STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
STRAIGHT PATH SERVICE STATION, 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 December 1, 1999 through November 30, 2004.	:	DECISION DTA NO. 821621

Petitioner, Straight Path Service Station, Inc., filed an exception to the determination of the Administrative Law Judge issued on December 30, 2008. Petitioner appeared by David L. Silverman, Esq. The Division of Taxation appeared by Daniel Smirlock, Esq. (Osborne K. Jack, Esq., of counsel).

Petitioner filed a brief in support of its exception. The Division of Taxation filed a letter brief in opposition. Petitioner filed a reply brief. Oral argument, at petitioner's request, was heard on October 14, 2009 in Troy, New York.

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

ISSUES

I. Whether the Administrative Law Judge correctly determined that the Division of Taxation was entitled to use an estimated audit methodology to determine petitioner's sales and use tax liability for the period in issue.

II. Whether the Administrative Law Judge correctly determined that petitioner failed to demonstrate reasonable cause for the abatement of penalties asserted by the Division of Taxation pursuant to Tax Law § 1145.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge, except for finding of fact "8," which has been modified. The Administrative Law Judge's findings of fact and the modified finding of fact are set forth below.

During the period December 1, 1999 through November 30, 2004 (the period in issue), petitioner operated service stations in Franklin Square, Huntington Station and West Babylon, New York, making sales of gasoline, diesel fuel, cigarettes, and miscellaneous convenience store items. Only the West Babylon location had a mini market, while the other locations sold merchandise from booths located near the gasoline pumps.

The Division of Taxation ("Division") began its audit of petitioner on October 4, 2002, when it mailed petitioner an appointment letter and a request for books and records for the period December 1, 1999 through August 31, 2002 with respect to petitioner's sales and use tax liability. The letter specifically requested all books and records pertaining to sales and use tax liability and made reference to a detailed list of records it wished to examine at the appointment. The letter also stated that additional records and information might be requested.

The "records requested list" attached to the October 4, 2002 letter included the following documents and information for the entire audit period: sales tax returns; worksheets and cancelled checks; federal income tax returns; New York State corporation tax returns; the general ledger; general journal and closing entries for the entire audit period; sales invoices; exemption documents; chart of accounts; fixed asset purchase and sales invoices; expense purchase

invoices; merchandise purchase invoices; bank statements, canceled checks and deposit slips; cash receipts journal; cash disbursement journal; corporate book; financial statements; power of attorney; depreciation schedules; other locations and their respective functions. At no time during the pendency of the audit of petitioner were all of these records produced at one time for inspection.

The first auditor assigned to the case, Jennifer D. Buscemi, contacted petitioner's representative, Steven Schneiderman, CPA, and arranged to meet him at his office on November 27, 2002. At that time, she was presented only with copies of the federal income tax returns for the audit period, sales and use tax returns and related schedules and worksheets for the period March 2001 through August 2002, the year-end trial balances for 2001 and 2002 and purchases as demonstrated by check disbursements. It was not disclosed in the record when petitioner or its representative informed the Division that it maintained no original source documentation for its sales of gasoline, diesel or kerosene. However, Mr. Schneiderman told Ms. Buscemi that he did not have the records requested available for inspection and that producing them would have been too voluminous and "almost impossible." Further, since petitioner maintained no source documentation of its sales, there was no documentation of sales produced for the first meeting with the auditor. Mr. Schneiderman never had records for the first seven months of the audit period to offer the Division.

Utilizing the information supplied by Mr. Schneiderman at the November 27, 2002 meeting, the auditor analyzed gross sales and attempted a purchases reconciliation for the years 2001 and 2002. After finding additional missing information, Ms. Buscemi made an additional request for records from Mr. Schneiderman by letter, dated January 9, 2003. Ms. Buscemi requested copies of the sales and use tax returns for the period December 1, 1999 through

February 28, 2001, the 1999 and 2000 income statements, invoices for fixed assets purchased during the audit period, three months of purchases paid for by check for the period March 1, 2002 through May 31, 2002 (the test period) and six months of cash purchases as listed on petitioner's sales tax return worksheets for the period March 1, 2002 through August 31, 2002.

As noted, petitioner maintained no original source documentation for sales, such as cash register tapes, sales invoices or cash receipts journals, and instead it filed its sales tax returns for the period in issue on the basis of purchases of petroleum products. Although the opening and ending inventory amounts were available to petitioner, only purchase information was used to estimate sales, while opening and ending inventory amounts were assumed to be equal and inconsequential over time. This created a discrepancy between the gallons petitioner determined to be sales and sales calculated by the Division, which utilized petitioner's inventory figures, purchases and pump prices to arrive at the monthly and quarterly sales during the test period.

A subsequent meeting took place between Ms. Buscemi and Mr. Schneiderman on May 21, 2003, at which the auditor received missing sales tax return information and gas purchase invoices for March through May of 2002. The auditor also transcribed cash purchase information for the months of June and July, 2002.

We modify finding of fact "8" of the Administrative Law Judge's determination to read as follows:

> Sometime prior to February 26, 2004, the audit file was reassigned to a second auditor, Robert DeFilippis, who informed Mr. Schneiderman by letter of June 9, 2005, that the audit period was being expanded to include the period September 1, 2002 through November 30, 2004 and that all books and records pertinent to petitioner's sales and use tax liability for the updated period should be available for review at the next appointment. The records requested were set forth on a separate sheet and included sales invoices, sales receipts journals and other

> records included with the original appointment letter of October 4, 2002. Again, no original source documentation of sales was produced by petitioner.[1]

The Division met Mr. Schneiderman at his office on June 15, 2004 and reviewed purchase invoices, schedules and petitioner's method of preparing its sales tax returns. Based on this information and average selling prices for gas stations in petitioner's geographic area, the Division began an analysis of petitioner's sales tax return worksheets. After a year of further investigation, the Division completed its corrected sales tax return worksheets for March through May 2002, compared them with petitioner's worksheets and determined error ratios and the resulting additional sales tax due on sales of petroleum products. Additionally, the Division utilized third party information to confirm convenience store sales, sales tax on convenience store sales and prepaid cigarette tax.

After meetings with petitioner on June 10 and October 14, 2005, the Division received additional documentation of average prices per gallon of gasoline sold during the test period of March through May 2002, prepaid gasoline tax, diesel invoices for March 2002 and a reconciliation of gas and diesel purchases during the test quarter. Mr. DeFilippis told Mr. Schneiderman that the books and records petitioner had produced were insufficient to substantiate the tax reported on petitioner's returns under audit, a conclusion that Mr. Schneiderman conceded the auditor had reached and unequivocally communicated to him.

Using information supplied by petitioner, the Division took opening inventory, added purchases and subtracted closing inventory to arrive at net purchases, which were deemed total gallons sold. This figure was multiplied by the average selling price supplied by petitioner to

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[1] We modify finding of fact "8" to more accurately reflect the record.

arrive at sales in dollars for the test quarter. The inventory figures and purchase information were supplied in petitioner's sales tax return worksheets.

Audited taxable sales were determined to be $1,055,608.00 with sales tax due thereon of $89,726.00. Since tax reported on the returns was $88,477.00, a difference of $1,249.00, an error rate of 1.41% (1249/88477) was established and applied to the tax reported for the entire audit period, $2,450,014.00, resulting in additional tax due of $34,545.00.

The Division utilized the information supplied by petitioner to establish net gallons sold per month and applied the sales tax paid per gallon ($0.10 for gasoline and $0.11 for diesel) to arrive at the correct prepaid tax on gallons sold during the test period.

The Division's examination of prepaid sales tax on petroleum products during the test quarter indicated that petitioner had reported a prepaid sales tax credit of $90,198.00. However, the Division's analysis indicated that petitioner was only entitled to $83,491.00, indicating that petitioner had overreported by 7.44%. The Division applied this percentage to the credit claimed by petitioner for the entire audit period, $1,846,826.00, to arrive at additional tax due for overreported prepaid tax credits of $137,404.00.

A review of the capital assets indicated that there were complete records for the entire audit period, which revealed a total of $5,542.00 in untaxed assets, yielding additional tax due of $462.96. Reported convenience store sales, prepaid cigarette tax and expense purchases were analyzed and accepted as reported.

Petitioner's accountant, Mr. Schneiderman, explained that the erroneous prepaid tax credit taken by petitioner on its sales and use tax return for the test quarter was a result of a transposition error that resulted in an overreported prepaid tax credit of $6,707.00, and that his prepaid tax calculation without the error equaled the Division's prepaid tax computation, despite

the fact that he and the Division used different methods of computation. The exact location of the transposition error was not disclosed nor was there a detailed description of the error itself. In fact, Mr. Schneiderman conceded that there had been "three or four periods" where transposition errors had been made with resultant overreporting of prepaid tax. However, he never identified the specific periods.

Petitioner filed a New York State and Local Quarterly Sales and Use Tax Return for Part-Quarterly Filers, form ST-810, for the test period, March 1, 2002 through May 31, 2002, on or about June 19, 2002, prepared by Mr. Schneiderman. Form ST-810.10 is also required of vendors selling motor fuel and provides for a calculation of tax adjustments including the prepaid sales tax credit. Although the form ST-810 was submitted in evidence by the Division with no objection by petitioner, the form ST-810.10 was not attached as required and petitioner made no offer of the form of its own. Any error in the computation of the prepaid tax credit would have been apparent on the form ST-810.10, since it set forth taxable sales of motor fuel and diesel motor fuel by taxing jurisdiction, which would have provided the basic information to calculate the prepaid tax credit.

Petitioner submitted into evidence purchase invoices from OK Petroleum for diesel and gasoline for each month in the audit period except the months of June and July 2002 for gas and the months of March and July 2002 for diesel fuel. Therefore, the record does not contain all the purchase invoices for the test period, nor was it established whether the invoices represented all fuel purchases.

Mr. Schneiderman equated gallons purchased with gallons sold in reporting sales on petitioner's sales and use tax returns, noting that he did so under the assumption that the opening and closing inventories were almost identical or within one or two hundred gallons and,

therefore, were insignificant over the course of the audit period. Each reporting period, petitioner sent him records of the gallons purchased and pump price information to calculate the sales tax to be reported.

Petitioner maintained summaries of each day's transactions at its stations, comprised of a computer generated document, cash drop summaries, convenience store register tapes, credit card sales and cigarette sales information. The summary was referred to as a shift report. One such report was issued per day for each station, with the exception of stations that remained open for 24 hours, for which two reports may have been generated. Shift reports set forth the following: the gallons sold for the day by grade and the dollar amount of the sales; it included credit card sales (but it was noted that most credit card sales for fuel went directly to OK Petroleum); cash drops in the safe; sales of cigarettes; and sales of convenience store items. The shift reports did not show receipts for cash sales. The cash drops listed in the shift reports did not delineate the sources of the cash, whether it was received for fuel sales or otherwise. Shift reports were not produced in response to the initial request for all books and records pertinent to petitioner's sales and use tax liability nor were a substantial number of them produced to the Division at any time prior to the issuance of the Notice of Determination to establish petitioner's correct sales tax liability.

Some shift reports were shown to and utilized by the Division to establish petitioner's average pump prices in effect during the test quarter. Since the reports did not record individual sales, only summaries of total sales, the Division did not consider them reliable books of entry or original source documentation for sales of gas and diesel fuel; rather, they were seen as an informal summary or daybook with no backup documentation. Although petitioner's controller, Mr. John Mussachia, believed the shift reports to be the best evidence of sales that petitioner

maintained, petitioner itself did not utilize the shift reports to prepare its sales and use tax returns because the process was considered too time-consuming. Instead, Mr. Musacchia sent Mr. Schneiderman summary sheets that stated the total gallons purchased and pump prices, from which sales and prepaid tax was computed. The gallons-purchased figure on the summary was reported by the station managers who noted each delivery during the month. The pump prices were taken from the shift reports. In addition, the summary sheets sent to Mr. Schneiderman for preparation of the tax returns contained beginning and ending inventory amounts, which were ignored for purposes of filing the sales tax returns. The summary sheets, like the purchase invoices produced by petitioner, could not be tied into the general ledger.

The Division was made aware of the shift reports during the audit when the taxpayer produced some samples to establish the actual pump prices for gasoline and diesel fuel. However, at no time during the audit was a complete set of the shift reports produced as documentation for actual sales made by petitioner, despite the requests by the Division for all books and records pertaining to petitioner's sales and use tax liability.

The Division mailed to petitioner a Statement of Proposed Audit Change, dated January 5, 2006, which explained that additional sales and use taxes had been determined in accordance with Tax Law § 1138, based upon an audit of petitioner's available records. The statement asserted additional tax due of $172,411.96, interest of $110,777.99 and penalty of $50,618.98 for a total amount due of $333,808.82 for the period December 1, 1999 through November 30, 2004. Included in the mailing with the statement was a copy of the audit workpapers.

Petitioner disagreed with the audit result and a conference was held on January 13, 2006 to discuss the Division's conclusions. Mr. Schneiderman voiced a particular objection to the overreporting of prepaid gasoline tax. Subsequently, after performing a review of two years of

returns, Mr. Schneiderman informed the Division that the test quarter was the only one he found with a significant error. The Division considered this observation and offered him the opportunity to provide additional documentation for two additional quarters, those ended August 31, 2001 and August 31, 2002. However, upon learning it was the Division's intention to average the results of the differences found in those quarters with the results of the test quarter, Mr. Schneiderman declined to provide the documentation, on the belief that such a methodology would still produce a larger tax liability than was warranted.

After learning that no further documentation would be provided, the Division issued to petitioner a Notice of Determination, dated March 20, 2006, which asserted additional sales and use taxes due for the period December 1, 1999 through November 30, 2004 in the sum of $172,411.96, plus penalty and interest for a total amount due of $338,684.37.

Petitioner filed a petition for a conference in the Bureau of Mediation and Conciliation Services ("BCMS"), which was held on July 20, 2006. Petitioner contested the audit results on the basis that it always had adequate books and records, which would have permitted a detailed audit but were never reviewed. Therefore, petitioner asserted that to resort to an estimated audit methodology was not justified.

The conferee requested that the Division meet with petitioner to review the complete books and records, and a meeting was scheduled and took place on September 7, 2006. The day prior to the meeting, both the conferee and the auditor contacted Mr. Schneiderman to confirm that the complete books and records would be available for review and were informed that all the records would be available. In fact, petitioner did not produce the records promised, including any sales documentation, original source or otherwise; complete purchase invoices; and complete shift reports. At the meeting, the Division used the records for the quarter ended August 31,

2004, a quarter with records available, and determined that the purchases reflected on the invoices provided exceeded purchases set forth on the general ledger by approximately $325,000.00. Since this result undermined reliance on the purchase figures used to estimate sales by both the Division and petitioner, the Division decided not to rely on any of the documentation provided.

In an electronic mail message to the conferee, dated September 21, 2006, the team leader, Mr. Frank Grillo, stated that petitioner had only produced 49 percent of the records promised and that he was skeptical of the computer-generated purchase invoices produced because he feared that they could be created and printed at will. Mr. Grillo explained that he and the auditors performed a test on the records for the quarter ended August 31, 2004, yielding the discovery of the discrepancy between the general ledger and purchase invoices. Since this test indicated an overstatement in prepaid sales tax and an understatement in sales tax remitted, Mr. Grillo believed that the results of the test confirmed the findings of the audit and the Division's choice of a test period audit methodology in the absence of complete and adequate records.

Mr. Musacchia, petitioner's controller, conceded that petitioner and its supplier, OK Petroleum, were owned by the same person, and formal invoicing was not always deemed necessary for purchases between the two companies, which might have accounted for the discrepancy between the general ledger and the purchase invoices. Further, credit card payments for motor fuel purchases from OK Petroleum were settled directly into the bank account of OK Petroleum by the click of a button, a practice that was common for OK Petroleum but allegedly not disclosed to Mr. Schneiderman, causing further confusion when trying to reconstruct sales from purchase information. For these reasons, he informed the conferee that the Division's

choice of a test period estimated audit methodology was justified in the absence of complete records.

On December 29, 2006, a conciliation order was issued sustaining the Notice of Determination.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

In his determination, the Administrative Law Judge referenced applicable provisions of the Tax Law and relevant case law to explain the procedure to be followed by the Division when conducting an audit to determine a taxpayer's liability for sales and use tax.

The Administrative Law Judge found that the Division made "at least two adequate, unequivocal and clear requests for all of petitioner's records related to its sales tax liability for the entire audit period." The Administrative Law Judge concluded that petitioner ignored these requests, provided no sales records at all and demonstrated that it prepared its sales tax returns by approximating its tax liability, relying on summary sheets of purchases and average pump prices and ignoring beginning and ending inventory figures.

The Administrative Law Judge pointed out that the Division's regulations require that where no written document of sale is given to a customer, the seller must keep daily records of all cash and credit sales to insure that the records provide sufficient detail to independently determine the taxable status of each sale and the amount of tax due and collected thereon, or be substantiated by an analysis of supporting records. The Administrative Law Judge found that petitioner did not maintain records for motor fuel sales as required and no other source documentation of sales existed.

The Administrative Law Judge observed that at the initial meeting with the Division, petitioner produced only a small fraction of the records requested and no records of sales. Mr.

Schneiderman conceded at the hearing that sales records were not maintained and never existed and that he had no records for the first seven months of the audit period, before he was employed by petitioner.

The Administrative Law Judge detailed the requests for records made by the Division throughout the audit and the nature of the records provided in response. The Administrative Law Judge found that the Division reviewed the records presented by petitioner and it correctly concluded that they were not adequate to do a complete audit, since there were no source documents, i.e., sales invoices, complete purchase invoices or cash register tapes, submitted by petitioner. The Administrative Law Judge noted that, during the audit, petitioner did not produce a complete general ledger, a complete set of shift reports for the purpose of establishing sales, or any evidence of cash sales of fuel.

The Administrative Law Judge rejected petitioner's argument that the shift reports it maintained constituted original source documentation of sales. Those records were reviewed by the Division for pump prices but not requested for purposes of establishing sales, as there was no source documentation underlying the data for most of the entries, i.e., there was no documentation that would allow one to trace a transaction from the purchase of the commodity to the final sale transaction with the customer, most notably for motor fuel sales. Further, the Administrative Law Judge found no breakdown of cash sales for fuel and no accounting for the substantial number of credit card sales that were settled directly to OK Petroleum.

The Administrative Law Judge observed that even petitioner did not avail itself of the shift reports in preparing its own sales tax returns, instead choosing to use purchase records to create summaries for Mr. Schneiderman, who never questioned or investigated the underlying information he was provided.

Thus, the Administrative Law Judge concluded that since Mr. Schneiderman used only the purchases listed on the summaries given to him in preparing the tax returns, the filed returns were estimates without any source documentation behind them.

The Administrative Law Judge distinguished the decision of ***Matter of A & A Serv. Sta.*** (Tax Appeals Tribunal, February 5, 2004), in which the Tribunal held that the Division's use of shift "sheets" to determine petitioner's true tax liability in an estimated audit methodology was reasonable. The Administrative Law Judge pointed out that, unlike the instant matter, A & A voluntarily produced the sheets for the entire audit period for the purpose of establishing meter readings in dollars and gallons for each of petitioner's ten pumps and set forth fuel inventories. The A & A shift sheets indicated a large discrepancy in the number of gallons of gas stated on the paid invoices and A & A was held liable for the tax on the additional gallons. Here, the Administrative Law Judge found that the Division used the shift reports provided for the purpose of determining an accurate average pump price for calculating a sales figure to petitioner's advantage. Although the Administrative Law Judge found that petitioner was in a position to offer all of the reports for the purpose of establishing its sales and use tax liability or constructing a coherent presentation of sales data from which an accurate portrayal of its sales could be exposed, it failed to produce them. Further, since petitioner prepared its returns using summary purchase figures in gallons to which it applied an average pump price and not actual sales as reported in the shift reports, the Administrative Law Judge concluded that petitioner's methodology for preparing its returns would never agree with the sales recorded on the shift reports and would supply little support for the accuracy of the returns filed.

The Administrative Law Judge reviewed the estimated methodology employed by the Division to calculate petitioner's taxable sales, which he found to be "very similar to the

methodology petitioner used in preparing its returns, with the exception that the Division utilized the opening and ending inventories" and which produced an error rate of only 1.41% for the tested quarter ending May 31, 2002. The Administrative Law Judge rejected petitioner's argument that the inventory will always be sold over time and therefore need not be considered in calculating sales and sales tax liability, finding that because it does not lend itself to accuracy for any given quarter, any deficiency caused by taking this risk remains with petitioner.

The Administrative Law Judge found that the Division determined an error rate for the overreporting of prepaid tax credits for the tested quarter to be 7.44%. The Administrative Law Judge did not accept petitioner's claim that the error rate was due to a transposition error because petitioner never offered proof of where the mistake was made. Further, the Administrative Law Judge found that petitioner refused to submit additional documentation for two other quarters when invited to do so by the Division, noting that the Division's intention to average the differences found in the three quarters would result in an unacceptably large deficiency for petitioner, even though it would have underscored the error, if any, in the test period and bolstered petitioner's argument that an isolated error had caused the large overreporting of the prepaid sales tax credit.

The Administrative Law Judge found that petitioner had the burden of proof to show, by clear and convincing evidence, that the result of the audit was unreasonably inaccurate or that the amount of tax assessed was erroneous and petitioner failed to meet this burden as it offered no evidence to refute the audit results. The Administrative Law Judge stated: "Without original source documentation the Division utilized petitioner's own records to test its tax reporting on the basis of purchases and pump prices, the same information available to petitioner when it prepared its returns. It used the same information to determine the proper amount of prepaid tax

credits, which was consistent with and derived from its test of motor fuel sales. The Division was under no obligation to utilize and test information that was not original source documentation, information not used by petitioner and, not least of which, was never produced for the entire audit period."

The Administrative Law Judge rejected petitioner's contention that the Division refused to examine its records at the September 7, 2006 meeting with petitioner's representative as petitioner did not produce any source documentation for its sales during the audit period and did not have all shift reports and purchase invoices available. The test performed that day by the Division on the quarter ended August 31, 2004, yielded a large discrepancy between purchases per invoices and those recorded in the general ledger, which the Administrative Law Judge found further supported the Division's decision to resort to an indirect audit methodology. Thus, the Administrative Law Judge concluded that the Division was afforded no reason to change its position or audit methodology on the basis of what was presented.

The Administrative Law Judge found that petitioner failed to establish that its underreporting of sales resulted from anything other than its own failure to maintain accurate records of sales and, therefore, as there was no showing of reasonable cause and the absence of willful neglect for its failure to pay the appropriate amount of sales tax, there was no basis for abating the penalties assessed.

ARGUMENTS ON EXCEPTION

On exception, petitioner argues that it fully complied with the Division's requests for books and records. However, petitioner maintains that the Division failed to adequately review them. Petitioner believes that the Administrative Law Judge placed "inordinate significance" on letters from the auditors requesting the production of documents (Petitioner's brief in support,

p. 37). Although not provided at the initial meeting with the auditor, these documents, petitioner maintains, were always available but never examined by the Division. Petitioner argues that if the Division can perform a detailed audit for the test period, it should do so for the entire audit period. Petitioner further maintains that the extrapolation of a three month test period over the five year period of the audit was not a methodology reasonably calculated to determine the amount of taxes due.

While it did not rely on its own shift reports for the preparation of its tax returns, petitioner argues that the methodology it used to prepare its tax returns was at least as accurate and less time-consuming than adding up the volume totals in the shift reports. Petitioner asserts that its method of computing sales tax was accurate and that any discrepancy inherent in using beginning and ending inventories was insignificant. Petitioner maintains that its shift reports were, in fact, source documents that could have been used by the Division to determine petitioner's sales tax liability. Further, petitioner believes that its purchase invoices could have been used to determine its prepaid sales tax credit.

Petitioner maintains that the Division relied on similar shift reports to assess tax in ***Matter of A & A Serv. Sta. (supra)*** and their use was upheld by the Tax Appeals Tribunal. Petitioner argues that it is inconsistent to determine that they are unreliable in the present case. Petitioner insists that contrary to the Administrative Law Judge's conclusion, petitioner did offer the shift reports to the auditor but they were refused.

Petitioner asserts that no determination was made by the Division that its records were inadequate to conduct a complete audit prior to deciding to use a test period audit. By doing so, petitioner argues that the Division violated the Tax Law and relevant precedent and that the audit results cannot be sustained (***see***, ***Matter of Schuck Trucking***, Tax Appeals Tribunal, March 1,

2001). Petitioner points out that the original auditor never made an entry in her audit report indicating that the records presented were insufficient. Further, petitioner notes that the original auditor did not appear at the hearing nor was an affidavit provided by her indicating that she found the records presented to have been inadequate for conducting an audit.

Petitioner maintains that the successor auditor did not look at the records provided by petitioner but merely focused on the test period selected by the initial auditor. Petitioner asserts that, as a result, no determination of inadequate records was ever made.

Petitioner argues that even though it did not maintain records of each individual sale nor issue a sales receipt to each customer, it was still entitled to show compliance with the Tax Law by reference to other records it maintained, such as its general ledgers, shift reports, bank statements and purchase invoices. Based on case law, petitioner maintains that the Division is not empowered to prescribe the proof necessary for it to prevail at a hearing.

Petitioner asserts that the Division failed to request and to review records provided for the extended audit period, as well. Further, petitioner maintains that the Division failed to review even a single period in the extended audit period. Rather, the Division assumed the inadequacy of the records for that period.

Petitioner argues that no basis exists for the imposition of penalty.

In opposition, the Division asserts that the record does not support petitioner's claims that it complied with the Division's requests for books and records, that the Division failed to adequately review its books and records, or that the method used by petitioner to compute its tax liability was accurate. The Division further asserts that petitioner provided incomplete purchase invoices, general ledgers, shift reports and receipts, and no source documents for its sales. After the auditor's first appointment with petitioner's representative, the Division notes that petitioner

provided only some of the documents requested. Further, petitioner's representative, Mr. Schneiderman, testified that he was informed by the second auditor that petitioner's records were inadequate and they were not sufficient to allow the auditor to determine if what was reported on the sales tax returns was accurate.

The Division maintains that petitioner's method of preparing its returns was not accurate because it was not based on sales records. Rather, it was based on quarterly purchases and average pump prices, without consideration of either a beginning inventory or an ending inventory. The Division points out that although petitioner claimed that its understatement of tax liability for the test period was due to a transposition error, petitioner never identified the error. Had petitioner's reporting system been accurate, the Division believes that petitioner could have identified and corrected such an error.

The Division argues that petitioner's shift reports are not source documents for sales. Rather, they are simply summaries of petitioner's transactions without receipts, invoices or any other detail of the individual transactions contained in the report. The Division disputes petitioner's interpretation of ***A & A Serv. Sta. (supra)*** and asserts that in that case, the Tribunal held that the Division was authorized to use shift reports as a reasonable indirect method to determine tax liability. The Division argues that the Tribunal held that shift reports do not constitute source documents for sales. Noting that the Division's regulations provide that where no receipt is given to a customer, the vendor is required to keep daily records of all cash and credit sales, the Division maintains that shift reports are inadequate to meet this requirement. As a result, the Division asserts that it is irrelevant whether petitioner possessed shift reports for the entire audit period.

Despite petitioner's claims to the contrary, the Division maintains that complete purchase invoices were not provided to the Division during the audit. Without complete general ledgers, purchase journals or other books of original entry, the Division argues that it was impossible to determine what percentage of petitioner's purchase invoices were provided at the hearing, especially since petitioner admitted that it did not always receive purchase invoices from OK Petroleum. Further, without complete purchase invoices, it was impossible to determine the amount of prepaid tax credit to which petitioner is entitled. However, the Division posits that even if prepaid taxes could be determined accurately, the credit is available only on the sale of motor fuel, and there was no source documentation provided for motor fuel sales.

The Division maintains that while it is common for auditors to make an entry in the Audit Record that a taxpayer's books and records were inadequate, there is no statutory or regulatory requirement that this be done. The Division asserts that both the original auditor and the second auditor made clear and unequivocal requests for petitioner's records, and the inadequacy of the records provided was obvious. The Division argues that petitioner did not comply with the record keeping requirements of the Tax Law and the Division's regulations because its purchase invoices, general ledgers and shift reports were all incomplete. Therefore, the Division maintains, it was impossible to use these records to determine petitioner's tax liability.

The Division claims that petitioner's argument that the Division did not review petitioner's records for the extended audit period is without merit. The Division points out that a written request was made for books and records for the extended audit period and that after reviewing documents provided, the auditor informed petitioner's representative that the records were insufficient to perform a detailed audit.

The Division agrees with the Administrative Law Judge's determination that petitioner failed to show that its underpayment of tax was due to reasonable cause and not due to willful neglect. Further, the Division believes that the penalty was properly imposed for petitioner's failure to maintain and provide appropriate records.

OPINION

Tax Law § 1138(a)(1) provides that if "a return required by this article is not filed, or if a return when filed is incorrect or insufficient, the amount of tax due shall be determined by [the Division of Taxation] from such information as shall be available. If necessary, the tax may be estimated on the basis of external indices . . ." This language has been interpreted to provide that "[t]he honest and conscientious taxpayer who maintains comprehensive records as required has a right to expect that they will be used in any audit to determine his ultimate liability" (***Matter of Chartair v. State Tax Commn.***, 65 AD2d 44 [1978]).

To determine the adequacy of a taxpayer's records, the Division must first request (***Matter of Christ Cella v. State Tax Commn.,*** 102 AD2d 352 [1984]) and thoroughly examine (***Matter of King Crab Rest. v. Chu***, 134 AD2d 51 [1987]) the taxpayer's books and records for the entire period of the proposed assessment (***Matter of Adamides v. Chu***, 134 AD2d 776 [1987], ***lv denied*** 71 NY2d 806 [1988]). The request for records must be explicit and not "weak and casual" (***see***, ***Matter of Christ Cella v. State Tax Commn., supra***).

The purpose of the examination is to determine, through verification drawn independently from within these records (***Matter of Giordano v. State Tax Commn.***, 145 AD2d 726 [1988]; ***Matter of Urban Liqs. v. State Tax Commn.***, 90 AD2d 576 [1982]; ***Matter of Meyer v. State Tax Commn.***, 61 AD2d 223 [1987], ***lv denied*** 44 NY2d 645 [1978]; ***see also, Matter of Hennekens v. State Tax Commn.***, 114 AD2d 599 [1985]), that they are, in fact, so insufficient

that it is "virtually impossible [for the Division of Taxation] to verify taxable sales receipts and conduct a complete audit" (***Matter of Chartair v. State Tax Commn., supra***), "from which the exact amount of tax can be determined" (***see***, ***Matter of Mohawk Airlines v. Tully***, 75 AD2d 249 [1980]).

Where the Division follows this procedure, thereby demonstrating that the records are incomplete or inaccurate, the Division may resort to external indices to estimate tax (***see***, ***Matter of Urban Liqs. v. State Tax Commn., supra***). The estimate methodology utilized must be reasonably calculated to reflect taxes due (***Matter of W.T. Grant Co. v. Joseph***, 2 NY2d 196 [1957] ***cert denied*** 355 US 869 [1957]) but exactness in the outcome of the audit method is not required (***Matter of Markowitz v. State Tax Commn.***, 54 AD2d 1023 [1976], ***affd*** 44 NY2d 684 [1978]; ***see also***, ***Matter of Cinelli***, Tax Appeals Tribunal, September 14, 1989). 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]; ***see also***, ***Matter of Cousins Serv. Sta.***, Tax Appeals Tribunal, August 11, 1988). In addition, "[c]onsiderable latitude is given an auditor's method of estimating sales under such circumstances as exist in [each] case" (***see***, ***Matter of Grecian Sq. v. State Tax Commn.***, 119 AD2d 948 [1986]).

Petitioner argues, as it did before the Administrative Law Judge, that the Division never made an adequate request for its books and records. Further, petitioner maintains that it was always prepared to provide complete books and records to the Division in order for the Division to conduct a complete audit. However, according to petitioner, the Division refused to examine the books and records provided and to conduct a complete audit.

We find that petitioner's position is not supported by the facts. The October 4, 2002 letter sent to petitioner at the commencement of the audit constituted a valid request for the records needed in order for the Division to conclude whether or not a complete audit of petitioner's books and records could be conducted. The request was not "weak and casual." Rather, it specified in detail the records that the Division sought to review.

Petitioner's representative at the audit, Mr. Schneiderman, provided some of the requested records, but failed to provide any evidence of individual sales. Mr. Schneiderman testified at the hearing that he had no records for the first seven months of the audit period, as it was prior to his employment by petitioner. Despite this shortcoming, petitioner continues to insist that it had complete books and records available that should have been used to conduct a complete and detailed audit.

It cannot be denied that it would have been clearer if the auditors had noted in their audit log that after reviewing the records provided by petitioner, they made a determination that petitioner's records were inadequate to serve as the basis of a complete audit and that resorting to external indices was warranted. The audit record did not contain such entries. Nonetheless, it is clear from the actions taken by the original auditor that she did review the records provided and did conclude that they were not sufficient to conduct a complete audit. Likewise, the second auditor made a request for petitioner's books and records for the extended audit period by letter dated June 9, 2005. Once again, petitioner failed to supply the requested records documenting individual sales that would have enabled the auditor to conduct a complete audit.

Petitioner is correct when it notes that neither the Tax Law nor the Division's regulations require that a vendor issue a cash register receipt or sales invoice with every sales transaction. The Division's regulations (20 NYCRR § 533.2[b]) provide the following:

(b) Sales records.

(1) Every person required to collect tax, including every person purchasing or selling tangible personal property for resale must keep records of every sale, amusement charge, charge for dues or occupancy, and all amounts paid, charged or due thereon, and of the tax payable thereon. The records must contain a true copy of each:

(i) sales slip, invoice, receipt, contract, statement or other memorandum of sale;
(ii) guest check, hotel guest check, receipt from admissions such as ticket stubs, receipt from dues; and
(iii) cash register tape and any other original sales document.

Where no written document is given to the customer, the seller shall keep a daily record of all cash and credit sales in a day book or similar book (emphasis added).

While petitioner maintains that its "shift reports" constituted such daily record, petitioner is incorrect. Not only were such shift reports not provided for the entire audit period to the auditors but, as the Administrative Law Judge concluded, in reviewing the shift reports, "there was no breakdown of cash sales for fuel and there was no accounting for the substantial number of credit card sales that were settled directly to OK Petroleum." As a result, we agree that it was not possible to compare the information on the shift reports with petitioner's other records for an accurate determination of all sales that took place.

As the Administrative Law Judge pointed out, petitioner could not rely on the Tribunal's decision in ***A & A Serv. Sta. (supra)*** to support its argument that shift reports were adequate source documentation for sales. In that case, we affirmed the Administrative Law Judge's determination that the Division was entitled to rely on the taxpayer's shift reports as a reasonable method of estimating its tax liability when adequate source documentation was not provided. There, the taxpayer prepared its tax returns based on an estimate of its liability much as petitioner did in this case.

Once it was determined that a complete audit could not be conducted, the Division used petitioner's records to estimate its tax liability for a test period. The Division found a variance of less than 2% on examination of its reported sales. It then extrapolated this error ratio over the entire audit period. We find that this was a reasonable method of estimating petitioner's taxable sales of motor fuel.

A greater error rate was determined in relation to petitioner's reports of prepaid sales tax on its purchases of motor fuel. It seems that this may have been exacerbated by the fact that some purchases from OK Petroleum were not properly invoiced. Further, while petitioner's representative insisted that the error ratio resulted from a transcription error made by him in reporting motor fuel sales during the test period selected by the Division, the alleged error was never identified by petitioner. Although the Division offered to review two additional quarters and average the results with those obtained for the initial test period, petitioner declined to provide the documentation for those quarters.

As a result, we find that the Division employed a reasonable methodology to estimate petitioner's entitlement to prepaid sales tax on its motor fuel purchases. Our conclusion is bolstered by the post-audit review conducted by the Division of petitioner's purchase records for a sales tax quarter within the extended audit period. This review disclosed an approximate $325,000.00 gap between the purchases reflected on the invoices provided and purchases set forth in the general ledger.

While petitioner argues that penalty was not properly imposed by the Division, we find that petitioner has not met its burden to demonstrate that its underreporting of tax was due to reasonable cause and the absence of willful neglect.

We find that the Administrative Law Judge completely and adequately addressed the issues presented to him and correctly applied the relevant law to the facts of this case. Petitioner has offered no evidence below, and no argument on exception, that demonstrate that the Administrative Law Judge's determination is incorrect. As a result, we affirm the determination of the Administrative Law Judge.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Straight Path Service Station, Inc. is denied;

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

3. The petition of Straight Path Service Station, Inc. is denied; and

4. The Notice of Determination dated March 20, 2006 is sustained.

DATED:Troy, New York
March 1, 2010

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

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