

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
VALLEY STREAM BEVERAGES, INC.	:	DECISION
	:	DTA NO. 821117
for Revision of a Determination or for Refund of	:	
Sales and Use Taxes under Articles 28 and 29 of the	:	
Tax Law for the Period December 1, 1999 through	:	
November 30, 2002.	:	

Petitioner, Valley Stream Beverages, Inc., filed an exception to the determination issued by the Administrative Law Judge on November 8, 2007. Petitioner appeared by Lawrence R. Cole, CPA. The Division of Taxation appeared by Daniel Smirlock, Esq. (Peter B. Ostwald, Esq., of counsel).

Petitioner filed a brief in support of its exception. The Division of Taxation filed a brief in opposition. Petitioner filed a reply brief. Oral argument, at the request of petitioner, was held on July 7, 2008 in Troy, New York.

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

ISSUES

I. Whether petitioner had complete books and records, thereby rendering the Division of Taxation's use of a test period audit method improper.

II. Whether petitioner has established any facts or circumstances warranting the reduction or abatement of penalties imposed.

FINDINGS OF FACT

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

Petitioner, Valley Stream Beverage, Inc., sold beverages at retail and wholesale. Petitioner sold mostly beer and soda. It also sold ice and miscellaneous items such as iced tea. Petitioner's president and sole shareholder was at all relevant times Michael Fredericks.

From 1995 through August 2000, Mr. Fredericks was also the sole shareholder of Turnpike Beverage, Inc. ("Turnpike Beverage"), a similar beverage business, located about two miles from petitioner's business premises. In August 2000, Mr. Fredericks sold all of his shares in Turnpike Beverage to Andrej Podgorski. Mr. Podgorski continued to operate Turnpike Beverage until May 2002, when he sold the business to VIP, Inc. VIP, Inc., continued to operate the business from the same location and continued to do business as "Turnpike Beverage."

On December 10, 2002, the Division of Taxation ("Division") sent a letter to petitioner scheduling an appointment to commence a sales and use tax field audit of petitioner's business for the period December 1, 1999 through November 30, 2002. The Division's letter requested that all of petitioner's books and records pertaining to sales tax liability for that period be available for review. Among the records specifically requested in an attached Records Requested List were the general ledger, cash receipts journal, Federal income tax returns, purchase invoices, sales invoices, bank statements, and exemption documents. By letter dated May 20, 2003, the Division specifically requested that petitioner make available cash register tapes and wholesale invoices for the audit period, as well as any resale certificates or exemption certificates. Additionally, by letter dated March 17, 2004, the Division requested original wholesale invoices

and exemption documents for the quarter ended November 2002 and petitioner's original wholesale daybook. The letter noted that copies of such wholesale invoices and pages from a wholesale daybook for the quarter ended November 2002 had been previously provided.

In response to the Division's requests, among other records, petitioner produced monthly summary worksheets, which contained entries for beer, soda, ice, miscellaneous (e.g., iced tea) sales, bottle deposits, bottle returns, checks, charges, and cash. Petitioner did not produce detailed cash register tapes to verify the amounts listed on the monthly worksheets. The cash register tapes that were produced were summary tapes that did not indicate the item being sold. The monthly worksheets also contained entries for wholesale deposits. Petitioner did not ring wholesale sales through the cash register. Petitioner did not produce its wholesale daybook.

Petitioner also provided the Division with its sales tax returns and the Division compared gross sales as reported on the sales tax returns with gross sales as listed on the monthly worksheets. This comparison showed that gross sales as listed on the monthly worksheets were greater than gross sales as reported on the sales tax returns. Additionally, taxable sales as listed on the monthly worksheets were greater than taxable sales as reported on the sales tax returns.

Based on the lack of detailed cash register tapes, the resulting inability to verify the monthly worksheets, the fact that all sales were not rung through the cash register, and the differences between gross and taxable sales per the monthly worksheets and the sales tax returns, the Division concluded that petitioner's records were inadequate for the purpose of verifying taxable sales and therefore decided to estimate petitioner's sales tax liability for the audit period using a test period methodology.

The Division selected the sales tax quarter September 1, 2002 through November 30, 2002 as the test period. As a starting point, the Division deemed petitioner's bank deposits and cash

payroll as indicated by petitioner's annual W-3 forms (Transmittal of Wage and Tax Statements) to be gross sales.¹ As determined in this manner, petitioner's gross sales for the test period were \$240,350.38. From this amount, the Division subtracted \$117,657.00, petitioner's taxable sales reported during the test period. The resulting difference, \$122,693.38, was deemed claimed nontaxable sales. Of this amount, the Division allowed \$1,020.81 for sales of nontaxable beverages (e.g., iced tea). Petitioner presented exempt organization certificates and resale certificates with respect to test period sales invoices totaling \$68,697.34. Upon review, the Division determined that such exemption documentation was insufficient and, therefore, disallowed an exemption with respect to \$58,311.99 of such invoices. The Division allowed an exemption with respect to \$10,385.35 of such invoices. Petitioner presented no exemption documentation for the remaining \$52,975.23 in deemed claimed nontaxable sales; such sales were therefore determined to be taxable. The Division, thus, disallowed a total of \$111,287.22 in claimed nontaxable receipts for the test period. The Division calculated a disallowance rate of 90.70 percent based on the ratio of total disallowed nontaxable receipts to total claimed nontaxable receipts for the test period. The Division then determined petitioner's claimed nontaxable sales for each quarter of the audit period, calculated as previously described (bank deposits plus cash payroll less reported taxable sales), and applied the 90.70 percent disallowance rate to claimed nontaxable sales for each quarter. These calculations resulted in additional taxable sales and, ultimately, additional tax due of \$126,025.57 for the audit period.

Of the \$68,697.34 in test period receipts for which exemption documentation was submitted, \$54,014.00 were receipts for sales to Turnpike Beverage.

¹ It is noted that petitioner's bank deposits closely correspond to gross sales as indicated by petitioner's general ledger. Indeed, the Division's workpapers reveal that throughout the audit period petitioner's bank deposits total \$3,237,742.73 and sales per the general ledger total \$3,231,580.29, a difference of about .2 percent.

On November 8, 2004, following the audit, the Division issued to petitioner a Notice of Determination that assessed \$126,025.57 in additional tax due, plus interest and penalties, for the period December 1, 1999 through November 30, 2002. The penalties assessed in the notice were imposed pursuant to Tax Law §1145(a)(1)(i) and (vi) (an omission of an amount greater than 25 percent of the tax due).

Following a conciliation conference, the Division's Bureau of Conciliation and Mediation Services issued a Conciliation Order dated March 3, 2006, which reduced the assessment at issue to \$81,482.91, plus penalties and interest. The reduction results from the use of lower rates of disallowance for claimed nontaxable sales. For the period December 1, 1999 through February 28, 2002, the Division used a rate of disallowance of 70.26 percent to calculate additional taxable sales. Several factors contributed to this lower disallowance rate. First, the test period starting point of gross sales, determined as previously noted, was reduced by \$36,000.00 because of a recalculation (and correction) of the cash payroll for the three-month test period. Second, claimed nontaxable sales for the test period were reduced by allowances for bottle deposits and cigarette taxes. Third, a sale of \$601.60 to an exempt organization, previously disallowed, was allowed. All of the sales to Turnpike Beverage remained disallowed. For the period March 1, 2002 through November 30, 2002, the Division used a rate of disallowance of 14.40 percent. In addition to the factors noted above, this disallowance rate resulted from the allowance of sales to Turnpike Beverage as nontaxable sales for resale.

During the course of the audit, on June 16, 2003, petitioner presented the Division with two resale certificates (Form ST-120) listing petitioner as the seller and Turnpike Beverage as the purchaser. These certificates were incomplete as neither was dated, neither indicated whether it was a single-use or blanket certificate as required on the form, and neither contained information

describing the business of the purchaser as required on the form. Both did list a sales tax certificate of authority number for Turnpike Beverage and both purport to bear the signature of Mr. Podgorski as president of Turnpike Beverage.

Later during the audit, on or about August 2, 2004, petitioner provided the Division with additional resale certificates with respect to Turnpike Beverage. Specifically, petitioner provided a completed blanket resale certificate with a handwritten date of June 16, 2000 indicating purchases for resale by Turnpike Beverage from petitioner. This certificate was signed by Mr. Podgorski and had the certificate of authority number and the business information regarding Turnpike Beverage. Also at that time, petitioner provided a completed blanket resale certificate dated May 5, 2002 listing petitioner as the seller and VIP, Inc. as the purchaser.

Still later, on August 19, 2004, petitioner provided an additional completed blanket resale certificate with a handwritten date of July 1, 2004 listing petitioner as the seller and Turnpike Beverage as the purchaser.

Petitioner regularly made sales to Turnpike Beverage throughout the audit period. Petitioner's owner, Mr. Fredericks, made these sales to save on costs, as he could get a better price from suppliers by purchasing in greater volume. Mr. Fredericks started this practice when he owned both petitioner and Turnpike Beverage and continued it when Mr. Podgorski owned Turnpike Beverage, and later when VIP, Inc., owned the business (*see*, findings of fact above). It was a simple matter to load Turnpike Beverage's purchases in a van for the short five-minute ride to Turnpike Beverage.

A review of the invoices reflecting the \$54,014.00 in purchases during the test period made by VIP, Inc., doing business as Turnpike Beverage, shows 20 separate purchases during the three-month period in amounts ranging from \$1,493.91 to \$5,111.69. The purchases are almost

all beer, mostly in large quantities. Typical of such purchases is an invoice dated September 3, 2002, which totaled \$3,611.85. Among the items listed on this invoice are 75 Budweiser 30-packs, 70 Coors Light 30-packs, 25 Busch 30-packs, 16 Budweiser 12-packs, 12 Michelob Light 12-packs, 10 Bud Light 30-packs, 10 Bud Ice 30-packs, 10 Budweiser 18-packs, and smaller quantities of several other brands of beer.

Petitioner was previously audited by the Division for the period December 1, 1994 through May 31, 1999. During that audit the Division determined that petitioner's sales tax records were inadequate because cash register tapes did not indicate the item being sold. This audit resulted in an agreed assessment of \$22,203.00 in additional sales tax due. During the period of the prior audit, petitioner made significant sales to Turnpike Beverage, which it claimed were exempt from sales tax as sales for resale. The Division accepted such claimed nontaxable status in the prior audit. The audit report indicates that, in the prior audit, wholesale sales were tested and allowed.

Although, as noted, Mr. Fredericks sold all of his shares in Turnpike Beverage to Andrezej Podgorski in August 2000, and Mr. Podgorski operated Turnpike Beverage until May 2002. Mr. Fredericks remained the owner associated with Turnpike Beverage's sales tax identification number on the Division's records until Turnpike Beverage, Inc. filed its final return in May 2002.

Petitioner's reported taxable sales for the audit period totaled \$1,591,971.00. The modified assessment, adjusted pursuant to the Conciliation Order dated March 3, 2006, asserts \$958,622.32 in additional taxable (or disallowed nontaxable) sales. Hence, penalties under Tax Law §1145(a)(1)(vi) for an omission of an amount greater than 25 percent of the tax due remain applicable.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

In his determination, the Administrative Law Judge concluded that petitioner's books and records were inadequate and that the Division was authorized to conduct its audit using an appropriate methodology to arrive at estimated sales tax.

Most of the assessment involved sales to wholesalers. Although during the audit, petitioner was unable to provide all the resale certificates, petitioner was able to produce such documentation at the hearing, and coupled with the testimony of Mr. Fredericks, the Administrative Law Judge determined that petitioner did establish that it regularly sold product to Turnpike Beverage in order to save on costs and that petitioner had been making such sales to Turnpike Beverage during the period that he owned both businesses, subsequently when Mr. Podgorski owned Turnpike Beverage and still later when VIP, Inc. owned the business. In light of this evidence, the Administrative Law Judge directed the Division to adjust the assessment by allowing such sales as nontaxable. The Division did not take an exception to this conclusion.

Lastly, the Administrative Law Judge addressed the issue of penalties asserted pursuant to Tax Law § 1145(a)(1)(i) and (vi). The first subparagraph imposes a penalty on any person failing to file or pay over any sales tax. Such penalty may be canceled if the failure was due to reasonable cause and not due to willful neglect. Such penalty was sustained since petitioner's assertion that it maintained adequate books and records, in light of the conclusion by the Administrative Law Judge that petitioner did not, failed to establish reasonable cause for its failure to pay taxes and, as such, the Administrative Law Judge upheld the imposition of penalty under Tax Law § 1145(a)(1)(i).

However, with respect to the penalty imposed pursuant to subparagraph (vi), the Administrative Law Judge noted that this penalty is imposed upon any person who omits from

the total amount of tax required to be shown on a sales tax return, an amount in excess of 25 percent of such total amount. Since the Administrative Law Judge determined that a major portion of the assessment was adjusted based upon his allowance of the nontaxable sales, the amount of tax now due and owing was not in excess of 25 percent of the total due and, thus, such penalty was canceled.

ARGUMENTS ON EXCEPTION

In its exception, petitioner continues to maintain that it provided adequate books and records. Petitioner claims that its cash register tapes accurately reflected total taxable sales because the nontaxable sales were not rung up on the register. Petitioner reasons that since the Administrative Law Judge found that sales to Turnpike Beverage were, in fact, nontaxable, it follows that every amount reflected on the cash register summary tapes were necessarily taxable sales. Following this analysis, petitioner argues that all there is left to look at are its books and records, which are adequate. Therefore, it argues that the Division was not authorized to use any estimate audit methodology and, thus, the assessment and remaining penalty should be canceled.

The Division argues in opposition that petitioner did not provide adequate books and records to substantiate its reported sales. The Division states that the cash register tapes were not detailed. The Division maintains that it could not verify sales as recorded on the monthly work sheets. Therefore, the Division asserts that petitioner has not sustained its burden to show that it is entitled to further adjustments to the modified assessment.

OPINION

After a thorough and careful review of the record in this matter, we find that the Administrative Law Judge adequately and correctly dealt with the issues raised by petitioner herein. Petitioner has presented no basis for us to modify the determination in any respect.

Therefore, we affirm the determination of the Administrative Law Judge for the reasons stated therein.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Valley Stream Beverages, Inc. is denied;
2. The determination of the Administrative Law Judge is sustained;
3. The petition of Valley Stream Beverages, Inc. is granted to the extent set forth in conclusions of law "C" and "F" of the Administrative Law Judge's determination, but in all other respects is denied; and
4. The Division of Taxation is directed to adjust the Notice of Determination dated November 8, 2004, as modified pursuant to the Conciliation Order dated March 3, 2006, and as further modified in accordance with paragraph "3" above.

DATED: Troy, New York
January 8, 2009

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

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

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