STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
CONTINENTAL CARPET CO. AND STANLEY MALTZ, AS PRESIDENT	:	DETERMINATION
for Revision of Determinations or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period March 1, 1984 through February 29, 1988.	:	

Petitioners, Continental Carpet Co. and Stanley Maltz, as president, 233 Libbey Parkway, Weymouth, Massachusetts 02190, filed a petition[1] for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1984 through February 29, 1988 (File No. 807098).

A hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on July 25, 1990 at 1:15 P.M., with all briefs submitted by October 17, 1990. Petitioners appeared by Dennis Fasman, CPA, and Stewart Buxbaum, CPA. The Division of Taxation appeared by William F. Collins, Esq. (Kevin A. Cahill, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation properly determined the amount of tax due from petitioner Continental Carpet Co. as a result of a field audit of its books and records.

II. Whether the Division of Taxation properly utilized a markup percentage provided by

[1]Although the matter concerning Stanley Maltz was not noticed for hearing with the matter of Continental Carpet Co., the parties stipulated to have both matters heard simultaneously. No petition was offered in evidence for Stanley Maltz. Therefore, his position is deemed identical to that of Continental Carpet Co. No issue of his responsibility for the taxes was raised.

petitioner Stanley Maltz in arriving at the tax due as stated on the assessments herein.

III. Whether, if adequate records did in fact exist as alleged by the Division, there was a necessity for an audit method agreement prior to the use of the markup percentage provided by Mr. Maltz.

IV. Whether an adequate request for books and records was made by the Division.

V. Whether petitioners have shown reasonable cause for the remittance of penalties asserted against them pursuant to Tax Law § 1145(a)(1)(i) and (vi).

FINDINGS OF FACT

On May 4, 1989, the Division of Taxation issued to Continental Carpet Co. (hereinafter "Continental") a Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period March 1, 1984 through August 31, 1987, setting forth total tax due of $18,652.05, penalty of $5,177.51 and interest of $8,787.44, for a total amount due of $32,617.00. On the same date, a second Notice of Determination and Demand for Payment of Sales and Use Taxes Due was issued to Continental for the period September 1, 1987 through February 29, 1988 which set forth additional tax due of $6,242.61, penalty of $1,519.97 and interest of $997.03, for a total amount due of $8,759.61. Finally, on May 4, 1989, the Division issued to Continental a Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period June 1, 1985 through February 29, 1988 setting forth penalty only of $1,697.35 which was assessed pursuant to Tax Law § 1145(a)(1)(vi).

On May 4, 1989, the Division of Taxation issued three notices of determination and demands for payment of sales and use taxes due to Stanley Maltz, as president of Continental Carpet Co. (hereinafter "Maltz"), which set forth the same total tax, penalty and interest due for the same periods as those set forth on the notices issued to Continental as set forth in Finding of Fact "1" above. The explanation for Maltz's assessments indicated that he was liable individually and as president of Continental under Tax Law §§ 1131(1) and 1133 as determined to be due in accordance with Tax Law §§ 1138(a) and 1145.

During the audit period, Continental was a vendor of installed and uninstalled carpeting

and tiles and associated products located in Massachusetts. At no time during the audit period did it file New York State sales and compensating use tax returns or pay over any taxes to the Commissioner of Taxation and Finance.

On April 8, 1988, the auditor mailed to Continental an appointment letter and questionnaire which requested a meeting with petitioners on May 9, 1988. In fact, the auditor travelled to Continental's offices at its Massachusetts location and spent three days auditing the books and records of the company on May 9, 10 and 11, 1988. The audit included an analysis of sales invoices and purchase records for the period March 1, 1984 through February 29, 1988. Said analysis determined that the sales and purchase records were adequate, and no audit election method agreement was signed because a "detailed" audit was conducted, i.e., every invoice indicating a sale in New York State was analyzed and appropriate items were taxed. Additionally, the auditor spoke with Maltz regarding the business and his tax obligations to New York State. It was learned that Continental purchased its carpeting tax free and then either resold the carpeting uninstalled or incorporated it into installed sales (capital improvements).

Originally, the auditor prepared a worksheet which reflected the material charge from each sales invoice and the applicable use tax due on that amount. However, after speaking with Maltz on May 16, 1988, she allowed a 27% markup on the cost of these materials which resulted in a 27% decrease in material expense and tax thereon.

In addition, the auditor analyzed sales invoices for uninstalled carpeting and tiles as well as associated items and applied the applicable tax rate to same.

Additional taxable purchases derived from the material cost components on sales invoices were determined to be $282,745.71, for an additional tax due on same of $21,352.66. Additional taxable sales (of uninstalled carpeting) were determined to be $50,268.58, or an additional tax due thereon of $3,542.00. Total additional taxable sales and/or purchases and expenses were $333,014.29 and additional tax due was determined to be $24,894.66.

Additional penalties and interest were assessed pursuant to Tax Law § 1145(a)(1)(i) for failing to file a return or to pay or pay over any tax to the Commissioner within the time

required, and also pursuant to Tax Law § 1145(a)(1)(vi) for omitting from the total amount of State and local sales and compensating use taxes required to be shown on a return an amount in excess of 25% of the amount of such taxes required to be shown on the return.

Neither Maltz nor any other employee or officer of Continental appeared at hearing. However, on July 23, 1990, Maltz stated in an affidavit that he was present at the audit conducted by the New York State sales tax audit staff and that he conferred with the staff during their conduct of the audit. Maltz contended in his affidavit that various percentages of costing carpeting were discussed, ranging from a low of 27% to a high of 50% markup over cost. Maltz stated in his affidavit that he never agreed verbally or in writing to the use of any test or indirect method to determine the cost of the carpeting going into the sales invoices, and that he was prepared to offer bills for each job to allocate costs directly if he had been asked.

However, Maltz never presented any evidence of the markup percentage to the audit staff and entered only four sales invoices into evidence at hearing through his representatives. Although four invoices from a company called Collins and Aikman, Floor Coverings Division, located in Dalton, Georgia, indicating Continental as the purchaser, were submitted in evidence as substantiation for markup percentages in excess of 27%, there was no clear correlation or tie-in between the purchase invoices from Collins and Aikman and Continental's invoices submitted in evidence. Furthermore, at no time during the audit or at any time through formal hearing were job file folders presented to the audit staff, conferee or administrative law judge which clearly identified the material and its cost used in the specific sales.

SUMMARY OF PETITIONERS' POSITION

Petitioners contend that the audit was erroneously conducted and that their rights were abrogated. Petitioners contend that the auditor's May 16, 1988 telephone call to Maltz, inquiring with regard to the markup percentage, indicated that the audit had been flawed and that the auditor never requested purchase invoices or job cost sheets during the conduct of the audit. As a result, petitioners claim that the Division did in fact resort to external indices in determining the assessment herein and that a proper request for records was never made and

that the procedures adopted by the auditor in this action were arbitrary and capricious and lacked a rational basis. Finally, petitioners contend that the auditor had to establish a cost basis by the utilization of an indirect method (using the 27% markup) and there was no evidence of a written agreement signed by the taxpayer authorizing the use of said indirect method.

CONCLUSIONS OF LAW

A. The first issue which must be dealt with is whether the Division of Taxation performed a full, detailed audit of petitioner Continental Carpet Co. or whether it estimated petitioners' tax liability by resorting to external indices due to the insufficiency of petitioners' records (Tax Law § 1138[a][1]).

The auditor in this matter spent three days at Continental's place of business in Massachusetts examining its books and records. The auditor reviewed and found adequate both sales and purchase records. The auditor made a full schedule of Continental's sales invoices subject to New York taxation which broke down expenses for material costs and labor. Originally, the auditor prepared worksheets which allowed for no markup of the material costs but, after consulting with Maltz on May 16, 1988, she reduced said costs by 27%, a markup figure supplied by Maltz, president of Continental, and accepted by the auditor in good faith as a courtesy to petitioners.

Having established the adequacy of the records, the auditor then totalled material costs from petitioners' available records, consistent with Tax Law § 1138(a)(1), and applied the applicable tax rates. Retail sales in New York were not disputed. Further, the taxability of the material component was not disputed because said items are subject to tax pursuant to Tax Law § 1110 as materials purchased for use in connection with a capital improvement (Tax Law § 1101[b][4]; see, D. C. Distributors, Inc., Advisory Opinion, TSB-A-88[27]S, May 11, 1988).

Although seemingly inconsistent, it is clear that the auditor found the sales invoices and purchase invoices to be adequate, but no direct correlation could be made between specific purchase invoices and specific sales invoices thereby indicating the markup utilized by petitioners. Therefore, the auditor requested the markup on materials from Maltz. Continental

contends that this was an external index used to estimate its taxes, and that it had job folders and substantiation which could have demonstrated the allocation of material costs for each job, had it been asked to do so. However, Continental provided no further documentation to justify a higher markup percentage after the May 16, 1988 telephone conversation with the auditor until it presented four purchase invoices and four sales invoices at formal hearing on July 25, 1990. Those records did not demonstrate a clear correlation between the materials purchased and those incorporated into the specific sales invoices. Also, using a markup percentage provided by petitioner Maltz cannot be considered an external index, since the information was generated by petitioners and reflected confidential information on their business practices. Given the circumstances under which it was provided, it was perhaps more reliable than any business record produced and provided the bridge between petitioners' purchase and sales records. In any event, the auditor's contemporaneous entry in her log with regard to her telephone conversation with Mr. Maltz on May 16, 1988 is more credible than Maltz's affidavit, drafted by his representative and executed on July 23, 1990 (over two years later).

It is concluded that Continental, an unregistered vendor filing no tax returns in the State of New York during the period in issue and remitting no tax whatsoever, had adequate sales and purchase records from which the Division was able to accurately compute tax due. The fact that the Division allowed for a 27% markup on the material costs included in the capital improvement projects was an allowance based not upon external indices but upon information proffered by its president to the auditor. Continental's contention that other markup percentages were discussed or that other documentation was available but not requested is totally unfounded. The documentation presented at hearing was not adequate to correlate the purchase invoices to the sales invoices and the Maltz affidavit was just not credible in light of his statement that he had bills for each job but did not disclose them because no one asked for them. He never argued the points that he was an unregistered vendor not filing returns or paying taxes, only the amount. Knowing this, he still did not come forward with evidence to liquidate said sum, because no one asked him for specific documents under his control which he

chose to withhold. Such behavior has no logical motivation. The burden of proof in Division of Tax Appeals' hearings is upon the petitioner (20 NYCRR 3000.10[d][4]) and it is determined that petitioners herein have not carried that burden.

Because it is found that a full, detailed audit was performed, it is not necessary to reach the issue of whether the Division properly utilized estimation procedures in accordance with Matter of Chartair, Inc. v. State Tax Commission (65 AD2d 44, 411 NYS2d 41). Additionally, since a test period audit was not utilized herein, it was not necessary for the Division to acquire an audit method agreement showing that petitioners knowingly waived their rights to a complete audit (Matter of James G. Kennedy and Co., Inc. v. Chu, 125 AD2d 773, 509 NYS2d 199, 201).

B. Petitioners have also raised the issue of whether a proper request for books and records was made in this matter. As noted in the facts, an appointment letter was sent to Continental on April 8, 1988, along with a questionnaire, which specified May 9, 1988 as the meeting date and, in fact, the auditor did meet with petitioners at their business location on May 9, 10, and 11, 1988. Petitioners do not deny that records were requested by the auditor, but insist that job folders and other documentation of costs were omitted from the request. However, it is clear that the Division requested petitioners' books and records with regard to sales and purchases and examined those for the period March 1, 1984 through February 29, 1988. Since the appointment letter was sent on April 8, 1988, it was logical to request and examine records for the three-year period ending on the last day of the quarter just ended, February 29, 1988. For petitioners to conclude that a full request for books and records was not made because they failed to produce the required documentation or proof to correlate the purchase invoices with the sales invoices is clearly erroneous. Once they were informed of the proposed audit findings, basic common sense dictated that they provide any information which would correct any errors in that proposed assessment.[2] Therefore, it is found that the request for

[2]Petitioners did not deny receipt of the appointment letter or questionnaire, only the specific requests for job costs. They also did not deny that their purchases of materials used in the New York jobs were taxable. The very narrow issue of petitioners' markup on materials was known to

books and records made by the Division in this matter was more than casual and weak (Christ Cella v. State Tax Commission, 102 AD2d 352, 477 NYS2d 858), that it encompassed the entire period of the assessment (Adamides v. Chu, 134 AD2d 776, 521 NYS2d 826, lv denied 71 NY2d 806, 530 NYS2d 109), and that the auditor made a thorough examination of the books and records (King Crab Restaurant v. Chu, 134 AD2d 51, 522 NYS2d 978). The record is clear that it was possible to determine Continental's tax liability solely from its available records and no resort to external indices needed to be made (cf., Urban Liquors v. State Tax Commission, 90 AD2d 576, 456 NYS2d 138).

C. Continental raised the defense in its petition that either it or one of its customers was operating under a "pre-existing and valid direct payment permit". The regulations at 20 NYCRR 532.5(a) define a direct payment permit as:

> "a notice to a vendor that the holder thereof is authorized to pay directly to the Tax Commission any tax due on purchases made. The vendor's responsibility for the collection of tax from the permit holder is waived upon the receipt of such permit."

No such direct payment permit has been placed in evidence herein. Petitioners' attention is directed to the regulation at 20 NYCRR 532.5(e)(2)(iii) which, in example 3, describes one of several instances in which a direct payment permit may not be used. In that example, a contractor is prohibited from using the direct payment permit of a customer to defer his payment of tax on purchases which were used by him in the erection of a warehouse. The example states that the contractor's liability for tax on its purchases is not relieved by his customer's direct payment permit. Therefore, Continental would have had to have its own direct payment permit. Since it did not prove the existence of same, it is concluded none existed.

D. Given the facts and conclusions set forth above, petitioners are liable for penalties and

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petitioners from August 1988 to May 4, 1989, when the notices were issued, yet they chose not to bring the alleged errors to the attention of the Division. It is likewise noted that they did not produce the original appointment letter and questionnaire which they claim were deficient.

additional interest pursuant to Tax Law § 1145(a)(1)(i) and (vi). Further, petitioners have not offered any reasonable cause which would justify the remittance of said penalties or additional interest pursuant to Tax Law § 1145(a)(1)(iii) or (vi).

E. The petition of Continental Carpet Co. and Stanley Maltz, as president, is denied and the six notices of determination and demands for payment of sales and use taxes due dated May 4, 1989 are sustained.

DATED: Troy, New York

6/14/91

ADMINISTRATIVE LAW JUDGE