STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
CLIFTON LIQUOR CORP.	:	
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 June 1, 2001 through February 29, 2004.	:	DECISION DTA Nos. 821405 and 821560
In the Matter of the Petition	:	
of	:	
JOSE CEPEDA	:	
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 June 1, 2001 through February 29, 2004.[1]	:	

Petitioners, Clifton Liquor Corp. and Jose Cepeda, filed an exception to the determination of the Administrative Law Judge issued on July 23, 2009. Petitioners appeared by Leonard L. Fein, CPA. The Division of Taxation appeared by Daniel Smirlock, Esq. (Lori P. Antolick, Esq., of counsel).

Petitioners filed a brief in support of their exception. The Division of Taxation filed a brief in opposition. Petitioners filed a reply brief. Oral argument, at petitioners' request, was heard on September 15, 2010, in New York, New York.

[1] Since consents extending the statute of limitations were not executed by petitioner Jose Cepeda for the period June 1, 2001 through August 31, 2002, the Division of Taxation concedes that it does not have authority to pursue the tax for these periods from Mr. Cepeda.

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

*ISSUE*S

I. Whether the audit methodology used by the Division of Taxation was reasonably calculated to determine the sales tax liability for Clifton Liquor Corp. and its owner Jose Cepeda during the period in issue.

II. Whether the Division of Taxation properly imposed penalties in this matter.

FINDINGS OF FACT

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

Petitioner Clifton Liquor Corp. (Clifton Liquor), doing business as Rand Liquor, is a liquor store located at 1029 Bedford Avenue, Brooklyn, New York. Located on a corner, the physical size of the store is approximately 20 feet by 80 feet, and two people were observed by a Division of Taxation employee to be working in the store. All of the liquor and the cash register are surrounded by glass walls, such that they cannot be touched by the public. Petitioner Jose Cepeda, a native of the Dominican Republic who spoke little English, was an officer of the corporation during the period in issue. There is no dispute as to his status as a responsible officer. Although the Division of Taxation's (Division) audit of Clifton Liquor focused on the sales of liquor, petitioners' representative disclosed at the hearing that petitioners' primary business was a check-cashing business, with liquor sales as a secondary business.

The Division sent correspondence to petitioners, dated February 25, 2004, scheduling a field audit appointment for March 11, 2004 at petitioners' place of business. The appointment letter requested that all books and records pertaining to petitioners' sales and use tax liability for

the period under audit, June 1, 2001 through November 30, 2003, be available for review. A list of records to be presented included sales tax returns, worksheets and canceled checks, federal income tax returns and New York State corporation franchise tax returns, general ledger, general journal and closing entries, sales invoices and all exemption documents supporting nontaxable sales, a chart of accounts, fixed asset purchases and expense purchase invoices, bank statements, canceled checks and deposit slips for all accounts, cash disbursements journal, cash register tapes and guest checks for the entire audit period. The letter also advised petitioners to have:

> an owner, officer or employee with personal knowledge of your business operations attend the opening conference, even if a representative will be present. A firsthand explanation will help to eliminate possible misunderstandings and will provide quick answers to help establish the initial audit plan.

The Division of Taxation (Division) then sent correspondence to petitioner Clifton Liquor, dated June 30, 2004, scheduling a field audit appointment for July 8, 2004 at its place of business. The appointment letter requested that all books and records pertaining to petitioner's sales and use tax liability for the period under audit, June 1, 2001 through February 29, 2004, be available for review. A list of records to be presented included the same records previously requested.

In response to the Division's request for books and records, Clifton Liquor provided some of its bank statements for the period December 18, 2001 through January 16, 2002, bank deposits for October 17, 2001 through November 16, 2001, the general ledger for 2001 and merchandise inventory for 2003. The Division later received a sheet listing some expenses, without actual bills, a few monthly bank statements and about 80 canceled checks, many of which were for large sums of money ranging from $10,000.00 to $100,000.00, payable to a variety of unidentified individuals. The Division's auditor could not reconcile these checks with any of the

scant business records. The Division's auditor made a determination that the books and records were insufficient to conduct a detailed audit.

The Division submitted into evidence a schedule of returns filed, based upon sales tax returns filed for Clifton Liquor during the audit period. Gross sales, equal in this case to taxable sales, for the period June 1, 2001 through February 29, 2004, as reported by petitioners were $2,420,434.00, with sales tax paid in the amount of $200,379.77.

At the commencement of an audit, as a part of its routine practice of auditing liquor stores, and the practice it followed in this case, the Division issued letters to known wholesale wine and liquor suppliers who provided wine and liquor to Clifton Liquor, requesting that they provide the Division with the amount of beverages purchased by the corporation during the period in issue.

The third-party liquor vendors contacted by the Division provided the following information between March and June 2004 as to sales made to Clifton Liquor during the audit period:

Third-party vendor	**Purchases during the audit period**
Royal	$15,992.00
Paramount Eber	520,400.00
Peerless	3,941,342.00
5 Star Fine	15,093.00
OPICI Wine	57,636.00
Grant & Son	32,931.00
Premier Gallo Wine	1,276,706.00
Charmer	3,692,910.00
Batavia	17,175.00
TOTAL	**$9,570,184.00**

When it became apparent that Clifton Liquor's books and records were inadequate to perform a detailed audit, the Division used third-party supplier information to estimate Clifton Liquor's taxable wine and liquor sales for the audit period. The Division determined that petitioner's total purchases of wine and liquor during the period in issue were $9,570,184.00. The Division calculated a markup percentage from the liquor store industry average gross profit (29.7%), derived from the Robert Morris Associates Annual Statement Studies (Financial Ratio Benchmarks for 2002-2003), for a business with sales in a range equivalent to petitioners' business during the audit period. The Division applied the calculated markup percentage of 29.7% to these purchases, to arrive at estimated taxable sales of $12,412,528.65, from which the Division subtracted petitioner's reported taxable sales of $2,420,434.00, resulting in additional taxable sales of $9,992,094.65, and additional sales tax due of $827,913.85. The Division additionally assessed both statutory and omnibus penalties based upon the significant underreporting of sales.

A Consent Extending the Period of Limitations for Assessment of Sales and Use Taxes was executed by Clifton Liquor, to cover the taxable periods June 1, 2001 through February 29, 2004, and determine an assessment of tax on or before December 20, 2005. A similar consent, however, was not executed by petitioner Jose Cepeda.

The Division issued a Notice of Determination, dated March 7, 2005, which assessed additional sales and use taxes in the amount of $827,913.85, plus penalties and interest, for a total of $1,777,503.94, for the period June 1, 2001 through February 29, 2004 (Assessment ID L-025107506-6) to petitioner Clifton Liquor. The Division issued a Notice of Determination, dated December 5, 2005, which assessed additional sales and use taxes in the amount of $827,913.85,

plus penalties and interest, for a total of $1,982,674.89, for the period June 1, 2001 through February 29, 2004 (Assessment ID L-025107506-6) to petitioner Jose Cepeda (see footnote 1).

Petitioner submitted into evidence what was described as a physical inventory listing, taken by Clifton Liquor employees on December 31, 2003, listing inventory totaling $2,009,457.79. No invoices supporting purchases of this inventory or other documents supporting the same were submitted.

In order to support petitioners' assertion that the markup on wine and liquor was considerably less than the 29.7% determined by the Division, petitioners' representative introduced 15 purchase invoices predominantly from 2007, with several from 2005 and 2006, of liquor purchases by Clifton Liquor. Sales documentation was introduced that included register tapes that petitioners created several days before the hearing on October 23 and 24, 2007. The register tapes bearing Clifton Liquor's name and address, identified the liquor, size of the bottle, and a selling price, in addition to bearing the words "For Quotation, NOT For Sales." By determining the number of bottles purchased from these invoices and utilizing the sales prices on the register tapes previously described, petitioners calculated total sales generated from the 15 purchase invoices to be $430,428.26. Also generated from the 15 invoices was the total purchases for the same liquor, $397,280.20, the difference of which represented the gross profit from these invoices of $33,148.06. Petitioners divided the gross profit by the total purchases to determine the markup on the liquor of 8.3%.

No purchase invoices or sales records from the audit period were submitted.

Common practice in the liquor industry during the audit period was a practice referred to as "bill and hold." Companies such as Clifton Liquor would take advantage of special pricing in a particular month, but not necessarily take delivery at the same time. The vendors would store

the purchases in their warehouses and generally prepare invoices, but leave the invoices open for some period of time.

The Division submitted into evidence correspondence dated December 7, 2004, addressing the value of goods put into storage with Charmer by Clifton Liquor during 2003. The letter stated, "The total value of goods put into storage in 2003 was $100,126.13." Attached to the letter was a printout of liquor and wine items placed in storage between April 30, 2003 and December 31, 2003, with a listing of the per case and total pricing, showing a grand total of $101,126.13. No other information concerning the bill and hold policy, or the date until which the product was held, was submitted with this information.

Atlantic Wines and Spirits, a division of Empire Merchants, issued a statement concerning its bill and hold policy as it concerns petitioners. Prepared June 30, 2008, it states:

> This letter is to confirm and verify that Clifton Liquor Corp. DBR [*sic*] Rand Liquor at 1029 Bedford Avenue, Brooklyn, New York 11205 stored cases of liquor in our licensed warehouse in accordance of our Bill & Hold policy prior to February 28, 2004. The cases purchased by Rand Liquor (Peerless Customer # 026263) cost in excess of $1,643,319.00 were store [*sic*] in our warehouse at 16 Bridgewater Street, Brooklyn, New York 11222 and had not yet been delivered to Rand Liquor. At that time the invoices were open and had not been paid.

After the first day of the hearing in this matter, petitioners requested subpoenas from the administrative law judge for several of the third-party vendors' records and in order to elicit testimony clarifying the purchases relied upon for the assessment. The administrative law judge prepared subpoenas for Empire Merchants (the successor to Peerless and Charmer), Premier Wine & Spirit (the successor to Premier Gallo Wine), and Southern Wine and Spirits (the successor to Eber's product line and later to Gallo). Petitioners' representative offered proof of service of such subpoenas.

On the second day of the hearing, March 13, 2008,[2] Rosemarie Mills of Southern Wine and Spirits (Southern), appeared in response to one of the subpoenas to testify. She established that Gallo became Premier Wine and Spirits (Premier), which was later purchased by Southern. Ms. Mills further established that as to the third-party verified purchases by Clifton Liquor, any volume discounts permitted by the vendor were reflected in the amount provided, and there were no bill and hold or other storage charges that were not taken into account in the amounts as reported by the company, since during the audit period any storage was charged by an outside company and separately billed.

Approximately two weeks after the second day of hearing concluded, a package was delivered to the administrative law judge with documents that were the subject of a subpoena issued by petitioners to Empire Merchants, the successor to Charmer Industries and Peerless Importers, Inc., two of the vendors from whom Clifton Liquor purchased product during the audit period. There was no cover letter or explanation of the contents. The records appeared to be a listing of purchases by Clifton Liquor during the audit period, as well as for periods outside the audit time frame. Since these documents were mislaid in transit from Empire, petitioners were given an opportunity to offer the documents into the record, time to obtain an affidavit of explanation from Empire or request that the hearing be reopened for testimony from an official of Empire familiar with the documents. Petitioners' representative opted to have the hearing re-opened and issued another subpoena to Empire in order to elicit an explanation of a discrepancy between the documents mailed pursuant to the prior subpoena and the vendor information obtained directly from each of the companies in 2004. At the reopened hearing, no representative from Empire appeared to clarify the documents, and they were submitted as

[2] This matter was rescheduled twice at the request of petitioners' representative due to eye surgery and resulting complications.

mailed, without explanation, showing purchases by Clifton Liquor during the audit period of approximately $2.7 million.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge noted that, as vendors, petitioners were required to maintain complete, adequate and accurate books and records of their sales tax liability and make such records available for audit by the Division upon request. The Administrative Law Judge found that the Division made a proper request and, upon review, properly determined that the records were insufficient to accurately determine taxable sales or conduct a full audit.

As a result, the Administrative Law Judge held that the Division was authorized to use an estimated audit method, so long as such method was reasonably calculated to reflect the taxes due. The Administrative Law Judge noted that, in the absence of records, the Division properly resorted to external indices and the resulting audit was supported by a rational basis.

The Administrative Law Judge observed that the burden rested with petitioners to present clear and convincing evidence that the audit method chosen by the Division led to unreasonably inaccurate results or that the amount of tax assessed was wholly inaccurate. The Administrative Law Judge fully considered petitioners' arguments and concluded that neither cancellation nor adjustment to the assessed tax was warranted.

The Administrative Law Judge further held that petitioners failed to adduce any information demonstrating that the failure to pay the appropriate amount of tax was due to reasonable cause and not willful neglect.

ARGUMENTS ON EXCEPTION

On exception, petitioners argue that the Administrative Law Judge erred in rejecting their arguments below. Petitioners challenge the audit employing the same arguments as below,

namely that the audit based upon external indices should be disregarded in favor of a markup percentage and that the auditor erred by not accounting for certain items, such as bill and hold stock, as well as ending inventory. Petitioners contend that the Division's case relies upon "pieces of paper." Petitioners also argue that, even if the assessment is upheld, penalties should be abated because petitioner, Jose Cepeda, is of foreign-birth and Clifton Liquor was his first business.

In opposition, the Division argues that the Administrative Law Judge was correct in determining that the audit was proper, and upholding the assessment of taxes due and the imposition of penalties. The Division maintains that petitioners provided no books, records, nor other credible testimony to warrant any adjustment in the assessment.

OPINION

Every person required to collect tax must maintain and make available for audit upon request records sufficient to verify all transactions in a manner suitable to determine the correct amount of tax due (***see*** Tax Law § 1135[a]; 20 NYCRR 533.2[a]). Failure to maintain and make available such records, or the maintenance of inadequate records, will result in the Division's estimating tax due.

To determine the adequacy of a taxpayer's books and records, the Division must first request and thoroughly examine the taxpayer's books and records for the entire period of the proposed assessment (***see Matter of Adamides v. Chu***, 134 AD2d 776 [1987], ***lv denied*** 71 NY2d 806 [1988]; ***see also Matter of King Crab Rest. v. Chu*** 134 AD2d 51 [1987]). The purpose of such an examination is to determine whether the records are so insufficient as to make it virtually impossible to verify taxable sales receipts and conduct a complete audit. Where the Division follows this procedure, thereby demonstrating that the records are incomplete or

inaccurate, it may resort to external indices to estimate tax (***see Matter of Urban Liqs. v. State Tax Commn.***, 90 AD2d 576 [1982]). When estimating sales tax due, the Division must adopt an audit method that will reasonably calculate the amount of taxes due (***Matter of W.T. Grant Co. v. Joseph***, 2 NY2d 196 [1957], ***cert denied*** 355 US 869 [1957]), but exactness in the audit results is not required (***see Matter of Markowitz v. State Tax Commn.,*** 54 AD2d 1023 [1976], ***affd*** 44 NY2d 684 [1978]).

The taxpayer bears the burden of proving with clear and convincing evidence that the assessment is erroneous (***Matter of Scarpulla v. State Tax Commn.***, 120 AD2d 842 [1986]) or that the audit methodology is unreasonable (***Matter of Surface Line Operators Fraternal Org. v. Tully,*** 85 AD2d 858 [1981]). In addition, "[c]onsiderable latitude is given an auditor's method of estimating sales under such circumstances as exist in [each] case" (***Matter of Grecian Sq. v. New York State Tax Commn.***, 119 AD2d 948, 950 [1986]). Whether the audit method used was "reasonably calculated to reflect the taxes due" (***Matter of W.T. Grant Co. v. Joseph, supra,*** at 206) can only be determined based on information made available to the auditor before the assessment is issued (***see Matter of Queens Discount Appliances***, Tax Appeals Tribunal, December 30, 1993; ***see also Matter of House of Audio of Lynbrook***, Tax Appeals Tribunal, January 2, 1992).

A review of the record reveals that the Administrative Law Judge properly reviewed the Division's audit. The Division issued proper requests for books and records from petitioners. Our review of the matter shows that the Division properly determined that the supplied records were unsuitable to verify taxable sales from Clifton Liquor. Where a proper request and examination reveals that the taxpayer's records are incomplete or inaccurate, the Division may properly estimate the additional tax due, if any (***see Matter of Urban Liqs. v. State Tax Commn.,***

supra). We find that the Division's use of external indices was reasonable, given the complete absence of reliable source documentation.

We find that the evidence presented by petitioners fails to show by clear and convincing evidence that the audit results are inaccurate. The Administrative Law Judge properly discounted the Empire Merchant data. This information was acquired after the audit period and entered into the record without explanation by petitioners. While petitioners attack the auditor's analysis of the data, they failed to offer a reliable explanation of the information. Petitioners' arguments regarding bill and hold stock, as well as ending inventory, were properly rejected because they lack a factual basis within the record. We see no reason to disturb the ruling of the Administrative Law Judge on these arguments. The Division is under no obligation to recreate books and records that a taxpayer fails or refuses to present. Any imprecision in the audit results arises by reason of petitioners' failure to maintain adequate books and records as required by Tax Law § 1135(a)(1), and must be borne by the taxpayers (***see Matter of Markowitz v. State Tax Commn., supra***).

Tax Law § 1145(a)(1)(i) authorizes the imposition of penalty for failure to pay any tax imposed under Articles 28 and 29 of the Tax Law. However, penalty may be abated if the failure to pay tax was due to reasonable cause and not due to willful neglect (***see*** Tax Law § 1145[a][1][iii]). Petitioners bear the burden of demonstrating the basis for an abatement of penalty. Petitioner Jose Cepeda's national origin and business inexperience simply do not present reasonable cause for failing to follow the law. Ignorance is not reasonable cause to abate penalty (***see Genesee Brewing Co. v. Village of Sodus Point,*** 126 Misc 2d 827, 834 [1984], ***affd*** 115 AD2d 313 [1985]; ***accord Matter of Nathel v. Commissioner of Taxation and Fin.***, 232 AD2d 836 [1996] [ignorance of the law is no excuse and a taxpayer is charged with knowledge

of the law, including subsequent judicial interpretation thereof]). Therefore, we agree with the Administrative Law Judge that petitioners did not meet their burden to show that their failure to pay tax was due to reasonable cause and not due to willful neglect.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Clifton Liquor Corp. and Jose Cepeda is denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petitions of Clifton Liquor Corp. and Jose Cepeda are denied; and

4. The Notice of Determination dated March 7, 2005 is sustained and the Notice of Determination dated December 5, 2005 is sustained as modified in accordance with footnote 1.

DATED: Troy, New York
March 10, 2011

/s/ James H. Tully, Jr.
James H. Tully, Jr.
President

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

/s/ Charles H. Nesbitt
Charles H. Nesbitt
Commissioner