STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
C & L SYSTEMS, INC./B & S APPLIANCES AND PHILIP HAFT AND PAUL SHUPACK, AS OFFICERS	:	DETERMINATION
	:	DTA NO. 810885
for Revision of Determinations or for Refunds of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period March 1, 1988 through August 31, 1990.	:	

Petitioners, C & L Systems, Inc./B & S Appliances, and Philip Haft, as officer, 190 Old Post Drive, Hauppauge, New York 11788, and Paul Shupack, as officer, 19 Shoreham Drive West, Dix Hills, New York 11746, filed a petition for revision of determinations or for refunds of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1988 through August 31, 1990.

A hearing was held before Timothy J. Alston, Administrative Law Judge, at the offices of the Division of Tax Appeals, Riverfront Professional Tower, 500 Federal Street, Troy, New York, on March 24, 1993 at 1:15 P.M. Neither party submitted a brief. Petitioners Haft and Shupack appeared pro se and on behalf of petitioner C & L Systems, Inc./B & S Appliances. The Division of Taxation appeared by William F. Collins, Esq. (Andrew S. Haber, Esq., of counsel).

ISSUE

Whether petitioners have shown error in the Division of Taxation's audit method or result.

FINDINGS OF FACT

On February 28, 1991, following an audit, the Division of Taxation ("Division") issued notices of determination and demands for payment of sales and use taxes due to petitioners C & L Systems, Inc./B & S Appliances, Philip Haft, president of C & L Systems, Inc./B & S

Appliances, and Paul Shupack, vice-president of C & L Systems, Inc./B & S Appliances. Each such notice assessed $8,650.25 in additional tax due, plus penalty and interest, for the period March 1, 1988 through August 31, 1990.[1] Also on February 28, 1991, the Division issued statutory notices to each of the aforementioned petitioners which assessed $865.02 in penalty due pursuant to Tax Law § 1145(a)(1)(vi) for the period March 1, 1988 through August 31, 1990.

Petitioner C & L Systems, Inc./B & S Appliances was engaged in the business of selling and installing central air conditioning systems and "through-wall" air conditioning systems. Petitioner also sold window air conditioners and "through-wall" air conditioner component parts. Petitioner went out of business in August 1990. The audit herein was conducted in January and February 1991.

On audit, the Division found tax due in two areas. The Division determined $4,956.60 in additional tax due resulting from an asserted underreporting of taxable sales and $3,693.65 in additional tax due

resulting from an asserted failure to pay sales tax on purchases of materials incorporated into capital improvement projects.

The audit herein was commenced with a written Division request for records related to the audit period. In response thereto, petitioner advised that no such records were available. The Division therefore estimated petitioner's sales tax liability by first obtaining the information reported on petitioner's Federal income tax return for the fiscal year ended October 31, 1988. This information was obtained via the Division's access to the Internal Revenue Service's Federal income tax computer system. Petitioner reported gross receipts of $618,885.00 for the fiscal year ended October 31, 1988.

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[1]Inasmuch as petitioners Hart and Shupack have not protested the Division's assertion of personal liability as responsible officers of the corporate petitioner, all references to "petitioner", unless otherwise indicated, shall refer to C & L Systems, Inc./B & S Appliances.

Next, the Division calculated petitioner's gross sales as reported on its quarterly sales tax returns for the same period. The Division reconciled the sales tax quarters that overlapped petitioner's fiscal year by apportioning the gross sales reported for those quarters pro rata. The Division thus calculated petitioner's reported gross sales for sales tax purposes for the fiscal year ended October 31, 1988 to be $544,660.68.

The Division then determined an error rate in petitioner's gross sales reported for sales tax purposes based upon the difference between gross receipts on its Federal income tax return ($618,885.00) and gross sales as reported on the sales tax returns ($544,660.68). The Division took this difference of $74,224.32 and divided it by gross sales reported of $544,660.68 to reach an error rate of 13.628%.

Next, the Division applied this error rate to petitioner's reported gross sales for each of the quarterly periods comprising the audit period. This computation resulted in adjusted gross sales per audit of $1,321,753.84. The Division determined that 5% (.05) of such adjusted gross sales constituted additional taxable sales. This computation resulted in additional taxable sales of $66,087.68 and additional tax due on sales in the instant matter of $4,956.60.

The 5% figure used to calculate additional taxable sales was derived from a previous audit of petitioner covering the period September 1985 through February 1988. In that audit, the Division determined that petitioner had failed to collect tax and failed to report as taxable sales of components for "through-wall" air conditioning systems.[2] The Division determined that petitioner purchased such components without payment of sales tax and had been selling such components to contractors and recording such transactions as "other income". From a review of the audit report in this previous audit, which was entered into evidence herein, it appears that the 5% figure was calculated using petitioner's records by dividing "through-wall" component sales for the period March 1, 1987 through May 31, 1987 by petitioner's gross sales for the same period. This resulted in the 5% figure which was used to compute additional taxable sales in

[2]A "through-wall" air conditioning system is an air conditioning unit installed in a wall.

the previous audit in a similar manner as that employed herein. Petitioner consented to the Division's determination of additional tax due in the audit of the period September 1985 through February 1988.

As noted previously, the assessment herein also consisted of tax due on certain materials purchased by petitioner incorporated into capital improvement projects. With respect to this component of the assessment, the Division multiplied adjusted gross sales (see, Finding of Fact "7") by

8.1%. This figure was determined on the previous audit (for the period September 1985 through February 1988) to be the percentage of gross sales constituting receipts from capital improvement projects where no tax was paid on material purchases.

The audit report for the previous audit indicated that the Division reviewed petitioner's purchase invoices for materials used in its capital improvement jobs. This review indicated that petitioner had not paid sales tax on purchases of materials used in its installation of "through-wall" air conditioning units. Using petitioner's records, the Division totaled petitioner's receipts from its "through-wall" installation jobs for the period March 1, 1987 through May 31, 1987 and divided that amount by petitioner's total gross sales for the same period. This calculation resulted in the 8.1% figure. As noted previously, petitioner consented to the Division's determination of additional tax due on the previous audit.

Having determined that $107,062.06, or 8.1%, of petitioner's adjusted gross sales of $1,321,753.84 constituted capital improvement sales where no tax was paid on material purchases, the Division next determined that 46% of this $107,062.06 in capital improvement sales (or $49,248.68) constituted material purchases. The Division assessed tax due of $3,693.65 on this $49,248.68.

The 46% figure used by the Division to reach the amount of material purchases comprising the "through-wall" installation receipts was derived from an audit of petitioner for the period December 1982 through November 1984. In that audit, the Division examined

petitioner's "through-wall" installation contracts and determined that material costs constituted about 46% of the total amount of such contracts. Petitioner consented to the additional tax due as determined by the Division on audit for the period December 1982 through November 1984.

Attached to the petition in the instant matter was a Bureau of Conciliation and Mediation Services ("BCMS") consent form by which BCMS proposed a resolution to the instant matter. Petitioner rejected this proposed resolution. At hearing, petitioner questioned the manner by which BCMS calculated the tax liability set forth in the consent. No evidence was presented regarding such calculations.

CONCLUSIONS OF LAW

A. Petitioner did not dispute that it failed to maintain and/or make available records sufficient to verify its taxable sales. Petitioner therefore did not dispute the Division's authority to determine tax by an indirect method pursuant to Tax Law § 1138(a) and the plethora of case law developed thereunder. Petitioner did take issue with the audit method employed by the Division and the audit result.

B. Where an indirect audit method is employed, such method must be reasonably calculated to reflect the taxes due (Matter of Ristorante Puglia, Ltd. v. Chu, 102 AD2d 348, 478 NYS2d 91, affd 69 NY2d 632, 511 NYS2d 228; Matter of W. T. Grant Co. v. Joseph, 2 NY2d 196, 159 NYS2d 150, 157, cert denied 355 US 869), but exactness is not required (Matter of Markowitz v. State Tax Commn., 54 AD2d 1023, 388 NYS2d 176, 177, affd 44 NY2d 684, 405 NYS2d 454; Matter of Lefkowitz, Tax Appeals Tribunal, May 3, 1990). The burden rests with the taxpayer to show by clear and convincing evidence that the methodology was reasonable or that the amount assessed was erroneous (Matter of Meskouris Bros. v. Chu, 139 AD2d 813, 526 NYS2d 679; Matter of Surface Line Operators Fraternal Org. v. Tully, 85 AD2d 858, 446 NYS2d 451). Historically, considerable latitude has been given to the auditor in his method of estimating sales in such circumstances as those that exist herein (Matter of Grecian Square v. New York State Tax Commn., 119 AD2d 948, 501 NYS2d 219, 221; Carmine Restaurant v. State Tax Commn., 99 AD2d 581, 471 NYS2d 402), and petitioner bears the burden to prove

the audit methodology unreasonable (Matter of Surface Line Operators Fraternal Org. v. Tully, supra). However, the record must contain sufficient evidence to allow the trier of fact to determine whether the audit has a rational basis (Matter of Grecian Square v. New York State Tax Commn., supra, 501 NYS2d at 221; Matter of Fashana, Tax Appeals Tribunal, September 21, 1989).

C. Upon review of the record herein, it is concluded that, given the absence of records available and considering that the business had ceased operations at the time of the audit, the Division's use of the prior audits and the Federal income tax return in determining petitioner's tax liability was rational and reasonable. Indeed, the circumstances of this case would seem to have foreclosed the use of many other audit methods, such as an observation test or a test period audit method.

D. Petitioner contended that the nature of its business had changed following the previous audit (covering the period September 1985 through February 1988) and that, as a result of an inability to secure financing during the period at issue, it had not been involved in any way in the sale or installation of "through-wall" air conditioning systems or component parts. Petitioner also contended that it no longer sold window air conditioners during the period at issue and that its only line of business during this period was the sale and installation of central air conditioning systems. Accordingly, since the source of the assessment herein was the sale of "through-wall" installations and parts, the assessment was erroneous. The evidence presented in support of petitioner's contentions consisted solely of the testimony of Mr. Shupack.

In the absence of any evidence in the record corroborating the testimony of Mr. Shupack, it is concluded that petitioner has failed to show "by clear and convincing evidence" (see, Matter of Surface Line Operators Fraternal Org. v. Tully, supra) that the assessment herein was erroneous. Accordingly, petitioner's contentions are rejected.

E. Regarding the BCMS consent form (see, Finding of Fact "13"), since petitioner chose to reject the proposed resolution made by BCMS, said document has no relevance to this determination (see, Tax Law § 170[3-a][f]).

F. The petition of C & L Systems, Inc./B & S Appliances and Philip Haft and Paul Shupack, as officers, is denied and the notices of determination and demands for payment of sales and use taxes due, dated February 28, 1991, are sustained.

DATED: Troy, New York
July 29, 1993

/s/ Timothy J. Alston
ADMINISTRATIVE LAW JUDGE