

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition :  
of :  
MOSES DYCKMAN : DETERMINATION  
D/B/A DYCKMAN'S :  
for Revision of a Determination or for Refund :  
of Sales and Use Taxes under Articles 28 and 29 :  
of the Tax Law for the Period September 1, 1981 :  
through August 31, 1984. :

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Petitioner, Moses Dyckman d/b/a Dyckman's, 73 West 47th Street, New York, New York 10036, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 1981 through August 31, 1989 (File No. 805671).

A hearing was held before Nigel G. Wright, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on May 4, 1989 at 10:00 A.M. Petitioner appeared by Lawrence Cole, C.P.A. The Division of Taxation appeared by William F. Collins, Esq. (Gary Palmer, Esq., of counsel).

ISSUES

I. Whether an audit of a jewelry store increasing its gross sales by use of a national average markup figure for jewelry stores is justified when the store's records are facially in good order but where its sales were made at a very low markup.

II. Whether an audit denying exclusions from sales tax for claimed out-of-state sales for a test period can be projected over the entire audit period when the auditor has not examined the books and records for the entire audit period.

FINDINGS OF FACT

(a) Petitioner, Moses Dyckman d/b/a Dyckman's, operates a jewelry store on West 47th Street in Manhattan, selling both at wholesale and retail. Petitioner rents space on its premises to eight or more other retail jewelers.

(b) Petitioner's gross sales for 1981, 1982 and 1983 were \$230,047.00, \$145,031.00 and \$109,448.00, respectively. His average markup over cost for those years was 34.92%, 9% and 1.84%, respectively.

(c) Petitioner's store manager testified that the average markup was approximately 10% to 20%, that no items were ever marked up as much as 50% and that expensive items were marked up the least.

(d) In 1983, petitioner's store underwent extensive renovations, resulting in a drop in business revenue.

Most of petitioner's displayed merchandise was marked with a confidential code which reflected the cost of the item, while other items had the actual price marked on them. In either case, the salesman could negotiate with a customer to make a sale at the best price possible. Some items were marked with a price but not with a cost. On such items the cost was understood by the salesmen to be 50% of the manufacturer's list price. Petitioner sold these at up to 40% below list price. Gold items were sold by weight at a price depending on the current market value of gold. At times, this resulted in a loss from the actual cost of the item.

(a) Petitioner kept sales records and had his invoices available. These, it is conceded by the Division of Taxation, were "facially" adequate. Petitioner also had all purchase records. The purchase invoices, however, could not always be associated with specific items sold because some items were made up of several different pieces so that no one purchase invoice would provide its cost.

(b) On December 17, 1986, the auditor called petitioner's representative and told him that she wanted to check nontaxable sales for the entire three-year period. This was over two years after the audit had commenced and after the second notice of determination had already been prepared (December 11, 1986). Petitioner refused to consent to this. The auditor claims that if petitioner had agreed to the test, she would have refrained from mailing out the second determination.

(a) The auditor checked the sales tax returns against Federal income tax returns and bank records. No unexplained differences were found.

(b) The auditor attempted to determine petitioner's markup over cost based on the current sales price of displayed merchandise. For seven items, the auditor was able to determine both the sales price and cost resulting in an average markup of 12.3%. For four items, the sales price and the price code were known and recorded by the auditor, resulting in an average markup of 17.32%. For nine items checked by the auditor, the price was listed but no information about the cost was recorded. The total selling price of all items was \$1,720.50 and the items where the markup was computed comprised 52% of the total (\$890.50).

Consents extending the period of limitations were executed by petitioner on seven occasions. The last two consents extended the limitations period to September 20, 1986 and December 20, 1986.

(a) A Notice of Determination and Demand for Payment of Sales and Use Taxes Due was issued on September 20, 1986 for sales and use taxes due of \$32,449.83, plus penalty at 25% of \$8,124.98 and interest of \$12,587.82, for a total amount due of \$53,212.63 for the period September 1, 1981 through August 31, 1984.

(b) A supplemental notice of determination was issued on December 20, 1986 for sales and use taxes due of \$44,312.51, plus penalty at 25% of \$11,078.15 and interest of \$26,836.67, for a total amount due of \$82,227.33 for the same period.

(c) Petitioner has not contested the imposition of the use tax in the amount of \$5,011.77 on purchases of fixed assets.

(a) In conducting the audit, the auditor started with the amount of purchases as reported on Federal income tax returns for the audit period, prorating 1981 figures and projecting from 1983 figures for 1984. Such purchases amounted to \$478,919.00. (The purchase figure in

petitioner's books amounted to \$441,906.00.) She then applied a markup percentage of 97.86% derived from data compiled in a 1968 edition of "Expenses in Retail Business" published by the NCR Corporation. (The Division of Taxation has subsequently submitted copies of pages from a 1973 edition of the same publication which includes a table of figures from which a markup percentage of 78.57% can be inferred.) From the markup percentage of 97.86%, the auditor computed adjusted gross sales of \$947,589.13.

(b) The auditor next examined records for the quarter ending November 30, 1983. She found reported gross sales of \$16,506.00 and wholesale sales, which were not included in reported sales, of \$5,176.50 for total gross sales of \$21,682.69. The taxable sales reported on the return were \$2,087.00. The nontaxable sales computed from the figures on the return were thus \$14,419.00. The auditor made a list of nontaxable sales (out-of-state sales) totalling \$14,013.00. Of this amount, \$6,833.00 was disallowed due to lack of proof of shipment to an out-of-state destination. The difference of \$7,180.00 was allowed. The allowable amount, when added to the wholesale sales of \$5,176.50, resulted in a total of allowable subtractions from gross sales of \$12,356.50. The \$7,180.00 of allowable out-of-state sales was 51.24% of the listed out-of-state sales and the disallowed \$6,833.00 was 48.76%. Since the nontaxable sales, as computed from the return for the quarter (\$14,419.00), were slightly higher than the listed sales (\$14,013.00), the auditor disallowed 48.76% of the tax return figure which resulted in \$7,030.80. The allowed portion of 51.24% resulted in an allowed amount of \$7,388.29 for the quarter.

(c) To arrive at figures for the entire audit period, the auditor projected the quarter's figures on the basis of computed gross sales for the quarter. The allowed amount of \$7,388.29 was 34.08% of the calculated gross sales of \$21,682.69. The wholesale sales (all allowed) were 23.87% of that figure. These ratios, when applied to the audit period's calculated gross sales (based on purchases) of \$947,589.13, result in allowances for out-of-state sales and wholesale sales of \$322,938.37 and \$226,189.52, respectively. Taxable sales thus amount to \$398,461.22. After subtracting the reported sales of \$65,269.00, this left additional taxable sales of \$333,192.22 and an additional tax due at 8¼% of \$27,488.36.

(d) To prepare the assessment and presumably to calculate interest, the auditor computed the tax due by sales tax quarters using a margin of error of 510.49% computed by dividing the audited taxable sales by the reported taxable sales. With this computation the additional taxable sales for the audit period amounted to \$333,191.71 and the additional tax due to \$27,488.06. A use tax of \$5,011.77 was computed on purchases in three of the quarters. The total tax due was thus \$32,499.83.

The supplemental determination was based on the same markup percentage as used in the first determination. The allowable subtractions from gross sales were reduced, however, from \$549,127.89 to \$12,009.00. The allowed subtractions were for \$5,176.00 of wholesale sales in the quarter ending November 30, 1983 and \$6,833.00 for allowable nontaxable out-of-state sales for the same quarter (see Finding of Fact "7[b]"). (This figure of \$6,833.00 should be \$7,180.00 and the total should be \$12,356.00 as noted separately in the auditor's workpapers.) All other claimed subtractions from gross sales were denied. This resulted in audited taxable sales of \$935,580.13. Audited taxable sales less reported taxable sales of \$65,269.00 resulted in additional taxable sales of \$870,311.13 which, when divided by reported sales of \$65,269.00, results in a 1333.42% error rate. (As noted by the auditor, to correct the mistake made in out-of-state sales, this should have been 1332.89%.) The taxable sales as thus computed amounted to \$870,309.90 and the additional tax due to \$71,800.57. No use tax was computed for this determination. The sales tax determined in the first notice, \$27,488.06 (but not the use tax which had been computed), was subtracted from this figure to arrive at the second determination of \$44,312.51.

CONCLUSIONS OF LAW

A. The recordkeeping requirements of the Division of Taxation are set forth in 20 NYCRR 533.2. The Division does not assert that these requirements were not met. Rather, testimony at the hearing reflects that all sales invoices were available to the auditor and that such invoices were reconciled with the Federal return. In addition, the auditor did not attempt to determine whether purchase invoices per books were accurate, although these were also at her disposal.

Notwithstanding the fact that the store's records were in good order, the auditor applied a national average markup figure because the actual sales were made at a very low markup. Although there is statutory authority for the use of "external indices" to determine the amount of tax due in certain circumstances (*see*, Tax Law § 1138[a]), "resort to such method must be founded upon an insufficiency of record keeping which makes it virtually impossible to verify taxable sales receipts and conduct a complete audit" (Matter of Chartair v. State Tax Commn., 65 AD2d 44, 411 NYS2d 41). Such is not the case here. That the auditor believed that petitioner's markup was too low or that she tried her best to verify it does not justify an audit based on a markup compiled using a test period from petitioner's own books (Matter of Valley Supreme Supermarket and Arthur Moriano, State Tax Commn., October 20, 1986 [TSB-H-86(19)S]). It necessarily follows that the auditor's belief cannot justify a markup based not on petitioner's books but, instead, on a national average. Therefore, the increase on petitioner's gross sales must be disallowed.

B. The out-of-state sales claimed by petitioner will be allowed with the exception of the amount disallowed for the quarter ending November 30, 1983. It is clear that petitioner made sufficient records available to the auditor for the entire audit period. The auditor, however, did not avail herself of these records and it was only after the initial notice of determination had been issued that there was any request made for out-of-state sales records. This request does not justify the auditor's disregard of petitioner's records nor her subsequent projection of the test period results over the entire audit period (Matter of Christ Cella v. State Tax Commn., 102 AD2d 352, 477 NYS2d 858; Matter of King Crab v. State Tax Commn., 134 AD2d 51, 522 NYS2d 978; Matter of Adamides v. Chu, 134 AD2d 776, 521 NYS2d 826).

With respect to the out-of-state sales disallowed for the quarter ending November 30, 1983, petitioner has offered no documents or testimony that show that the sales in issue were, in fact, out-of-state sales.

C. The petition of Moses Dyckman d/b/a Dyckman's is granted to the extent that the supplemental notice of determination issued December 20, 1986 is cancelled, and the notice of determination issued September 20, 1986 shall be recomputed to include only the use tax and the sales tax on the disallowed out-of-state sales for the quarter ending November 30, 1983.

DATED: Troy, New York  
March 29, 1990

/s/ Nigel G. Wright  
ADMINISTRATIVE LAW JUDGE