

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petitions :  
of :  
DISANCO HOME CENTER CORPORATION : DETERMINATION  
AND CARMEN SANTORA, AS OFFICER :  
for Revision of Determinations or for Refunds :  
of Sales and Use Taxes under Articles 28 and 29 :  
of the Tax Law for the Period September 1, 1982 :  
through November 30, 1985. :

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Petitioners, Disanco Home Center Corporation and Carmen Santora, as officer, 890 Portland Avenue, Rochester, New York 14621, filed petitions for revision of determinations or for refunds of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 1982 through November 30, 1985 (File Nos. 802961 and 802962).

A hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, 259 Monroe Avenue, Rochester, New York on December 1, 1987 at 1:15 P.M., with all briefs to be filed by February 16, 1988. Petitioner appeared by Paul H. Shanahan, Esq. The Audit Division appeared by William F. Collins, Esq. (Michael B. Infantino, Esq., of counsel).

ISSUES

I. Whether, as the result of a field audit, the Audit Division correctly determined petitioners' sales and use tax liability.

II. Whether the penalties and interest in excess of the minimum which were imposed against the corporation and its president should be waived.

FINDINGS OF FACT

1. In 1982 petitioner Disanco Home Center Corporation ("Home Center") began operating a hardware store. The Home Center was located in an economically depressed area. Petitioner Carmen Santora was the president of the Home Center. During the period in issue, Mr. Santora also engaged in the building remodeling business. One advantage to Mr. Santora in opening the Home Center was that it enabled him to purchase items such as nails, locksets and hinges at wholesale prices, thereby reducing the cost of his remodeling business.

2. The Home Center began as a hardware store operating under a franchise. As a franchise, the Home Center was obligated to purchase certain items such as snowblowers and large lawnmowers which petitioner found did not sell well in a low income area. In order to attract more customers, the Home Center began selling beer and food products. In April 1985 the Home Center suffered a fire. When the Home Center reopened, city road construction rendered it difficult to gain access to the store by car.

3. In the course of the audit, the Audit Division requested all of the Home Center's books

and records pertaining to its sales tax liability including journals, ledgers, sales invoices, cash register tapes and exemption certificates. In response, the Home Center was unable to provide either cash register tapes or selling prices of the grocery store items.

4. The Audit Division found that the gross receipts reported on the Home Center's Federal income tax returns substantially exceeded the gross sales reported on the corporation's sales and use tax returns. The same discrepancy appeared between the gross sales reported on the Home Center's financial statements and the gross sales reported on the corporation's sales and use tax returns. The difference in gross sales was attributable to the Home Center's not including the remodeling sales in its gross sales on its sales and use tax returns.

5. On the basis of Audit Division experience, the Audit Division marked up hardware purchases by 100 percent and purchases of taxable grocery items by 30 percent to compute audited taxable sales for the period at issue.

6. The foregoing analysis led the Audit Division to conclude that the Home Center owed sales tax in the amount of \$14,118.39 on unreported taxable sales. The Audit Division also determined on the basis of the Home Center's records that the corporation owed tax in the amount of \$6,028.13 on the purchase of materials used in construction work.

7. On the basis of the foregoing analysis, the Audit Division, on December 19, 1985, issued two notices of determination and demands for payment of sales and use taxes due to the Home Center which in combination assessed a deficiency of sales and use taxes for the period September 1, 1982 through August 31, 1985 in the amount of \$20,146.54 plus penalty of \$4,335.86 and interest of \$4,633.98 for a total amount due of \$29,116.38. On the same date, notices were issued to Carmen Santora, as officer of the Home Center, assessing the same amount of tax, penalty and interest.

8. On or about January 31, 1986 petitioners filed a Tax Amnesty Application and paid \$5,355.85, representing the tax assessed on the purchase of materials used in construction work for the period September 1, 1982 through November 30, 1984. The penalty assessed for the corresponding period was cancelled pursuant to the amnesty application.

9. On June 5, 1986 Carmen Santora, as president of the Home Center, signed a Statement of Proposed Audit Adjustment wherein the parties agreed to the tax due on the purchase of materials used in construction work for the periods ended February 28, 1985 through November 30, 1985. The amount of tax agreed to and paid was \$672.28 plus penalty and interest.

10. Following the issuance of the assessments on December 19, 1985, petitioners submitted information pertaining to a fire loss which had occurred in April 1985. This information showed that after the loss, petitioner's accountant wrote a letter to the Home Center's insurance company stating that the value of the ending inventory was estimated utilizing a 50 percent markup on cost. The 50 percent markup was, in turn, based on two financial studies of the retail industry.

11. The Audit Division weighted the hardware markup of 50 percent and the previous grocery markup of 30 percent in relation to total purchases to arrive at a weighted markup of 37 percent. The weighted markup was then multiplied by the purchases as reported on the financial statements to determine audited taxable sales. The amount of audited taxable sales was then reduced by taxes previously paid to determine that sales tax was due in the amount of \$6,850.51.

12. On February 25, 1986 the Audit Division issued a revised Notice of Determination and Demand for Payment of Sales and Use Taxes Due to the Home Center assessing a deficiency of sales and use taxes for the period September 1, 1982 through November 30, 1984 in the amount of \$11,053.85 plus penalty of \$2,614.69 and interest of \$2,996.15 for a total amount due of \$16,664.69. On June 6, 1986 the Audit Division issued a revised Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period December 1, 1984 through November 30, 1985 assessing a deficiency of sales and use tax in the amount of \$1,824.79 plus penalty of \$318.23 and interest of \$228.30 for a total amount due of \$2,371.32. On February 25, 1986 and June 6, 1986, the Audit Division issued notices of determination to Mr. Santora as an officer of the Home Center which assessed the same amount of tax, penalty and interest which had been assessed against the Home Center. The amount of tax assessed was premised upon the revised amount of sales tax found due of \$6,850.51 (Finding of Fact "11") and the tax found due on the purchase of materials in construction work of \$6,028.13 (Finding of Fact "6"). That is, the assessments of February 25, 1986 and June 6, 1986 did not take into account the amnesty application and payment (Finding of Fact "8") or the payment remitted with the Statement of Proposed Audit Adjustment (Finding of Fact "9").

13. After the issuance of the last assessment, petitioners attended a prehearing conference wherein invoices were submitted showing that 7.85 percent of the Home Center's purchases consisted of food which was exempt from sales and use tax. The Audit Division also agreed to a two percent adjustment for theft. Consequently, the amount of tax currently asserted to be due is \$5,549.60 for the periods ending February 28, 1983 through May 31, 1985.

14. As noted, in April 1985 the Home Center suffered a fire loss. As a result of this fire, the Home Center suffered an estimated inventory loss of \$40,000.00. When the Audit Division performed its audit, no adjustment was made for the loss of inventory due to the fire. No evidence was presented as to the amount of the Home Center's beginning inventory.

15. It was the Home Center's practice to ring up sales on a cash register which contained keys for taxable and nontaxable items. At the end of each day, Mr. Santora obtained a tape from the cash register which showed the total taxable and nontaxable sales. This information would be transcribed onto monthly ledger sheets and given to petitioners' accountant in order to prepare the sales and use tax returns.

16. Some portion of the cash register printout sheets were destroyed in the fire of April 1985. The Audit Division declined to utilize those printout sheets which were not destroyed by the fire when conducting its audit.

#### SUMMARY OF PETITIONERS' POSITION

17. At the hearing, petitioners argued that the audit method employed resulted in an incorrect determination of the sales tax due since it did not take into account the ending inventory which was destroyed by fire. Petitioners submit that a test period audit methodology should have been used and, further, that the Audit Division erroneously disregarded some of their records. Petitioners also argued that a portion of the original assessment which was paid arose from the use of materials which were purchased for the store. Therefore, petitioners argue that they are being assessed tax twice, that is, tax on the assumption that the item was sold and tax for the use of the item. Lastly, petitioners request that penalty and interest be abated.

#### CONCLUSIONS OF LAW

A. That section 1138(a)(1) of the Tax Law provides, in part, that if a return required to be filed is incorrect or insufficient, the amount of tax due shall be determined on the basis of such information as may be available. This paragraph further provides that, if necessary, the tax may be estimated on the basis of external indices.

B. That since petitioners did not have records from which one could determine whether tax had been charged on all taxable items or whether the proper tax had been charged in each instance, the use of an indirect audit method to estimate the tax due was reasonable under the circumstances (see, e.g., *Matter of Licata v. Chu*, 64 NY2d 873). Therefore, it was permissible for the Audit Division to disregard those cash register printouts which were available.

C. That when the records are incomplete or insufficient, it is the duty of the Audit Division to select a method reasonably calculated to reflect tax due (*Matter of Surface Line Operators Fraternal Organization v. Tully*, 85 AD2d 858). In this instance, the Audit Division employed such a method. When beginning inventory and ending inventory are the same, purchases equal cost of goods sold. Since there is no evidence that the level of inventory fluctuated, petitioners have not established that the Audit Division's disregard of the ending inventory which was lost in the fire resulted in an incorrect determination of the sales and use tax due. Furthermore, once it is determined that the use of an indirect audit methodology is appropriate, there is no requirement that a particular audit methodology be used. Therefore, the Audit Division was not required to perform a test period audit. It is noted that petitioners could have performed their own test period audit in an attempt to show that the Audit Division's estimate was erroneous. Lastly, since the matter was not pursued in the course of the hearing, there is no evidence to show that petitioner was charged tax twice on the same item.

D. That Tax Law § 1145(a)(1)(i) provides that "[a]ny person failing to file a return or to pay or pay over any tax to the [commissioner] within the time required by this article shall be subject to a penalty". However, if the taxpayer establishes that the failure to comply with the law was due to reasonable cause and not willful neglect, said penalties and interest in excess of the minimum prescribed under Tax Law § 1145 will be remitted. (Tax Law § 1145[a][1] [former (ii)]; 20 NYCRR 536.5[a].) In this matter, there is no evidence to show that the failure to pay was due to reasonable cause and not willful neglect. Consequently, there is no basis for the remission of penalties or interest in excess of the minimum.

E. That the petitions of Disanco Home Center Corporation and Carmen Santora, as officer, are denied, and the assessments, as modified to take account of previous payments and conference adjustments (Findings of Fact "12" and "13") are sustained.

DATED: Albany, New York  
February 17, 1989

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ADMINISTRATIVE LAW JUDGE