H" and "J" of the determination of the Administrative Law Judge and, except as so granted, the petitions are in all other respects denied;

5. The Notices of Determination dated June 20, 2003 and June 23, 2003, respectively, are modified in accordance with paragraph "4" above; and

6. The Notices of Deficiency dated June 26, 2003 are sustained.

DATED: Troy, New York
March 13, 2008

/s/ Charles H. Nesbitt
Charles H. Nesbitt
President

/s/ Carroll R. Jenkins
Carroll R. Jenkins
Commissioner

/s/ Robert J. McDermott
Robert J. McDermott
Commissioner